

# China Aoyuan (CAPG)

Steady as she goes

CREDIT  
CHINA PROPERTY

- ▶ 1H17 recognised revenue up 26% y-o-y, with gross and EBITDA margin at similar levels to 2016
- ▶ Notable increase in net debt on active land banking activities; yet, we take comfort from the group's strong liquidity
- ▶ Maintain Overweight fundamental recommendation and initiate hold trading call on CAPG'19, '20 with the bonds fairly valued

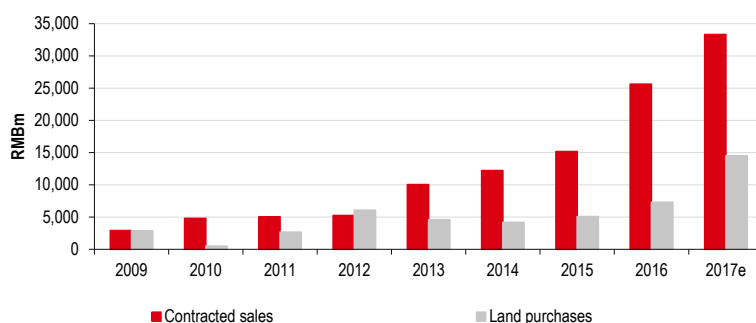
**Keith Chan**

Head of Corporate Credit Research, Asia-Pacific  
The Hongkong and Shanghai Banking Corporation Limited  
keithkfchan@hsbc.com.hk  
+852 2822 4522

## Stable 1H17 results

On 17 August 2017, China Aoyuan (CAPG; rated B1/B+, bond rated B2/B) announced a decent set of 1H17 results with no surprises. The group's recognised revenue was up 26% y-o-y to RMB8bn, while profitability was stable with the gross margin at 27% and the EBITDA margin at 19%. As a result, EBITDA grew in tandem with the top line, rising by 27% y-o-y to RMB1.5bn. We witnessed a notable RMB5.5bn increase in net debt during the period, with net debt rising to RMB14.6bn as of end-June 2017 from RMB9.1bn as of end-2016, which pushed net gearing up to 80% from 62%. The increase in debt leverage, in our view, reflects the group's active land banking activities, with RMB9.7bn spent on land payments in 1H17, with most land acquired via secondary purchases (i.e. M&A) rather than through land auctions. We draw comfort from the group's strong balance sheet liquidity (unrestricted cash on hand of RMB13.7bn covers short-term debt of RMB10.0bn) and broadened financing channel. In February 2017, the group secured a HKD1.5bn three-year HKD/USD-dual currency club loan at LIBOR/HIBOR + 450bp from six overseas banks; this, together with USD250m CAPG'20 at a 6.35% coupon, helps the group redeem USD300m CAPG'19-17c at an 11.25% coupon. As a result, borrowing cost fell further to 7.6% per annum from 8.1%.

## 1. China Aoyuan: Land banking growing in tandem with property sales



Source: China Aoyuan, HSBC estimates

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**2. China Aoyuan: Negative free cash flow to narrow in 2H17e versus 1H17**

