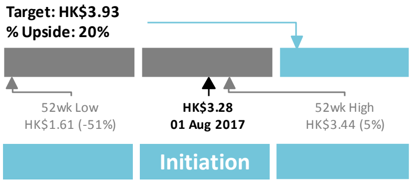
China Aoyuan Property Group (3883 HK)

Target Price	HK$3.93
Current Price	HK$3.28
% Upside	20%

High Exposure to Big Bay Area

Real Estate
Hong Kong
01 Aug 2017

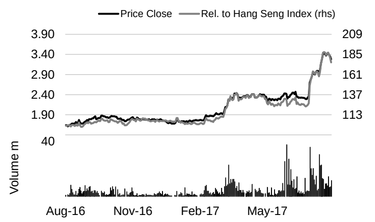
BUY



Basic Share Information

Market cap	HK$8.76b / US$1.12b
Daily traded value (3mth)	US$3.11m
Shares outstanding	2,672m
Free float	55.5%
Net debt-to-equity	58.9%
1 yr high	HK$3.44
1 yr low	HK$1.61
Major shareholding	52.1%
Last HTI contact w/ Co	01 Jul 17

Price/Volume



Source: Bloomberg

Please vote for me!
Asiamoney Brokers Poll 2017

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Strong Growth Momentum and Margin

Summary: We initiate coverage on China Aoyuan Property Group (AOY) with a BUY rating and a target price of HK$3.93, a 55% target discount to our NAV estimate of HK$8.73. AOY has large and high-quality land bank in terms of location and cost, especially in the Guangdong–Hong Kong–Macao Big Bay Area (the fourth-largest coastal economic zone globally), with 3.5mn sqm of gross floor area (GFA). Both contracted sales value and contracted GFA sold have grown rapidly since 2013, at CAGRs that far outpace the overall market and the average of its comparable peers. Unbooked sales at end-FY16 had risen to Rmb29.2bn, approximately 2.6x FY16 revenue, implying high visibility on revenue. We also think AOY's overseas strategy is proving to be successful. Given that the possession of a diversified land bank can reduce policy risk in housing markets and given AOY's ability to transform growth into profitability, we expect a strong performance from AOY among non-SOE small and mid-sized developers.

Target Price and Catalyst: We derive our target price of HK$3.93 from a 55% discount to our NAV estimate, equivalent to the average for small and mid-sized developers, excluding AOY. We expect a new peak in contracted sales in FY17 could be a catalyst for the shares.

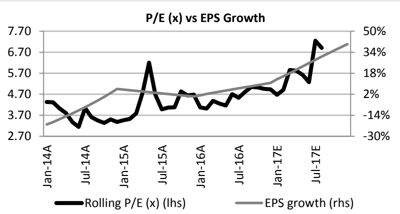
Earnings: Contracted sales have grown rapidly since 2013, at a 48.6% CAGR, much faster than the 16.2% for the overall market and the 28% for the 21 listed developers that we track. In addition, unbooked sales at end-FY16 had risen to Rmb29.2bn, approximately 2.6x FY16 revenue, implying high visibility on revenue. Sales guidance for FY17 is Rmb33bn, implying 29% YoY growth. In H1 FY17, contracted sales were Rmb16.5bn, with a lock-in rate of around 50%, which implies that sales are on track to meet full-year guidance based on historical patterns. We expect sustained growth in contracted sales to help the company to meet its target of Rmb50bn in FY19.

Valuation: We believe that a discounted cash flow (DCF)-derived net asset value (NAV) is the most suitable methodology to determine fair value for property developers. Our DCF analysis for AOY implies a NAV of HK$8.73 per share. AOY is currently trading at a 62% discount to our NAV estimate and on 5.9x our FY17 EPS estimate, at a 38% discount to the 9.3x of peers with similar market caps. Although we use the average discount to NAV for non-AOY small and mid-sized developers to derive our target price, we think that, driven by high sales growth, AOY could even trade above this average.

	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E	Trend
Total turnover (Rmbm)	9,572	11,827	16,915	20,076	28,211	
Operating profit (Rmbm)	1,625	1,965	3,337	3,899	6,068	
Pre-tax profit (Rmbm)	1,884	2,085	3,188	3,762	5,931	
Net income to ord equity (Rmbm)	812	881	1,210	1,694	2,989	
Net profit growth	0.3%	8.5%	37.3%	40.0%	76.5%	
P/E (x)	9.68	8.75	6.24	4.46	2.52	
Adj EV/EBITDA (x)	10.78	10.54	6.27	5.46	3.41	
P/B (x)	0.95	0.85	0.78	0.68	0.56	
ROE	10.2%	10.3%	13.0%	16.3%	24.3%	
Dividend yield	3.1%	3.4%	4.8%	6.7%	11.9%	
EPS HTI New (Rmb)	0.29	0.32	0.45	0.63	1.12	
Consensus EPS (Rmb)	0.36	0.38	0.48	0.63	0.79	
HTI EPS vs Consensus	(19.0%)	(15.0%)	(5.7%)	0.1%	42.5%	

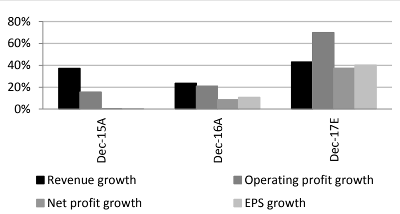
Source: Company data, Bloomberg, HTI estimates
Click here to download the working model

Valuation



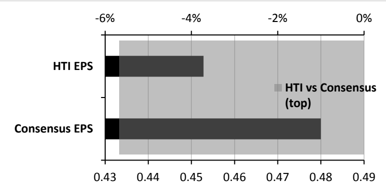
Source: Company data, Bloomberg, HTI estimates

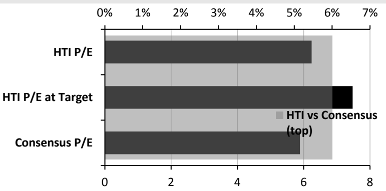
Earnings Trends



Source: Company data, Bloomberg, HTI estimates

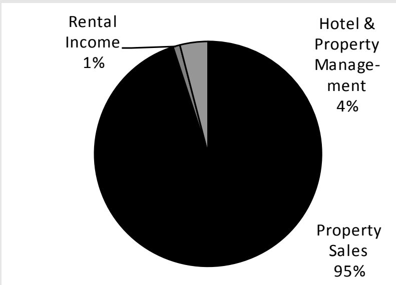
Earnings: HTI vs Consensus





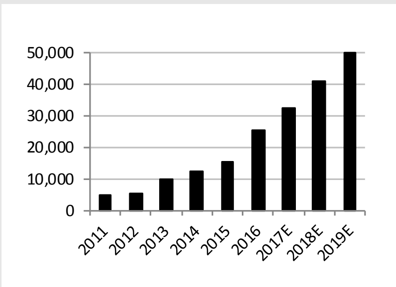
Source: Company data, Bloomberg, HTI estimates

FY16 Sales Breakdown



Source: Company data

Contracted Sales (Rmb mn)



Source: Company data, HTI estimates

Investment Thesis

BUY

- As AOY had 4.78mn sqm of land bank in the Guangdong–Hong Kong–Macau Big Bay Area as of end-FY16, we expect it to benefit from the development of this area, the fourth-largest coastal economic zone after New York Bay, Los Angeles Bay, and Tokyo Bay.
- We think AOY's existing land bank of 14.7mn sqm, mostly based in first- and second-tier cities, and satellite cities in the Pearl and Yangtze deltas, is sufficient to support growth in the next few years.
- AOY's growth has outpaced the overall property market and the average of its listed peers. Contracted sales have grown rapidly since 2013, at a 48.6% CAGR, much faster than the 16.2% for the overall market. AOY ranks in the top tier of listed developers.
- AOY is currently trading at 5.9x our FY17 EPS estimate, at a 38% discount to the 9.3x of peers with similar market caps. As such, we think AOY's shares are undervalued.
- As of March 2017, AOY had four overseas projects, three in Sydney and one in Vancouver. We think that AOY's localization strategy for overseas expansion should be successful, with higher net profit margin and lower interest costs driving overall growth. In addition, this diversification could also reduce policy risk towards housing markets.
- Risks include economic growth in China being much lower than our expectations, impacting property-buying sentiment, new property launches being slower than in past years, and any tightening of government policies on China's property market. In the case of any of these events, revenue may not grow as fast as we expect.

Company Snapshot

China Aoyuan Group Limited (AOY) has been developing residential properties for more than two decades, incorporating healthy living concepts into residential communities. The Cathay Capital Group, a US investment fund, is one of AOY's substantial shareholders. AOY was listed on the Main Board of the Hong Kong Stock Exchange in 2007. As of 2 February 2017, Guo Zi Wen, founder and chairman, with his brother, the present CEO, own 52% of the company's shares. AOY's strategy is to focus on China's five major economic regions—the Pearl River Delta, the Yangtze River Delta, the Yangtze Delta, Central and Western China, and the Beibuwan and Bohai Rim.

