HSBC Global Research

China Aoyuan (CAPG)

Strong 1H18 results, attractive risk reward

FIXED INCOME
CREDIT

China

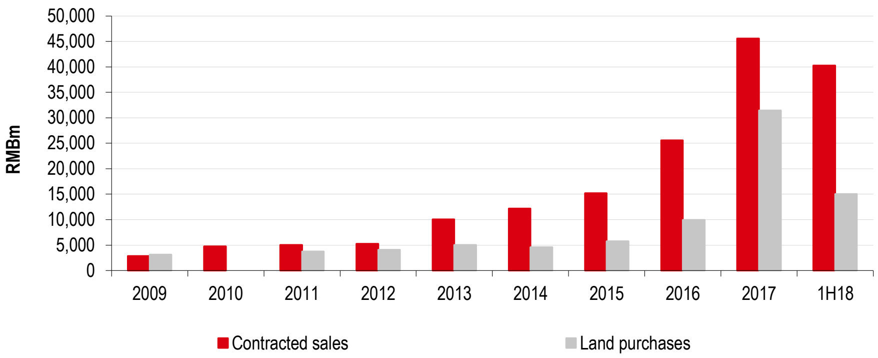
- Strong 1H18 results with 68% y-o-y increase in recognised revenue to RMB14bn; profitability improved, with gross margin at 29% in 1H18 versus 27% in 1H17 and 2017
- Reported net gearing and debt-to-cap edged higher to 68% and 61% as of June 2018, from 51% and 60% as of end 2017, respectively, which is not a surprise given its active land banking
- Maintain Overweight fundamental recommendation and initiate buy trading call on CAPG'21 (98/98.5, 8.3%/8.1%)

Keith Chan
Head of Corp Credit Research, ASP
The Hongkong and Shanghai Banking Corporation Limited
keithkfchan@hsbc.com.hk
+852 2822 4522

Strong 1H18 results, increase in debt leverage within expectation

On 17 August 2018, China Aoyuan (CAPG; rated B1/B+/BB-, bond rated B2/B/BB-) announced a strong set of 1H18 results. Recognised revenue was up by 68% y-o-y to RMB14bn, driven by 48% y-o-y increase in gross floor area delivered to 1.6 million sq m, as well as 14% y-o-y increase in recognised average selling price to RMB7,868 per sq m. Profitability improved, with gross and EBITDA margin up at 29% and 20% in 1H18 versus 27% and 19%, respectively, in 1H17. Debt leverage increased as a result of the group's active land banking (RMB15bn land purchases in 1H18, mainly via M&A), with reported net gearing and debt-to-capitalisation up to 68% and 61%, respectively, as of June 2018, versus 51% and 60% as of end-2017. The increase in debt leverage is not a surprise to us, as the group actively pursues land banking opportunities and paves the way for the next phase of growth.

1. China Aoyuan: Contracted sales versus land purchases



Source: China Aoyuan, HSBC

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2. China Aoyuan: Revised cash flow forecast for 2018

Year ended Dec (RMBbn)	1H18	2H18e	HSBC 2018 forecast (previous)	HSBC 2018 forecast (new)	Change
Cash sales proceeds	**31.2**	**27.2**	**58.4**	**58.4**	**0%**
Construction costs	-13.5	-9.5	-23.0	-23.0	0%
Interest expense	-1.5	-1.9	-3.0	-3.3	10%
SG&A, tax	-4.0	-4.7	-8.7	-8.7	0%
Recurrent income	0.0	0.0	0.0	0.0	0%
Operating cash flow (OCF)	**12.2**	**11.2**	**23.7**	**23.4**	**-1%**
Land premium payment	-12.6	-17.4	-30.0	-30.0	0%
Project/ project stake disposal	0.0	0.0	0.0	0.0	0%
Others	-5.7	0.0	0.0	-5.7	NA
Free cash flow (FCF)	**-6.1**	**-6.2**	**-6.3**	**-12.3**	**95%**
Cash dividend	0.0	-0.7	-0.7	-0.7	0%
Share repurchases	0.0	0.0	0.0	0.0	0%
Retained cash flow (RCF)	**-6.1**	**-6.9**	**-7.0**	**-13.0**	**86%**
Additional onshore borrowings	1.0	0.0	-0.4	1.0	NA
Additional offshore borrowings	3.6	2.7*	2.6	6.3	143%
Perpetual issuance/ share placement	0.0	0.0	0.0	0.0	0%
Change in cash	**-1.4**	**-4.3**	**-4.8**	**-5.7**	**18%**
Unrestricted cash balance at beginning of year	**24.8**	**23.4**	**24.8**	**24.8**	**NA**
Unrestricted cash balance at end of year	**23.4**	**19.2**	**20.0**	**19.2**	**-4%**

Source: China Aoyuan, HSBC estimates * Assuming the group issues USD300m HY bonds in 2H18e

China Aoyuan's balance sheet liquidity is adequate, in our view. Pro-forma for the HKD700m draw-down of offshore loan, as well as the refinancing of the RMB2.4bn 5.80% matured onshore bond with dual-tranche onshore RMB2.4bn private placement notes at an average interest cost of 8.25%, the group's unrestricted cash on hand of RMB24.0bn covers its short-term debt of RMB22.6bn as of end-June 2018. We also note the group has USD300m unutilised NDRC quota for USD bond issuance, which could be utilised before end-2018.