Year ended Dec (RMBbn)	1H17	2H17e	HSBC 2017e estimate (old)	HSBC 2017e estimate (new)	Change
<b>Cash sales proceeds</b>	<b>14.2</b>	<b>16.8</b>	<b>28.3</b>	<b>31.0</b>	<b>10%</b>
Construction costs	-7.9	-5.1	-12.0	-13.0	8%
Interest expense	-0.7	-1.1	-1.5	-1.8	21%
SG&A, tax	-2.0	-2.8	-4.5	-4.9	10%
Recurrent income	0.0	0.0	0.0	0.0	0%
<b>Operating cash flow (OCF)</b>	<b>3.6</b>	<b>7.7</b>	<b>10.3</b>	<b>11.3</b>	<b>9%</b>
Land premium payment	-9.7	-10.3	-13.0	-20.0	54%
Project/project stake disposal	0.0	0.0	0.0	0.0	0%
Others	0.6	-0.6	0.0	0.0	0%
<b>Free cash flow (FCF)</b>	<b>-5.5</b>	<b>-3.2</b>	<b>-2.7</b>	<b>-8.7</b>	<b>224%</b>
Cash dividend	0.0	-0.4	-0.4	-0.4	0%
Share repurchases	0.0	0.0	0.0	0.0	0%
<b>Retained cash flow (RCF)</b>	<b>-5.5</b>	<b>-3.6</b>	<b>-3.1</b>	<b>-9.1</b>	<b>195%</b>
Additional onshore borrowings	7.5	0.0	0.0	7.5	NA
Additional offshore borrowings	1.2	0.4	0.9	1.7	88%
Perpetual issuance/share placement	0.0	0.0	0.0	0.0	0%
<b>Change in cash</b>	<b>3.3</b>	<b>-3.2</b>	<b>-2.2</b>	<b>0.1</b>	<b>NA</b>
<b>Unrestricted cash balance at beginning of year</b>	<b>10.5</b>	<b>13.7</b>	<b>10.5</b>	<b>10.5</b>	<b>NA</b>
<b>Unrestricted cash balance at end of year</b>	<b>13.7</b>	<b>10.5</b>	<b>8.3</b>	<b>10.5</b>	<b>28%</b>

Note: Outstanding land premium as of June 2017: RMB3.33bn, all of which will be paid in 2017.  
Source: China Aoyuan, HSBC estimates

**Maintain Overweight fundamental recommendation; initiate hold trading call on CAPG'19, '20**

We expect China Aoyuan's negative free cash flow to narrow substantially in 2H17 versus 1H17, with decreased cash outflow on land banking. We expect the group will achieve contracted sales of RMB36-37bn for 2017 versus the group's sales target of RMB33.3bn (i.e. 2H17 contracted sales of RMB19.5-20.5bn), driven by saleable resources of RMB43.6bn in 2H17. With strong demand for residential properties, the group has been maintaining its residential/commercial properties sales mix at 70/30. We also expect the group's profitability to remain steady in 2018 versus 2017. Maintain Overweight fundamental recommendation on China Aoyuan in view of its broadened financing channel and prudent financial management record, with key downside risk as aggressive debt-funded expansion. At 102.5/102.75 and 102.5/103 (bid/ask), CAPG'19 and '20 yield 4.9%/4.8% and 5.2%/5.0% (bid/ask), respectively, which we believe fairly values them versus B-rated peers. Initiate hold trading call on CAPG'19 and '20, with the key upside risk being continual inflow into Asian HY products, which re-prices bonds to tighter than fair value, and the key downside risk being increased USD bond supply of China property HY bonds at the wide level.

**3. China Aoyuan: Consolidated income statement**

Year ended Dec (RMBm)	2015	2016	1H2016	1H2017	Y-o-Y
Revenue	9,572	11,827	6,480	8,154	26%
Cost of sales	(6,926)	(8,550)	(4,857)	(5,963)	23%
Gross profit	2,646	3,277	1,622	2,191	35%
Selling, admin & operating expenses	(890)	(1,082)	(429)	(678)	58%
Operating profit	1,756	2,195	1,193	1,514	27%
Finance costs	(91)	(157)	(79)	(118)	50%
Other revenue and gains	192	79	9	172	1761%
Share of profit in associated & JCEs	28	(32)	(11)	(39)	250%
Tax	(977)	(1,078)	(511)	(669)	31%
Minority interest	(95)	(126)	(35)	(108)	212%
Net profit	812	881	567	750	32%
<u>Memo item:</u>					
Depreciation and amortisation	34	42	19	23	17%
EBITDA	1,790	2,237	1,213	1,536	27%
Total interests	(1,393)	(1,771)	(853)	(838)	-2%

