

China Aoyuan (CAPG)

Pursuing growth with financial prudence

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China

- ▶ Strong FY2017 results with 62% y-o-y growth in top-line to RMB19bn; profitability largely stable, with debt leverage kept in track (reported net gearing 51%, as of end-2017)
- ▶ RMB73bn contracted sales target set for 2018, up 60% versus RMB46bn actual contracted sales in 2017; ample saleable resources of RMB121.5bn for the year
- ▶ Maintain Overweight fundamental recommendation and initiate hold trading call on CAPG'22 (92.875/93.375, 7.3%/7.1%) with bonds fairly valued against B-rated peers

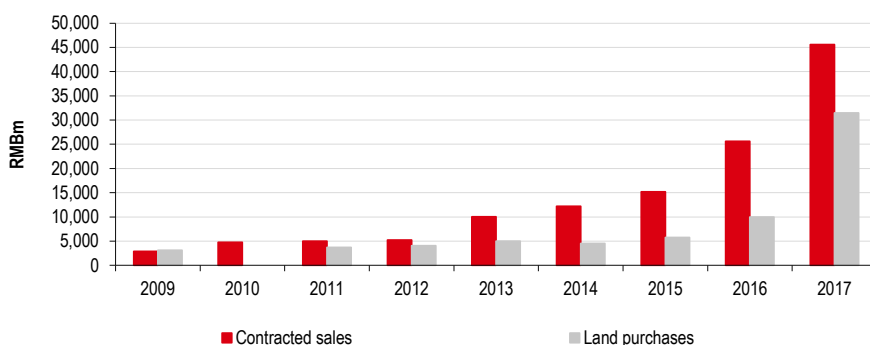
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Strong FY2017 results

On 14 March 2018, China Aoyuan (CAPG; rated B1/B+, bond rated B2/B) announced strong FY2017 results. Driven by a 51% y-o-y increase in gross floor area delivered (2.4 million sq m) in 2017 and 6% y-o-y growth of recognised average selling price to RMB7,397 per sq m, revenue increased 62% y-o-y to RMB19bn. Profitability is largely stable, with gross and EBITDA margin at 27% and 18%, respectively, in 2017 vs 28% and 19% in 2016. Despite its active land banking, with 58 new projects acquired for total consideration of more than RMB30bn in 2017, the group's debt leverage stayed at manageable level, in our view. Debt-to-capitalisation edged higher to 60% as of end-2017 from 56% as of end-2016. Reported net gearing of 51% stayed comfortably within the group's cap of 80%, with substantial capital contribution from minority shareholders of the newly acquired projects which helped fuel a notable increase in minority interests on its balance sheet (i.e. RMB17bn as of end-2017 vs RMB6bn as of end-2016).

1. China Aoyuan: Pursuing growth with financial prudence



Source: China Aoyuan, HSBC

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2. China Aoyuan: Active land replenishment paving the way for RMB100bn sales in 2019

Year ended December (RMBbn)	1H17	2H17	2017 actual	HSBC 2017 forecast	Variance	HSBC 2018 forecast
Cash sales proceeds	14.2	21.3	35.6	31.0	15%	58.4
Construction costs	-7.9	-8.1	-16.0	-13.0	23%	-23.0
Interest expense	-0.7	-1.3	-2.0	-1.8	11%	-3.0
SG&A, tax	-2.0	-3.3	-5.3	-4.9	7%	-8.7
Recurrent income	0.0	0.0	0.0	0.0	0%	0.0
Operating cash flow (OCF)	3.6	8.6	12.3	11.3	9%	23.7
Land premium payment	-9.7	-12.4	-22.2	-15.0	48%	-30.0
Project/ project stake disposal	0.0	0.0	0.0	0.0	0%	0.0
Others	1.4	1.3	2.7	0.0	NA	0.0
Free cash flow (FCF)	-4.7	-2.5	-7.2	-3.7	94%	-6.3
Cash dividend	0.0	-0.4	-0.4	-0.4	0%	-0.7
Share repurchases	0.0	0.0	0.0	0.0	0%	0.0
Retained cash flow (RCF)	-4.7	-2.9	-7.6	-4.1	85%	-7.0
Additional onshore borrowings	6.9	10.4	17.2	7.5	130%	0.0
Additional offshore borrowings	1.1	3.7	4.8	3.3	44%	-0.3
Perpetual issuance/ share placement	0.0	0.0	0.0	0.0	0%	0.0
Change in cash	3.3	11.1	14.4	6.7	115%	-7.3
Unrestricted cash balance at beginning of year	10.5	13.7	10.5	10.5	NA	24.8
Unrestricted cash balance at end of year	13.7	24.8	24.8	17.2	44%	17.5

Note: Outstanding land premium carried forward from 2017: RMB6.25bn. Source: China Aoyuan, HSBC

Adequate balance sheet liquidity; RMB73bn contracted sales target set for 2018

China Aoyuan's balance sheet liquidity is adequate, in our view, with unrestricted cash on hand of RMB24.8bn covering short-term debt of RMB20.5bn, as of end-2017. The group has diversified onshore and offshore funding channels. On 13 March 2018, it raised HKD1.6bn HKD/USD dual tranche three-year offshore loan facilities at a favourable funding cost of LIBOR/HIBOR+395bp, which covers bulk of its funding needs for the maturity of USD250m CAPG'18 with a coupon rate of 10.875% in May 2018.

