China Aoyuan Property Group Limited --------------------------Upgrade to OUTPERFORM

High visibility for high earnings growth; upgrade on attractive valuation **EPS: ▲ TP: ▲**

Jianping Chen / Research Analyst / 852 2101 7189 / jianping.chen@credit-suisse.com
Summer Wang, CFA / Research Analyst / 852 2101 6539 / summer.wang@credit-suisse.com
Patrick Ng / Research Analyst / 852 2101 7163 / patrick.ng@credit-suisse.com

- Aoyuan's 1H18 core profit increased 40% YoY to Rmb981 mn, driven by top line growth with post-LAT margin flattish YoY. Its 1H18 core profit represented 45% of our FY18 full-year estimate (vs 51% for 1H17). No interim dividend was proposed.
- Its contracted sales continued to beat expectation, up 143% YoY in 7M18. With unrecognised sales of Rmb84 bn, this has fully secured our estimate for FY18-19 development revenue. We raise our contracted sales estimate by 8% to Rmb78 bn in 2018.
- Aoyuan recorded negative free cash flow of Rmb4.7 bn in 1H18, with land acquisition/construction acceleration to drive future sales growth. Its higher debt repayment pressure will inevitably make it more vulnerable to rising financing cost. Nevertheless, we believe continued sales resilience should offer some relief.
- We lift our EPS estimates to reflect Aoyuan's higher revenue, raise NAV estimate by 12% to reflect its newly acquired land in 1H18, lift TP to HK$7.80 (from HK$7.00) on 40% NAV discount (unchanged), and upgrade to OUTPERFORM (from Neutral) on the stock's valuation turning attractive, trading at 58% NAV discount and 4.1x FY19 P/E (highly secured).

Bbg/RIC	**3883 HK / 3883.HK**	**Price (20 Aug 18 , HK$)**			**5.21**
Rating (prev. rating)	**O (N) [V]**	**TP (prev. TP HK$)**			**7.80 (7.00)**
52-wk range (HK$)	7.59 - 3.03	Est. pot. % chg. to TP			50
Mkt cap (HK$/US$ mn)	13,971.0/ 1,780.0	Blue sky scenario (HK$)			12.90
ADTO-6M (US$ mn)	10.1	Grey sky scenario (HK$)			3.50
Free float (%)	45.9	**Performance**	**1M**	**3M**	**12M**
Major shareholders	Guo Ziwen (54.1%)	Absolute (%)	0.4	(23.6)	73.7
		Relative (%)	6.3	(8.8)	73.0

Year	**12/16A**	**12/17A**	**12/18E**	**12/19E**	**12/20E**
EBITDA (Rmb mn)	2,319	3,545	5,599	7,637	10,553
Net profit (Rmb mn)	1,015	1,361	2,177	3,006	3,881
EPS (CS adj. Rmb)	0.37	0.51	0.81	1.12	1.45
- Change from prev. EPS (%)	n.a.	n.a.	0.4	5.8	5.2
- Consensus EPS (Rmb)	n.a.	n.a.	0.92	1.26	1.67
EPS growth (%)	21.9	36.6	59.9	38.1	29.1
P/E (x)	12.2	8.9	5.6	4.1	3.1
Dividend yield (%)	3.3	5.5	7.1	9.9	12.7
EV/EBITDA (x)	9.0	7.9	6.1	4.6	3.5
ROE (%)	11.8	14.3	20.0	23.6	25.6
Net debt(cash)/equity (%)	58.9	58.8	74.9	72.0	67.0
NAV per share (Rmb)	—	9.9	10.9	—	—
Disc./(prem.) to NAV (%)	—	54.2	58.4	—	—

Note 1: China Aoyuan Property Group Limited is a property developer focusing on the Greater Bay Area. It was listed on the main board of HKEX in 2007.

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1H18 core profit increased 40% YoY

Aoyuan's 1H18 core profit increased 40% YoY to Rmb981 mn, well on track to achieve our full-year FY18E earnings growth of 60% YoY. The growth was driven by 68% YoY increase in revenue, of which gross floor area (GFA) delivery/booking price grew 48%/14% YoY. Its post-LAT gross margin was flat at 24%, while the ratio of SG&A expense to revenue widened 0.9 pp, which is reasonable given its fast expansion on contracted sales. No interim dividend was proposed.

We raise our contracted sales estimate by 8% on its strong YTD performance

Aoyuan 1H18 contracted sales were Rmb40 bn, translating into a satisfactory sell-through rate of 60%. With this, and contracted sales of Rmb6 bn in July, Aoyuan has secured 63% of management's full-year sales target for 2018. On more saleable resources, we believe management should comfortably beat its original sales target (Rmb73 bn vs saleable resources budget of Rmb126 bn). Indeed, Aoyuan acquired new land parcels of 7.3 mn sqm in GFA in 1H18 (vs contracted GFA of 3.9 mn sqm). Its new-starts in 1H18 came in at 5.2 mn sqm in GFA, equivalent to ~80% of its full-year construction commencement in 2017. The newly acquired land parcels and accelerating construction should reserve sufficient saleable resources to drive growth, in our view. We raise our contracted sales estimate by 8% to Rmb78 bn for 2018, implying a full-year growth rate of 71% YoY.

