China Aoyuan Group Limited

Surveillance Report

Summary	
Issuer Rating	BB+
Outlook	Stable
Location	China
Industry	Homebuilder and Real Estate
Date	11 October 2021

Operating Data:
China Aoyuan Group Limited

	31 Dec 2020	30 Jun 2021
Revenue (RMB: in million)	67,794	32,510
Contracted Sales (RMB: in million)	133,010	67,580
Contracted Sales ASP (RMB/square meter)	10,325	11,333
Contracted Sales GFA (million square meters)	12.88	5.96
Land Bank GFA (million square meters)	57.18	53.38

ASP: Average Selling Price
GFA: Gross Floor Area
Source: Aoyuan's 2020 annual report, Aoyuan's 2021 interim report and Lianhe Global

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Applicable Criteria
General Corporate Rating Criteria (16 July 2018)

Lianhe Ratings Global Limited ("Lianhe Global") has affirmed 'BB+' global scale Long-term Issuer and Issuance Credit Rating of China Aoyuan Group Limited; Issuer Rating Outlook Stable.

Summary

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

The Stable Outlook reflects our expectations that Aoyuan will continue to deleverage while maintaining an adequate land bank portfolio for future development. We also expect the company to improve 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 next 12 to 18 months, in light of the lukewarm sentiment of economic growth and tightening government financial and policy measures.

Rating Rationale

Deleveraging Effort Underway to Meet the 3-Redline Thresholds: Aoyuan expanded its land bank by more than threefold to 53.58 million square meters GFA at end-June 2021 from 14.7 million square meters at end-2016. The company had a sizable land portfolio across 95 cities (including 3 overseas cities) – of which about 36% was located in South China, at end-June 2021. In recent years, Aoyuan's land acquisition strategy has been increasing exposure to tier 2 cities in South China, 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.

At the same time, Aoyuan also increased its financial leverage to fund its land expansion in 2020. Aoyuan spent c. RMB45 billion on land acquisitions, representing a year-on-year increase of c. 57%, in 2020. Since the start of 2021, Aoyuan has substantially slowed its land acquisition pace. In 1H2021, Aoyuan spent only c. RMB7 billion on land acquisition, representing c. 12% of its cash collection from the contracted sales proceeds. The company has also started to deleverage by paring down its total borrowings. The company had lowered its total borrowings to c. RMB111.3 billion at end-June 2021 from c. RMB115 billion at end-2020, representing a decrease of c. 4%. The company expects to reduce its total borrowings to below RMB100 billion by end-2021. At end-June 2021, the company passed 2 of the 3-Redline thresholds. Aoyuan plans to meet all the 3-Redline thresholds by 2022.

Strong Execution Capability and High Operating Efficiency to Sustain Growth: Aoyuan relies on 25 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 6.8 months in 2020 from 8.8 months in 2017. In addition, Aoyuan achieved a high cash collection rate of 87% in 1H2021 with adequate mortgage quotas from the four leading national banks. We believe these incremental improvements as a whole will likely improve its operating efficiency to sustain growth.

Rising Land Costs Put Pressure on Profitability: Aoyuan is able to keep its land cost under control with mergers and acquisitions ("M&A") as primary land acquisition channel, which cumulatively contributed about 68% of the land bank in the past decade. Its average cost of land increased to RMB 2,826 per square meter at end-June 2021 from RMB1,855 at end-2016. However, as the management plans to increase the portion of land acquired through urban renewal 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.

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 develops large shopping malls in core locations of lower-tier cities to complement its residential projects with an aim to achieve higher sell-through rates and contracted sales. In addition, Aoyuan primarily focuses on first-time home buyers and first-time upgraders with latent demand, which could mitigate the associated risks.

Urban Renewal to Play an Increasing Role: Aoyuan has ventured into over 70 urban renewal projects with a particular focus on the Greater Bay Area. Aoyuan's saleable resources comprised 63% and 37% of high- and low-tier cities, respectively, at end-June 2021. Aoyuan's saleable resource composition improved to 84% and 16% 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 help maintain the company's overall profitability.