Strong contracted sales momentum, offshore funding channel further diversified

China Aoyuan has strong contracted sales momentum year-to-date. Contracted sales in 7M18 was up 143% y-o-y to RMB46bn, exceeding its full-year 2017 contracted sales and representing 63% of its full-year contracted sales target of RMB73bn. The group has adequate saleable resources of RMB82.3bn for 2H18, inclusive RMB53.7bn new launches and RMB28.6bn carried forward from 1H18. We believe it will continue to look for land replenishment opportunities while maintaining a prudent financial management policy. To be specific, the group targets to keep its reported net gearing at below 80% (68% as of June 2018). We also take comfort from the group's

3. China Aoyuan: Consolidated income statements

Year ended Dec (RMBm)	2016	2017	1H17	1H18	Y-o-Y
Revenue	11,827	19,115	8,154	13,667	67.6%
Cost of sales	(8,550)	(14,004)	(5,963)	(9,764)	63.8%
Gross Profit	3,277	5,111	2,191	3,902	78.1%
Selling, admin & operating expenses	(1,082)	(1,726)	(678)	(1,251)	84.6%
Operating profit	2,195	3,386	1,514	2,651	75.1%
Finance costs	(157)	(268)	(118)	(173)	46.2%
Other revenue and gains	79	624	172	506	195.0%
Share of profit in associates & JCEs	(32)	(116)	(39)	89	NA
Tax	(1,078)	(1,674)	(669)	(1,599)	138.9%
Minority interest	(126)	(312)	(108)	(259)	139.1%
Net profit	881	1,640	750	1,216	62.1%
Memo item:					
Depreciation and amortization	42	53	23	42	83.9%
EBITDA	2,237	3,439	1,536	2,693	75.3%
Total interests	(1,771)	(2,135)	(838)	(1,722)	105.5%

Source: China Aoyuan, HSBC

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

Year ended Dec (RMBm)	2016	2017	1H17	1H18
Cash and cash equivalents	10,471	24,769	13,734	23,408
Restricted bank deposits	486	1,771	1,080	2,415
Properties for sale	43,513	77,207	55,357	94,369
Other short-term assets	5,360	12,363	6,820	17,807
Investment properties	5,425	6,360	5,836	6,931
Other long-term assets	1,164	3,335	1,930	8,328
Bank loans and borrowings	4,506	20,490	9,761	24,973
Trade and other payables	6,795	14,579	8,222	20,324
Sales deposits	20,524	34,760	24,861	48,074
Other short-term liabilities	4,318	5,744	4,736	9,109
LT borrowings	13,875	19,880	16,565	20,041
Others	1,770	3,226	2,332	2,310
Minority interest	5,713	16,971	9,017	17,674
Shareholders' equity	8,918	10,155	9,264	10,752
Memo items:				
Cash	10,471	24,769	13,734	23,408
Debt	18,380	40,370	26,326	45,014
Net debt	7,910	15,601	12,592	21,606
Total equity	14,631	27,126	18,281	28,426
Total capitalisation	33,012	67,496	44,607	73,441
Total assets	66,418	125,806	84,758	153,258
Financial metrics				
Gross margin (%)	27.7%	26.7%	26.9%	28.6%
Operating margin (%)	18.6%	17.7%	18.6%	19.4%
EBITDA margin (%)	18.9%	18.0%	18.8%	19.7%
EBITDA/total interest (x)	1.26	1.61	1.83	1.56
Return on equity (%)	6.7%	7.9%	9.1%	8.8%
Return on total assets (%)	1.5%	1.7%	2.0%	1.7%
Debt/EBITDA (x)	8.22	11.74	8.57	8.36
Net debt/EBITDA (x)	3.54	4.54	4.10	4.01
Debt/equity (x)	1.26	1.49	1.44	1.58
Net debt/equity (x)	0.54	0.58	0.69	0.76
Debt/total capitalisation (%)	55.7%	59.8%	59.0%	61.3%
Net debt/net total capitalisation (%)	35.1%	36.5%	40.8%	43.2%
Cash/total assets (%)	15.8%	19.7%	16.2%	15.3%

Source: China Aoyuan, HSBC

cooperation with Henderson Land, a renowned blue chip Hong Kong developer/landlord, for the Guangzhou Panyu Nitrogen Fertilizer Plant re-development project, and further diversification of its offshore debt fundraising channel with HKD3.2bn three-year club loans raised at a favourable interest rate of HIBOR+395bp.

We maintain our Overweight fundamental recommendation on China Aoyuan on the back of its established execution track record, particularly in the Greater Bay Area, and its diversified funding channel. Key downside risk, in our view, is the group pursuing aggressive debt-funded expansion. At 98/98.5 (bid/ask), CAPG’21 yields 8.3%/8.1% (bid/ask) which we believe offers attractive risk-reward to credit investors, we initiate a buy trading call on CAPG’21. Key downside risk is China property USD HY bond supply at wider yields.

5. HSBC’s trading call history on CAPG’21 USD

Issue	Issue size (USDm)	Date	From	To	Px bid	Px ask	Yield bid (%)	Yield ask (%)
CAPG'21	425	21-Aug-18	N/A	Buy	98.0	98.5	8.3	8.1

Source: HSBC

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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 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	4.56	20 Aug 2018	6

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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