Key Investment Metrics

Revenue Growth

Low | Medium | **High**

Contracted sales have grown rapidly since 2013 at a 48.6% CAGR, much faster than the 16.2% for the market overall and the 28% for the 21 listed developers that we track. We expect growth in contracted sales to help the company meet its target of Rmb50bn in FY19.

Profit Margins

Low | **Medium** | High

We think management has demonstrated its capabilities by maintaining a higher gross profit margin than the company's listed peers in FY13–16, in a range of 27–31%. Property segment GPM is stable, while in the investment property segment, it has been clearly increasing since FY14. Other segments' margins have also been improving in recent years.

Shareholder Returns

Low | **Medium** | High

The dividend has grown steadily over FY11–16, from HK$0.05 per share to HK$0.15 per share, excluding the special dividend in FY12. The payout ratio was stable at 30% in FY14–16, and we assume the same ratio for our forecast horizon.

Balance Sheet Risks

High | Medium | **Low**

The net gearing ratio fell from 83.7% in FY13 to 58.9% in FY16, while contracted sales grew at a 36.6% CAGR in FY13–16. Due to balance sheet strengthening, borrowing costs have fallen from 11.4% in FY13 to 7.6% as of February 2017. We believe funding costs should fall further as the yields on its bonds that mature in FY18 have dropped to 4.7%, yields on bonds maturing in FY19 have fallen to 5.1%, and on those maturing in FY20 to 5.3%.

Barriers to Entry

Low | Medium | High

There are more than 90,000 developers in China because barriers to entry to the property sector are not high.

International Exposure/Breakdown

High | **Medium** | Low

AOY mainly operates in China, focusing on five major economic regions, while it also had four overseas projects (three in Sydney and one in Vancouver) as of March 2017.

FX Exposure

High | Medium | **Low**

We think foreign currency risk is small. The company's major transactions are conducted in CNY. At end-FY16, assets in HKD and USD accounted for less than 1% of total assets, and foreign currency liabilities accounted for 13% of total liabilities. The Group has entered into certain foreign currency forward contracts to keep the net exposure of currency risk to an appropriate level.

Corporate Governance

Low | Medium | **High**

AOY has been listed on the SEHK since 2007 and has a clean track record of corporate governance. There are four executive directors and three independent non-executive directors on its board. The company's website provides both English- and Chinese-language information to investors. We consider AOY's corporate governance to be good.

Our Model Assumptions

Contracted sales have grown rapidly since 2013, at a 48.6% CAGR, much faster than the overall market's 16.2%

Profit & Loss (Rmbm)	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E
Total turnover	9,572	11,827	16,915	20,076	28,211
Cost of sales	(6,926)	(8,550)	(12,256)	(14,488)	(20,083)
Gross profit	**2,646**	**3,277**	**4,659**	**5,587**	**8,128**
Total operating costs	(890)	(1,082)	(1,380)	(1,743)	(2,112)
Net other operating income	(131)	(231)	58	55	53
Operating profit	**1,625**	**1,965**	**3,337**	**3,899**	**6,068**
Operating EBITDA	1,659	2,006	3,381	3,946	6,118
Depreciation and amortisation	**(34)**	**(42)**	**(44)**	**(47)**	**(49)**
Net income from investments	384	277	-	-	-
Interest expense	(91)	(157)	(149)	(137)	(137)
Exceptional income - net	(33)	0	-	-	-
Pre-tax profit	**1,884**	**2,085**	**3,188**	**3,762**	**5,931**
Taxation	(977)	(1,078)	(1,500)	(1,647)	(2,294)
Minority interests	(95)	(126)	(479)	(421)	(648)
Net income to ord equity	**812**	**881**	**1,210**	**1,694**	**2,989**

Source: Company, HTI estimates

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Key P/L Takeaway

AOY ranks in the top tier of listed developers in terms of contracted sales growth in the last five years

AOY has a solid record of growth in its developer business, with contracted sales growing rapidly since 2013, at a 48.6% CAGR, much faster than the 16.2% for the market overall and the 28% for the 21 listed developers that we track. Although growth slowed in 2011 and 2012 because of inconsistencies in the selling schedule with its joint venture partner in Beijing, growth picked up in FY13 after the company disposed of its stake in this joint venture for an Rmb8.6bn disposal gain in 2012.

AOY ranks in the top tier of listed developers in terms of contracted sales growth in the last five years.

In FY17, sales are guided to reach a new high of Rmb33bn, with unbooked sales of Rmb29.2bn. In H1 FY17, contracted sales were Rmb16.5bn, with a lock-in rate of around 50%, which implies that sales are on track to meet full-year guidance based on historical patterns.

Our Model Assumptions

We expect inventories to be low

Other current assets includes properties for sale

Tangible fixed assets includes investment properties

We do not think the company is likely to issue new shares

Balance Sheet (Rmbm)	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E
Total cash and equivalents	9,036	10,956	10,358	9,665	9,856
Inventories	-	26	26	26	26
Other current assets	34,162	48,847	62,090	79,492	96,204
Total current assets	**43,198**	**59,830**	**72,475**	**89,184**	**106,087**
Tangible fixed assets	4,998	5,930	6,257	6,603	6,970
Intangible assets	-	5	3	3	3
Total investments	444	326	326	326	326
Total other assets	187	328	347	367	389
Total non-current assets	**5,629**	**6,589**	**6,932**	**7,298**	**7,687**
Total assets	**48,827**	**66,418**	**79,406**	**96,482**	**113,773**
Short-term debt	2,570	2,997	5,870	5,870	5,870
Accounts payable	5,348	6,795	8,493	10,022	11,525
Other current liabilities	14,851	24,842	34,929	48,787	61,569
Total current liabilities	**22,770**	**34,634**	**49,293**	**64,679**	**78,965**
Long-term debt	4,803	4,983	13,697	13,697	13,697
Other liabilities	9,678	12,170	641	705	775
Total non-current liabilities	**14,481**	**17,153**	**14,338**	**14,402**	**14,473**
Total liabilities	**37,251**	**51,787**	**63,631**	**79,081**	**93,438**
Common stocks	26	25	25	25	25
Retained earnings reserve	8,216	8,893	9,702	11,032	13,514
Shareholders' equity	**8,243**	**8,918**	**9,727**	**11,058**	**13,539**
Minority interests	3,333	5,713	6,048	6,343	6,797
Other equity	-	(0)	-	0	0
Total equity	**11,576**	**14,631**	**15,775**	**17,401**	**20,336**
Total liabilities & shareholders' equity	**48,827**	**66,418**	**79,406**	**96,482**	**113,773**

Source: Company, HTI estimates

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✓ **Key B/S Takeaway**

We expect sustained growth in contracted sales to help the company to meet its target of Rmb50bn in FY19, meaning that current assets should also increase

AOY has maintained a good balance between growth and financial health. The net gearing ratio fell from 83.7% in FY13 to 58.9% in FY16, while contracted sales grew at a 36.6% CAGR in FY13–16. Due to balance sheet strengthening, borrowing costs have fallen from 11.4% in FY13 to 7.6% as of February 2017. We believe funding costs should fall further as the yields on its bonds that mature in FY18 have dropped to 4.7%, yields on bonds maturing in FY19 have fallen to 5.1%, and on those maturing in FY20 to 5.3%.

Our Model Assumptions

We expect interest expenses to remain stable in FY17–19

We do not expect AOY to issue new shares in FY17–19

We assume negative free cash flow in FY17 and FY18, then returning to positive territory in FY19; high cash flow in FY16 was due to new debt

Cash Flow (Rmbm)	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E
Operating profit	**1,625**	**1,965**	**3,337**	**3,899**	**6,068**
Depreciation and amortisation	34	42	44	47	49
Changes in working capital	(2,955)	(3,310)	(1,656)	(2,233)	(2,665)
Other operating cash flow	(2,853)	8,331	(162)	(37)	(121)
Operating cash flow	**(4,149)**	**7,027**	**1,564**	**1,675**	**3,332**
Interest paid	(91)	(157)	(149)	(137)	(137)
Tax paid	1,217	(925)	(1,263)	(1,386)	(2,006)
Cash flow from operations	**(3,023)**	**5,945**	**152**	**152**	**1,188**
Capex	(885)	(703)	(371)	(393)	(416)
Other investing cash flow	(40)	(3,366)	58	55	53
Cash flow from investing activities	**(924)**	**(4,069)**	**(313)**	**(338)**	**(363)**
Dividends paid to ordinary shareholders	(242)	(245)	(259)	(363)	(508)
Proceeds from issue of shares	(44)	53	-	-	-
Increase in debt	(313)	(671)	-	-	-
Other financing cash flow	7,403	1,670	(179)	(144)	(126)
Cash flow from financing activities	**6,804**	**808**	**(438)**	**(506)**	**(634)**
Cash at beginning of period	4,852	7,769	10,471	9,872	9,180
Total cash generated	**2,856**	**2,683**	**(599)**	**(692)**	**191**
Forex effects	61	18	-	-	-
Implied cash at end of period	**7,769**	**10,471**	**9,872**	**9,180**	**9,371**
Free cash flow	**(3,908)**	**5,242**	**(218)**	**(240)**	**772**

Source: Company, HTI estimates

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Key Cash Flow Takeaway

Unbooked sales at end-FY16 had risen to Rmb29.2bn, approximately 2.6x FY16 revenue, implying high visibility on revenue

Operating cash flows were negative in FY12–15, turning positive in FY16 due to growth in profits and higher property sales. We expect operating cash flow to remain positive.

