OCBC Bank

Asia Credit Research

Earnings Review: China Aoyuan Group Limited ("CAPG")

Issuer Profile: Neutral (5)

Ticker: **CAPG**

Background

China Aoyuan Group Limited ("CAPG") (previously China Aoyuan Property Group Limited) is incorporated in the Cayman Islands and listed in Hong Kong. As at 30 April 2019, CAPG's has a market cap of HKD24.5bn (~SGD4.4bn). CAPG focuses on property development mainly in China. Headquartered in Guangzhou City, it has an established positioning in the Greater Bay Area. CAPG spun-off Aoyuan Healthy Life Group (property management services) on the Hong Kong stock exchange in March 2019.

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Recommendation

- CAPG recorded a strong performance for 2018 with revenue up 62% y/y to RMB31.0bn and contracted sales providing visibility for 2019. Nonetheless, working capital remains high as CAPG would need to deliver units to buyer and we expect short term debt to be refinanced rather than paid down.
- In our view, CAPG's debt-to-asset is understated by ~10-12% for 2018 due to existence of minority investors at subsidiaries where it does not have 100% control. While credit metrics have deteriorated somewhat since 2017, CAPG's access to financing markets (across equity, bank debt and debt capital markets) remains considerable, supporting its issuer profile at Neutral (5).
- Within its own curve, we prefer the SGD-denominated CAPG 7.15% '21s which pays ~70bps above the USD-bond with the same put date. However, if we compare the CAPG 7.15% '21s with other Chinese property development peers in the SGD market, the bond is trading tight in our view which suggests to investors to take profit on the CAPG 7.15% '21s and reinvest the proceeds elsewhere. Oxley Holdings Ltd ("OHLSP", Issuer profile Neutral (5))'s OHLSP 5.0% '19s has a short maturity in November 2019 and trading at 344bps above swap while the OHLSP 5.15% '20s are trading at 456bps above swap. We do not cover Central China Real Estate Ltd ("CENCHI") or Logan Property Holdings Co. Ltd. ("LOGPH").

Relative Value:

Bond	Maturity/Put date	Gross gearing[1]	Ask Yield to Maturity/ Ask Yield to Put	Spread (bps)
CAPG 7.15% '21s	07/09/2020[2]	1.88x	4.96%	300
CAPG 7.95% '21s-USD	07/09/2020[2]	1.88x	4.22%[3]	227[3]
CENCHI 6.0% '20s	02/05/2020	1.93x	5.71%	375
LOGPH 6.0% '21s	16/04/2021	1.39x	6.09%	413

Indicative prices as at 2 May 2019 Source: Bloomberg
(1) Gross gearing based on latest available financials
(2) Same put and call date
(3) In implied SGD-terms

Key Considerations

- **Strong performance in 2018:** Gross revenue was up 62.2% y/y to RMB31.0bn with the second half of the year recognising 56% of full year 2018 revenue. The increase in revenue for 2018 was driven by both the increase in gross floor area delivered (up 35.8% y/y) to 3.3mn sqm and the increase in average selling price ("ASP") by 21.8% to RMB9,007 per sqm. Gross margin improved to 31% from 27% in 2017, driven by higher ASP. In particular, a higher proportion of units sold were commercial apartments which came with higher ASP (apartment units on commercial zoned land) versus residential apartments. Commercial apartments made up 10% of area sold in sqm in 2018 versus 4% in 2017. CAPG ended the year with net profit to owners of the company of RMB2.4bn (2017: RMB1.6bn). CAPG enters into partnerships as part of its on-going business although the company aims for control on development projects. In 2018, 18% of total net profit was attributable to minority investors at non-wholly owned subsidiaries (2017: 16%).

- **Recognised revenue in the bag for 2019:** Contracted sales as at end-2018 was RMB91.3bn, exceeding the full year target of RMB73.0bn by 25.1% (85% was attributable to owns of the company). These would be recognized progressively when units are handed over to buyers over a 1.5 to 2 year period. The average selling price on these was RMB10,300 per sqm, 1.4% higher than those recognized in 2018. The Greater Bay Area (9 cities in Guangdong Province plus Hong Kong and Macao) comprise about a third of total contracted sales. In the first four months of 2019, CAPG achieved contracted sales (unaudited) of RMB28.3bn, up 36% y/y versus the first four months in 2018 ("4M2018"). While the growth is still impressive, pace of growth had declined perhaps to maintain disciplined gearing levels. In 4M2018, CAPG saw a 143% y/y growth in contracted sales versus 4M2017. For 2018, CAPG's cash collection ratio (sales proceeds divided by annual contracted sales amount) was healthy though somewhat lower at ~78% (2017 and 1H2018: ~80%).We will continue monitoring this figure.

- **Interest coverage and gross gearing deteriorated somewhat:** EBITDA (based on our calculation which does not include other income and other expenses) was RMB6.5bn (up 91% y/y). We think cash interest paid is more representative of interest coverage for CAPG given that interest are capitalized. In 2018, cash interest paid was RMB3.6bn, we find EBITDA/Cash interest paid was 1.8x, slightly higher than the 1.7x in 2017. In end-2018, minority investors made up 61% of total equity, which indicates that CAPG does not have full claims over the assets (conversely do not assume all of the liabilities) at these entities. Nonetheless, we do not have the full breakdown of the asset and liabilities at these non-wholly owned subsidiaries. Simplistically we take the consolidated numbers in our assessment though understanding this is more broad-brush versus peers whose numbers are not complicated by the existence of significant minority interests and in our view, debt-to-asset may be understated by ~10-12% for 2018. As at 31 December 2018, unadjusted gross debt to equity was 1.88x (30 June 2018: 1.58x). Unadjusted gross debt to the aggregate amount of investment properties and property for sale was 0.47x, slightly higher than the 0.45x as at 30 June 2018.

- **Large working capital needs:** At end-2018, CAPG's land bank was ~34.1mn sqm with total saleable resources of RMB365.0bn and per company this is sufficient for its development needs in the next three years. That being said, CAPG is expected to continue replenishing its land bank and typically spends a third of contracted sales on land premium each year. At end-2018, CAPG had RMB23.3bn in capital commitments (excluding share of commitments to joint ventures). These include construction cost, land payments, acquisition of subsidiaries and joint venture, though targeted land acquisitions in 2019 may drive capital commitments higher. Similar to its peers, pre-sales continue to be an important cash flow driver. In 2018, CAPG recorded RMB22.6bn in increase in contract liabilities, boosting cash flow from operations. Nonetheless, as investing outflows was high at RMB17.0bn (mainly due to acquisitions for land bank-holding targets) versus net cash flow from operations of RMB8.6bn, with the cash gap mainly funded by net new borrowings of RMB14.9bn.

- **Short term debt coming due:** At end-2018, short term debt was heavy at RMB23.7bn (41% of total debt). While unrestricted cash balance had increased to RMB36.0bn (end-2017: RMB24.8bn), we think it is more likely for the remaining short term debt to be refinanced rather than paid down given the high working capital needs. CAPG maintains considerable access to debt markets. Year to date, CAPG has completed three USD bond transactions (two new issues and one re-tap), raising USD1.0bn (~RMB4.95bn). Per CAPG, it still has RMB31.8bn in unutilized credit facilities.

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Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings ("IPR") into a 7 point Issuer Profile Score ("IPS") scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

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Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

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Other

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Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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