Rising net gearing largely manageable

Aoyuan recorded negative free cash out flow of Rmb4.7 bn in 1H18 and net gearing rose to 73% as at end of June-2018. Also, we see higher-than-peers' repayment pressure for Aoyuan, with its tight short-term debt-coverage ratio of 1.0x. This should inevitably make it more vulnerable to the rising financing cost. Nevertheless, we believe its strong contracted sales and satisfactory cash collection rate (80% in 1H18) should offer some relief. Meanwhile, the potential margin pressure should be more than offset by its strong top line growth.

Upgrade to OUTPERFORM

Aoyuan has accumulated unrecognised sales of Rmb84 bn, with embedded gross profit margin at 26-28% (vs 26.7% in FY17 or 28.6% in 1H18). This has essentially fully secured our combined property development revenue estimate for FY18-19. With such a high revenue lock-in ratio, we believe Aoyuan's 4.1x FY19E P/E has turned more attractive. We raise our NAV estimate by 12% to factor in its new land acquisitions in 1H18 and lift TP to HK$7.80 based on an unchanged 40% NAV discount. Upgrade to OUTPERFORM. Catalysts include: (1) kick-off of its Zhuhai redevelopment project which is to offer saleable resources of Rmb24 bn in end-2018 and (2) potential share buyback or stake increase post results. Aoyuan bought back 3.7 mn shares in June-2018 and its chairman raised some stake in it in January-April.

Figure 1: 1H18 result summary-Aoyuan

	1H18	**1H17**	**YoY changes**
Contracted sales (Rmb mn)	40,291	16,520	144%
Revenue (Rmb mn)	13,667	8,154	68%
Gross profit (Rmb mn)	3,277	1,953	68%
Core profit (Rmb mn)	981	703	40%
EPS (Rmb)	0.37	0.26	39%
Post-LAT gross margin (%)	24.0%	24.0%	0.0 ppt
Core margin (%)	7.2%	8.6%	-1.4 ppt
	Jun-18	**Dec-17**	**Changes**
Gross debt (Rmb mn)	46,517	42,495	9%
Cash (Rmb mn)	25,823	26,540	-3%
Net debt (Rmb mn)	20,694	15,955	30%
Net gearing (%)	72.8%	58.8%	14.0 ppt
% of short-term debt	55.1%	49.7%	5.4 ppt

Source: Company data, Credit Suisse estimates.

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Companies Mentioned *(Price as of 20-Aug-2018)*

China Aoyuan Property Group Limited (3883.HK, HK$5.21, OUTPERFORM[V], TP HK$7.8)

Disclosure Appendix

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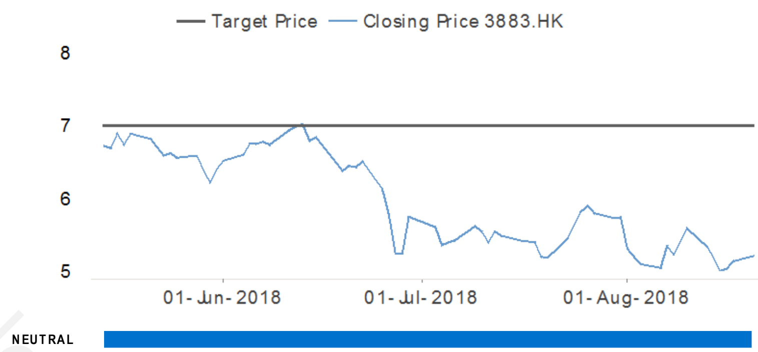
3883.HK Date	Closing Price (HK$)	Target Price (HK$)	Rating
14-May-18	6.72	7.00	N *

** Asterisk signifies initiation or assumption of coverage.*



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Target Price and Rating
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Method: We raise our NAV estimate by 12% to factor in its new land acquisitions in 1H18 and our TP is revised up to HK$7.8 based on an unchanged 40% discount. The OUTPERFORM rating reflects the stock's valuation turning attractive. Catalysts include: (1) kick-off of its Zhuhai redevelopment project which is to offer saleable resources of Rmb24 bn in end-2018 and (2) potential share buyback or stake increase post results. To recap, Aoyuan bought back 3.7 mn shares in June-2018 and its chairman raised some stake in January-April.

Risk: Downside risks to our TP of HK$7.8 and OUTPERFORM rating include weaker-than-expected sentiment in lower-tier cities and tighter-than-expected refinancing tightening for developers.

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