Issuer Profile:
Neutral (5)

Ticker:
CAPG

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China Aoyuan Group Limited ("CAPG")

Recommendation

- **CAPG saw a strong profit number for 1H2019 with net profit of RMB2.8bn (1H2018: RMB1.5bn), from previously sold properties though only recognized in 1H2019. At RMB68bn, growth of contracted sales for the first eight months of 2019 has moderated y/y, though from a high base.**
- **Overall we think CAPG's credit profile have deteriorated in 1H2019, particularly against 1H2018, with unadjusted gross gearing ballooning to 2.2x (30 June 2018: 1.6x) amidst a weakening sector outlook. That being said, CAPG continues to maintain a strong access to diverse funding channels, which should help support it's refinancing.**
- **The announced stake acquisition in an insurance firm had reduced internal liquidity somewhat as we expect purchase payments to have been made post-1H2019 while the entry into an unfamiliar business also opens up the company to new risks. As of writing, there is no certainty of deal completion and in our view, is a credit positive if it does not get completed as the payments will be refunded.**
- **Comparing only against its own USD-bond with a same call/put date, we think the CAPG 7.15% '21s looks interesting at a YTP of 4.34% (~80bps pick up against its USD bond). Both are putable in September 2020 at par. However, we think it is somewhat tight against the LOGPH 6.125% '21s which is trading at a YTM of 4.85%, which matures seven months later. As such we are holding the CAPG 7.15% '21s at neutral.**
- **We are maintaining CAPG's issuer profile at Neutral (5) for now and do not cover both Central China Real Estate Ltd ("CENCHI") and Logan Property Holdings Co Ltd ("LOGPH").**

Relative Value:

Bond	Maturity / Put date	Gross gearing[2]	Ask YTM/ YTP	Spread
CAPG 7.15% '21s	07/09/2020[1]	2.2x	4.34%	269bps
CAPG 7.95% '21s-USD	07/09/2020[1]	2.2x	3.55%[3]	191bps
CENCHI 6.25% '20s	02/05/2020	2.4x	5.24%	354bps
LOGPH 6.125% '21s	16/04/2021	1.6x	4.85%	322bps

Indicative prices as at 19 September 2019 Source: Bloomberg
(1) Same put and call date
(2) Gross gearing based on latest available semi-annual results, not including lease liabilities
(3) In implied SGD-terms

Background

- China Aoyuan Group Limited ("CAPG") is incorporated in the Cayman Islands and listed in Hong Kong. As at 19 September 2019, CAPG's has a market cap of HKD24.9bn (~SGD4.4bn). CAPG focuses on property development mainly in China. Headquartered in Guangzhou City, CAPG has an established position in the Greater Bay Area. CAPG spun-off Aoyuan Healthy Life Group ("Aoyuan Healthy", a property management services company) as a separately listed company in March 2019. CAPG holds ~55%-stake in Aoyuan Healthy.
- Mr Guo Zi Wen, CAPG's Chairman is the largest shareholder in CAPG with a ~55%-deemed interest in the company.

Key Considerations

- **Strong profits in 1H2019 from previously sold properties:** Revenue was up 73.2% y/y in 1H2019 to RMB23.7bn while gross profit was up by 80.6% y/y to RMB7.0bn on the back of strong contracted sales where properties were handed over in 1H2019. Despite the expanded operations, the increase in selling and distribution and administrative expenses were contained at 68% y/y, leading to a higher EBITDA (based on our calculation which does not include other income and other expenses) by 87% y/y to RMB4.9bn. CAPG ended the half year at a profit for the period of RMB2.8bn (1H2018: RMB1.5bn). Reported interest expense was only RMB276.4mn though much of the interest expense were capitalised as part of properties under development for sale and investment properties under development. In our view, the gross amount of interest (including amounts capitalised) is more representative of the interest coverage at CAPG. This was RMB3.3bn in 1H2019 versus only RMB1.7bn in 1H2018, with resultant EBITDA/Interest coverage of 1.5x in 1H2019, in line with 1H2018 though lower than the 1.8x for 2018.

