

Initiate CAPG'20 on OW and CAPG'19 on MW, Maintain OW on CAPG'18

The company delivered a satisfactory annual result for FY16 with an improved credit profile and decent earnings. We remain constructive on the company's fundamentals and initiate coverage on CAPG'20 with OW and CAPG'19 with MW, given CAPG'20 (YTM of 5.3%, 2.6 years duration) is offering 30bp yield pick-up by 0.6 year extension in duration, relative to CAPG'19 (YTM of 5%, 2 years duration). Separately, we maintain OW on CAPG'18 as short dated play. CAPG'18 now is trading at 4.2% with 1.2 years duration.

Low put probability for high cash coupon domestic bonds

The company has four tranches of domestic bonds to be refinanced in 2017/2018 including one maturity bond (RMB2.4bn) due in July'18 and three issuances (RMB3.5bn) becoming puttable in 2017/2018, respectively. CAPG's RMB11bn in cash of as of Dec'16 should fully cover its borrowings due within next two years including the maturity domestic bond. The other three domestic bonds are rated AA by a domestic agency, and we view the put probability relatively low, buffered by high cash coupons ranging from 5.88%~7.9% p.a. respectively. AA-rated issuances are trading around 4.3%~4.5% on average for 1~3 year durations in the domestic bond market.

Improved credit profile supported by cash and earnings

Total debts increased by RMB3.3bn to RMB19.6bn as of Dec'16 and net debt rose by only RMB1.3bn, offset by RMB1.9bn increase in cash. Total equity increased by RMB3bn mainly due to the incremental in non-controlling interests. As a result, net gearing improved to 59% as of Dec'16 from 63% as of Dec'15. Separately, revenue rose by 24% YoY to RMB11.8bn and gross profit margin remained flat at a decent level of 28% in FY16. EBITDA rose by 25% YoY to RMB2.2Bn in FY16 compared with RMB1.8bn in FY15, driven by a higher gross profit. Debt to EBITDA improved slightly to 8.7X as of Dec'16 from 9.1X as of Dec'15, and net debt to EBITDA remained solid at 3.8X as of Dec'16 versus 4.1X as of Dec'15 thanks to a strong cash position on hand.

Contracted sales and land bank

The company recorded contracted sales of RMB25.6bn in FY16 with 69% growth rate YoY driven by 7% growth in ASP and 58% increase in GFA. Management targets contracted sales of RMB33.3bn for FY17 with 30% growth YoY, backed by RMB54.5bn sellable resources. In land market CAPG spent RMB10bn in FY16 to acquire 17 pieces of lands, representing 39% of FY16 contracted sales. The outstanding land premium as of Dec'16 was RMB2.3bn and it has been almost paid off as of the date of writing. Gross land banks were 14.7mn sqm as of Dec'16 including 23% from Guangzhou, 12% from Shenzhen, 23% from Guangdong province (excluding GZ/SZ). CAPG guides a negative net cash flow of RMB1.1bn for FY17 (Table 1), projected net gearing would be 66% as of Dec'17 under the projection, remaining at comfortable.

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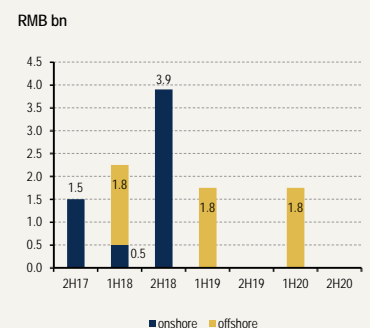
Jessie Huang
Research Analyst
Merrill Lynch (Hong Kong)
+852 3508 3061
jessie.huang@bam.com

Table 1: Cash flow breakdown

	2016 A	2017 E
Cash receipts	23.0	28.3
Cash expenses		
Construction	9.7	12.0
Land	6.3	11.1
Tax	2.2	3.0
SG&A	1.0	1.5
Interest	1.5	1.5
Dividends	0.3	0.3
Others	0.7	
Cash outflow	21.7	29.4
Net cash flow	1.3	-1.1

Source: BofA Merrill Lynch Global Research, the company

Chart 1: Onshore/offshore bond maturity profile (RMB'bn)



Source: BofA Merrill Lynch Global Research, the company
Onshore bond maturity is based on first put date.

