

China Aoyuan Property Group (3883 HK)

Member of quant-based [HTI Portfolios](#): Momentum

Target Price **HK\$7.69**
 Current Price **HK\$6.00**
 % Upside **28%**

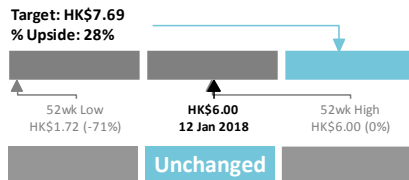
On Contracted Sales and Land Bank, 2018 Could Be Another Stellar Year

Real Estate

Hong Kong

12 Jan 2018

BUY



Basic Share Information

Market cap	HK\$16.06b / US\$2.05b
Daily traded value (3mth)	US\$8.64m
Shares outstanding	2,672m
Free float	56.1%
Net debt-to-equity	58.9%
1 yr high	HK\$6.00
1 yr low	HK\$1.72
Major shareholding	52.0%
Last HTI contact w/ Co	10 Jan 18

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	48.1%	35.4%	246.8%
Absolute USD	47.8%	35.1%	243.7%
Relative to HSI	40%	26%	210.5%



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A 30% Contracted Sales CAGR Achievable in FY18–20

Summary: In FY17, contracted sales grew rapidly, reaching Rmb45bn, 20% above company plans. Based on this outperformance, we maintain our BUY rating and raise our target price from HK\$3.93 to HK\$7.69. China Aoyuan Property Group (AOY) had 17mn sqm of total land bank at end-June 2017, mainly focused on the Guangdong–Hong Kong–Macau Big Bay Area, and Central and Western China. We believe AOY has sufficient land reserves, and its strong growth in contracted sales could drive revenue growth over the next few years. We attended an analyst meeting with management in December, at which AOY outlined its incentive mechanism for project investment, whereby project managers need to personally invest in any agreed investment decision. In cities where housing prices are controlled by the government, such as Shenzhen, AOY's strategy is to develop projects in low-price districts, thus avoiding the effects of policy-mandated price limits. We think AOY has a high ability to transform growth into profitability, and we believe it can meet its Rmb50–60bn contracted sales target for FY18.

Target Price and Catalyst: We narrow the target discount to our HK\$11.80 NAV estimate from 45% to 35% to derive our new target price of HK\$7.69. The announcement of FY17 results, expected in February, could be a catalyst for the shares.

Earnings: Contracted sales grew at a rapid 36.6% CAGR in FY13–16, and reached Rmb45bn in FY17, 20% ahead of the company's full-year plan. We estimate unbooked sales at end-FY17 were around Rmb40bn, which should support future revenue growth. Taking into account high growth in contracted sales and the company's ample land bank, we expect a 46.3% revenue CAGR over our forecast period. We believe AOY can meet its contracted sales target of Rmb50–60bn for FY18, and Rmb70–80bn for FY19.

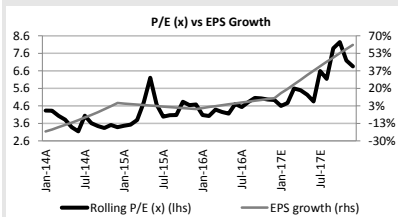
Valuation: We think that a discounted cash flow (DCF)-derived net asset value (NAV) is the most suitable methodology to determine fair value for property developers. Based on an updated land bank valuation to including new land, and our estimates of revenue from other segments, we raise our NAV estimate from HK\$8.73 to HK\$11.80 per share. AOY is currently trading at a 49% discount to our NAV estimate, and on 9.58x our FY17 EPS estimate, lower than the 10.4x of peers with similar market caps. Driven by high sales growth and increasing ASPs, we think that AOY could trade above the average small and mid-sized developer discount to NAV, and so we narrow our target discount from 45% to 35% to derive our new target price of HK\$7.69.

