

Maintain OW on CAPG'18 and MW on CAPG'19

CAPG's interim results for 1H16 show improvement on net gearing/leverage and strong growth in revenues/earnings. We maintain OW on CAPG'18 (YTM of 4.45% with 1.77 workout period) on attractive valuation and MW on CAPG'19 (YTM of 3.2% with 0.42 workout period) due to fair valuation and supportive fundamentals.

Improved credit metrics as manageable debt profile and strong earnings

Total debts increased by RMB2bn to RMB18.3bn and net debts rose marginally by RMB0.8bn with 11% growth HoH. Net gearing ratio improved significantly to 56% as of Jun16 from 63% as of Dec15 due to a higher equity basis. The company still had RMB1.5bn trust loans (~8% of total debts), but funding costs of such loans are relatively low at 8%. Non-RMB debts' contribution slightly decreased to 37% in 1H16 from 39% in FY15. Average funding cost decreased to 8.4% p.a. in 1H16 from 9.5% p.a. in FY15 as the company redeemed two high-cost offshore HYs (CAPG17 and one private senior notes) in 1H16 through low-cost funding (syn-loan and new issuance).

Revenue grew by 65% to RMB6.5bn YoY, driven by 140% growth in recognized GFA which more than offset the 32% decrease in recognized ASP. Guangdong province was the major revenue contributor with 67% share including 44% from Guangzhou. Gross profit increased by 40% YoY but gross profit margin lowered to 25% in 1H16 versus 29% in 1H15, due to reducing contribution from commercial/retail product which traditionally contributed higher gross profit margin. EBITDA rose by 36% YoY to RMB1.2bn mostly in line with the growth of gross profit. Thanks to the improvement in earnings and manageable debt profile, debt to LTM EBITDA improved to 8.7X as of Jun16 accordingly, compared with 9.1X as of Dec15.

Net cash outflow in 1H16

The company recorded a net cash outflow of RMB 0.8bn in 1H16 – cash receipt was RMB9.5bn and cash outflow mainly included capex of RMB4.1bn, land payment of RMB2.5bn and other expenses of RMB3.7bn. The company purchased 4 pieces of land in 1H with total consideration of RMB5.3bn, representing 50% of 1H contracted sales. Outstanding land premiums as of Jun16 were RMB1bn. Company possibly could record a negative cash flow of RMB2.2bn for FY16 based on guidance given more aggressive land acquisition. Net gearing should be around 66% based on such a net cash outflow.

Robust contracted sales

Contracted sales in 1H16 were RMB10.5bn, up by 73% YoY, representing 62% of the full year target. The strong growth of contracted sales was driven by 56% increase in contracted sales GFA and 11% growth in ASP. By geography, Guangdong maintained the largest contribution with 50% share including 16% from Guangzhou. Guangzhou's contribution by contracted sales had however dropped to 16% in 1H16 from 28% in 1H15 due to delay in project launches. Sellable resources for 2H16 are RMB 19.2bn. The company has no plan to revise up the full year target.

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Table 1: Cash flow breakdown

RMB'bn	1H16	2H16E	2016E
Cash receipts	9.5	5.0	14.5
Other income		0.6	0.6
Cash expenses			
Construction	-4.1	-2.2	-6.3
Land	-2.5	-3.5	-6.0
Tax	-1.0	-0.4	-1.4
SG&A	-0.4	-0.6	-1.0
Interest	-0.6	-0.9	-1.5
Others	-1.7	0.6	-1.1
Cash outflow	-10.3	-7.0	-17.3
Net cash flow	-0.8	-1.4	-2.2

Source: BofA Merrill Lynch Global Research, company

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Table 2: Financial statements

(RMB mn)			
Income Statement (RMB mn)	1H15	1H16	YoY%
Turnover	3,935	6,480	65%
Gross Profit	1,156	1,622	40%
<i>margin</i>	29.4%	25.0%	
Selling and marketing costs	(101)	(192)	89%
Admin. Expenses	(178)	(238)	33%
Operating profits	877	1,193	36%
<i>margin</i>	22%	18%	
Other gains/ (losses)	78	(132)	
Fair value changes on investment properties	125	130	
Net financing costs	(59)	(79)	
Taxations	(465)	(511)	
Minorities	(17)	(35)	
Net profit	538	567	5%
EBITDA	895	1,213	36%
EBITDA margin	23%	19%	
Total interest expenses	604	853	41%