We think AOY's existing land reserves should be sufficient for future demand. As a result, we assume capex declines over our forecast period from the Rmb703mn reported in FY16.

We expect free cash flow to turn negative in FY17–18, but see a rebound to Rmb772mn in FY19.

Our Model Assumptions

We expect dividends to increase on high revenue growth

We expect GPM of 28–29%

We expect net gearing to drop as equity increases on higher profit recognition and growth in contracted sales

Key Driver Takeaway

We think AOY shows high ability to transform its growth into profitability, with higher-than-peer GPM since 2013

Per Share Data	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E
EPS (Rmb)	0.29	0.32	0.45	0.63	1.12
FDEPS (Rmb)	0.29	0.32	0.45	0.63	1.12
Revenue per share (Rmb)	3.44	4.34	6.33	7.51	10.56
Operating EBITDA per share (Rmb)	0.60	0.74	1.27	1.48	2.29
BVPS (Rmb)	2.96	3.34	3.64	4.14	5.07
DPS (Rmb)	0.09	0.10	0.14	0.19	0.34
Recurrent cash flow per share (Rmb)	(1.09)	2.18	0.06	0.06	0.44
Shares in issue (million)	2,784	2,672	2,672	2,672	2,672
Year end adjusted shares in issue (m)	2,784	2,672	2,672	2,672	2,672
Key Ratios	**Dec-15A**	**Dec-16A**	**Dec-17E**	**Dec-18E**	**Dec-19E**
Valuation Measures					
P/Sales (x)	0.82	0.65	0.45	0.38	0.27
P/E (x)	9.68	8.75	6.24	4.46	2.52
P/CF (x)	na	1.30	49.55	49.58	6.35
P/B (x)	0.95	0.85	0.78	0.68	0.56
Adj EV/EBITDA (x)	10.78	10.54	6.27	5.46	3.41
Dividend yield	3.1%	3.4%	4.8%	6.7%	11.9%
Growth					
Revenue growth	37.2%	23.6%	43.0%	18.7%	40.5%
Operating profit growth	15.5%	20.9%	69.9%	16.8%	55.6%
Net profit growth	0.3%	8.5%	37.3%	40.0%	76.5%
Margins					
Gross margin	27.6%	27.7%	27.5%	27.8%	28.8%
Operating EBITDA margin	17.3%	17.0%	20.0%	19.7%	21.7%
Operating margin	17.0%	16.6%	19.7%	19.4%	21.5%
Pretax profit margin	19.7%	17.6%	18.8%	18.7%	21.0%
Tax rate	51.8%	51.7%	47.0%	43.8%	38.7%
Net profit margin	8.5%	7.4%	7.2%	8.4%	10.6%
Key Ratios					
ROE	10.2%	10.3%	13.0%	16.3%	24.3%
ROA	1.9%	1.5%	1.7%	1.9%	2.8%
Capex/revenue	9.2%	5.9%	2.2%	2.0%	1.5%
Current ratio (x)	1.90	1.73	1.47	1.38	1.34
Creditor days	281.8	290.8	252.9	252.5	209.5
Inventory days	-	1.13	0.79	0.67	0.48
Sales/avg assets	0.22	0.21	0.23	0.23	0.27
Credit analysis					
EBITDA/interest paid (x)	18.15	12.74	22.74	28.81	44.66
OCF/interest paid (x)	(33.06)	37.76	1.02	1.11	8.68
Debt/EBITDA (x)	4.44	3.98	5.79	4.96	3.20
Debt/equity	63.7%	54.5%	124.0%	112.5%	96.2%
Net debt to equity	62.7%	58.9%	58.4%	56.9%	47.8%

Source: Company, HTI estimates

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We think management has demonstrated its capabilities by maintaining a higher gross profit margin than the company's listed peers in FY13–16, in a range of 27–31%. Property segment GPM is stable, while in the investment property segment, it has been clearly increasing since FY14. Other segments' margins have also been improving in recent years. Overseas projects have a higher net profit margin than domestic projects.

The dividend has grown steadily over FY11–16, from HK$0.05 per share to HK$0.15 per share, excluding the special dividend in FY12. The payout ratio was stable at 30% in FY14–16, and we assume the same rate for our forecast horizon.

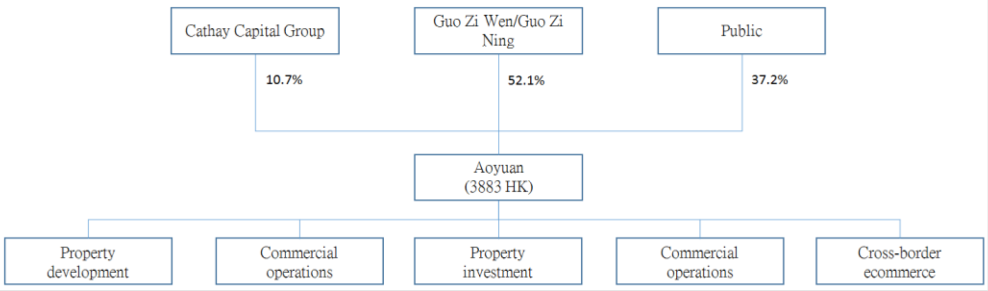
Company Outline and Operational Review

China Aoyuan Group Limited (AOY) has been developing residential properties for more than two decades, incorporating healthy living concepts into residential communities. The Cathay Capital Group, a US investment fund, is one of AOY's substantial shareholders. AOY was listed on the Main Board of the Hong Kong Stock Exchange in 2007.

As of 2 February 2017, Guo Zi Wen, founder and chairman, with his brother, the present CEO, own 52% of the company's shares. AOY's strategy is to focus on China's five major economic regions—the Pearl River Delta, the Yangtze River Delta, the Yangtze Delta, Central and Western China, and the Beibuwan and Bohai Rim.

The Cathay Capital Group, a US investment fund, is one of AOY's substantial shareholders

Shareholding Structure (As of end-FY16)



Source: Company data

Strong Growth Momentum

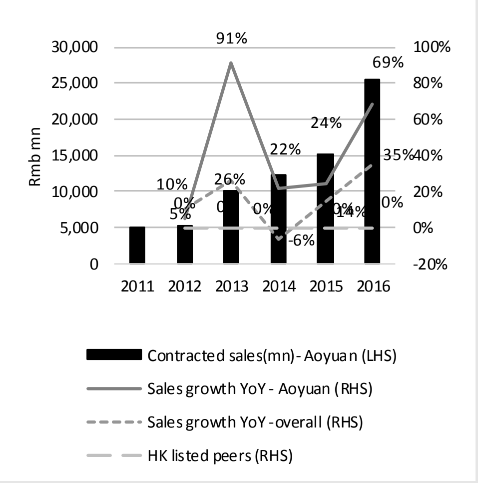
AOY focuses on China's five major economic regions of the Pearl River Delta, the Yangtze River Delta, the Yangtze Delta, Central and Western China, and the Beibuwan and Bohai Rim

Growth Exceeds Overall Property Market and Average of Listed Peers

AOY has a solid record of growth in its developer business, with contracted sales growing rapidly since 2013, at a 48.6% CAGR, much faster than the 16.2% for the market overall and the 28% for the 21 listed developers that we track. AOY's contracted GFA sold has also grown at a 37.4% CAGR, much higher than the 8.7% for the overall market and the 25% for the 21 listed developers we track. Although growth slowed in 2011 and 2012 because of inconsistencies in the selling schedule with its joint venture partner in Beijing, growth picked up in FY13 after the company disposed of its stake in this joint venture for an Rmb8.6bn disposal gain in 2012. AOY ranks in the top tier of listed developers in terms of contracted sales growth in the last five years.

