

## HK/PRC: Revisiting Selective Credits Post Market Sell-Off

## China Aoyuan Property Group &lt;CAPG&gt; [B3/B-]

## Dollar Debt Outstanding

Amount (US\$mn)	Coupon (%)	Maturity	Indicative Mid Price	Indicative Mid Yield (%)	Recommendation
225	13.875	11/2017	109.4	10.6	Initiating coverage with Overweight recommendation on the complex. Although, along the CAPG curve, we prefer the '17 for yield pick-up opportunity. While gearing is likely to remain high for the year, sustainable sales collections from its portfolio of residential and commercial properties should support an adequate liquidity position. From a risk-return perspective, we think the bonds still offer better relative value compared to peers in the 'B' rating bucket (like FTHDGR'19 which at 12.7% ytw is in our view fair value only).
300	11.25	1/2019	99.5	11.4	

Source: Company, DBS, Bloomberg Finance L.P.

## Summary Financials

FYE Dec	Revenue (RMBm)	EBITDA (RMBm)	EBITDA Margin (%)	Total Debt (RMBm)	Debt/EBITDA (X)	EBITDA Int. Cover (X)	Debt/Capitalisation (%)
2013A	5,729	1,122	19.6	9,524	8.5	1.3	55.9
2012A	3,943	611	15.5	4,923	8.2	1.3	40.9

Source: Company, DBS, Bloomberg Finance L.P.

## Key credit highlights

- Premised on a residential and commercial dual model, pre-sales momentum is likely to remain sustainable for the year. In Q1'14, CAPG achieved contracted sales of RMB2.1bn (+84% yoy), equating to about 14% of its full year target of RMB15bn (+50% yoy) and in line with industry average YTD. Encouragingly, ASP was higher at RMB10.2k/sm (+68%), underscored by increased sales of commercial properties (CPs) that accounted for 58% of contracted sales.

In FY13, the group's actual contracted sales hit RMB10bn which surpassed its target of RMB8.5bn comfortably by 118%. During the period, residential properties sale accounted for 61% (FY12: 63%) vs commercial property at 39% (FY12: 37%). While sale of commercial properties tend to be less predictable, it generates higher GPM of 35-38% compared to residential property sales GPM of 25-28%. Their CPs are largely developed for sale, with only about 20% being retained by the group as IPs to establish future recurrent income stream. Underscored by the higher proportional shift in sales of commercial properties during the period, contracted ASP improved to RMB9.4k/sm (+49% yoy). The group achieved sell-through and cash collection ratios of 60% and 81%, respectively.

Underpinning CAPG's commendable operating performance is the group's residential and commercial dual model, premised on a standardized development strategy that is easily replicable from project-to-project and focused on quick churn rate. While it may be argued that sale of CPs tend to be less predictable, it is not subjected to the stringent HPRs. Seizing urban development opportunities in Guangdong (its home base), CAPG's portfolio of CPs include not only retail shops but also commercial apartments that are suitable for end-buyer occupier use as well as business purposes. For their mixed commercial use projects like Chongqing Aoyuan, Guangzhou Aoyuan City Plaza etc, the group can commence pre-sales within six months of land acquisition.

Going forward, CAPG expects sale of CPs vs residential properties to be equally balanced, with a blended average GPM in the 30%++ range. For this year, CAPG's planned saleable resources total almost RMB30bn, of which c.25% comprised inventories carried from last year, and the balance, new projects. Most of these stemmed from Guangzhou and Guangdong (c.60%), with the balance from Chongqing (12%), Hunan (16%), Shenyang (9%) and others (3%). Amid concern over a slowing market and increasing difficulty in accessing mortgage financing, conservatively, the group is

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expecting sell through rate to be lower at 50%, and cash collection ratio to be around 80%. Its sales profile FYE14 is likely to be biased towards 2H (1H: 40 vs 2H: 60). As of end FY13, CAPG's completed but unsold inventory stood at c.670k sq m.