	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E	Trend
Total turnover (Rmbm)	9,572	11,827	18,633	25,404	37,005	■ ■ ■ ■ ■
Operating profit (Rmbm)	1,625	1,965	3,162	4,802	7,089	■ ■ ■ ■ ■
Pre-tax profit (Rmbm)	1,884	2,085	3,014	4,665	6,952	■ ■ ■ ■ ■
Net income to ord equity (Rmbm)	812	881	1,392	2,613	3,454	■ ■ ■ ■ ■
Net profit growth	0.3%	8.5%	58.1%	87.7%	32.2%	■ ■ ■ ■ ■
P/E (x)	17.11	15.45	9.58	5.10	3.86	■ ■ ■ ■ ■
Adj EV/EBITDA (x)	15.68	15.27	9.35	5.95	3.93	■ ■ ■ ■ ■
P/B (x)	1.69	1.50	1.33	1.10	0.91	■ ■ ■ ■ ■
ROE	10.2%	10.3%	14.7%	23.5%	25.7%	■ ■ ■ ■ ■
Dividend yield	2.1%	3.0%	3.7%	6.9%	9.1%	■ ■ ■ ■ ■
EPS HTI old (Rmb)	0.29	0.32	0.45	0.63	1.12	■ ■ ■ ■ ■
EPS HTI New (Rmb)	0.29	0.32	0.52	0.98	1.29	■ ■ ■ ■ ■
Consensus EPS (Rmb)	0.36	0.38	0.58	0.81	1.05	■ ■ ■ ■ ■
HTI EPS vs Consensus	(19.0%)	(15.0%)	(10.6%)	20.6%	23.6%	■ ■ ■ ■ ■

Source: Company data, Bloomberg, HTI estimates

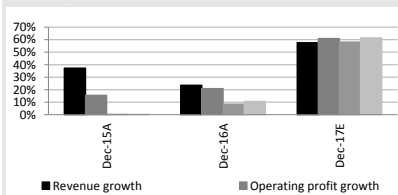
Click [here](#) to download the working model

Valuation



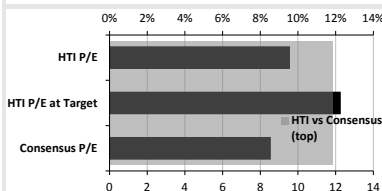
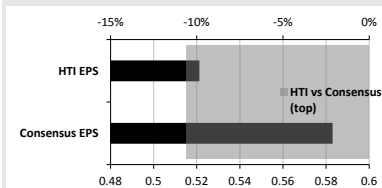
Source: Company data, Bloomberg, HTI estimates

Earnings Trends



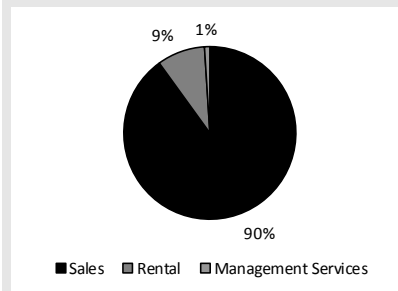
Source: Company data, Bloomberg, HTI estimates

Earnings: HTI vs Consensus



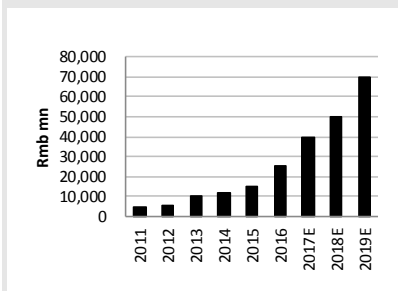
Source: Company data, Bloomberg, HTI estimates

H1 FY17 Revenue Breakdown



Source: Company data

Contracted Sales



Source: Company data, HTI estimates

Investment Thesis

BUY

➤ Contracted sales reached Rmb45bn in FY17, 20% higher than the company’s plan. We believe AOY can maintain rapid revenue growth in the next few years.

➤ As of June 2017, AOY had 17mn sqm of land bank, 58% of which is in the Guangdong–Hong Kong–Macau Big Bay Area. We expect the company to benefit from the development of this area, the world’s fourth-largest coastal economic zone after New York Bay, Los Angeles Bay, and Tokyo Bay.

➤ We attended an analyst meeting with management in December. Management outlined its property development strategy for Shenzhen City, of buying land and developing projects in districts with relatively low housing prices to avoid the effects of the government’s policy of limiting prices.

➤ In H1 FY17, AOY acquired 20 new property projects, half of which are in the Guangdong–Hong Kong–Macau Big Bay Area. We think AOY has enough land to support development for the next few years.