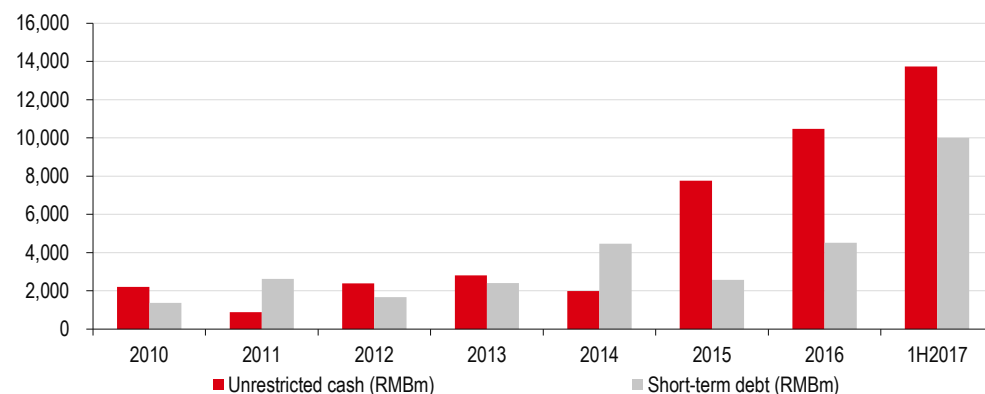
Source: China Aoyuan, HSBC

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

Year ended Dec (RMBm)	2015	2016	1H2016	1H2017
Cash and cash equivalents	7,769	10,471	10,186	13,734
Restricted bank deposits	1,267	486	25	1,080
Properties for sale	31,792	43,513	38,866	55,357
Other short-term assets	2,370	5,360	3,736	6,820
Investment properties	4,505	5,425	4,621	5,836
Other long-term assets	1,124	1,164	1,093	1,930
Bank loans and borrowings	2,570	4,506	4,111	10,013
Trade and other payables	5,348	6,795	7,200	8,222
Sales deposits	9,823	20,524	12,440	24,861
Other short-term liabilities	5,028	4,318	4,422	4,483
LT borrowings	14,027	15,062	15,462	18,321
Others	454	583	458	575
Minority interest	3,333	5,713	5,797	9,017
Shareholders' equity	8,243	8,918	8,636	9,264
<b>Memo items:</b>				
Cash	7,769	10,471	10,186	13,734
Debt	16,598	19,568	19,574	28,335
Net debt	8,829	9,097	9,388	14,601
Total equity	11,576	14,631	14,433	18,281
Total capitalisation	28,174	34,199	34,007	46,616
Total assets	48,827	66,418	58,527	84,758
<b>Financial metrics</b>				
Gross margin (%)	27.6%	27.7%	25.0%	26.9%
Operating margin (%)	18.3%	18.6%	18.4%	18.6%
EBITDA margin (%)	18.7%	18.9%	18.7%	18.8%
EBITDA/total interest (x)	1.29	1.26	1.42	1.83
Return on equity (%)	7.9%	6.7%	8.7%	9.1%
Return on total assets (%)	1.9%	1.5%	2.1%	2.0%
Debt/EBITDA (x)	9.27	8.75	8.07	9.22
Net debt/EBITDA (x)	4.93	4.07	3.87	4.75
Debt/equity (x)	1.43	1.34	1.36	1.55
Net debt/equity (x)	0.76	0.62	0.65	0.80
Debt/total capitalisation (%)	58.9%	57.2%	57.6%	60.8%
Net debt/net total capitalisation (%)	43.3%	38.3%	39.4%	44.4%
Cash/total assets (%)	15.9%	15.8%	17.4%	16.2%

Source: China Aoyuan, HSBC

#### 5. China Aoyuan: Substantial improvement in balance sheet liquidity since 2015



Source: China Aoyuan, HSBC

#### 6. China Aoyuan: HSBC's trading call history on CAPG USD bonds

	Issue size	Date	From	To
CAPG'19	250	21-Aug-17	N/A	Hold
CAPG'20	250	21-Aug-17	N/A	Hold

Source: HSBC

# Disclosure appendix

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Source: HSBC

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### Recommendation changes for long-term investment opportunities

#### Recommendation History of CHINA AOYUAN

From	To	Date	Analyst
Neutral	Overweight	08 March 2016	Keith Chan
Not Rated	Neutral	11 December 2013	Keith Chan

Source: HSBC

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Source: HSBC

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Issuer of report

The Hongkong and Shanghai Banking Corporation Limited

Level 19, 1 Queen's Road Central

Hong Kong SAR

Telephone: +852 2843 9111

Fax: +852 2801 4138

Website: www.research.hsbc.com

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