Revenue and contracted sales dynamics	1H15	1H16	YoY%
Property development revenue (RMB bn)	3.8	6.3	64%
Recognised ASP (RMB/sqm)	11,217	7,670	-32%
Recognised GFA (mn sqm)	0.3	0.82	140%
Contracted sales (RMB bn)	6.1	10.5	73%
Contracted ASP (RMB/sqm)	7,382	8,184	11%
GFA sold (mn sqm)	0.8	1.3	56%

Balance sheet (RMB mn) and land bank (mn sqm)	End-Dec'15	End-Jun'16	HoH%
Cash	9,036	10,211	13%
Unrestricted cash	7,769	10,186	31%
Total debt	16,298	18,289	12%
Net debt	7,262	8,077	11%
Short term debt	2,570	4,111	60%
Total equity (inc. MI)	11,576	14,433	25%
Total debt/cap(%)	58%	56%	
Net debt/ equity(%)	63%	56%	
Cash/ST debt (x)	3.5x	2.5x	
LTM EBITDA/Interest Expenses	1.3x	1.3x	
Debt/EBITDA	9.1x	8.7x	
Total Land bank (mn sqm)	13.3	13.8	

Source: BofA Merrill Lynch Global Research, company

Valuation & risk

China Aoyuan (CAPG)

CAPG's interim result for 1H16 showed strong growth in revenue (65% up YoY) and earnings (EBITDA up 36% YoY) and improvement in net gearing/leverage. Contracted sales have been on track with 62% achieved in 1H to full year target. We think valuation of CAPG'19 with YTW of 3.2% is fair in single-B sector, but CAPG'18 with YTM of 4.5% with workout period of 1.8 looks cheap given its high repayment clarity. Risk to our recommendation would be (1) sharp pick-up in land acquisitions resulting in higher leverage/net gearing, and (2) more aggressive overseas expansion.

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Security pricing

China Aoyuan Property Group Ltd. / CAPG

Security	Amt	Maturity date	Ratings Moody's/S&P/Fitch	Next call		Price	Price date	YTW* (%)	STW (Govt+bps)
				Call date	Call price				
11.25, Senior, USD, 2019:B	300	17-JAN-2019	B3/B-/B+	17-Jan-2017	105.63	108.48	19-Aug-2016	3.90	352
10.875, Senior, USD, 2018:B	250	26-MAY-2018	N.A./B-/B+			110.09	19-Aug-2016	4.84	411

For pricing information refer to "Other Important Disclosures" below.

* For loans, YTW reflects yield to maturity.

B=Bond; CS=Capital Security (Not including Equity Preferred); CDS=Credit Default Swap; EP=Equity Preferred

Disclosures

Important Disclosures

Credit opinion history

China Aoyuan Property Group Ltd. / CAPG

Security	Date^	Action	Recommendation
11.25, Senior, USD, 2019:B	31-Jul-2015		Overweight-30%
	09-Nov-2015	Rating System Change	Marketweight
	18-Apr-2016	Restricted	NA
	18-Apr-2016	Coverage Resumed	Marketweight
10.875, Senior, USD, 2018:B	31-Jul-2015		Overweight-30%
	21-Sep-2015	Upgrade	Overweight-70%
	09-Nov-2015	Rating System Change	Overweight
	18-Apr-2016	Restricted	NA
	18-Apr-2016	Coverage Resumed	Overweight

Table reflects credit opinion history as of previous business day's close. ^First date of recommendation within the last 36 months, if for an issuer or within the last 12 months, if for a security. Prior to November 9, 2015, the investment opinion system included Overweight-100%, Overweight-70%, Overweight-30%, Underweight-30%, Underweight-70% and Underweight-100%. As of November 9, 2015, the investment opinion system is contained at the end of the report under the heading "BofA Merrill Lynch Credit Opinion Key."

B=Bond; CS=Capital Security (Not including Equity Preferred); EP=Equity Preferred; CDS=Credit Default Swap

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	145	36.07%	Buy	131	90.34%
Hold	177	44.03%	Hold	158	89.27%
Sell	80	19.90%	Sell	70	87.50%

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