

Lianhe Global has assigned ‘BB+’ global scale Long-term Issuer Credit Rating with Stable Outlook to China Aoyuan Group Limited

HONG KONG, 11 October 2019 – Lianhe Ratings Global Limited (“Lianhe Global”), an international credit rating company, has assigned ‘BB+’ global scale Long-term Issuer Credit Rating to China Aoyuan Group Limited (“Aoyuan”). The Outlook is Stable.

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 moderately 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 to improve its operating efficiency gradually by delivering projects under development at a pace more commensurate to its contracted sales growth to boost its recognized revenues in the following 12 to 24 months.

Key Rating Rationales

Sizable Land Bank Supports Market Position: Aoyuan expanded its land bank by almost threefold to 40.1 million square meters GFA (81% attributable to the company) at end-June 2019 from 14.7 million square meters at end-2016, ensuring it is sufficient to support contracted sales target for the next 2 years. The company had a sizable land portfolio across 72 domestic cities and 3 overseas cities – of which about 44% was located in South China, at end-June 2019. Aoyuan’s land acquisition strategy has in recent years started to focus 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 2018 (2016: 69%; 2017: 78%; 2018: 100%). Aoyuan achieved total contracted sales of RMB78.6 billion (which represented an increase of 29% year-over-year) in the first nine months of 2019, which placed it 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 primary land acquisition channel, which cumulatively contributed about 68% of the land bank in the past decade; its average cost of land only marginally edged up to RMB2,321 per square meter at end-June 2019 from RMB1,916 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

24 months if home price indices turn tepid. The company registered an average selling price of RMB9,007 per square meter for its recognized sales in 2018.

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.

Moderate Presence of Commercial Property Segment: Aoyuan recognized about 30% of revenue from commercial property sales in 2018 and reported about 20% of contracted sales from commercial property sales in 1H2019. Commercial properties conceptually carry a higher risk for property developers as they are more susceptible to price gyrations 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 promote 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 perceptibly increased in tandem with its asset base as measured by a debt to capitalization ratio to 66% at end-2018 from 58% at end-2016. That said, we expect its financial leverage to marginally normalize if the management effectively begins to maintain 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 24 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 an EBITDA interest coverage ratio to decrease to below 2x or a debt to capitalization ratio to increase to above 70%, and/or its operating performance were to deteriorate such that either its contracted sales or cash flow from operating activities experience a material decline.

We would consider upgrading Aoyuan's rating in the event where it were to lower its financial leverage as measured by a debt to 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 China Aoyuan's rating is Lianhe Global's General Corporate Rating Criteria published on 16 July 2018 which can be found at the website www.lhratingsglobal.com.

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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