➤ AOY has maintained a good GPM level over the past seven years, of 27–31%. We expect GPM to remain at 27% over our forecast period.

➤ Risks include economic growth in China being much lower than our expectations, impacting property-buying sentiment, new property launches being slower than in past, 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

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 30 June 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 at a rapid 46% CAGR since 2013, and reached Rmb45bn in FY17, 20% ahead of the company's full-year plan. Taking into account high growth in contracted sales and the company's ample land bank, we expect a 46.3% revenue CAGR over our forecast period.

Profit Margins

Low **Medium** High

AOY has maintained a good GPM level over the past seven years, of 27–31%. We expect GPM to remain at 27% over FY17–19. Our NPM estimates for FY17–19 are 9–10%, excluding any change in the fair value of investment properties.

Shareholder Returns

Low **Medium** High

The dividend grew 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, while we assume it improves to 35% in our forecast horizon.

Balance Sheet Risks

High Medium **Low**

The net gearing ratio trended down from 84% in FY13 to 59% in FY16, while contracted sales showed a 36.6% CAGR in FY13–16. Due to balance sheet strengthening, borrowing costs fell from 11.4% in FY13 to 7.6% in June 2017. We expect funding costs to fall further as yields on 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 six overseas projects (four in Sydney and two in Vancouver) as of June 2017.

FX Exposure

High Medium **Low**

We think foreign currency risk is small. The company's major transactions are conducted in CNY. At June 2017, assets in HKD and USD accounted for less than 1% of total assets, and only 2.5% of total cash was denominated in foreign currencies. The Group has entered into certain foreign currency forward contracts to keep net exposure to currency risk at 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 grew at a rapid 36.6% CAGR in FY13–16, and we expect a 46% revenue CAGR for FY17–19

We do not factor any revaluation gains into our estimates for FY17–19

We assume 8% of total profit before tax comes from non-controlling interests

✓ **Key P/L Takeaway**
Taking into account high growth in contracted sales and the company's ample land bank, we expect a 46.3% revenue CAGR over our forecast period

Profit & Loss (Rmbm)	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E
Total turnover	9,572	11,827	18,633	25,404	37,005
Cost of sales	(6,926)	(8,550)	(13,602)	(18,545)	(27,013)
Gross profit	2,646	3,277	5,031	6,859	9,991
Total operating costs	(890)	(1,082)	(1,926)	(2,112)	(2,957)
Net other operating income	(131)	(231)	58	56	55
Operating profit	1,625	1,965	3,162	4,802	7,089
Operating EBITDA	1,659	2,006	3,207	4,849	7,139
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	3,014	4,665	6,952
Taxation	(977)	(1,078)	(1,500)	(1,825)	(3,198)
Minority interests	(95)	(126)	(121)	(227)	(300)
Net income to ord equity	812	881	1,392	2,613	3,454

Source: Company, HTI estimates

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Contracted sales grew at a rapid 36.6% CAGR in FY13–16, and reached Rmb45bn in FY17, 20% ahead of the company's full-year plan. Taking into account high growth in contracted sales and the company's ample land bank, we expect a 46.3% revenue CAGR over our forecast period.

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

✓ **Key B/S Takeaway**

We expect sustained growth in contracted sales to help the company to meet its target of Rmb50–60bn in FY18, meaning that current assets should also increase

Balance Sheet (Rmbm)	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E
Total cash and equivalents	9,036	10,956	10,183	10,199	10,159
Inventories	-	26	26	26	26
Other current assets	34,162	48,847	70,967	89,992	113,956
Total current assets	43,198	59,830	81,177	100,217	124,141
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	88,108	107,515	131,828
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	43,557	59,086	79,075
Total current liabilities	22,770	34,634	57,921	74,978	96,471
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	72,259	89,381	110,944
Common stocks	26	25	25	25	25
Retained earnings reserve	8,216	8,893	10,026	12,152	14,691
Shareholders' equity	8,243	8,918	10,051	12,177	14,717
Minority interests	3,333	5,713	5,798	5,957	6,167
Other equity	-	(0)	-	0	(0)
Total equity	11,576	14,631	15,849	18,134	20,884
Total liabilities & shareholders' equity	48,827	66,418	88,108	107,515	131,828