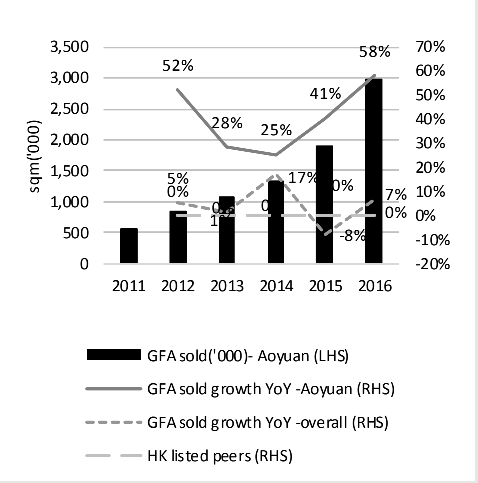
AOY has shown solid growth in contracted sales value and in contracted GFA sold in the past five years

Sales Value



Source: Company data

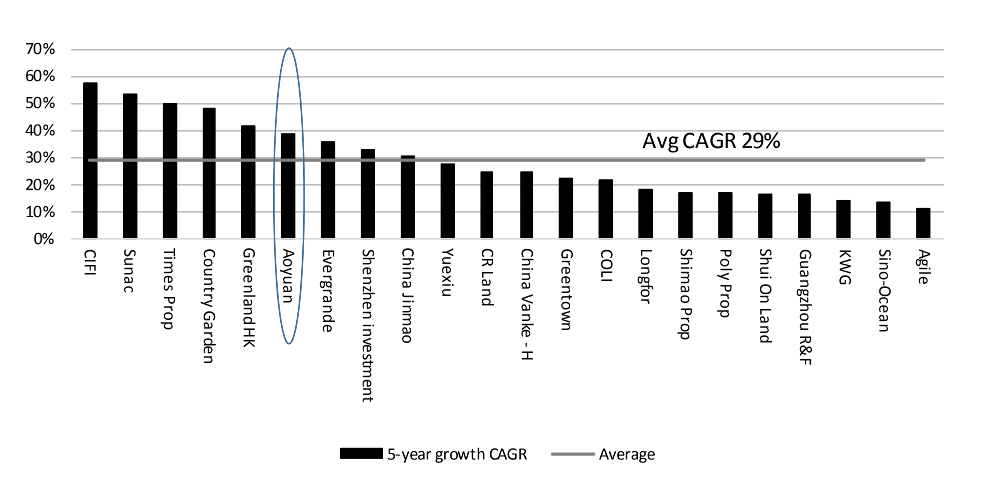
Sales Volume



Source: Company data

We believe AOY can achieve its goal of Rmb33bn in contracted sales in FY17

Past Five-Year Contracted Sales CAGR

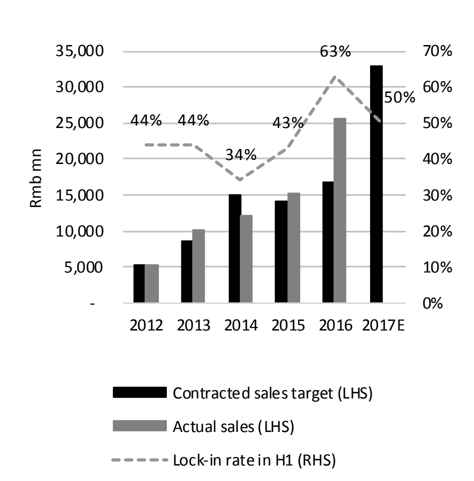


Source: Company data

On Track to Achieve Rmb33bn Sales Target, with Rmb29.2bn in Unbooked Sales

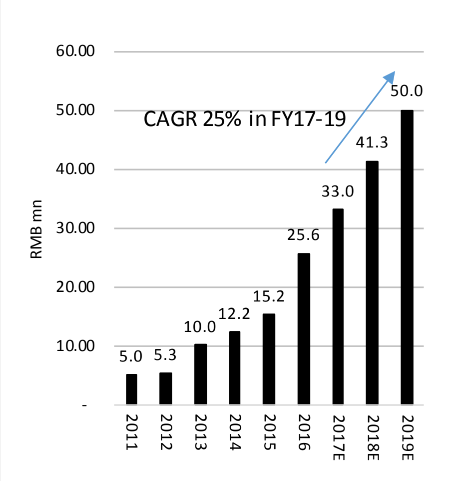
Sales guidance for FY17 is Rmb33bn, implying 29% YoY growth. In H1 FY17, contracted sales were Rmb16.5bn, with a lock-in rate of around 50%, which implies that sales are on track to meet full-year guidance based on historical patterns. Since 2012, AOY has been able to meet its full-year target so long as H1 contracted sales exceed 43% of the full-year target. Since 2012, AOY has only missed its sales target once—in FY14—due to negative growth in the overall property market in that year. We expect sustained growth in contracted sales to help the company to meet its target of Rmb50bn in FY19. In addition, unbooked sales at end-FY16 had risen to Rmb29.2bn, approximately 2.6x FY16 revenue, because contracted sales take one or two years to be booked as revenue.

H1 Lock-In Rate



Source: Company data

Contracted Sales and Forecasts



Source: Company data, HTI estimates

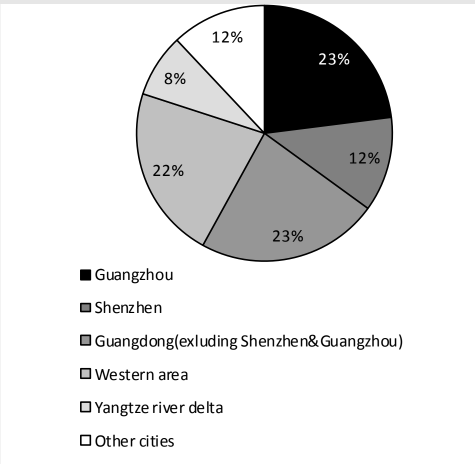
Low Land Cost and High Exposure to Big Bay Area

High-Quality Land Bank in Terms of Location and Cost

As of end-FY16, AOY had 14.7mn sqm of land bank, of which, in terms of land value, 58% is in Guangdong Province, 22% in Western China, and 8% in the Yangtze River Delta. AOY has high land exposure in the Guangdong–Hong Kong–Macao Big Bay Area with around 3.5mn sqm of GFA. AOY already has projects in Guangzhou, Shenzhen, Zhuhai, Foshan, Zhongshan, Huizhou, and Jiangmen. We think AOY's existing land bank, which is mostly based in first- and second-tier cities, and satellite cities in the Pearl and Yangtze deltas, is sufficient to support growth in the next few years. AOY's low land cost, of Rmb1,855 per sqm as of end-FY16 implies healthy project profitability. We believe AOY's land bank should support its achievement of Rmb50bn in contracted sales in FY19. We also think AOY should benefit from the development of the Guangdong–Hong Kong–Macau Big Bay Area, the fourth-largest coastal economic zone in the world after New York Bay, Los Angeles Bay, and Tokyo Bay. AOY has projects in seven of the 11 cities in the Guangdong–Hong Kong–Macau Big Bay Area, with GFA of around 3.6mn sqm.

We think AOY stands to benefit from the development of the Guangdong–Hong Kong–Macau Big Bay Area

Land Bank by Value



Source: Company data

Guangdong–Hong Kong–Macao Big Bay Area

Source: Company data

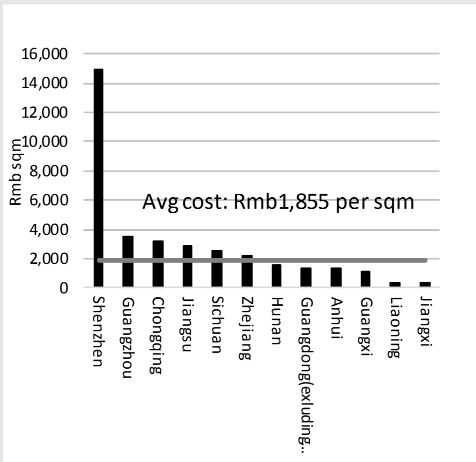
AOY has a diversified land bank with low land costs in the Guangdong–Hong Kong–Macao Big Bay Area and overseas

Guangdong–Hong Kong–Macao Big Bay Land Bank

Cities	GFA sqm '000
Guangzhou	1,816
Shenzhen	218
Zhuhai	271
Foshan	639
Zhongshan	182
Huizhou	339
Jiangmen	122
Subtotal	**3,586**

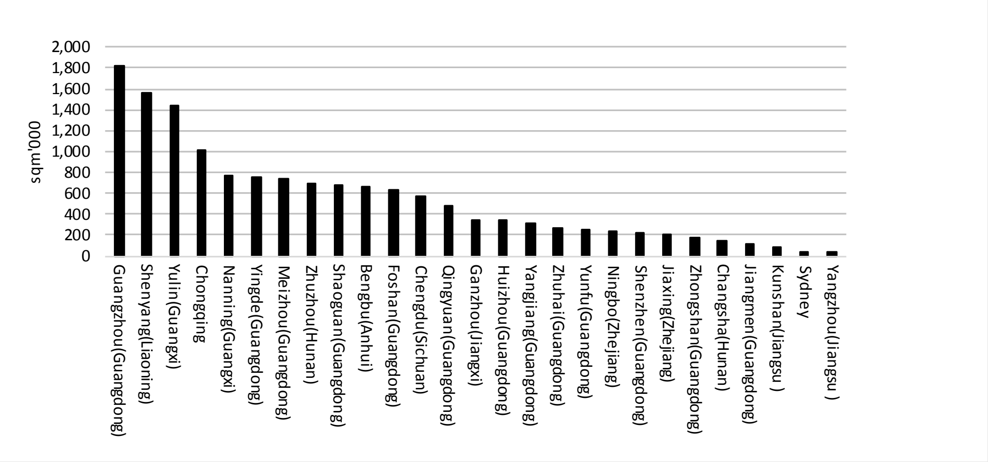
Source: Company data

Land Cost (As of FY16)