China Aoyuan sets its 2018 contracted sales target at RMB73bn, representing 60% y-o-y growth versus RMB46bn contracted sales achieved in 2017. The group's increase in sales is supported by ample saleable resources of RMB121.5bn for 2018, in our view. Based on current plan, the group targets to reach the RMB100bn annual contracted sales milestone by 2019. To fuel its growth in operating scale, we believe it will stay active in land acquisitions in 2018. In our base case, we budget RMB30bn land premium payment in 2018e. As such, we believe the debt leverage will go up in 2018 versus 2017. Yet, reported net gearing should stay within 80%, in line with the financial covenants of its offshore bank loans.

3. China Aoyuan: Consolidated income statements

Year ended Dec (RMBm)	2015	2016	2017	Y-o-Y
Revenue	9,572	11,827	19,115	62%
Cost of sales	(6,926)	(8,550)	(14,004)	64%
Gross Profit	2,646	3,277	5,111	56%
Selling, admin & operating expenses	(890)	(1,082)	(1,726)	60%
Operating profit	1,756	2,195	3,386	54%
Finance costs	(91)	(157)	(268)	70%
Other revenue and gains	192	79	624	689%
Share of profit in associates & JCEs	28	(32)	(116)	262%
Tax	(977)	(1,078)	(1,674)	55%
Minority interest	(95)	(126)	(312)	148%
Net profit	812	881	1,640	86%
Memo item:				
Depreciation and amortization	34	42	53	28%
EBITDA	1,790	2,237	3,439	54%
Total interests	(1,393)	(1,771)	(2,135)	21%

Source: China Aoyuan, HSBC

4. China Aoyuan: Consolidated balance sheet and key financial metrics

Year ended Dec (RMBm)	2015	2016	2017
Cash and cash equivalents	7,769	10,471	24,769
Restricted bank deposits	1,267	486	1,771
Properties for sale	31,792	43,513	77,207
Other short-term assets	2,370	5,360	12,363
Investment properties	4,505	5,425	6,360
Other long-term assets	1,124	1,164	3,335
Bank loans and borrowings	2,570	4,506	20,490
Trade and other payables	5,348	6,795	14,579
Sales deposits	9,823	20,524	34,760
Other short-term liabilities	5,028	4,318	5,744
LT borrowings	13,727	13,875	19,880
Others	754	1,770	3,226
Minority interest	3,333	5,713	16,971
Shareholders' equity	8,243	8,918	10,155
Memo items:			
Cash	7,769	10,471	24,769
Debt	16,298	18,380	40,370
Net debt	8,529	7,910	15,601
Total equity	11,576	14,631	27,126
Total capitalisation	27,874	33,012	67,496
Total assets	48,827	66,418	125,806
Financial metrics			
Gross margin (%)	27.6%	27.7%	26.7%
Operating margin (%)	18.3%	18.6%	17.7%
EBITDA margin (%)	18.7%	18.9%	18.0%
EBITDA/total interest (x)	1.29	1.26	1.61
Return on equity (%)	7.9%	6.7%	7.9%
Return on total assets (%)	1.9%	1.5%	1.7%
Debt/EBITDA (x)	9.10	8.22	11.74
Net debt/EBITDA (x)	4.76	3.54	4.54
Debt/equity (x)	1.41	1.26	1.49
Net debt/equity (x)	0.74	0.54	0.58
Debt/total capitalisation (%)	58.5%	55.7%	59.8%
Net debt/net total capitalisation (%)	42.4%	35.1%	36.5%
Cash/total assets (%)	15.9%	15.8%	19.7%

Source: China Aoyuan, HSBC

Maintain Overweight fundamental recommendation; initiate hold CAPG'22

We reiterate our Overweight fundamental recommendation on China Aoyuan on its low-cost and large-scale land bank (25 million sq m with average unit land cost RMB2,131 per sq m, 20% of the group's contracted sales average selling price of RMB10,158 per sq m in 2017), diversified funding channels and track record of financial prudence. Key downside risk, in our view, is the group pursuing aggressive debt-funded expansion.

At 92.875/93.375 (bid/ask), CAPG'22 yields 7.3%/7.1% (bid/ask) which we deem as fairly valued against B-rated China property peers. Initiate hold trading call on CAPG'22, with key upside risk as re-rating of the bonds on credit rating upside potential and key downside risk as continued China property HY USD bond supply at wider yields.

5. HSBC's trading call history on CAPG'22

Issue	Issue size (USDm)	Date	From	To	Price bid	Price ask	Yield bid (%)	Yield ask (%)
CAPG'22	250	16-Mar-18	N/A	Hold	92.875	93.375	7.3	7.1

Source: HSBC

Disclosure appendix

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	All Covered issuers		Issuers to whom HSBC has provided Investment Banking in the past 12 months	
	Count	Percentage	Count	Percentage
Overweight	92	23	34	37
Neutral	232	58	76	33
Underweight	79	19	18	23

Source: HSBC

For the distribution of non-independent ratings published by HSBC, please see the disclosure page available at <http://www.hsbcnet.com/gbm/financial-regulation/investment-recommendations-disclosures>.

Recommendation changes for long-term investment opportunities

Recommendation History of CHINA AOYUAN

From	To	Date	Analyst
Neutral	Overweight	08 Mar 2016	Keith Chan
Not Rated	Neutral	11 Dec 2013	Keith Chan

Source: HSBC

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Company	Ticker	Recent price	Price date	Disclosure
CHINA AOYUAN	3883.HK	5.76	15 Mar 2018	6

Source: HSBC

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