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China Aoyuan Property Group <CAPG> '18 & '19 [B3/B- Stable]

FY15 update – overall slight improvement in financial profile but gearing remains elevated-(NK)

- FYE15, the group registered improvement in revenues and EBITDA to RMB9.6bn (+37% yoy) and RMB1.8bn (+35% yoy), underpinned by the increase in recognized GFA delivered of 1mn sm (+11% yoy) and recognized ASP of RMB9.1k/sqm (+23% yoy). Operating margin, however, was marginally lower at 18.7% (FY14: c.19%), due to the increase in development cost. Sales from Guangzhou, Chongqing, Shenyang, Zhongshan and other cities accounted for 54%, 15%, 5%, 5% and 21% respectively. By product segmentation, sale of residential apartments accounted for 41%, followed by commercial apartments (/SOHO type) at 39%, retail ships + others (the remaining 20%).

  Contracted sales totaled RMB15.2bn (+25% yoy) or about 113% of full year target of RMB13.5bn, which puts the group slightly above industry average in the Chinese HY property space where cumulative contracted sales to full year target was about 95% level. The result was supported by higher GFA sold of 1.9m sqm (+46% yoy), though this was negated by lower ASP of RMB8k/sqm (-12% yoy). 66% came from sale of residential apartments vs. 48% in FY14, which the management attributed this to project locations. Commercial and retail development sales came in at 13% and 18%, followed by low density residential (3%).

  By cities breakdown, reflective of the more diversified market spread, Guangzhou accounted for 18% (vs 50% a year ago), followed by Guangdong (others) @ 26%, Chongqing @ 17%, Hunan 8%, Shenyang 4%, Guangxi (11%), Anhui (8%) and Sydney (Australia, 7%). During the period, the group achieved a sell-through rate of 60% (vs full year target of 55%) and cash collection ratio of c.82%. As of end FY15, the group's completed but unsold stock stood at c.1m sqm. As of end FY15, the group has about RMB14bn of un-booked revenue, and on average about RMB8-10bn could be recognized, which will help to seal earnings visibility for the year.

- *Gearing remain elevated, due to the active land acquisition and sales of commercial property (CP) tends to be unpredictable.* On the back of its active land renewal, total borrowing rose to RMB16.3bn (FY14: RMB11.5bn). As part of its ALM and funding cost initiatives, CAPG adopted several onshore and offshore capital market exercises as well as tapping on bank syndicate facilities. At the same time, as guided, CAPG redeemed its '17 notes in full (in Nov'15 & Feb'16). These have allowed the group to lower its effective borrowing cost to 9.5% (vs. 10.2% in FY14) and is targeting to bring this down to 9%.

As the proceeds were partially used for refinancing, its proportion of trust loans to total borrowings dipped to 13% (vs 15% a year ago), while onshore debt stood at 44% (vs 51% previously), offshore bank borrowings @ 9% (vs 6% previously), and senior notes @ 30% (vs 28% previously). In light of the yuan devaluation, at current borrowing currencies weighting, we think the risk of currency mismatch is manageable for the group. The management advised that should the yuan continues to depreciate and US$ borrowing becomes more costly, CAPG could further tap the onshore bond (including panda bonds) route and would need to carefully consider hedging options in light of incremental costs. Gearing remained high at almost 9x (vs. FY14's 8.6x), though it recorded a slight improvement in EBITDA interest coverage at 1.3x (FY14: 1x). This is because CPs tends to tie up capital resources and demand (particularly retail shops) less predictable, although margins tend to be higher than residential properties.

During the period, the group's cash holdings were higher than norm, totalling RMB9bn (more than 80% was unrestricted) relative to ST-debt of RMB2.6bn. The higher than usual cash balance was temporarily influenced by the un-used proceeds from the sale of debt securities/fund raising exercises (as outlined above). The latter has also helped to extend the group's debt maturity profile and eased re-financing risk. Aside from the ST-debt, the group's other borrowings will mature within 1-2 years @ 34%, 2-5 years @ 49% and >5years @ 1%. In addition, CAPG has undrawn banking facilities of c.RMB1bn.

In term of working capital management, its past due account (>180days to >3 years) was about 40% (vs 36% FYE14) of total receivables. The management explained that the slight rise in aged receivable was reflective of the group's surge in pre-sales growth from 91% yoy in FY13 and 22% yoy in FY14. No impaired provision has been established, as the management is confident that these receivables are recoverable. As it takes about 3 years (on average) for a project to be completed-delivered, considerations under such pre-sale contracts are 'protected' as about half of the property titles value are still vested with the developer (CAPG) and thereby providing adequate buffer.