Source: Company data

Land Bank by City



Source: Company data

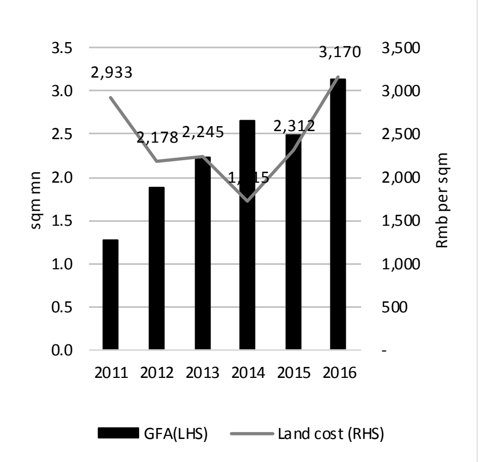
Overseas Expansion

As of March 2017, AOY had four overseas projects, three in Sydney and one in Vancouver. In 2015, contracted sales from One30 Hyde Park in Sydney (acquired in FY15) were Rmb1,022mn and the contribution in FY16 from One30 Hyde Park and The Maison 188 in Sydney was Rmb856mn. The GPM of overseas projects is 26–29%, the same as AOY's domestic projects, but NPM is higher due to the absence of land appreciation tax (LAT). We think that AOY's localization strategy for overseas expansion should be successful. AOY can borrow money from local banks at an around 5% interest rate, and 75% of home buyers are locals, implying that the impact of tightened foreign exchange controls on buyers from China is much lower than it would be at other China developers. In a new city, AOY chooses to cooperate with local developers to learn local practices and build credibility and relationships with local banks.

Prudent Land Acquisitions

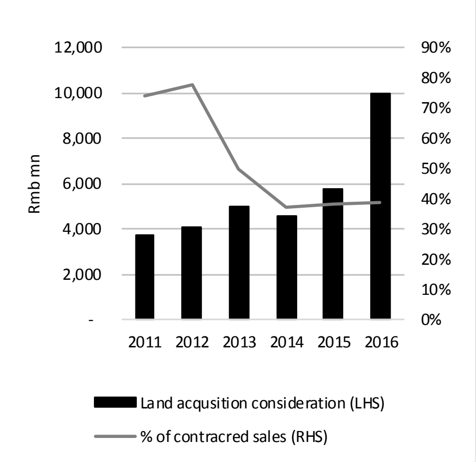
AOY has pursued a prudent land acquisition strategy since 2013. The ratio of land acquisition to contracted sales is 37–39%, ensuring sufficient land resources to support growth.

Land Acquisitions



Source: Company data

Land Acquisitions and Contracted Sales



Source: Company data

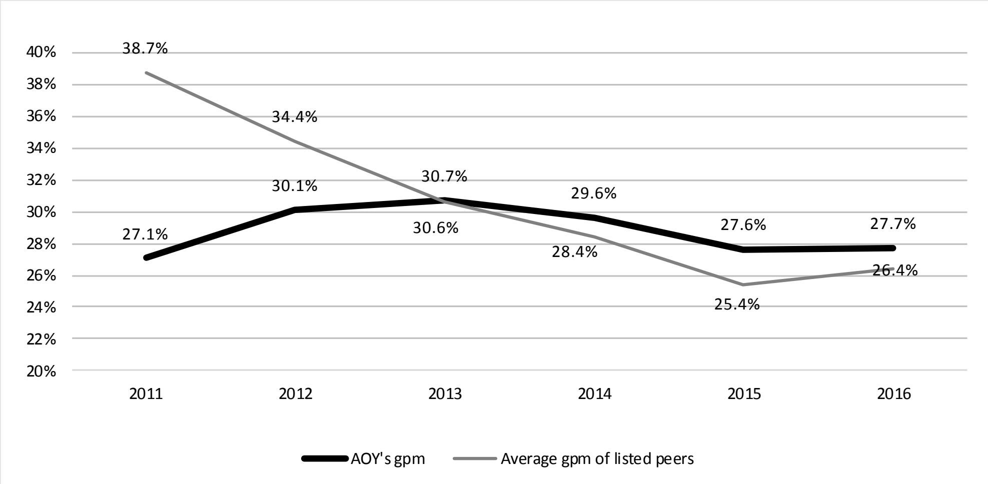
Capable of Transforming Growth into Profitability

AOY has shown the ability to transform growth into profitability, with GPM higher than its listed peers since 2013

Higher GPM and Faster Growth than Listed Peers

We think management has demonstrated its capabilities by maintaining a higher gross profit margin than the company's listed peers in FY13–16, the period when AOY's contracted sales were growing at a CAGR of 48.6%, much faster than the 16.2% for the market overall and the 28% for the 21 listed developers that we track.

GPM Trend Compared with Peers



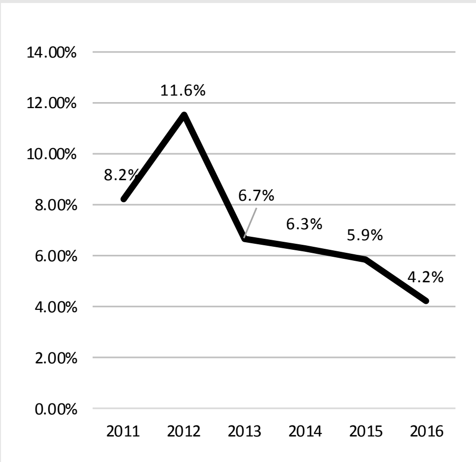
Source: Company data

Prudent SG&A Control Enhances Profitability

The ratio of SG&A costs to contracted sales dropped from 5.9% in FY15 to 4.2% in FY16, lower than the 5.1% at its listed peers. We think this low ratio well demonstrates AOY's superior cost-control ability, since AOY does not benefit as much from economies of scale as its peers due to its smaller contracted sales base.

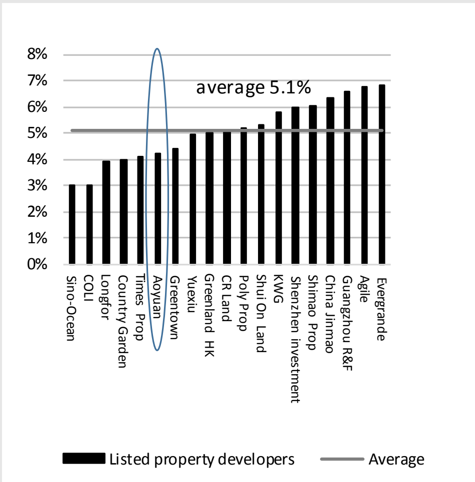
Ability to control costs has improved in the past few years

SG&A Costs to Contracted Sales



Source: Company data

FY16 SG&A Costs to Contracted Sales



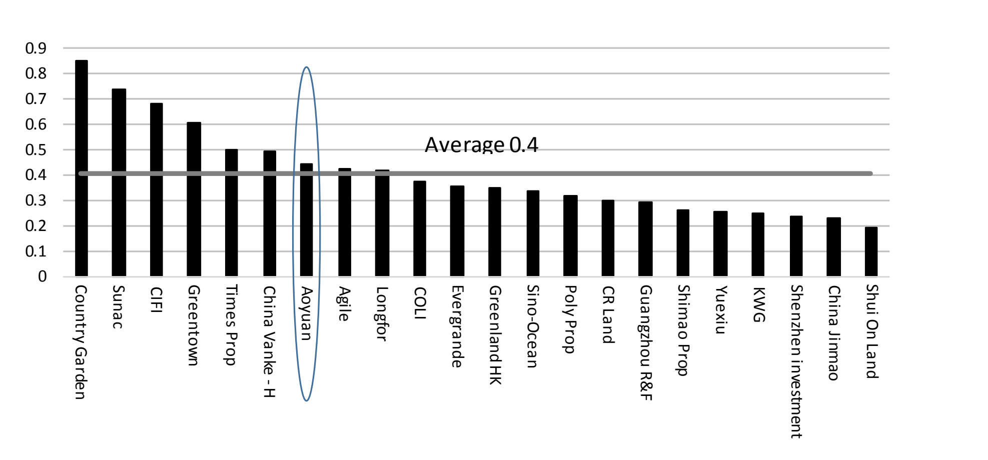
Source: Company data

Net gearing has fallen noticeably between FY13 and FY16, and borrowing costs have also dropped, to 7.6% in FY17, implying a healthy financial position

Higher-than-Peer Asset Turnover

To measure the operational efficiency of property developers at the enterprise level, we believe that using contracted sales rather than revenues provides a better gauge in calculating asset turnover. This is because property companies sell properties and collect money through pre-sales before booking revenues. AOY's asset turnover was 0.44 in 2016, higher than the sector average of 0.4, showing management's ability to transform assets into sales.