- Adhering strategic thrust on Guangdong and large tier II/III cities, with product offerings that appeal to the bulging mid-class first-time home buyers. Apart from focusing on core markets (Guangdong/Guangzhou), CAPG's strategic thrust is to expand into large tier fringe cities (like Chongqing, Hunan & Jiangsu). Catering mainly to the bulging middle-class, first-time home buyers, CAPG's products are small/mid-sized residential units (mainly bare shell, 90-110sq m in size) as well as loft-style commercial apartments. On average, about 60% of its customers rely on bank mortgage financing, with the balance through cash (either lump sum or via installment).

As with the other developers and reflective of the tight onshore liquidity market, the duration of mortgage disbursement from financiers to CAPG has stretched out to two/three months (from previous four/six weeks). Still, CAPG is optimistic that its pre-sales target for the year is achievable. It has about RMB9.5bn in un-booked revenue, of which some 75% will be recognized this year, which will help to seal earnings visibility for FY14.

- Liquidity improved but gearing likely to remain high, due to stepped-up land acquisition and sales of commercial property tends to be unpredictable. In FY13, CAPG acquired 8 residential and commercial projects in Guangzhou, Chongqing, Foshan, Jiangmen, Yangjiang and Meizhou with total GFA of 2.1m sqm for total consideration of RMB4.7bn.

As of end FY13, its total land reserves stood at 11.2mn sqm. Guangdong/Guangzhou accounts for c.49% of its land bank, followed by Liaoning (18%), Guangxi (11%), Hunan (8%), Chongqing (7%), Jiangxi (5%) and Jiangsu (2%). By development breakdown, almost 70% is held for residential project, and the remainder for CP/IP projects. Its average land cost is about 12% of contracted ASP, which still provide some buffer for the group to earn modest profit margins.

However, most of its land acquisitions were debt funded, which saw CAPG re-tapping an additional US\$100mn notes in Jan'13, thereby raising its 2017 bond issue to a total of US\$225mn. In Jan'14, CAPG sold US\$300mn 11.25% notes (due 2019).

Resultantly, total debt in FY13 almost doubled to RMB9.5bn. About 50% of its debt are onshore, with offshore borrowing (including the bond issues) at 22%, and the remainder comprising trust loans. The latter funding cost is about 12%, and CAPG is looking to reduce its reliance on trust loans to about 20% of borrowings by the end of this year (possibly through bank syndication route with expected funding cost of about 6.5-7%).

Gearing remained high at 8.5x (FY12: 8.2x) and EBITDA interest coverage was flat at 1.3x (as of end FY13). This is because CPs tends to tie up capital resources and demand (particularly retail shops) less predictable, although margins tend to be higher than residential properties. The management has guided that the group's pace of land acquisition for FY14 is likely to moderate, in light of current market sentiments. It is expecting net leverage ratio to be <80% for this year. Still, the pace of land renewal is on our monitoring radar, considering the group's growth appetite and they need to remain discipline on capex spend (especially should the market turn for the worse).

Liquidity, however, is expected to remain adequate. As of end FY13, its cash holdings (unrestricted) stood at RMB2.8bn which was about sufficient to cover short-term debt of RMB2.4bn. It has undrawn bank facilities of c.RMB2.8bn. At the same time, it has an evenly ladder debt maturity profile with about 25% of debt maturing <1 year, with another 39% maturing within >1-2 years' horizon, 33% within 2-5 years and 3% > 5 years.

