Fixed Income
Credit Commentary

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CMBI Credit Commentary - CAPG

CAPG: Vigilant investment penetrates deleverage

China Aoyuan reported better than excepted interim results, featuring intact income statement and slightly improved balance sheet. Aoyuan delivered mild deleverage in 1H21 with debts cut of 4%, thanks to its contained land acquisitions. It guided to cut total debts by 10%-15% in 2021FY (vs. 2020), improve its debt maturity profile in 2021FY, and to be fully in compliance with "3 red lines" by 2022. CAPGs were 3pts higher post result announcements. **We maintain our neutral view on CAPG curve.**

Margin stabilized but NCI increased because of lower attributable ratio in recent years' pre-sales. In 1H21, China Aoyuan delivered steady P&L with revenue of RMB32.4bn (+15% yoy, driven by recognition of URPs of RMB1bn), EBITDA of RMB5.5bn (-4% yoy). Gross margin of stabilized at 25% (flat with 2020). NCI as of net income increased to 36% from 18% in 1H21, as a result of Aoyuan's lower equity portion of pre-sales in recent years.

Aoyuan showed mild deleverage. Open market maturities could be funded with internal resources. In 1H21, Aoyuan's total debts/net debts declined 3%/4% vs. 2020YE, which is in line with management's committed debts reduction target of 5% per annual. Cash/ST debts, net gearing and adj. liabilities/assets ratio remained largely unchanged. Although covered by its reported cash, Aoyuan's ST debts remained high (46% of total debts vs. 45% in 2020), compared to industry peers. Aoyuan will have USD688mn offshore and RMB3.4bn onshore, totaling ~RMB7.9bn public market maturities by 1H22. We think Aoyuan could handle the upcoming public maturities with internal resources (mainly unrestricted cash of RMB60.6bn reported in 1H21).

Company expects the total debts to reduce below RMB100bn by repaying short-term debts, and improve ST debts of total debts to below 40% by 2021, per management guidance during the result presentation.

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Achievable debts reduction target in 2021, driven by vigilant land investment in 1H21. Aoyuan was prudent in land investment in 1H, as evidenced by attributable land expenditure only accounted for ~16.8% of its cash collection (RMB41.8bn), or ~10% of gross contracted sales (RMB67.6bn). Company's free cash flow, on a consolidated basis, was RMB4.7bn in 1H21. Management guided to contained land expenditure below 20% of its pre-sales in 2021. With that, we expect full year free cash could be ~RMB10bn, and the deleveraging target is achievable.

URP conversion added to its saleable resources, mitigating investment pressure. Company converted ~13bn of land bank from URPs and expects to convert total of RMB40bn of land bank for FY2021. Aoyuan's acceleration in URP conversion, in our view, will help the company to defend its profitability among B+/BB- rated peers, and mitigate investment pressure from competition with other developers in public auction, under the centralized land supply system. Management guided the gross margin from URP is 35-40%, compared to its current unrecognized revenue's gross margin of 25%-27%.

Lower contract liabilities despite good pre-sales. Aoyuan reported satisfactory pre-sales in 1H21 of RMB67.6bn (+33% yoy), lower attributable ratio of 72% (2020: 74%), and improved cash collection ratio of 87%. With that, we expect Aoyuan's attributable cash collection should be over RMB40bn in 1H21. Nonetheless, balance of contract liabilities declined to RMB63.4bn as same-year cash collection rate declined, reflected some of the down payments have been paid by installments starting 2H20.

Sizable minority interest remained as a major concern. In 1H21, Aoyuan reported MI as of total equity of 66% (2020: 66%), highest among sector peers. We believe such change is due to 1) introduction of third party into the URPs; 2) consolidation of Aoyuan Beauty Valley (equity interest of only 29.3%) in 2020; 3) higher cooperation in property development projects. However, we acknowledge that such high portion of MI could hinder Aoyuan's balance sheet transparency. The gradual decrease of the attributable ratio of its presales may add uncertainty in the potential decline of MI.

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