FY16 Contracted Sales to Average Assets

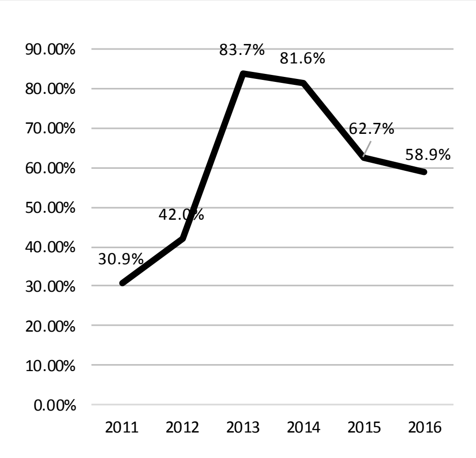


Source: Company data

Good Balance between Growth and Financial Health

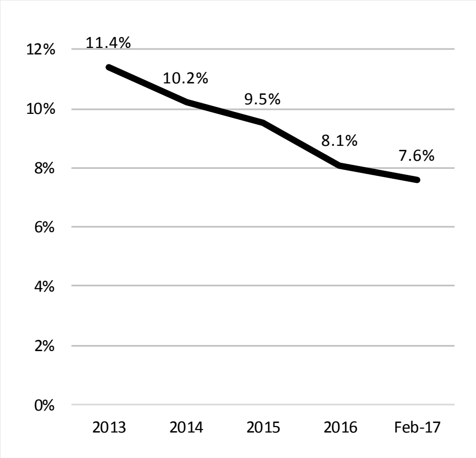
AOY has maintained a good balance between growth and financial health. The net gearing ratio fell from 83.7% in FY13 to 58.9% in FY16, while contracted sales grew at a 36.6% CAGR in FY13–16. Due to balance sheet strengthening, borrowing costs have fallen from 11.4% in FY13 to 7.6% as of February 2017. We believe funding costs should fall further as the yields on its bonds that mature in FY18 have dropped to 4.7%, yields on bonds maturing in FY19 have fallen to 5.1%, and on those maturing in FY20 to 5.3%.

Net Gearing



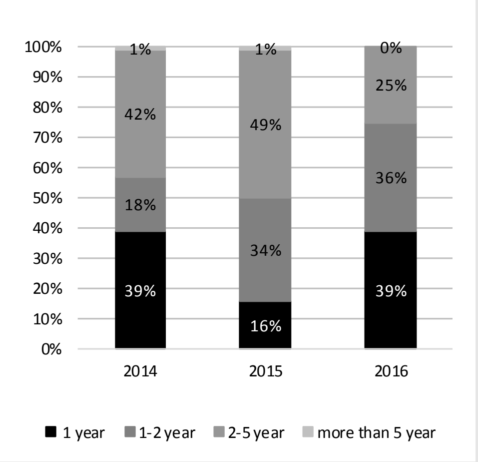
Source: Company data

Borrowing Cost



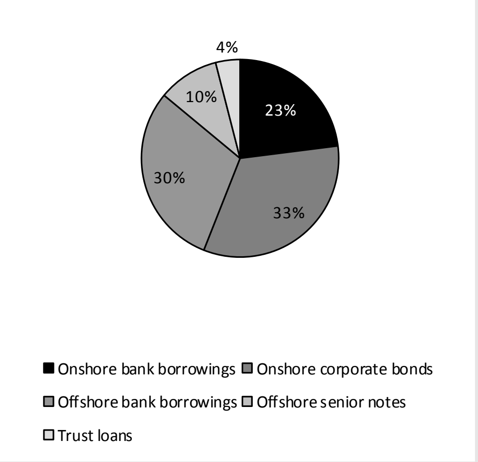
Source: Company data

Debt Maturity



Source: Company data

Debt Breakdown by Type



Source: Company data

Valuation

We believe that DCF-derived NAV is the most suitable methodology to determine fair value for property developers because it not only captures the total asset value of the company but also avoids potential volatility in booking schedules for small- and mid-sized developers. Our DCF analysis for AOY implies a NAV of HK$8.73 per share. AOY is currently trading at a 62% discount to our NAV estimate and on 5.9x our FY17 EPS estimate, at a 37% discount to the 9.3x of peers with similar market caps. Although we use the average discount to NAV for non-AOY small and mid-sized developers to derive our target price, we think that, driven by high sales growth, AOY could even trade above this average.

NAV Estimates

	Value (HKD mn)	Value (HKD per share)	As % of GAV (%)
Development properties	26,996	10.10	81%
Investment properties	6,235	2.33	19%
GAV	33,231	12.44	100%
Net Debt	(9,898)	-3.70	-
NAV (HKD)	23,333	8.73	-

Source: Company data, HTI estimates

AOY has a lower PER than its peers

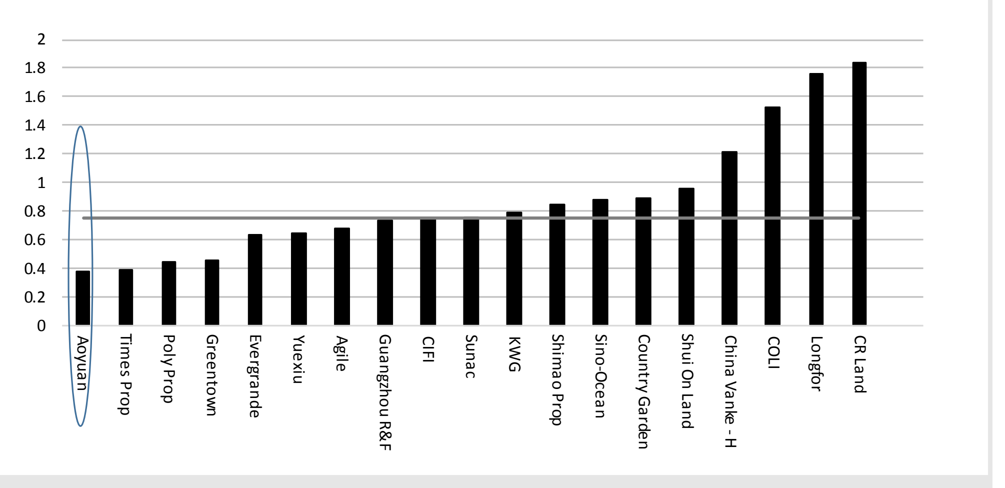
Non-SOE Small and Mid-Sized Developer Comparison (1 August 2017)

	Ticker	Share price (HK$)	Mkt cap (HK$mn)	Rating	NAV/sh (HK$)	Disc. to NAV (%)	PE (X) FY17	PE (X) FY18	PB (X) FY17	PB (X) FY18
China South City*	1668 HK	1.70	13,611	Buy	6.23	73%	10.2	9.0	0.5	0.5
CIFI	884 HK	4.23	28,845	Buy	10.11	58%	6.3	5.7	1.4	1.2
Franshion (China Jinmao)	817 HK	3.57	38,109	NR	5.50	35%	9.7	7.9	1.0	0.9
Greenland HK	337 HK	2.83	7,906	Buy	10.25	72%	4.7	3.8	0.7	0.6
Greentown	3900 HK	10.32	22,336	NR	19.00	46%	10.4	9.7	0.7	0.7
Guangzhou R&F	2777 HK	13.86	44,662	Neutral	30.48	55%	5.2	4.0	0.8	0.7
KWG	1813 HK	5.68	17,921	NR	11.68	51%	4.4	4.0	0.6	0.5
Poly Prop	119 HK	4.04	14,793	NR	6.50	38%	35.4	23.9	0.6	0.6
Shimao Prop	813 HK	14.90	50,467	Buy	30.00	50%	5.8	5.5	0.7	0.7
Shui On Land	272 HK	1.94	15,638	Buy	6.84	72%	7.6	6.4	0.4	0.3
Sino-Ocean	3377 HK	4.27	32,095	NR	8.50	50%	7.6	6.5	0.6	0.6
Times Prop	1233 HK	6.51	11,337	Buy	12.17	47%	4.2	2.7	0.9	0.7
Simple avg	–	–	–	–	–	**54%**	**9.3**	**7.4**	**0.7**	**0.7**
Aoyuan	3883 HK	3.28	9,000	Buy	8.73	62%	6.2	4.5	0.8	0.7

Note: China South City's financial year ends in March; Consensus data for non-rated (NR) stocks
Source: Company data, Bloomberg, HTI estimates