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Refer to important disclosures on page 4 to 6. Analyst Certification on page 3. Valuation & Risk on page 2.

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Table 2: Financial statements

(RMB mn)					
Income Statement (RMB mn)					
	2015	2016	YoY%		
Turnover	9,572	11,827	24%		
Gross Profit	2,646	3,277	24%		
<i>margin</i>	27.6%	27.7%			
Selling and marketing costs	(489)	(592)			
Admin. Expenses	(402)	(489)			
Operating profits	1,756	2,195	25%		
<i>margin</i>	18%	19%			
Other gains/ (losses)	(136)	(263)			
Fair value changes on investment properties	356	310			
Net financing costs	(91)	(157)			
Taxations	(977)	(1,078)			
Minorities	(95)	(126)			
Net profit	812	881	8%		
EBITDA	1,790	2,237	25%		
Total interest expenses	1,393	1,771	27%		
EBITDA/Interest Expenses	1.3x	1.3x			
Debt/EBITDA	9.1x	8.7x			
Revenue and contracted sales dynamics					
	2015	2016	YoY%		
Property development revenue (RMB bn)	9.3	11.2	21%		
Recognised ASP (RMB/sqm)	9,130	6,994	-23%		
Recognised GFA (mn sqm)	1.0	1.6	58%		
Contracted sales (RMB bn)	15.2	25.6	69%		
1H	6.1	10.5			
2H	9.1	15.1			
Contracted ASP (RMB/sqm)	8,037	8,591	7%		
GFA sold (mn sqm)	1.9	3.0	58%		
Balance sheet (RMB mn) and land bank (mn sqm)					
	End-Dec'15	End-Jun'16	End-Dec'16	hoh%	YoY%
Cash	9,036	10,211	10,956	7%	21%
Unrestricted cash	7,769	10,186	10,471	3%	35%
Total debt	16,298	18,289	19,568	7%	20%
Net debt	7,262	8,077	8,611	7%	19%
Short term debt	2,570	4,111	4,506	10%	75%
Total equity (inc. MI)	11,576	14,433	14,631	1%	26%
Total debt/cap(%)	58%	56%	57%		
Net debt/ equity(%)	63%	56%	59%		
Cash/ST debt (x)	3.5x	2.5x	2.4x		
Total Land bank (mn sqm)	13.3	13.8	14.7		

Source: BofA Merrill Lynch Global Research, the company

Valuation & risk

China Aoyuan (CAPG)

CAPG delivered a satisfactory annual result for FY16 supported by improved credit profile and decent earnings. Net gearing improved to 59% as of Dec'16 from 53% as of Dec'15. Net debt to EBITDA improved to 3.8X as of Dec'16 versus 4.1X as of Dec'15. The company achieved RMB25.6bn contracted sales with 69% growth rate YoY in FY16. We are OW on CAPG'20 and MW on CAPG'19, given CAPG'20 trading at YTM of 5.3% offer 30bps yield pick-up by 0.6-year duration, relative to CAPG'19 trading at 5% on YTM basis with 2-years duration. We maintain OW on CAPG'18 as short-dated play. CAPG'18 now is trading at 4.2% with 1.2-years duration. Downside 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. Upside risk to our recommendations: (1) the company would continue to deliver strong contracted sales which might enhance its liquidity further. (2) the company possibly will be upgraded by rating agency given both S&P/Moody's have put the company on Positive outlook.

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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				
10.875, Senior, USD, 2018:B	250	26-MAY-2018	N.A./B-/BB-			107.17	10-Mar-2017	4.69	351

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	Price
10.875, Senior, USD, 2018:B	29-Feb-2016		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."

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

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Corporate Credit Issuer Investment Rating Distribution: Global Group (as of 31 Dec 2016)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	143	35.93%	Buy	125	87.41%
Hold	183	45.98%	Hold	157	85.79%
Sell	72	18.09%	Sell	58	80.56%

* Issuers that were investment banking clients of BofA Merrill Lynch or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only corporate credit issuer recommendations. A corporate credit issuer rated Overweight is included as a Buy, a corporate credit issuer rated Marketweight is included as a Hold, and a corporate credit issuer rated Underweight is included as a Sell.

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