Source: Company, HTI estimates

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The net gearing ratio trended down from 84% in FY13 to 59% in FY16, while contracted sales showed a 36.6% CAGR in FY13–16. Due to balance sheet strengthening, borrowing costs fell from 11.4% in FY13 to 7.6% in June 2017. We expect funding costs to fall further as yields on 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, returning to positive territory in FY18 and 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	3,162	4,802	7,089
Depreciation and amortisation	34	42	44	47	49
Changes in working capital	(2,955)	(3,310)	(1,904)	(2,184)	(2,711)
Other operating cash flow	(2,853)	8,331	87	(87)	(77)
Operating cash flow	(4,149)	7,027	1,389	2,577	4,350
Interest paid	(91)	(157)	(149)	(137)	(137)
Tax paid	1,217	(925)	(1,263)	(1,563)	(2,911)
Cash flow from operations	(3,023)	5,945	(22)	877	1,303
Capex	(885)	(703)	(371)	(393)	(416)
Other investing cash flow	(40)	(3,366)	58	56	55
Cash flow from investing activities	(924)	(4,069)	(313)	(337)	(360)
Proceeds from issue of shares	(428)	(565)	-	-	-
Increase in debt	(313)	(671)	-	-	-
Other financing cash flow	7,544	2,043	(438)	(524)	(983)
Cash flow from financing activities	6,804	808	(438)	(524)	(983)
Cash at beginning of period	4,852	7,769	10,471	9,697	9,714
Total cash generated	2,856	2,683	(774)	16	(41)
Forex effects	61	18	-	-	-
Implied cash at end of period	7,769	10,471	9,697	9,714	9,673
Free cash flow	(3,908)	5,242	(393)	484	887

Source: Company, HTI estimates

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✓ **Key Cash Flow Takeaway**
We estimate unbooked sales at end-FY17 were around Rmb40bn, which should support future revenue growth

Operating cash flow was 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, but see a rebound to Rmb886mn in FY19.

Our Model Assumptions

We estimate a stable 35% payout ratio over FY17–19, implying potential dividend increases on revenue growth

We expect GPM to be 27% over our forecast period

We estimate NPM is around 9% over FY17–19, excluding any revaluation gains

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

Key Driver Takeaway
We think AOY has a high ability to transform growth into profitability, with a higher-than-peer GPM since 2013

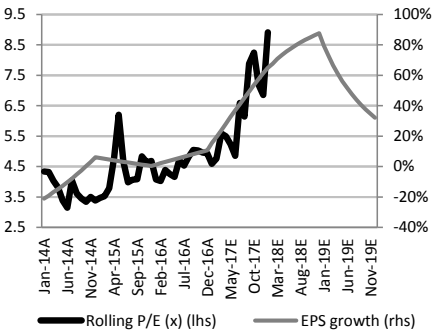
Per Share Data	Dec-15A	Dec-16A	Dec-17E	Dec-18E	Dec-19E
EPS (Rmb)	0.29	0.32	0.52	0.98	1.29
FDEPS (Rmb)	0.29	0.32	0.52	0.98	1.29
Revenue per share (Rmb)	3.44	4.34	6.97	9.51	13.85
Operating EBITDA per share (Rmb)	0.60	0.74	1.20	1.82	2.67
BVPS (Rmb)	2.96	3.34	3.76	4.56	5.51
DPS (Rmb)	0.11	0.15	0.18	0.34	0.45
Recurrent cash flow per share (Rmb)	(1.09)	2.18	(0.01)	0.33	0.49
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)	1.45	1.15	0.72	0.52	0.36
P/E (x)	17.11	15.45	9.58	5.10	3.86
P/CF (x)	na	2.29	na	15.20	10.24
P/B (x)	1.69	1.50	1.33	1.10	0.91
Adj EV/EBITDA (x)	15.68	15.27	9.35	5.95	3.93
Dividend yield	2.1%	3.0%	3.7%	6.9%	9.1%
Growth					
Revenue growth	37.2%	23.6%	57.5%	36.3%	45.7%
Operating profit growth	15.5%	20.9%	61.0%	51.9%	47.6%
Net profit growth	0.3%	8.5%	58.1%	87.7%	32.2%
Margins					
Gross margin	27.6%	27.7%	27.0%	27.0%	27.0%
Operating EBITDA margin	17.3%	17.0%	17.2%	19.1%	19.3%
Operating margin	17.0%	16.6%	17.0%	18.9%	19.2%
Pretax profit margin	19.7%	17.6%	16.2%	18.4%	18.8%
Tax rate	51.8%	51.7%	49.8%	39.1%	46.0%
Net profit margin	8.5%	7.4%	7.5%	10.3%	9.3%
Key Ratios					
ROE	10.2%	10.3%	14.7%	23.5%	25.7%
ROA	1.9%	1.5%	1.8%	2.7%	2.9%
Capex/revenue	9.2%	5.9%	2.0%	1.5%	1.1%
Current ratio (x)	1.90	1.73	1.40	1.34	1.29
Creditor days	281.8	290.8	227.9	197.3	155.7
Inventory days	-	1.13	0.71	0.52	0.36
Sales/avg assets	0.22	0.21	0.24	0.26	0.31
Credit analysis					
EBITDA/interest paid (x)	18.15	12.74	21.56	35.40	52.12
OCF/interest paid (x)	(33.06)	37.76	(0.15)	6.40	9.51
Debt/EBITDA (x)	4.44	3.98	6.10	4.04	2.74
Debt/equity	63.7%	54.5%	123.5%	107.9%	93.7%
Net debt to equity	62.7%	58.9%	59.2%	51.7%	45.1%