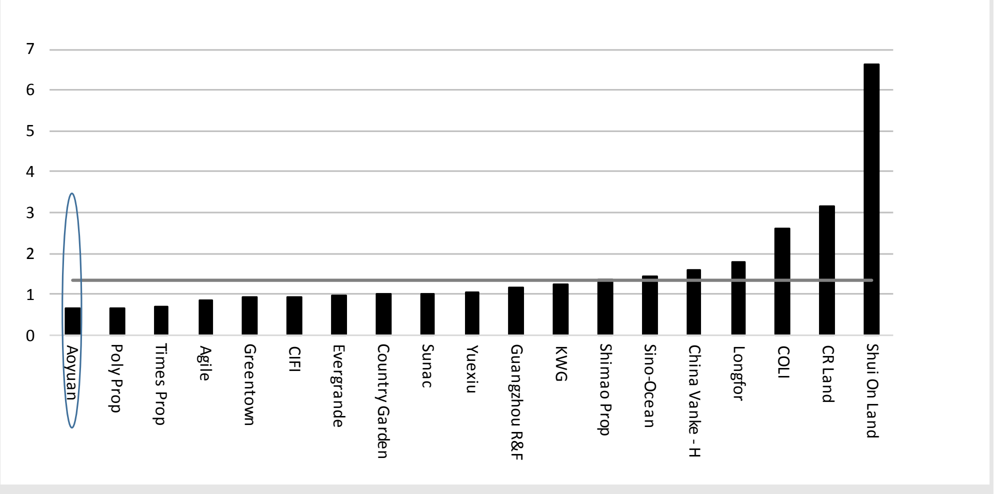
Another factor leading us to be positive on AOY is its market cap to attributed contracted sales ratio being lower than those of other property developers. In other words, AOY could generate more revenue at the same market capitalization than its peers. The following two charts show this for FY16 and H1 FY17.

Market Cap to Attributed Contracted Sales (FY16)



Source: CRIC, Bloomberg

Market Cap to Attributed Contracted Sales (H1 FY17)



Source: CRIC, Bloomberg

Risks to the Attainment of Our Rating and Target Price

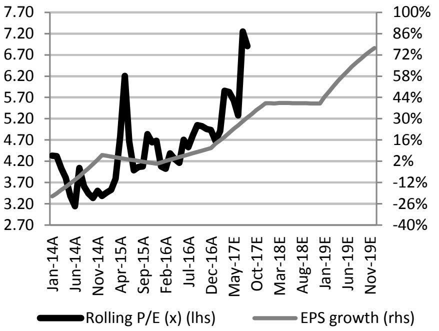
Most of AOY's revenue in FY11–16 comes from property sales. If economic growth in China is much slower than our expectation, and impacts property-buying sentiment, or the launch schedule for AOY's new properties is slower than in recent years, AOY's revenue may not grow as fast as we expect. China's property market could also be adversely impacted by changes in government policy, which are difficult to predict. Any policy tightening may also bring uncertainty to our earnings forecasts.

Peer Comparison

	Ticker	Share price (HK$)	Mkt cap (HK$mn)	Rating	TP (HK$)	Potential upside (%)	NAV/sh (HK$)	Disc. to NAV (%)	PE (X) FY17	PE (X) FY18	PB (X) FY17	PB (X) FY18	Yield (%) FY17	Yield (%) FY18	Net Gearing FY16	Adj. Gearing FY16	ROE (%) FY16	ROE (%) FY17
Agile	3383 HK	9.03	35,371	NR	na	na	10.65	15%	7.8	6.8	0.8	0.7	5.1%	5.6%	77.0%	70.8%	6.6%	9.7%
China South City*	1668 HK	1.7	13,611	Buy	2.41	42%	6.23	73%	10.2	9.0	0.5	0.5	2.9%	3.2%	83.9%	87.6%	13.9%	5.0%
China Vanke - H	2202 HK	22.75	294,661	Neutral	22.1	-3%	27.6	18%	7.8	6.1	1.6	1.4	5.8%	5.6%	25.9%	25.9%	19.7%	22.4%
CIFI	884 HK	4.23	28,845	Buy	4	-5%	10.11	58%	6.3	5.7	1.4	1.2	5.3%	6.2%	50.4%	48.4%	20.2%	24.4%
COLI	688 HK	26.5	290,339	Buy	35.2	33%	39.1	32%	6.9	5.6	1.1	1.0	2.9%	3.6%	7.4%	8.6%	17.1%	16.4%
Country Garden	2007 HK	10.5	224,077	Sell	3.11	-70%	6.22	-69%	13.9	11.2	2.3	2.0	2.2%	2.7%	63.4%	39.7%	16.7%	17.8%
CR Land	1109 HK	24.8	171,887	Buy	27.76	12%	37.625	34%	9.1	9.1	1.3	1.2	3.0%	3.0%	23.8%	33.3%	16.8%	16.9%
Evergrande	3333 HK	21	274,967	NR	na	na	15	-40%	15.8	10.9	4.2	3.3	3.6%	4.4%	173.0%	427.3%	10.7%	27.7%
Franshion (China Jinmao)	817 HK	3.57	38,109	NR	na	na	5.5	35%	9.7	7.9	1.0	0.9	4.1%	4.9%	53.5%	56.7%	7.9%	11.4%
Greenland HK	337 HK	2.83	7,906	Buy	3.73	32%	10.25	72%	4.7	3.8	0.7	0.6	4.3%	4.9%	120.6%	140.1%	14.6%	17.3%
Greentown	3900 HK	10.32	22,336	NR	na	na	19	46%	10.4	9.7	0.7	0.7	1.3%	1.9%	42.0%	23.9%	7.9%	6.6%
Guangzhou R&F	2777 HK	13.86	44,662	Neutral	15.24	10%	30.48	55%	5.2	4.0	0.8	0.7	7.7%	8.6%	159.9%	173.9%	16.0%	15.8%
KWG	1813 HK	5.68	17,921	NR	na	na	11.68	51%	4.4	4.0	0.6	0.5	7.5%	9.1%	64.5%	66.8%	15.0%	13.5%
Longfor	960 HK	19.4	114,102	Buy	16.14	-17%	23.09	16%	8.8	7.8	1.4	1.2	3.4%	3.9%	53.9%	53.9%	15.7%	16.6%
Poly Prop	119 HK	4.04	14,793	NR	na	na	6.5	38%	35.4	23.9	0.6	0.6	0.3%	0.7%	112.1%	39.3%	0.3%	1.6%
Red Star Macalline	1528 HK	8.2	29,716	Buy	11.47	40%	17.15	52%	9.2	8.1	0.6	0.6	6.2%	6.9%	32.3%	33.0%	10.1%	6.5%
Shenzhen investment	604 HK	3.58	27,461	Buy	4.88	36%	8.13	56%	7.8	5.9	0.8	0.7	5.8%	6.7%	34.8%	34.7%	11.5%	10.0%
Shimao Prop	813 HK	14.9	50,467	Buy	18	21%	30	50%	5.8	5.5	0.7	0.7	6.4%	6.7%	50.7%	55.7%	10.1%	13.5%
Shui On Land	272 HK	1.94	15,638	Buy	2.80	44%	6.84	72%	7.6	6.4	0.4	0.3	4.6%	5.5%	76.9%	86.1%	2.9%	4.8%
Sino-Ocean	3377 HK	4.27	32,095	NR	na	na	8.5	50%	7.6	6.5	0.6	0.6	5.2%	6.0%	49.5%	43.5%	8.7%	8.2%
SOHO China	410 HK	4.2	21,838	Sell	3.03	-28%	7.57	45%	34.0	29.7	0.5	0.5	1.5%	5.2%	31.7%	32.5%	2.6%	1.6%
Sunac	1918 HK	20.1	78,453	NR	na	na	14	-44%	24.5	11.6	2.3	2.0	1.4%	2.4%	171.9%	208.6%	11.7%	9.2%
Yuexiu	123 HK	1.45	17,982	NR	na	na	3	52%	9.7	8.2	0.5	0.5	4.5%	5.2%	65.8%	65.8%	5.1%	5.2%
Times Prop	1233 HK	6.51	11,337	Buy	6.09	-6%	12.17	47%	4.2	2.7	0.9	0.7	7.1%	9.0%	55.1%	55.1%	24.1%	23.1%
Simple avg	–	–	–	–	–	–	–	**34%**	**8.9**	**7.0**	**1.1**	**1.0**	**4.3%**	**5.1%**	**70.0%**	**79.6%**	**11.9%**	--
Aoyuan	**3883 HK**	**3.28**	**9000**	**Buy**	**3.93**	**20%**	**8.73**	**62%**	**6.2**	**4.5**	**0.8**	**0.7**	**4.8%**	**6.7%**	**58.9%**	–	**10.3%**	**13.0%**

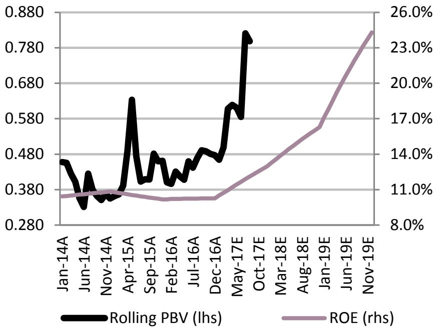
Share price data as of 1 August 2017; Consensus data is used for non-rated (NR) stocks. * China South City's financial year ends in March; Average PER excludes SOHO China and Poly Prop
Source: Company data, Bloomberg, HTI estimates

