Lianhe Global has affirmed 'BB+' global scale Long-term Issuer and Issuance Credit Rating to China Aoyuan Group Limited; Issuer Rating Outlook Stable

HONG KONG, 9 October 2020 – Lianhe Ratings Global Limited ("Lianhe Global"), an international credit rating company, has affirmed 'BB+' global scale Long-term Issuer Credit Rating to China Aoyuan Group Limited (3883.HK) ("Aoyuan" or "the company"). The Outlook is Stable.

Lianhe Global has also affirmed 'BB+' global scale Long-term Issuance Credit Rating to the USD460 million 6.35% senior unsecured notes due 2024 issued by Aoyuan at the same time.

The Issuer Rating reflects the Guangzhou-based company's continuous improvement in market position and brand recognition in the Chinese property market. The rating also considers Aoyuan's adequate liquidity position and good access to market funding. However, its high financial leverage and average profitability constrain its rating.

The Stable Outlook reflects our expectations that Aoyuan would acquire new land in a measured manner, lower its financial leverage, and continue improving its operating efficiency gradually by delivering projects under development at a pace more commensurate with its contracted sales growth to boost its recognized revenues in the following 12 to 18 months.

Key Rating Rationales

Sizable Land Bank Supports Market Position: Aoyuan expanded its land bank by more than threefold to 48.74 million square meters GFA (78% attributable to the company) at end-June 2020 from 14.7 million square meters at end-2016, ensuring its land bank is sufficient to support contracted sales target for the next 3 years. The company had a sizable land portfolio across 90 cities (including 3 overseas cities) – of which about 40% was located in South China, at end-June 2020. Aoyuan's land acquisition strategy has in recent years started focusing on tier 2 cities in the Greater Bay Area, Central and Western China, East China and to a lesser extent the Bohai Rim as major anchors, while selectively choosing surrounding and satellite cities in Central and Western China.

This helped boost its contracted sales growth from 2016 to 2019 (2016: 69%; 2017: 78%; 2018: 100%; 2019: 29%). Aoyuan achieved total contracted sales of RMB83.36 billion in the first nine months of 2020, which maintained its position among the top 30 property developers in China.

Low Land Costs But Expected to Rise: Aoyuan is able to keep its land cost under control with mergers and acquisitions ("M&A") as the primary land acquisition channel, which cumulatively contributed about 68% of the land bank in the past decade; its average cost of land edged up to RMB2,727 per square meter at end-June 2020 from RMB1,855 at end-2016. However, as the management plans to increase the portion of land acquired through public auction and other channels to support the development need over time, we expect Aoyuan's average land cost to rise and ultimately pressure the profit margin in the next 12 to 18 months if home price indices turn tepid. The company registered a contracted sales average selling price of RMB10,031 per square meter for the first nine months of 2020.

Aoyuan's material exposure to satellite cities that are usually categorized as tier 3 cities may pose a greater degree of uncertainty amid a decline of home price and/or sell-through rate. However, Aoyuan primarily focuses on first-time home buyers and first-time upgraders with latent demand, which largely mitigates the associated risks.

Urban Renewal to Play an Increasing Role: Aoyuan has ventured into 50 urban renewal projects with a particular focus on the Greater Bay Area region. Aoyuan's saleable resource comprised of 54% and 46% of high- and low-tier cities, respectively, at end-June 2020. However, Aoyuan's saleable resource composition improved to 77% and 23% of high- and low-tier cities, respectively, when including urban renewal projects. In general, Aoyuan invests in urban renewal projects at late or mature stages to mitigate the uncertainty risk. The expected higher gross margins from urban renewal projects will likely boost or at least maintain the company's overall profitability.

Strong Execution Capability and High Operating Efficiency to Sustain Growth: Aoyuan relies on 30 regional subsidiaries to boost and execute its sales nationwide. At the same time, the company enhances project standardization and employs centralized procurement to keep costs in check. Aoyuan is also able to shorten its presales launch timeline from land acquisition to 7.5 months in 2019 from 8.8 months in 2017. In addition, Aoyuan achieved a high cash collection rate of 90% in 1H2020. We believe these incremental improvements as a whole will likely improve Aoyuan's operating efficiency to sustain growth.

Moderate Presence of Commercial Property Segment: Aoyuan recognized about 17% of revenue from commercial property sales in 2019 and reported about 16% of contracted sales from commercial property sales in 1H2020. Commercial properties conceptually carry a higher risk for property developers as they are more susceptible to price gyration than residential properties of owner-occupied use under an economic downturn. However, Aoyuan largely utilizes these commercial properties to complement its residential properties in each project, which reduces the inherent risk to a certain degree, in our view.

Financial Leverage Constrains Credit Profile: Aoyuan has adopted a relatively aggressive expansion business model in a bid to increase its market presence since 2016 as it largely used debt to finance land acquisition and its asset base expansion. Such ambition boosted the company's market ranking but also stressed its financial leverage that inevitably constrains the intrinsic credit profile. Leverage perceivably increased in tandem with its asset base as measured by a debt to capitalization ratio to 73% at end-2019 from 58% at end-2016. That said, we expect its financial leverage to marginally normalize if the management effectively begins to maintain the company's business growth at a pace on par with similarly-rated peers and replenish its land bank in a measured manner in the next 12 to 18 months.

Rating Sensitivities

We would consider downgrading Aoyuan's rating if it were to aggressively replenish its land bank which results in an increase of its financial leverage as measured by debt/capitalization to over 75% or a decrease in its EBITDA interest coverage to below 2.0x consistently, and/or its operating performance were to deteriorate such that its contracted sales and/or revenue experience a material decline or liquidity profile is worsened.

We would consider upgrading Aoyuan's rating if it were to lower its financial leverage as measured by a debt/capitalization ratio to below 50% and an EBITDA interest coverage ratio to above 5x consistently.

About Lianhe Global

Lianhe Global is an international credit rating company that provides credit ratings to corporations, banks, non-bank financial institutions, local government financing vehicles, and other asset classes around the globe. Lianhe Global also provides credit risk research and other services related to credit ratings.

Rating Methodology

The principal methodology used in this Aoyuan's rating is Lianhe Global's General Corporate Rating Criteria published on 16 July 2018 which can be found at the website.

Note: The above Issuer/Issuance Credit Ratings are solicited at the request of the rated entity or a related third party.

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