Source: Company, HTI estimates

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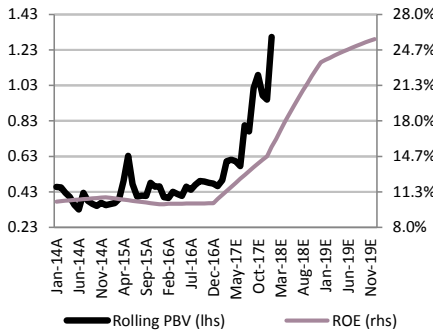
The dividend grew steadily over FY11–16, from HK\$0.05 per share to HK\$0.15 per share, excluding the special dividend in FY12. The payout ratio was stable at 30% in FY14–16, while we assume it improves to 35% in our forecast horizon.

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



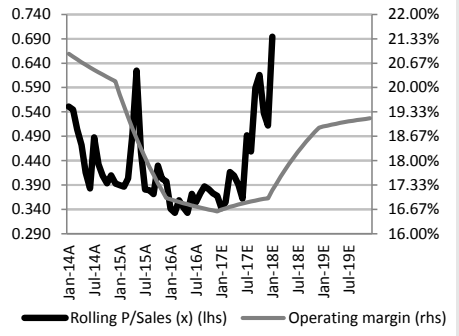
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



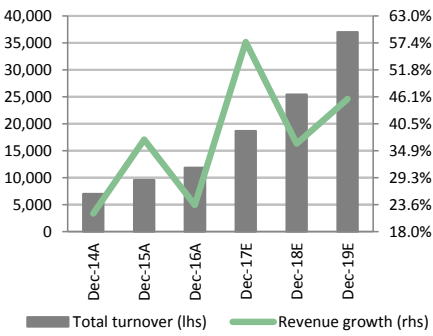
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



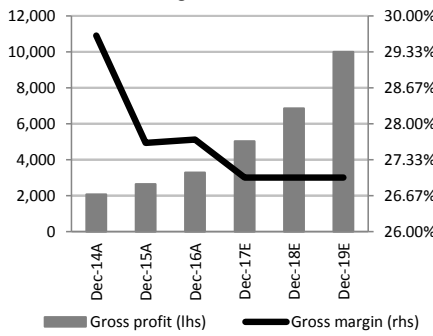
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



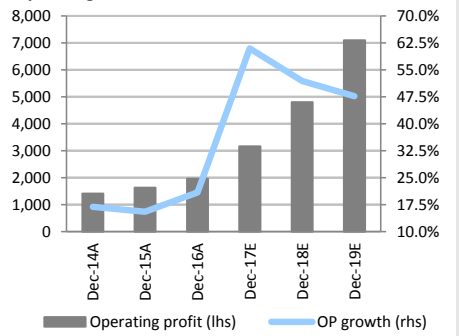
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