- **Gearing levels have risen:** As at 30 June 2019, unadjusted gross gearing (excluding amounts due to minority interest investors, joint venture partners and lease liabilities) had risen to 2.19x, up from the 1.88x as at end-2018). Observably, this had ballooned over the past year when unadjusted gross gearing was 1.58x as at 30 June 2018. We focus on the gross gearing levels as contract liabilities (eg: sales receipt in advance) is at RMB68.6bn, far exceeding the cash balance at CAPG). In end-2018, ~16% of the reported bank balances and cash are placed in specific bank accounts which can only be applied to designated property development projects. The breakdown was not provided as at 30 June 2019. This, along with restricted cash set aside to obtain bank loans, would tilt adjusted net gearing higher if we exclude these cash. Unadjusted gross debt to the aggregate amount of investment properties and property for sale was 0.53x, higher than the 0.47x in end-2018, directionally in line with unadjusted gross and net gearing, though still at comfortable levels. As at 30 June 2019, pledged assets (properties for sale, plant and equipment, investment properties, prepaid lease payment and restricted bank deposit) amounted to RMB43.5bn, representing ~29% of the aggregate value of these assets. During 1H2019, property-construction-related working capital was significant, unsurprisingly, given the ample pre-sales which CAPG had achieved in 2018, with new starts of 9.62mn sqm. During 1H2019, CAPG reported cash flow operations (after tax but before interest) at RMB2.0bn and insufficient to cover cash interest paid of RMB2.7bn while the company also paid RMB13.25bn in land premium

- **Short term debt coming due:** CAPG faces RMB33.6bn in short term debt as at 30 June 2019, representing 43% of gross debt. Post 1H2019 though, RMB2.5bn in short term debt had been repaid per company, bringing down short term debt-to-gross debt to 40% (we assume that debt is refinanced, rather than paid down). Further on 3 September 2019, the company announced that it had obtained regulatory approval to issue up to RMB4.2bn in domestic corporate bonds, of which RMB1.5bn had been priced as the first tranche for refinancing. We expect CAPG to continue seeking refinancing instead as cash balance at CAPG has large competing uses in the form of working capital to deliver on the housing units that had been pre-sold. CAPG continues to maintain a strong access to diverse funding channels, which should help support it's refinancing. We think the market is increasingly conscious over credit dispersion, which should assist CAPG's refinancing as investors move up the China property high yield credit curve.

- **Moderation in growth:** Growth rate of contracted sales have slowed at CAPG (albeit decelerating from earlier very high growth rates) and the broader China property sector faces headwinds. That being said, for 1H2019, CAPG managed to achieve contracted sales of RMB53.6bn (up 33% y/y) while in the first eight months of 2019 ("8M2019"), CAPG managed to achieve ~RMB68.0bn in contracted sales (up 28% y/y). 8M2019's average selling price was RMB10,082 per sqm, lower than the RMB10,323 per sqm in 8M2018, with the growth in contracted sales coming from a 31% y/y increase in sales area. We see moderated growth rates as a credit positive vis-à-vis continuing CAPG's breakneck sales pace which opens up the company to financing risks.

- **Entry into insurance business:** Post end-June 2019, CAPG announced that it has entered into share transfer agreements to buy a ~13.86%-stake in Aeon Life Insurance Company Ltd ("Aeon Life", Issuer profile: Unrated) for RMB3.26bn in cash. At signing, RMB2.4bn of cash would had been paid to vendor and another RMB0.6bn soon after. The remaining shall be deposited into an escrow and released upon approval of acquisition by the insurance regulator. CAPG's proposed entry into an unfamiliar business at a rich valuation, would have increased unadjusted net gearing to 0.81x (30 June 2019: 0.72x). Additionally, the below average solvency ratios of AEON Life increases the likelihood of future capital calls from shareholders, in our view. While CAPG diversifying beyond property development is not unexpected, it is less apparent what the near term synergies are between an insurance company based in Dalian versus CAPG's Greater Bay Area focused residential property development business. Should the deal go through, CAPG's credit direction will increasingly be inconsistent with that of an issuer profile of Neutral (5), in our view.

- **……though not a "done deal" yet:** The proposed transaction is subject to various conditions precedent, in particular the approval of the China Banking and Insurance Regulatory Commission ("CBIRC") and update of business registration in respect of the change of shareholders and in our view, there is still deal execution risk on this transaction and it is yet certain if the deal will reach completion. Assuming that the transaction does not receive approvals, the vendors shall refund the consideration to CAPG. We note that in August 2019, the CBIRC had rejected a separate overture by peer property developer, Greentown China Holdings Ltd (Issuer profile: Unrated) who was also earlier looking to buy a stake in the same insurance company.

Explanation of Issuer Profile Rating / Issuer Profile Score

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 into a 7 point Issuer Profile Score scale.

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

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Explanation of Bond Recommendation

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.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with 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.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform 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.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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