On expectation of cash collection ratio of c.80-85% and based on sell-through rate of 50%, the management has guided contracted sales collection of RMB12.8bn, relative to construction capex of RMB6.4bn, land premium c.RMB4bn (although only RMB500mn is committed), SG&A c.RMB800mn, interest expense c.RMB1.2bn, and tax c.RMB1.5bn. In all, ending cash balance for the year (considering cash balance c/f), is estimated at about RMB3.-3.5bn. However, should CAPG continue to be aggressive with its land acquisition, it would need to tap on more fund raising exercises. Assuming no incremental debt drawdown, we expect FCF to remain in slight negative territory for the year. Though, the management has guided that at this stage, no major funding exercise is anticipated, except for the need to re-finance its trust loans with a view to lower overall funding cost (as outlined above).

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- Thoughts on bond: while it is difficult to ascertain CAPG (as with any other developer)'s pre-sales momentum based on Q1 statistics; given its planned saleable resources and un-booked revenue, we think these should support the group's cash flows and liquidity profile. However, as its gearing is likely to remain high, its pace of land acquisition for the year will be on our monitoring radar. Notwithstanding, considering that more than two-thirds of the group's projects are in tier III cities (viz. Guangdong/

Guangzhou), and its residential and commercial dual model, we think CAPG is in a position to weather changes in market conditions. We are initiating coverage with Overweight recommendation on the complex. Although, along the CAPG curve, we prefer the '17 for yield pick-up opportunity. From a risk-return perspective, we think the bonds still offer better relative value compared to peers in the 'B' rating bucket (like FTHDGR'19 which at 12.7% ytw is in our view fair value only). <NK>

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## Consolidated Income Statement (RMB m)

FY Dec	2012A	2013A
Gross Revenue	3,943	5,729
COG	2,757	3,971
<b>Gross Profit</b>	<b>1,187</b>	<b>1,759</b>
Operating Expenses	576	636
Depreciation	31	34
<b>Operating (Loss) Profit</b>	<b>580</b>	<b>1,089</b>
Interest Expenses	66	44
Interest Income	76	22
Equity in Aff. Earnings	(7)	0
Other Income	27	76
<b>Pre-Tax Income</b>	<b>484</b>	<b>1,180</b>
Tax	593	513
Minority Interests	2	16
<b>Net Income</b>	<b>930</b>	<b>736</b>

## Consolidated Balance Sheet (RMB m)

FY Dec	2012A	2013A
Cash/Bank Balance	2,381	2,812
ST Fin Investments	0	0
Inventory	11,548	19,437
Accounts Receivable	19	169
Other Current Assets	2,736	4,363
Total Current Asset	16,684	26,781
Fixed Assets	376	415
Other Non Current Assets	3,753	2,735
<b>Total Assets</b>	<b>20,813</b>	<b>29,931</b>
ST Debts	1,675	2,411
Trade Accounts Payable	1,864	2,355
Other Current Liabilities	5,360	8,708
Total Current Liabilities	10,104	14,963
LT Borrowings	3,248	7,113
Other LT Liabilities	45	0
Total LT Liabilities	3,605	7,444
Equity	7,104	7,524
<b>Total Liabilities &amp; Equity</b>	<b>20,813</b>	<b>29,931</b>

## Consolidated Cash Flow Statement (RMB m)

FY Dec	2012A	2013A
Funds From Operations (FFO)	(496)	(103)
Operating Cash Flow (OCF)	(6,370)	(5,647)
Free Operating Cash Flow (FOCF)	(6,776)	(5,720)
Discretionary Cash Flow (DCF)	(6,776)	(5,720)

## Credit Metrics

FY Dec	2012A	2013A
Total Debt	4,923	9,524
Net Debt	2,542	6,712
EBITDA	611	1,122
Gross Margin (%)	30.1	30.7
EBITDA Margin (%)	15.5	19.6
EBITDA Interest Coverage (X)	1.3	1.3
Debt/EBITDA (X)	8.2	8.5
Net Debt/EBITDA (X)	4.2	6.0
Debt/Capitalisation (%)	40.9	55.9
Inventory (days)	1508.0	1762.3
Receivable (days)	1.8	10.6
Payable (days)	243.4	213.5

Source: Company, DBS

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