Moderate Presence of Commercial Property Segment: Aoyuan recognized c. 12% and c. 24% of revenue from commercial property sales in 2020 and 1H2021, respectively. Commercial properties 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, which reduces the inherent risk to a certain degree, in our view.

High Reliance on Partnerships Obscures Transparency: Aoyuan cooperates with other peers through joint ventures (JVs) and associates to acquire land and diversify project development risks. Advances and repayments from JVs and associates as well as non-controlling shareholders represent a substantial portion of Aoyuan's cash flow in investing activities. Aoyaun's attributable land bank and contracted sales accounted for approximately 67% and 72% of their respective gross figures at end-June 2021 and in 1H2021. As Aoyuan continues to rely on JVs and associates, we expect its exposure to JVs and associates would remain high which gives rise to financial transparency concerns.

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 70% 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.

Company Profile

Aoyuan is a Guangzhou-based Chinese property developer that mainly targets mass residential property development in selective tier 2 and tier 3 cities in South China with a focus on the Greater Bay Area. The company was listed on the Hong Kong Stock Exchange in 2007 (stock code: 3883.HK).

Property development segment served as Aoyuan's major revenue contributor, accounting for over 94% of the group's revenue. At end-June 2021, Aoyuan had 360 projects across 95 onshore and offshore cities, which include the major municipal and provincial cities such as Guangzhou, Shanghai, Beijing, Chongqing and Wuhan.

Exhibit 1: China Aoyuan's Shareholding Structure as of 8 October 2021

Shareholder	Percentage
Non-public Shareholders	
Ace Rise*	49.76%
Joy Pacific**	3.71%
Public Shareholders	
Successful Lotus****	3.85%
Other public Shareholders	42.68%
Total	**100.0%**

Note:
** Ace Rise is owned as to 90% by Joy Pacific** and as to 10% by Hopka Investments Limited (a company wholly-owned by Ms. Su Chaomei who is the wife of Mr. Guo Zi Ning, an executive Director).*

*** Joy Pacific is wholly-owned by Sturgeon Limited***.*

**** Sturgeon Limited is wholly-owned by Asia Square Holdings Ltd., as nominee and trustee for J. Safra Sarasin Trust Company (Singapore) Ltd. as the trustee holding such interests on trust for the beneficiaries of The Golden Jade Trust, a discretionary family trust established under the laws and regulations of Singapore. The settlors of The Golden Jade Trust are (i) Mr. Guo Zi Wen, an executive Director, the Chairman of the Company and a controlling Shareholder, and (ii) and Ms. Jiang Miner, spouse of Mr. Guo Zi Wen.*

***** Successful Lotus is wholly-owned by Lee Ka Kit, the executive director and co-chairman of Henderson Land Development Company Limited.*

Source: China Aoyuan

Exhibit 2: China Aoyuan's Revenue Breakdown by Business Segment (RMB: in million)

Revenue / % of total	FY2019		FY2020		1H2021	
Property Sales	48,091	95.1%	64,417	95.0%	30,710	94.5%
Property Investment	273	0.6%	239	0.4%	119	0.3%
Others	2,167	4.3%	3,138	4.6%	1,680	5.2%
Total	**50,531**	**100.0%**	**67,794**	**100.0%**	**32,510**	**100.0%**

Source: China Aoyuan

Key Financial Assumptions

- Contracted sales growth: c. 12.5% to 3% per annum for 2021-2023
- Delivered average selling price: c. 20% to 0% growth per annum for 2021-2023
- Total revenue: RMB77 to 92 billion for 2021-2023

Key Financial Metrics

2019A-2023F	Debt/Land Bank	EBITDA/Interest	Debt/Capitalization	Quick Ratio
Weighted Average	52%	2.2x	66%	0.4

Source: Aoyuan's annual reports, Lianhe Global's adjustments and forecasts

Full List of Issuance Ratings

A full list of affirmed issuance ratings is included below. Any rating action on Aoyuan's rating would result in a similar rating action on its USD notes:

- USD460 million 6.35% senior unsecured notes due 2024 affirmed at 'BB+'
- USD230 million 5.98% senior unsecured notes due 2025 affirmed at 'BB+'
- USD200 million 7.95% senior unsecured notes due 2024 affirmed at 'BB+'

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