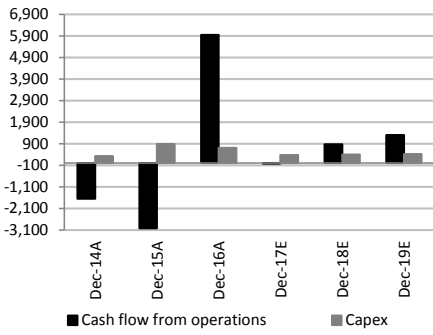
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



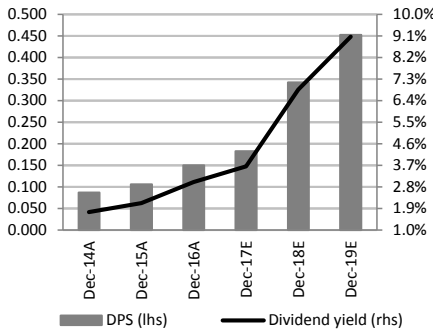
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rmbm)



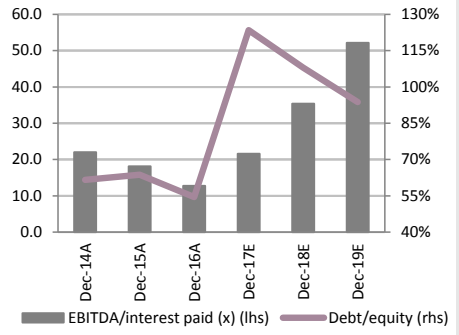
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rmb)



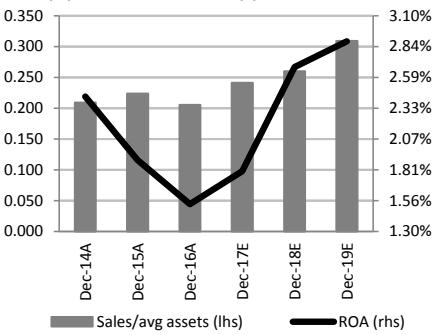
Source: Company data, Bloomberg, HTI estimates

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



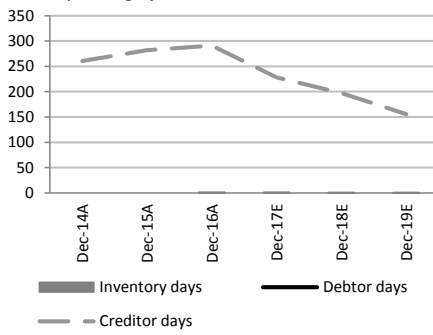
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



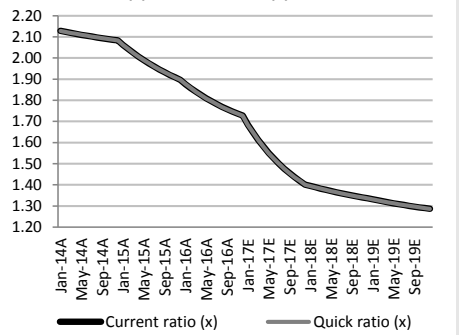
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

APPENDIX

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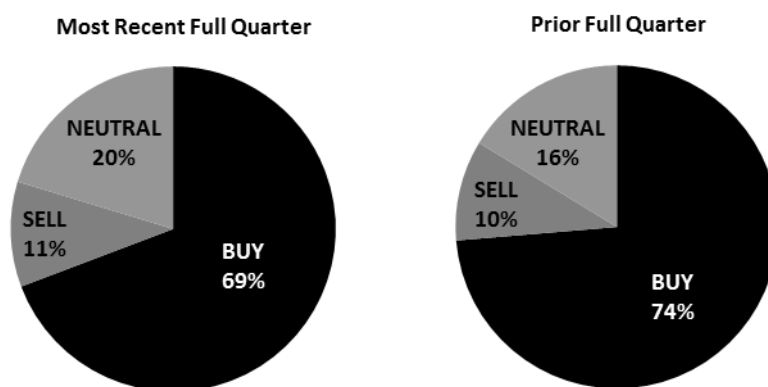
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Rating Distribution



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*Percentage of investment banking clients in each rating category.

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Recommendation Chart



Date	Recommendation	Target (HK\$)	Price (HK\$)
2017-08-01	Buy	3.93	3.28

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