P/E (x) vs EPS Growth (%)



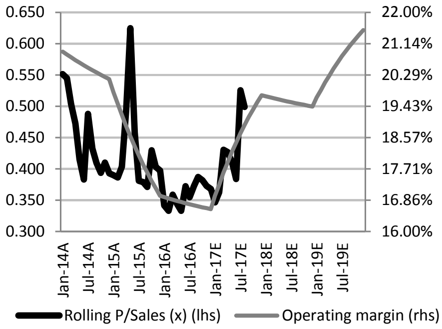
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



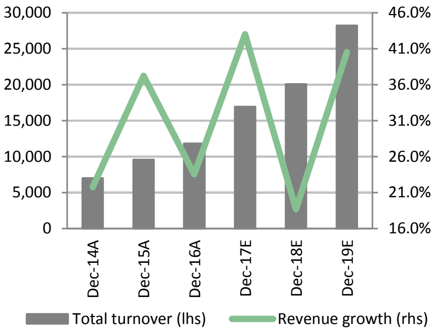
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



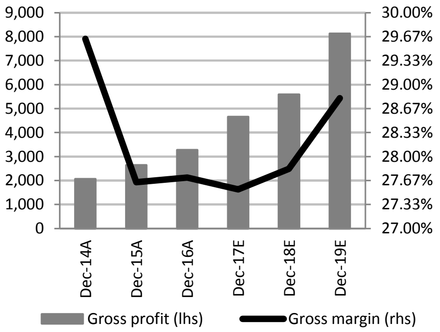
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



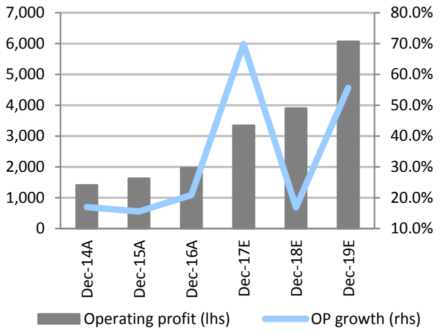
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



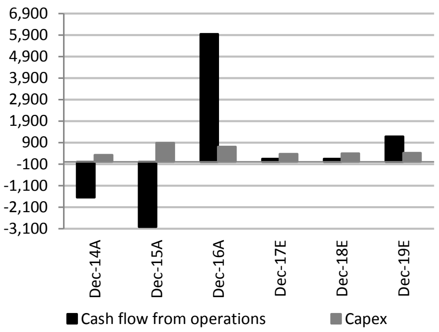
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



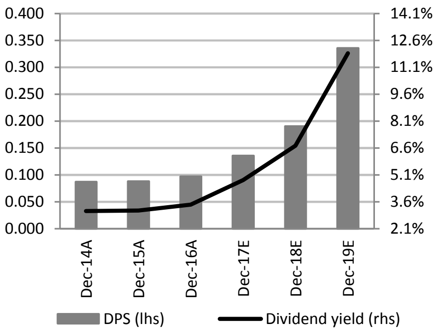
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rmbm)



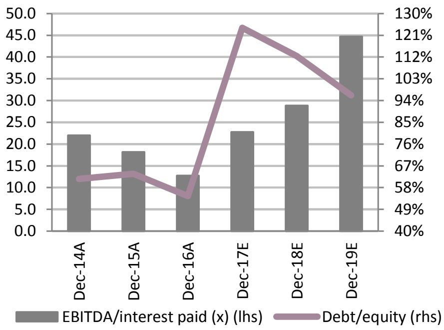
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rmb)



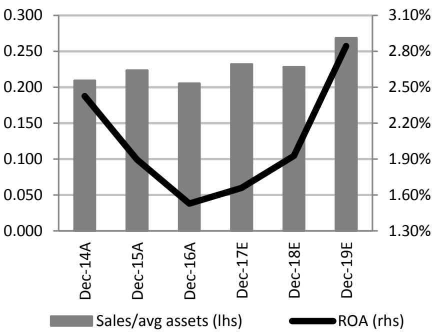
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



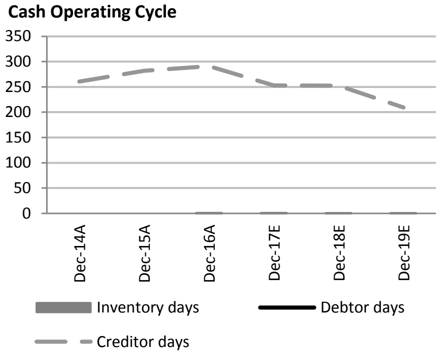
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



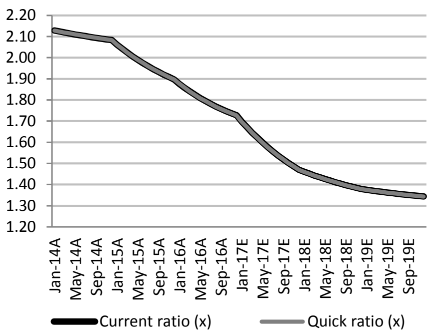
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

Revenue Growth

Contracted sales have grown rapidly since 2013 at a 48.6% CAGR, much faster than the 16.2% for the market overall and the 28% for the 21 listed developers that we track. We expect growth in contracted sales to help the company meet its target of Rmb50bn in FY19.

Profit Margins

We think management has demonstrated its capabilities by maintaining a higher gross profit margin than the company's listed peers in FY13–16, in a range of 27–31%. Property segment GPM is stable, while in the investment property segment, it has been clearly increasing since FY14. Other segments' margins have also been improving in recent years.

Shareholder Returns

The dividend has grown steadily over FY11–16, from HK$0.05 per share to HK$0.15 per share, excluding the special dividend in FY12. The payout ratio was stable at 30% in FY14–16, and we assume the same ratio for our forecast horizon.

Balance Sheet Risks

The net gearing ratio fell from 83.7% in FY13 to 58.9% in FY16, while contracted sales grew at a 36.6% CAGR in FY13–16. Due to balance sheet strengthening, borrowing costs have fallen from 11.4% in FY13 to 7.6% as of February 2017. We believe funding costs should fall further as the yields on its bonds that mature in FY18 have dropped to 4.7%, yields on bonds maturing in FY19 have fallen to 5.1%, and on those maturing in FY20 to 5.3%.

Key Takeaway

We think AOY should benefit from the development of the Guangdong–Hong Kong–Macau Big Bay Area, the fourth-largest coastal economic zone after New York Bay, Los Angeles Bay, and Tokyo Bay

Investment Thesis – Target Price – Share Price Catalysts

We think AOY's existing land bank, mostly based in first- and second-tier cities, and satellite cities in the Pearl and Yangtze deltas, is sufficient to support growth in the next few years. To measure the operational efficiency of property developers at the enterprise level, we believe that using contracted sales rather than revenues provides a better gauge in calculating asset turnover. AOY's asset turnover was 0.44 in 2016, higher than the sector average of 0.4, showing management's ability to transform assets into sales.

We believe that a DCF-derived NAV is the most suitable methodology to determine fair value for property developers. Our DCF analysis for AOY implies a NAV of HK$8.73 per share. We expect a new peak in contracted sales in FY17 could be a catalyst for the shares.

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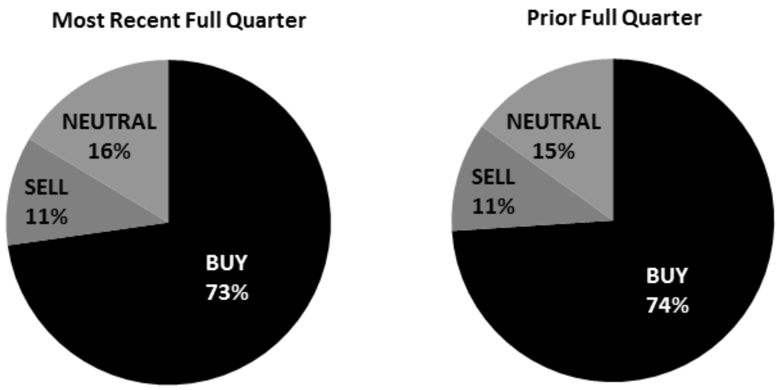
NEUTRAL: A stock under coverage with insufficient upside or downside to justify a BUY or SELL rating. For purposes only of FINRA/NYSE ratings distribution rules, our Neutral rating falls into a hold rating category.

Rating Distribution



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	BUY	Neutral (hold)	SELL
HTI Equity Research Coverage	73%	16%	11%
IB clients*	3%	6%	11%

*Percentage of investment banking clients in each rating category.
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Date	Recommendation	Target (HK$)	Price (HK$)
2017-08-01			

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity