August 15, 2017 08:00 PM GMT

China Aoyuan Property Group Ltd

Land Replenishing Bottleneck; Initiate at EW

Stock Rating	Industry View	Price Target
Equal-weight	Attractive	HK$3.30

We think Aoyuan will struggle to maintain its revenue scale and margins in the long term as it lacks an edge in land sourcing and its landbank is scattered across 28 cities. But in the short term, strong sales and earnings growth should support the share price.

Sales target of Rmb50bn by 2018 is achievable, but a lack of landbanking channels will limit further expansion: Given Aoyuan's high attributable ratio of 92%, we believe its current landbank of 14.7mn sqm or Rmb150bn in saleable resources is enough to support the company's Rmb50bn attributable sales target in 2018 (50% YoY growth). However, for 2019 and beyond, visibility is limited as the company failed to sufficiently replenish its landbank in 2015-16 and lacks channels to source plots cheaply.

Earnings growth of 20-30% in 2017-18, but margin decline from 2018: Aoyuan issued a positive profit alert in 1H17, with the bottom line up 40% YoY. It also guided for earnings to be up 30% in 2017 and 20% in 2018, mainly supported by high sales growth in 2015-17. However, we expect gross margins to decline in 2018-19, given: (1) a smaller contribution from high-margin projects in Guangzhou and (2) higher land costs but only stable ASPs.

Dispersed landbank in 28 cities may lead to operating deleverage: The company has only 14.65mn sqm GFA in total but has entered 28 cities including Sydney, Toronto and Vancouver. Compared to the industry, we think 500k sqm GFA per city across five different regions is very small and may lead to further operating deleverage, especially for a relatively small company. We expect SG&A/sales to rise from 4.2% in 2016 to 4.4% in 2019 after sales slow down.

Upside risk from potential addition to Shenzhen-Hong Kong Stock Connect: On August 16, the new list of Hang Seng Index stocks eligible for southbound trading will be released (effective from September 4). Aoyuan stated it has satisfied all the criteria for eligibility. Its potential addition to the list could attract onshore investors' inflow due to its cheap valuation at 4x 2018 P/E versus the industry average of 7x.

Where we could be wrong: Successful launch of urban renewal projects and sharp ASP increase *(upside)*; Greater-than-expected margin decline and sales started to decline in 2019.

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China Aoyuan Property Group Ltd (3883.HK, 3883 HK)

China Property / **China**

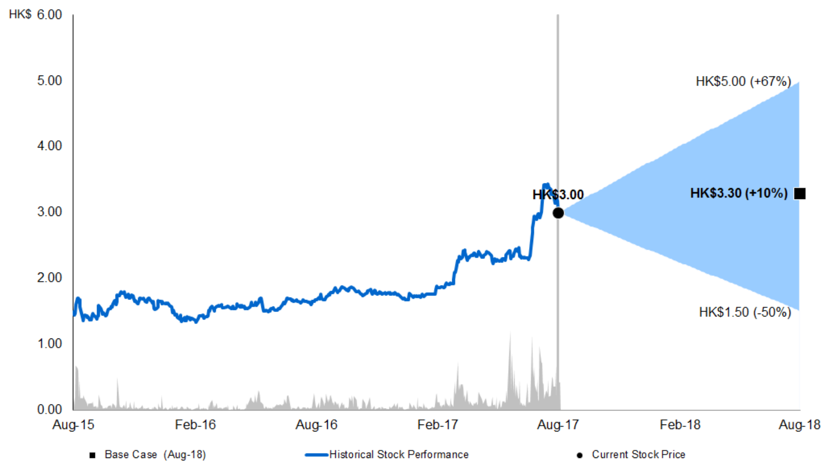
Stock Rating	**Equal-weight**
Industry View	**Attractive**
Price target	HK$3.30
Up/downside to price target (%)	9
Shr price, close (Aug 14, 2017)	HK$3.03
52-Week Range	HK$3.55-1.61
Sh out, dil, curr (mn)	2,672
Mkt cap, curr (mn)	Rmb6,896
EV, curr (mn)	Rmb21,048
Avg daily trading value (mn)	HK$11

Fiscal Year Ending	**12/16**	**12/17e**	**12/18e**	**12/19e**
ModelWare EPS (Rmb)	0.38	0.52	0.63	0.74
Consensus EPS (Rmb)§	0.38	0.48	0.64	0.87
Revenue, net (Rmb mn)	11,827	17,095	22,278	26,923
EBITDA (Rmb mn)	2,395	3,305	4,099	4,776
ModelWare net inc (Rmb mn)	1,014	1,384	1,695	1,966
P/E	4.1	5.0	4.1	3.5
P/BV	0.5	0.7	0.6	0.6
RNOA (%)	-	10.6	12.1	12.8
ROE (%)	-	15.5	17.1	17.7
EV/EBITDA	7.6	6.7	5.7	5.1
Div yld (%)	6.2	5.9	7.2	8.4
FCF yld ratio (%)**	139.3	(0.4)	(1.3)	3.1
Leverage (EOP) (%)	94.9	94.6	94.2	90.9

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework
§ = Consensus data is provided by Thomson Reuters Estimates
** = Based on consensus methodology
e = Morgan Stanley Research estimates

Risk-Reward: China Aoyuan (3383.HK, EW)

Land replenishment bottleneck and over-expansion



Source: Thomson Reuters, Morgan Stanley Research

Price Target **HK$3.30**

Our price target is set at a 55% discount to our base-case forward NAV estimate.

Bull **HK$ 5.0**

1.5x 2016 P/B

A new round of monetary easing drives property prices higher: We assume (1) the central government provides a new round of aggressive monetary stimulus to reach its GDP targets, driving investment demand and asset prices higher in 2017; (2) 10% growth in property prices across the board over the next 12 months

Base **HK$ 3.30**

1x 2016 P/B

ASP holds steady: We expect (1) sales volumes to decline 5% YoY in 2017, pressured by tightening measures in tier 1-2 cities; and (2) ASP to be flattish in tier 1-2 cities but increase 5% YoY in tier 3 cities, supported by healthy inventory, limited land supply, and expensive land prices transacted in 2016, buoying our NAV forecast for developers. Our 55% discount to NAV reflects Aoyuan's ranking in our scorecard.

Bear **HK$ 1.50**

0.45x 2016 P/B

Liquidity tightens sharply: We assume (1) further tightening of financial conditions and slower sell-through rates at the national level that weigh on developers' balance sheets and cash flows in 2017, forcing them to further soften asking prices; and (2) 10% property price declines over the next 12 months. We apply a 75% discount to NAV, which reflects the low end of the range of similar stocks in our scorecard.

Investment Thesis

- Aoyuan's solid scale (Rmb150bn in sellable resources) should drive earnings growth in 2017-18
- The potential addition to Shenzhen-Hong Kong Stock Connect may lead to valuation re-rating given Aoyuan stock is trading at 4x 2018 P/E, on our estimates, vs its H-share peers' average of 7x 2018 P/E
- However, earnings in 2019 and beyond may come under pressure given a lack of channels to replenish its landbank cheaply, aggressive expansion to new cities, and margin downtrend
- With more attractive options elsewhere in our industry coverage, we have an EW rating on Aoyuan

Key Value Drivers

- Property prices
- Contract sales
- Transaction volumes

Risks to Achieving Price Target

Upside risks:

- Special dividend announcement
- Successful launch of urban renewal projects
- Sharp ASP increase in its non-Guangzhou landbank

Downside risks:

- Greater-than-expected margin decline
- Sales decline in 2019

Financial Summary

Exhibit 1: Aoyuan: Financial summary

Balance Sheet: RMB mn	2015	2016	2017E	2018E	2019E
Current assets					
Properties under development	24,841	35,293	39,872	42,228	43,615
Completed Inventory	6,951	8,220	13,193	18,193	23,193
Trade & Other Receivables	1,753	3,604	5,210	6,789	8,205
Amts due from JV & Assoc	354	996	1,096	1,206	1,326
Tax recoverable	263	616	678	746	820
Restricted cash	1,267	143	486	486	486
Cash & cash Equiv.	7,769	10,471	13,032	16,059	15,704
Total current assets	**43,198**	**59,344**	**73,567**	**85,706**	**93,349**
Non-current assets					
Investment Prop.	4,505	5,425	5,425	5,425	5,425
Investments in JV & Asso.	369	316	326	339	354
Other LT Assets	740	704	1,244	1,827	2,457
Total non-current assets	**5,629**	**6,589**	**7,140**	**7,736**	**8,381**
Total assets	**48,827**	**66,418**	**80,850**	**93,584**	**101,873**
Non-current Liabilities					
Borrowings	13,727	15,062	18,074	21,689	21,689
Payable & Tax liabilities	454	583	699	839	1,007
Total Non-current Liabilities	**14,481**	**15,645**	**18,773**	**22,528**	**22,696**
Current Liabilities					
Trade & other payables	6,946	8,224	11,888	15,491	18,721
Customer Advances	9,823	20,524	26,306	29,499	31,904
Amounts due	1,228	296	312	330	350
Current Tax liabilities	2,202	2,593	2,852	3,137	3,451
Borrowings	2,570	4,506	4,956	5,452	5,997
Total Current Liabilities	22,770	36,143	46,314	53,909	60,424
Total Liabilities	**37,251**	**51,787**	**65,088**	**76,437**	**83,120**
Perpetual Capital Securities	-	-	-	-	-
Shareholders' Equity	**8,243**	**8,918**	**9,895**	**11,092**	**12,479**
Non-controlling interests	3,333	5,713	5,867	6,055	6,274
Total equity	**11,576**	**14,631**	**15,762**	**17,147**	**18,753**

Ratios	2015	2016	2017E	2018E	2019E
Net Debt to Equity ratio	63%	61%	60%	62%	61%
Consolidated GP Margin	27.6%	27.7%	27.7%	27.0%	26.3%
Net Margin on consolidated revenue	8.6%	8.6%	8.1%	7.6%	7.3%
Asset Turnover	19.6%	17.8%	21.1%	23.8%	26.4%
Asset Turnover on Contract sales	31.1%	38.5%	44.5%	56.6%	54.0%
Asset to Equity	5.92	7.45	8.17	8.44	8.16
ROE	10.0%	11.4%	14.0%	15.3%	15.8%
ROA	1.7%	1.5%	1.7%	1.8%	1.9%
Total Debt to Shareholders' Equity	2.0	2.2	2.3	2.4	2.2

Income Statement: RMB mn	2015	2016	2017E	2018E	2019E
Consolidated Revenue	**9,572**	**11,827**	**17,095**	**22,278**	**26,923**
Consolidated Gross profit	**2,646**	**3,277**	**4,735**	**6,015**	**7,081**
Other Income and gains	75	45	45	45	45
SG&A	(890)	(1,082)	(1,512)	(2,014)	(2,420)
Other expense	-	-	-	-	-
Operating profit	1,909	2,220	3,268	4,046	4,706
Finance income	72	54	54	54	54
Finance costs	(91)	(157)	(187)	(220)	(241)
Profit of JV & Assoc	28	(32)	10	13	16
Profit before tax	**1,884**	**2,085**	**3,146**	**3,893**	**4,535**
Income tax expenses	(977)	(1,078)	(1,607)	(2,009)	(2,350)
of which corp income tax	(605)	(657)	(992)	(1,228)	(1,430)
of which LAT	(372)	(421)	(616)	(782)	(921)
Non-controlling interests	(95)	(126)	(154)	(188)	(218)
Net profit	**823**	**1,014**	**1,384**	**1,695**	**1,966**
EPS	**0.30**	**0.37**	**0.52**	**0.63**	**0.74**

Cash flow: RMB mn	2015	2016	2017E	2018E	2019E
Profit before income taxes	1,884	2,085	3,146	3,893	4,535
Adjustment	11	341	177	207	225
– Depreciation	34	42	38	53	70
Chg in working capital	(3,170)	6,239	(1,713)	(2,138)	(2,167)
Net Cash from operating	**(3,023)**	**5,945**	**167**	**143**	**478**
Combination Exp.	(849)	(650)	-	-	-
Investments in Asso. & JV	234	(3,952)	(539)	(593)	(652)
PPE	(19)	(43)	(40)	(43)	(48)
Other Investing	(906)	(4,027)	(539)	(593)	(652)
Cash used in investing	**(924)**	**(4,069)**	**(578)**	**(636)**	**(700)**
Proceeds from borrowings	6,006	5,245	3,463	4,111	545
Proceeds from bonds	(6,318)	(5,916)	-	-	-
Issuance of shares	5,162	2,112	-	-	-
Equity inv. from MI	-	(1,600)	-	-	-
Repayments of borrowings	(54)	(327)	-	-	-
Other Fianacing	2,009	1,293	(491)	(590)	(679)
Net cash from financing	**6,804**	**808**	**2,972**	**3,520**	**(134)**
Net increase in cash	**2,856**	**2,683**	**2,561**	**3,027**	**(355)**

Source: Company data, Morgan Stanley Research; E=Morgan Stanley Research estimates. Note: Fiscal year ends December 31.

Investment Thesis

We initiate coverage on China Aoyuan Property with an Equal-weight rating and price target of HK$3.30. Our price target, which is derived from a 55% discount to our NAV estimate based on our scorecard, implies 10% upside potential.

Sales target of Rmb50bn by 2018: We expect the company to quickly expand in the next two years and reach its Rmb50bn attributable sales target by 2018 given the Rmb150bn sellable resources sitting in its landbank. This should lead to core net profits growth of 22-36% YoY in 2017-18 on broadly stable gross profit margins (27-28%).

However, visibility in 2019 and beyond could be limited due to the lack of land replenishing channels and falling margins: (1) Aoyuan's disciplined pace of landbank replenishment fell behind the industry's in 2015-16, especially in its home base of Guangzhou, limiting its ability to sustain the size of its landbank. With current tightening measures particularly in the company's landbank cities preventing property prices from rising, replenishing its landbank supply now would not make strategic sense; (2) We expect gross margin to be under pressure because the sales contribution from Guangzhou, where margins are higher (30%+), has declined from 48% in 2013 to 13% in 2016; (3) Overexpansion into new cities: Aoyuan entered 28 cities with only 15mn sqm of landbank including the areas surrounding Beijing, the Yangtze River Delta, and the Pearl River Delta. This may cause operating deleverage.

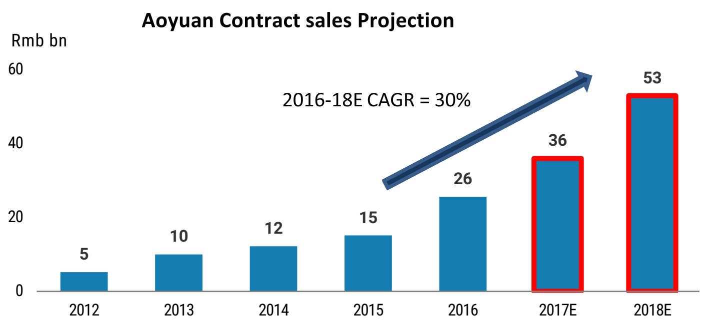
Shenzhen-Hong Kong Stock Connect: The potential addition of Aoyuan to the list could attract onshore investors' inflows due to its cheap valuation at 4x 2018E P/E.

Investment Positives

Visibility on achieving Rmb50bn in attributable sales by 2018 on Rmb150bn landbank

As of December 2016, Aoyuan has a total of **14.7mn sqm** of landbank or **Rmb150bn in sellable** resources. Given the high attributable ratio of 92%, we believe the current landbank is enough to support the company's Rmb50bn attributable sales target in 2018 (50% YoY growth).

Exhibit 2: We anticipate healthy sales growth in 2017/2018 on rich sellable resources



Source: Company data, Morgan Stanley Research; E=Morgan Stanley Research estimates

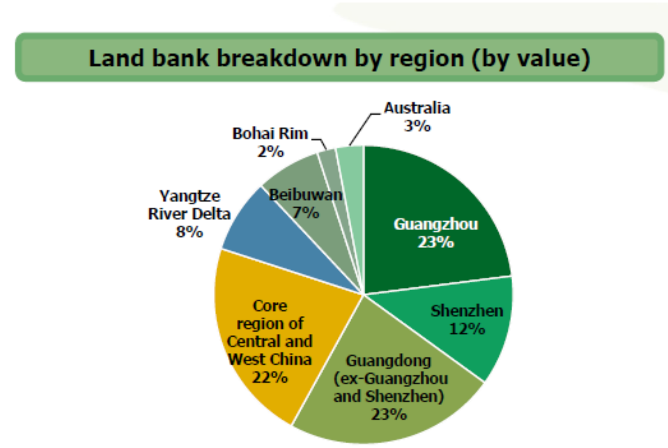
Landbank analysis:

- **Sales and margin driver – 58% of total landbank by value in Guangdong province, of which 23% is in Guangzhou:** Guangzhou is the hometown of company chairman Guo Zi Wen and the company's main base, with a 1.8mn sqm landbank worth Rmb3,564/sqm. Assuming an ASP of Rmb16k, the average ASP of its Guangzhou projects that were sold in 2016-1H17, we estimate its selling margins in 2017-20 to be above 30%. Aside from Guangzhou, the company has a presence in 12 other cities in Guangdong province including Shenzhen, Foshan, Zhuhai, and Zhongshan in the Guangdong-Hong Kong-Macau Greater Bay area, but at a smaller scale than in Guangzhou. The total GFA of its projects in Guangdong province (excluding Guangzhou and Shenzhen) is 4.8mn sqm with a land cost of about Rmb1,400/sqm. We estimate these projects generated gross margins of 28-30% in 2016, higher than the company's overall gross margin in the same period at 27.7%. **Outside Guangdong:** Aoyuan has projects in four other regions or 13 cities including Chengdu, Changsha, Shenyang, Ningbo, and Nanning, mainly tier 3 cities that saw property volumes improve YoY in 1H17. **Outside China – 3 cities:** Overseas, Aoyuan has four projects in Sydney and two in Canada that it acquired in 1H17.

- **By city tier:** 38% of Aoyuan's projects are in tier 1 cities, 42% are in tier 2, and 20% in lower-tier cities.

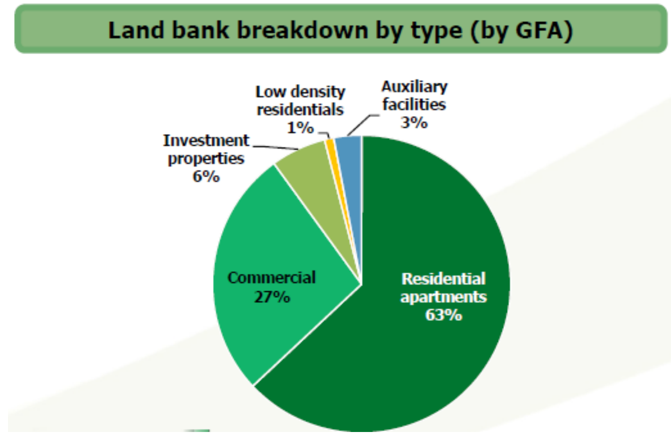
- **By type:** 27% of its projects are serviced apartments, mainly in Guangzhou (including Aoyuan Guangchang).

Exhibit 3: Guangdong province makes up 58% of Aoyuan's total landbank by value (as of December 2016)



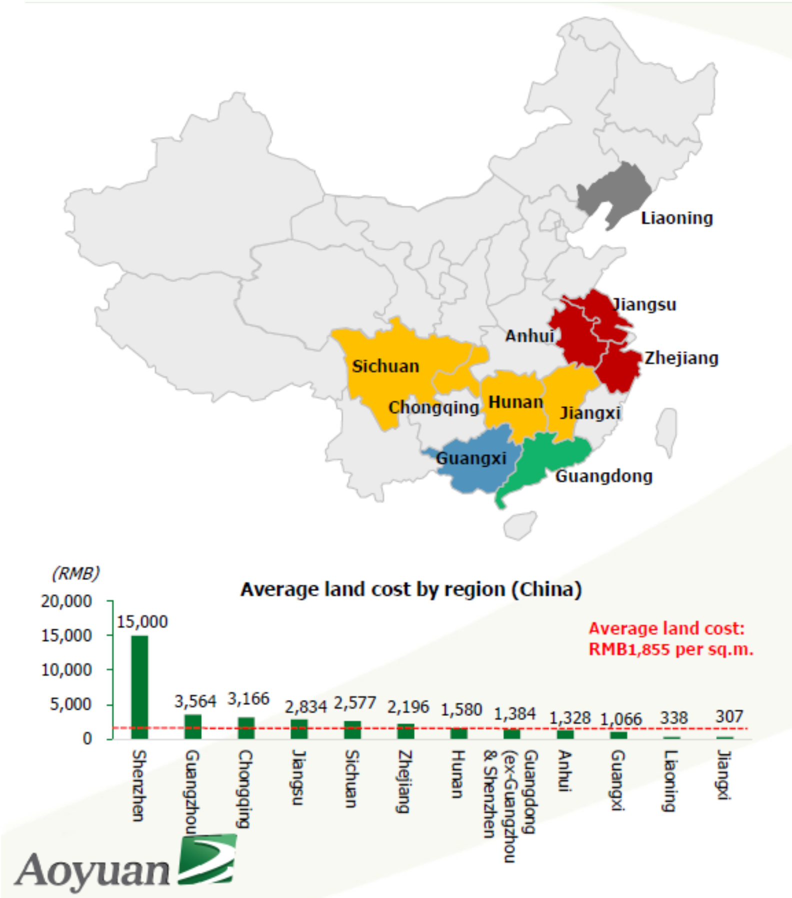
Source: Company data

Exhibit 4: Aoyuan: 27% of landbank in serviced apartments and street shops (as of December 2016)



Source: Company data

Exhibit 5: Landbank details: Aoyuan has a presence in 26 cities in China as of December 2016



Region	City	GFA ('000 sqm)
Guangzhou	Guangzhou	1,815.5
	Subtotal	**1,815.5**
Shenzhen	Shenzhen	217.8
	Subtotal	**217.8**
Guangdong (ex-Guangzhou & Shenzhen)	Zhuhai, Guangdong	270.8
	Foshan, Guangdong	638.6
	Zhongshan, Guangdong	182.0
	Huizhou, Guangdong	339.3
	Jiangmen, Guangdong	121.6
	Yangjiang, Guangdong	313.0
	Meizhou, Guangdong	739.5
	Qingyuan, Guangdong	485.2
	Yingde, Guangdong	756.5
	Yunfu, Guangdong	255.3
	Shaoguan, Guangdong	678.7
	Subtotal	**4,780.5**
Core region of Central and West China	Chongqing	1,008.4
	Chengdu, Sichuan	578.1
	Changsha, Hunan	148.9
	Zhuzhou, Hunan	697.5
	Ganzhou, Jiangxi	342.5
	Subtotal	**2,775.4**
Yangtze River Delta	Kunshan, Jiangsu	77.3
	Yangzhou, Jiangsu	36.5
	Jiaxing, Zhejiang	202.3
	Ningbo, Zhejiang	240.5
	Bengbu, Anhui	668.1
	Subtotal	**1,224.7**
Beibuwan	Nanning, Guangxi	773.2
	Yulin, Guangxi	1,448.6
	Subtotal	**2,221.8**
Bohai Rim	Shenyang, Liaoning	1,570.6
	Subtotal	**1,570.6**
Australia	Sydney, NSW	40.3
	Subtotal	**40.3**

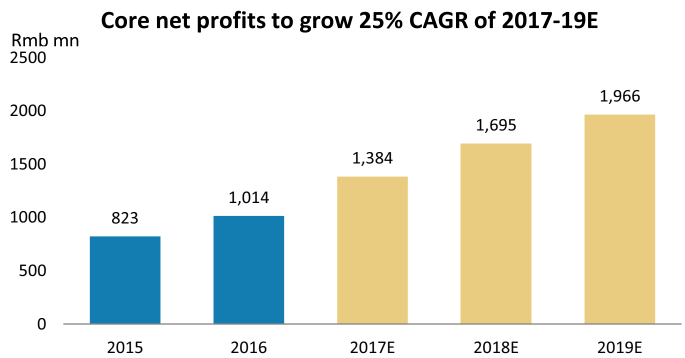
Source: Company data

High core net profit growth in 2017-18 (22-36% YoY)

We forecast a top line CAGR of 30% in 2017-18, benefiting from a strong pick up in contract sales growth in 2015-17. This is likely to drive similar bottom line growth with stable gross margin at 26-27%.

Another positive is the company's attributable ratio for its landbank of 92% vs. the industry average of 20-30%.

Exhibit 6: We expect core net profits to rise at a 25% CAGR, 2017-19



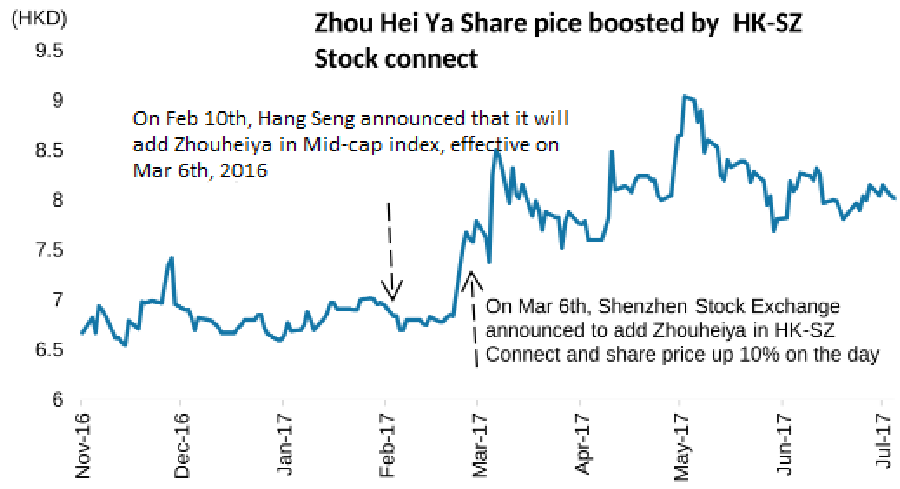
Source: Company data, Morgan Stanley Research; E=Morgan Stanley Research estimates

Potential addition to the Shenzhen-Hong Kong Stock Connect

Mainland investors have shown increasing interest in owning Hong Kong-listed stocks. As of June 2017, there are 415 Hong Kong-listed stocks that are available via the Connect. Southbound volumes have already contributed 12% of total volume on the Hong Kong Stock Exchange, which we think is significant. This has benefited the liquidity of stocks eligible for southbound trading. For example, Zhou Hei Ya posted a 10% daily gain with improved liquidity after being added to the list of stocks eligible for southbound trading.

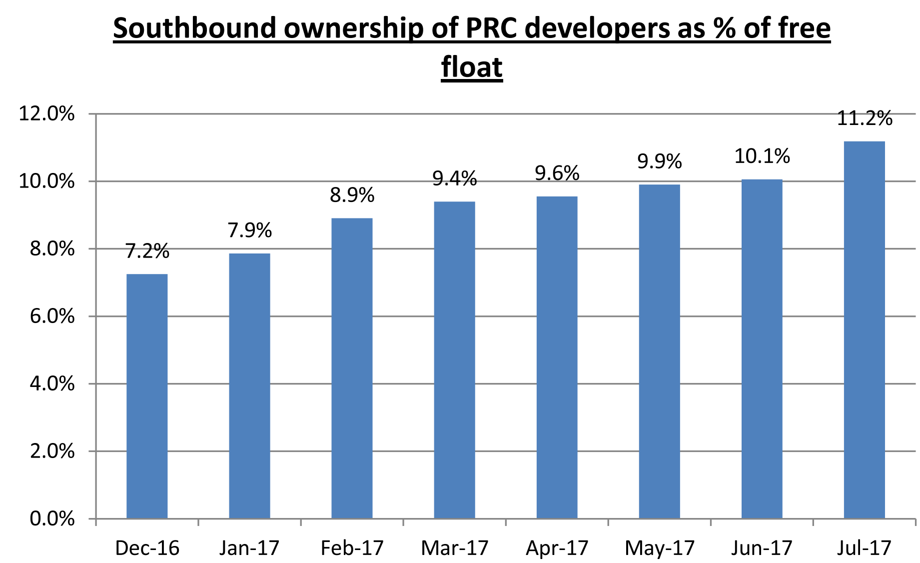
In order to qualify for eligibility in the Stock Connect, companies need to have (1) an average market cap of >HK$5bn in the past 12 months and be a member of the Hang Seng Composite Index; and (2) 12 months of median daily traded shares per month / free float shares >0.1%. The Hang Seng Composite Index rebalances twice a year, in March and September. It plans to announce the latest list of stocks eligible for southbound trading on August 16. Aoyuan management has stated that it has satisfied the necessary criteria.

Exhibit 7: Zhou Hei Ya was added into the Stock Connect soon after its inclusion in the Hang Seng Index



Source: Datastream

Exhibit 8: Southbound inflows to the property industry have increased since the beginning of the year



Source: Hong Kong Stock Exchange (HKEX). Note: We calculate Southbound ownership as an average of the following companies: Sunac, Evergrande, R&F, CIFI, KWG, Longfor, Country Garden, COLI, Yuexiu, CR Land, Jinmao, Agile, Sino Ocean, Vanke H, and Shimao.

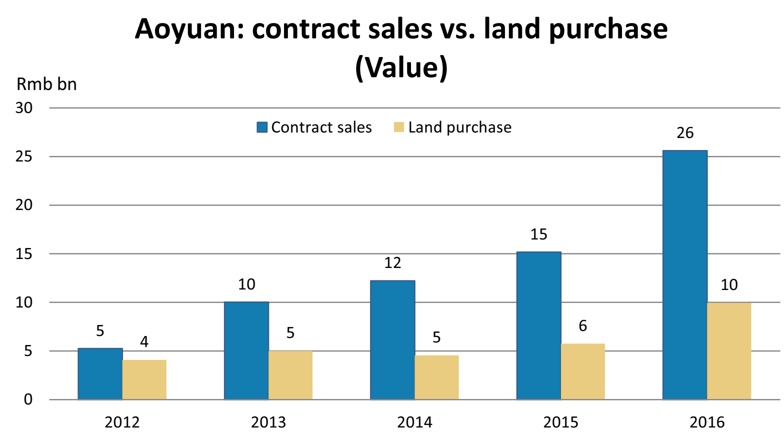
Investment Concerns

Not enough landbank for 2019 and beyond

2015/2016 land acquisition missed expectations: Aoyuan was disciplined in its landbank replenishment during 2015-16, with a value to sales ratio of 38%, below the industry average of 50%. As a result, we think the company is losing market share to competitors in the land market. After missing a good opportunity in 2015/16, we think it would be more risky to acquire land in 2017 given land prices continue to increase while property prices stay stable in tier 1, tier 2, and nearby tier 3 cities.

Few channels to acquire cheap land: As it is a small-scale non-SOE, Aoyuan lacks the means to acquire land at a low cost via the public land auction market. (1) **M&A:** Aoyuan has been actively looking at M&A opportunities; 74% of its land acquisition in 2016 was via M&A. However, in an already-competitive M&A market, it is difficult for small developers **to scale up** their landbanks via this channel given the associated risks involved in project-by-project acquisitions. For example, Aoyuan filed a lawsuit in relation to the Rmb1.1bn acquisition in 2009 of No. 8 Changan in Beijing relating to a stake dispute with its then partner. This resulted in a 3-year construction delay, constraining the group's cash flow. The dispute was eventually resolved in 2014. (2) **Urban renewal:** Aoyuan has a few village redevelopment projects in Zhuhai. Compared with old factory redevelopment projects, these projects have longer redevelopment cycles (at least 5-10 years vs 3-5 years for old factories). The projects' sustainability is also uncertain.

Exhibit 9: Modest land acquisitions since 2014



Source: Company data

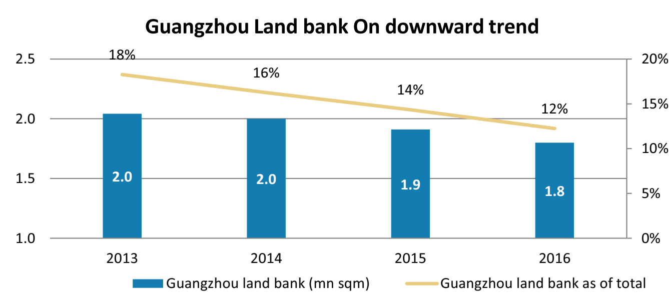
Exhibit 10: Very disciplined landbanking strategy since 2008

	No.	Avg. land cost (RMB per sqm)	Total GFA (sqm)	Total cost (RMB million)
2008	2	369	341,483	126
2009	4	876	3,583,868	3,138
2011	7	2,933	1,268,457	3,721
2012	8	2,178	1,874,914	4,084
2013	8	2,245	2,232,579	5,013
2014	8	1,715	2,657,445	4,557
2015	13	2,312	2,491,800	5,761
2016	17	3,170	3,138,700	9,950
Total	**67**	**2,067**	**17,589,246**	**36,300**

Source: Company data

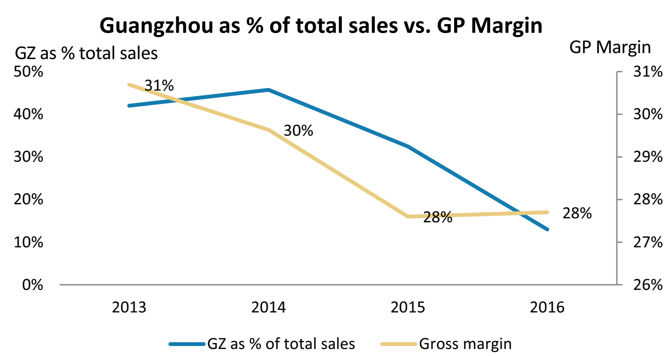
Gross margin on a downward trend: Guangzhou is Aoyuan's major margin contributor given its high ASP. The city's contribution to sales was highest in 2014 at 48%, but this fell to 13% in 2016 mainly due to the lack of land replenishment in this area in that period because of the short supply and intense competition. We expect this to continue to drag margins in 2018/19.

Exhibit 11: Aoyuan's overall gross margin is highly correlated to Guangzhou's contribution to sales



Source: Company data

Exhibit 12: Historically, the company's overall gross margin was largely determined by its Guangzhou landbank



Source: Company data

Impact of policy tightening

80% of Aoyuan's landbank is located in tier 1-2 cities, which are currently subject to property tightening measures, particularly price cap measures, which limit further property price upside. Other measures such as home purchase restrictions and an increase in the downpayment ratio may hurt demand in areas that Aoyuan is exposed to.

China's capital controls may affect the company's overseas projects

Aoyuan started developing projects overseas in 2015 by entering Sydney and acquiring 70% of One30 Hyde Park Sydney. The company has set up offices and committed to more projects in Sydney (currently four) and in early 2017 entered the Toronto and Vancouver markets. While the size of its landbank overseas is relatively small (5% of the total value), recent capital controls in China have already led to a halt in overseas acquisitions, which may weigh on the company's sale growth outlook.

Exhibit 13: One30 Hyde Park in Sydney

Source: Company data

Exhibit 14: Mirabell in Sydney

Source: Company data

Exhibit 15: Maison 188 Maroubra in Sydney

Source: Company data

Exhibit 16: Gordon in Sydney

Source: Company data

Earnings Forecasts

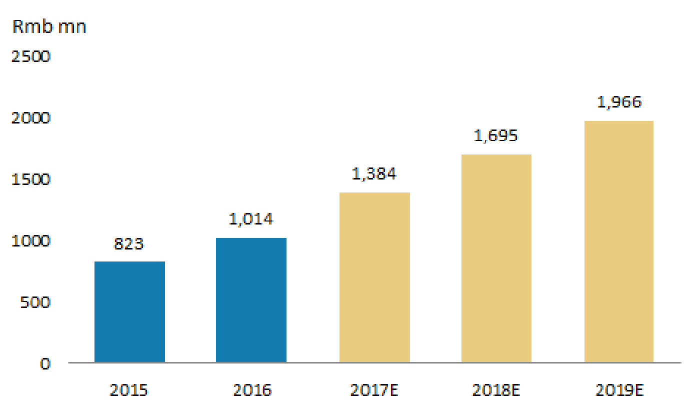
We forecast sales volumes to decline 5% YoY in 2017, pressured by tightening measures in tier 1-2 cities. However, we forecast ASP to be flattish in 1-2 cities and increase 5% in tier 3 cities. Under this environment, we believe the company will be on track to achieve its Rmb50bn attributable sales target by 2018.

Revenue CAGR of 30% YoY in 2017-19: We expect top-line growth to be mainly driven by a 30% contract sales CAGR, 2017-19. The company guided for 40% YoY revenue growth in 2017.

Gross margin to decline 2pp in 2019 vs 2016 levels: As the revenue contribution from its home base of Guangzhou declines, we expect this to drag Aoyuan's margin and forecast it to decline from 28% in 2015-17 to 27% in 2018 and 26% in 2019.

Core net profit to grow in the double digits in 2017-18, single digits in 2019: After factoring in our revenue and gross margin expectations, together with increasing SG&A expense on its expansion plans to new cities, we forecast Aoyuan's bottom line to rise by about 22-36% YoY in 2017-18, but by 16% YoY in 2019 due to margin compression.

Exhibit 17: We expect core net profits to rise at a 25% CAGR, 2017-19



Source: Company data, Morgan Stanley Research; E=Morgan Stanley Research estimates

Valuation Methodology

Our price target of HK$3.3 is based on a discount to our NAV estimate. We use discount to NAV method, a widely used approach in valuing the developer business. The purpose is to try to mark to market for developers' land or property projects, as these are booked at cost on the balance sheet. Our price target implies 10% upside potential.

Exhibit 18: Price target derivation

Property development Assumption		Note
Attributable Land bank (mn sqm)	12	Excl. Sold but not delivered
ASP (Rmb/sqm)	10,500	1H17
Net Margin	7%	
ASP growth	0%	
Cost of debt	8.1%	
Risk free rate	3.0%	
Mkt risk premium	7.0%	
Beta	1.8	
Cost of equity	15.6%	
Debt to (Debt + Equity)	78.0%	
WACC	8.2%	

Approach - Booked value + discount of future profit generated from current land bank				
Cash flow (Rmb bn)	2017E	2018E	2019E	2020E
Attributable Property sales (mn sqm)	3.5	3.5	3.5	1.2
ASP	9,975	9,975	9,975	9,975
Property sales	35	35	35	12
Net profits	2.5	2.5	2.5	0.9
PV of Net Income	2.5	2.5	2.3	0.7
Sum of PV	8.0			
Book value of equity	8.9			
NAV = Book value + sum of PV	16.9			
Discount to NAV	55.0%			
Fair value	7.6			
Number of shares (mn)	2,672			
Fair value (Rmb/share)	2.8			
Rmb/HKD exchange rate	1.15			
Fair value (HKD/share)	3.3			
Current share price (HKD/share) as of August 11th	3.0			
Upside	9%			

Source: Morgan Stanley Research; E=Morgan Stanley Research estimates

Valuation methodology – NAV

How to calculate NAV: We use a discounted cash flow model to estimate NAV, based on the company's landbank (13mn sqm as of December 2016) using 1H17 presales ASP. We estimate long-term net margin to be 8%, down from 9% in 2016 due to the depletion of its Guangzhou landbank and high replenishing land costs in a competitive market. Based on Aoyuan's current presales pace, we estimate the company will deplete its projects in four years, and we assume the company will not buy new land.

Key assumptions: We assume (1) 7.7% WACC, (2) 8% pretax cost of debt, based on the company's funding costs, and (3) 13.5% cost of equity (based on a 1.5x beta, 3%

risk-free rate, and 7% market risk premium, per our strategy team's forecasts. Then we add Aoyuan's Rmb8.9bn book value as of December 2016 to arrive at our NAV valuation. Our NAV estimate for the property development business is Rmb18.8bn.

For Aoyuan, we apply a 55% discount to our NAV estimate based on our developers' scorecard. We assign weightings to four criteria: (1) leverage; (2) asset turnover; (3) percentage of gross asset value in tier 1-2 cities; and (4) track record. The higher the score, the lower the NAV discount assigned to individual stocks. We apply our target discount/(premium) to our base-case 12-month forward NAV to arrive at our price target (Exhibit 19).

Scenario analysis

Bull case: On the macro side, we assume 10% YoY growth in property prices in 2017 on the back of monetary easing by the government to boost the economy, benefiting the company in terms of selling price and sell-through rate.

Bear case: On the macro side, we assume a 10% YoY decline in property prices in 2017 on the back of a sudden liquidity tightening to curb the rapidly expanding property price. This would force the company to sell projects at a lower price and put pressure on its balance sheet. We also assume that the company cuts back on its expansion plans.

Key risks to our price target

Upside risks: (1) The company indicates there is a possibility of a special dividend announcement as 2017 is the 10th anniversary of being listed in Hong Kong; (2) successful launch of urban renewal projects, which would support landbank expansion; (3) sharp ASP increase in its non-Guangzhou landbank, which would support margins.

Downside risks: (1) Greater-than-expected margin decline; (2) sales decline in 2019.

Exhibit 19: Morgan Stanley scorecard for stock ranking and assigning NAV discounts for price targets

Stock code	Name	Total Score	Tier 1&2 GAV %	Asset Turn 15-17E Avg	Dec-16 NDER*	Track Rec	Assigned NAV Target
688.HK	COLI	93	85%	35%	7%	10	10%
000002.SZ	Vanke (A)	85	79%	32%	26%	9	10%
1109.HK	CR Land	84	75%	28%	24%	10	10%
600048.SH	Poly Real Estate (A)	81	84%	27%	55%	9	20%
960.HK	Longfor	78	80%	27%	54%	8	30%
000069.SZ	Shenzhen OCT (A)	74	96%	33%	48%	3	30%
3380.HK	Logan	74	78%	26%	76%	8	30%
2007.HK	Country Gdn	74	45%	39%	49%	8	30%
884.HK	CIFI	68	90%	26%	50%	3	40%
600383.SH	Gemdale (A)	68	83%	38%	50%	1	40%
817.HK	China Jinmao	68	100%	16%	74%	5	40%
1918.HK	Sunac	68	75%	38%	208%	7	40%
604.HK	Shenzhen Investment	68	70%	23%	39%	6	40%
3333.HK	Evergrande	66	75%	30%	203%	8	40%
1813.HK	KWG	64	85%	16%	67%	5	50%
813.HK	Shimao	63	78%	22%	59%	4	50%
3883.HK	Aoyuan	61	38%	32%	61%	6	55%
3377.HK	Sino Ocean Land	60	90%	21%	44%	1	55%
123.HK	Yuexiu Property	60	85%	24%	53%	1	55%
81.HK	COGO	59	41%	30%	21%	4	55%
3383.HK	Agile	59	37%	32%	59%	5	55%
119.HK	Poly Property (H)	52	74%	21%	95%	2	65%
2777.HK	Guangzhou R&F	48	76%	21%	174%	2	65%
002146.SZ	Risesun (A)	40	30%	26%	128%	2	65%

Source: Company data, Morgan Stanley Research; E = Morgan Stanley Research estimates. * Agile perpetual capital securities (PCS) is treated as equity, whilst the other PCS is treated as debt.

Exhibit 20: China – Property: Valuation comparables

8/11/2017 H-Share	Rating	Share Price (HK$/share)	Mkt Cap US$mn	T/O US$mn Avg Daily	Target Price (HK$/share)	Upside Potential	P/E 2017e	P/E 2018e	Fwd NAV (HK$/share)	Disc to Fwd NAV	Development as % of total	IP as % of total Retail	IP as % of total Office^	Div Yield 2016	Div Yield 2017e	Div Yield 2018e	P/B 2016	P/B 2017e	NDER 2016
COLI	OW	25.30	35,460	69.3	36.00	42%	7.2	6.2	39.91	-37%	94%	0%	6%	3.0%	2.8%	3.2%	1.16	1.10	7%
Evergrande	EW	18.54	31,141	19.4	16.20	-13%	15.5	9.8	18.40	1%	66%	4%	30%	0.0%	4.3%	5.1%	5.23	4.88	432%
Vanke 'H'	EW	22.10	31,358	30.7	19.80	-10%	8.3	7.0	22.10	0%	100%	0%	0%	4.2%	5.0%	6.0%	1.83	1.62	26%
Country Garden	EW	9.62	26,263	9.7	8.70	-10%	11.4	7.2	12.28	-22%	96%	0%	4%	2.1%	2.8%	4.3%	2.58	2.13	49%
CR Land	OW	22.75	20,171	33.8	27.50	21%	7.8	6.7	30.63	-26%	63%	21%	16%	3.1%	3.2%	3.7%	1.35	1.20	20%
Longfor	EW	18.58	13,996	8.3	12.70	-32%	10.8	9.8	18.08	3%	91%	9%	0%	2.9%	1.9%	2.1%	1.49	1.34	54%
Sunac	OW	18.36	9,705	9.5	18.50	1%	23.4	7.5	30.80	-40%	100%	0%	0%	1.6%	1.7%	3.3%	2.59	2.39	208%
Shimao	OW	13.84	5,997	8.0	14.70	6%	6.2	5.4	29.36	-53%	87%	6%	7%	5.7%	4.9%	5.6%	0.77	0.71	59%
Guangzhou R&F	UW	15.24	6,282	9.5	7.90	-48%	5.5	5.3	22.72	-33%	88%	5%	7%	7.7%	8.9%	9.3%	0.95	0.87	174%
BBMG 'H'	UW	4.01	5,504	5.7	3.10	-23%	13.0	12.2	5.19	0%	64%	0%	20%	1.3%	0.8%	0.8%	1.14	0.78	80%
Logan	OW	7.20	5,062	1.4	9.00	25%	7.9	6.0	14.92	-52%	82%	9%	9%	3.5%	4.3%	5.7%	1.75	1.52	76%
China Jinmao	EW	3.35	4,575	2.2	3.50	4%	8.4	6.5	5.72	-41%	67%	0%	33%	2.8%	5.0%	6.1%	1.05	0.95	74%
Agile	OW	8.55	4,284	2.7	10.40	22%	5.8	5.3	23.16	-63%	95%	5%	0%	2.4%	4.3%	4.7%	0.69	0.64	49%
Sino Ocean Land	EW	4.02	3,866	4.2	3.90	-3%	6.7	6.5	8.57	-53%	86%	4%	9%	5.0%	5.2%	5.4%	0.58	0.55	44%
Red Star Macalline 'H'	OW	7.97	3,698	1.7	11.74	47%	8.3	7.0	NA	NA	0%	100%	0%	6.2%	6.0%	7.1%	0.56	0.55	32%
CIFI	OW	4.25	4,081	2.3	4.85	14%	6.6	5.1	8.08	-47%	98%	0%	2%	4.2%	5.3%	6.9%	1.62	1.41	50%
Shenzhen Inv	EW	3.39	3,247	5.4	3.80	12%	6.8	6.8	6.33	-46%	60%	10%	30%	5.1%	6.0%	6.0%	0.77	0.73	21%
SOHO	OW	4.03	2,681	3.2	5.00	33%	170.9	114.8	2.70	39%	10%	27%	63%	15.7%	15.8%	16.0%	0.52	0.56	-9%
Yuexiu Property	OW	1.37	2,173	4.0	1.64	20%	7.2	6.0	3.65	-62%	75%	10%	14%	4.8%	5.6%	6.7%	0.47	0.45	53%
KWG	OW	5.38	2,171	3.7	7.00	30%	4.0	3.9	13.96	-61%	96%	1%	3%	9.4%	7.2%	7.4%	0.58	0.53	67%
Joy City Prop.	OW	1.14	2,075	1.2	1.35	18%	33.3	16.9	2.70	-58%	27%	60%	13%	3.9%	1.3%	2.5%	0.53	0.54	37%
Yuexiu REIT	OW	4.97	1,867	2.5	5.60	20%	14.8	14.2	NA	NA	0%	33%	68%	6.5%	6.5%	6.5%	0.8	0.8	4%
Poly Property 'H'	UW	3.70	1,733	2.9	2.00	-46%	61.2	30.3	5.95	-38%	86%	6%	8%	0.0%	0.0%	0.0%	0.55	0.54	108%
Times Property	OW	6.04	1,346	1.1	7.10	18%	4.0	3.3	15.84	-62%	95%	0%	5%	6.2%	8.7%	10.7%	0.97	0.84	55%
COGO	OW	4.06	1,185	0.7	4.80	18%	5.9	4.8	10.66	-62%	95%	0%	5%	0.5%	0.9%	1.1%	0.89	0.77	21%
Aoyuan	EW	3.00	1,025	0.5	3.30	10%	4.9	4.0	7.33	-59%	90%	7%	3%	3.8%	6.0%	7.3%	0.76	0.69	59%
H-Share Coverage		**Simple average**				**7%**	**17.9**	**12.2**		**-30%**				**3.1%**	**3.9%**	**4.7%**	**1.3**	**1.2**	**59%**
H-Share Developers*		**Simple average**				**7%**	**8.2**	**6.1**		**-30%**				**3.0%**	**3.9%**	**4.7%**	**1.5**	**1.3**	**58%**

*H-Share Developers are H-share Coverage excluding BBMG, Red Star, SOHO, Joy City, Yuexiu REIT, and Poly

^including other IP

8/11/2017 A-Share	Rating	Share Price (Rmb/share)	Mkt Cap US$mn	T/O US$mn Avg Daily	Target Price (Rmb/share)	Upside Potential	P/E 2017e	P/E 2018e	Fwd NAV (Rmb/share)	Disc to Fwd NAV	Development as % of total	IP as % of total Retail	IP as % of total Office^	Div Yield 2016	Div Yield 2017e	Div Yield 2018e	P/B 2016	P/B 2017e	NDER 2016
Vanke 'A'	UW	22.02	32,151	505.0	17.10	-22%	9.7	8.2	19.01	16%	100%	0%	0%	3.6%	4.3%	5.1%	2.14	1.90	26%
Poly Real Estate 'A'	OW	9.84	17,520	109.4	11.20	14%	7.1	6.2	14.02	-30%	98%	0%	2%	3.2%	4.2%	4.8%	1.24	1.16	55%
Greenland Group 'A'	UW	7.37	13,465	71.1	7.10	-4%	12.3	10.6	17.80	-59%	87%	2%	0%	2.7%	3.3%	3.7%	1.65	1.53	290%
Shenzhen OCT 'A'	OW	8.46	10,423	32.0	9.80	16%	10.7	9.0	12.67	-33%	66%	0%	0%	1.2%	1.1%	1.3%	1.59	1.40	55%
Lujiazui Finance 'A'	UW	24.98	9,169	46.9	14.80	-41%	38.6	35.7	23.02	0%	2%	5%	93%	1.1%	1.6%	1.7%	6.15	5.79	117%
BBMG 'A'	UW	6.88	8,614	14.2	2.70	-61%	26.2	24.5	3.54	94%	64%	0%	20%	0.7%	0.4%	0.4%	1.66	1.57	80%
Gemdale 'A'	UW	11.21	7,597	61.5	8.40	-25%	11.1	9.9	14.05	-20%	92%	0%	8%	6.2%	4.5%	5.1%	1.35	1.30	28%
RiseSun 'A'	UW	10.31	6,731	26.5	3.30	-68%	11.6	9.4	9.44	9%	97%	0%	3%	3.9%	3.6%	4.4%	1.89	1.74	128%
Financial Street 'A'	OW	10.98	4,928	65.1	13.10	19%	9.0	6.4	21.73	-49%	63%	5%	33%	3.6%	4.4%	6.2%	1.2	1.1	119%
Shanghai Shimao 'A'	EW	4.90	2,760	11.2	5.14	5%	10.1	7.7	10.26	-52%	78%	18%	4%	1.6%	1.5%	1.9%	0.9	0.9	12%
A-Share Coverage		**Simple average**				**-16%**	**14.6**	**12.8**		**-22%**				**2.8%**	**2.7%**	**3.2%**	**1.88**	**1.87**	**86%**
A-Share Developers*		**Simple average**				**-9%**	**10.2**	**8.4**		**-28%**				**3.1%**	**3.0%**	**3.5%**	**1.80**	**1.80**	**86%**

*A-Share Developers are A-share Coverage excluding Lujiazui Finance and BBMG

^including other IP

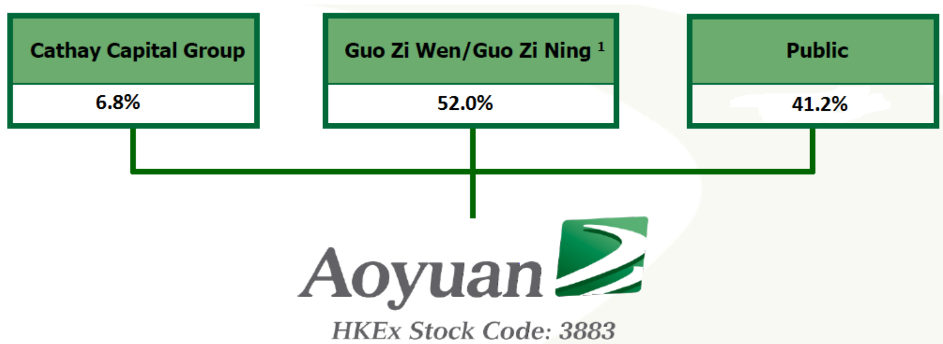
Source: Datastream, Morgan Stanley Research; E=Morgan Stanley Research estimates. *: Agile perpetual capital securities is treated as equity, whilst the other PCS is treated as debt.

Company Background

China Aoyuan Property Group was founded in 1996 and listed on the main board of the Hong Kong Stock Exchange on October 9, 2007 (Stock Code: 3883). It recorded contract sales of Rmb25bn in 2016. Starting in 2015, Aoyuan extended its footprint abroad to Sydney, Australia. To date, it has developed over 100 major property projects across 30 cities globally.

Chairman Guo Ziwen worked in a Panyu-based SOE before acquiring Aoyuan in 1996 from the local government. The company took advantage of the Olympic Games' popularity in the country in 2001, ahead of the country's hosting the games in 2008, and successfully built 18 "Olympic Garden" or sports+residential projects in China through a 20:80 JV with China Sports Industry Group. The JV ended in 2004 and since then Aoyuan has struggled to repeat the projects' success.

Exhibit 21: Shareholding structure (as of December 2016): Management owns 52% of the company



Source: Company data. Note: 1: Guo Zi Wen owns 46.8% of the company and his brother Guo Zi Ning owns a 5.2% stake.

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(as of July 31, 2017)

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For disclosure purposes only (in accordance with NASD and NYSE requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight, Not-Rated and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Not-Rated to hold and Underweight to sell recommendations, respectively.

	COVERAGE UNIVERSE		INVESTMENT BANKING CLIENTS (IBC)			OTHER MATERIAL INVESTMENT SERVICES CLIENTS (MISC)	
STOCK RATING CATEGORY	COUNT	% OF TOTAL	COUNT	% OF TOTAL IBC	% OF RATING CATEGORY	COUNT	% OF TOTAL OTHER MISC
Overweight/Buy	**1150**	**36%**	**299**	**40%**	**26%**	**556**	**37%**
Equal-weight/Hold	**1413**	**44%**	**349**	**47%**	**25%**	**692**	**46%**
Not-Rated/Hold	**61**	**2%**	**7**	**1%**	**11%**	**10**	**1%**
Underweight/Sell	**607**	**19%**	**93**	**12%**	**15%**	**242**	**16%**
TOTAL	**3,231**		**748**			**1500**	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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COMPANY (TICKER)	RATING (AS OF)	PRICE* (08/14/2017)
Jeffrey Zeng		
China Aoyuan Property Group Ltd (3883.HK)	E (08/15/2017)	HK$3.03
Times Property (1233.HK)	O (04/19/2017)	HK$6.16
John Lam, CFA		
Agile Group Holdings Ltd (3383.HK)	O (07/04/2016)	HK$8.60
BBMG Corporation (2009.HK)	U (04/05/2017)	HK$4.12
BBMG Corporation (601992.SS)	U (04/05/2017)	Rmb7.14
China Overseas Grand Oceans Group (0081.HK)	O (11/06/2015)	HK$4.19
China Overseas Land & Inv. (0688.HK)	O (05/19/2015)	HK$25.15
China Resources Land (1109.HK)	O (03/22/2016)	HK$22.85
China Vanke Co., Ltd. (000002.SZ)	U (02/07/2017)	Rmb21.95
China Vanke Co., Ltd. (2202.HK)	E (08/19/2014)	HK$22.10
Country Garden Holdings Company Limited (2007.HK)	E (10/31/2016)	HK$9.52
Evergrande Real Estate Group (3333.HK)	E (06/09/2017)	HK$19.04
Gemdale Corporation (600383.SS)	U (09/30/2015)	Rmb11.27
Guangzhou R&F Properties (2777.HK)	U (02/07/2017)	HK$15.52
KWG Property Holding Limited (1813.HK)	O (11/06/2015)	HK$5.48
Longfor Properties (0960.HK)	E (07/05/2017)	HK$18.82
Poly Property Group (0119.HK)	U (07/04/2016)	HK$3.71
Poly Real Estate Group (600048.SS)	O (11/06/2015)	Rmb9.89
Red Star Macalline Group Corp Ltd. (1528.HK)	O (03/23/2016)	HK$8.01
RiseSun Real Estate Development (002146.SZ)	U (09/30/2015)	Rmb10.52
Shenzhen Overseas Chinese Town (000069.SZ)	O (09/30/2015)	Rmb8.50
Shimao Property (0813.HK)	O (11/06/2015)	HK$13.86
Sino Ocean Land (3377.HK)	E (05/19/2015)	HK$4.08
Sunac China Holdings (1918.HK)	O (06/30/2017)	HK$18.90
Yuexiu Property (0123.HK)	E (07/04/2016)	HK$1.37
Leif Chang		
China Jinmao Holdings Group (0817.HK)	E (07/07/2017)	HK$3.35
CIFI Holdings Group (0884.HK)	O (05/29/2017)	HK$4.28
Financial Street Holdings Co Ltd (000402.SZ)	O (11/15/2016)	Rmb11.16
Greenland Holdings Corp Ltd (600606.SS)	U (11/15/2016)	Rmb7.48
Joy City Property (0207.HK)	O (02/22/2017)	HK$1.18
Shanghai Lujiazui Finance & Trade Zone (600663.SS)	U (10/15/2015)	Rmb24.77
Shanghai Shimao (600823.SS)	E (03/28/2016)	Rmb4.96
SOHO China (0410.HK)	O (11/15/2016)	HK$4.14
Yuexiu Real Estate Investment Trust (0405.HK)	O (02/24/2016)	HK$5.05

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* Historical prices are not split adjusted.