- *Overseas (property development in Sydney) and other non-residential projects.* Its One30 Hyde Park Sydney project (70% owned and launched since Aug'15) has garnered contracted sales of c.RMB1bn, and is expected to record almost similar sales amount for FY16. Following suit is its 100% owned 188 Maroubra Sydney project which land was acquired in Nov'15 for RMB86mn & construction cost estimated at RMB110mn. The development, a 70 unit residential project, with about RMB300mn in saleable resources is expected to be launch in mid-FY16. While pre-sale proceeds from the Australian projects are restricted until delivery at final closing of the units, the group has demonstrated the successful launch of its maiden One30 Hyde Park development, supported by the project prime location and limited land supply in that area. The management reiterated that the group has no other overseas plan and the focus will be on Sydney for now.

  As for the other cultural/tourism/leisure-related projects (in Shaoguan District), the management reiterated that their involvement is only to build/develop the complex and these are in collaboration with the local governments. Still, as previously outlined in our last reports, as we have seen some developers that had ventured into tourism/travel related theme projects which have not panned out as desired, these developments and associated investment outlay will be on our credit monitoring radar.

  As of end FY15, its land bank (totalling 13.3m sm) comprised Guangzhou @ 14%, Guangdong (ex-Guangzhou) @ 34%, Central & Western part (viz. Chongqing) @ 19%, Yangtze RD @ 9%, Beibuwan (Guangxi) @ 11%, and Bohai Rim (Liaoning) @ 13%. In all, about 32% of its land bank is in tier I cities, tier II @ 40% and lower tier @ 28%. In FY15, the group acquired 13 land parcels (including in Guangxi, Anhui, Zhuhai as well as Sydney) for a total consideration of RMB5.8bn and average land cost of RMB2.3k/sm (vis-à-vis contracted ASP of RMB8k/sm). In term of land replenishment, the group will continue to focus on higher-tier cities (such as Shenzhen, Zhuhai).

  For FY16, the group is targeting pre-sales of RMB17bn (+12% over FY15 actual), supported by saleable resources of approx. RMB29.8bn (of which about 34% will comprise inventories c/f from FY15 and the balance being new launches/projects). On the back of supportive regulatory policy framework, it expects sale of residential development (as in FY15) to drive topline and distribution profile is likely to remain 2H-skewed.

On expectation of cash collection ratio of c.80-85% and based on sell-through rate of 55-60%; FYE16, the management has guided contracted sales collection of RMB14-15bn, relative to construction capex of RMB6bn, land acquisition RMB6bn, SG&A c.RMB1bn, interest expense c.RMB1.5bn, tax c.RMB1.4bn & dividend payout c.RMB200mn. In all, ending net cash for the year (considering cash c/f & new borrowing drawn-down), is estimated at c.RMB7-8bn. However, should CAPG continue to be aggressive with its land acquisition, it would need to tap on more fund raising exercises, although it needs to be mindful of its leverage profile which remain high. Assuming no major incremental debt drawdown, we expect FCF to remain in negative territory for the year.

- *Thoughts on bond: For this year, on expectation that its newly acquired land sites (including its overseas projects in Australia) will start to yield meaningful contributions and on the back of its RMB14bn in un-booked revenue, we think the company's pre-sale target of RMB17bn is reasonably achievable. Post its FY15 result announcement, of the three rating agencies, Fitch has CAPG on B+/Positive, though in our view the group would need to prove its consistency in not only improving sales, but execution capability and financial discipline even as it grows its land bank. Given that more than two-thirds of CAPG's projects are in tier I/II cities and its residential-commercial dual model, the company remains poised to weather changes in market conditions. Its recent sale of notes (both in the offshore and onshore space) have helped to extend CAPG's debt maturity profile. Though, its gearing is likely to remain elevated for the year and its pace of land acquisition/growth (viz. its overseas expansion and foray into travel related/tourism projects) will remain on our monitoring radar. As outlined earlier, with the increasing onshore bond tap by Chinese property developers and technical support as investors bid up the remaining US$ bonds that will narrow the yield differential between onshore vs. offshore debt market, the CAPG curve has traded tight in the past few months. We continue to favor CAPG credit; however, against a dwindling issuance pipeline (especially in the better beta space of the Chinese HY property segment), the bonds will continue to trade at rich levels. At such toppish level, we are Marketweight on the '18s and '19s, or for those investors who prefer to cash up, to sell and take profits on these bonds now. They can consider re-entering at better pricing levels when opportunity arises.*

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