

China Aoyuan Property

Consensus Earnings Upgrades to Drive Share Price Higher

Raising PT to HK\$14.2/sh as we roll forward valuation to 2020E P/E

On the back of solid contracted sales, we expect to see market consensus upgrade their 2020-2021E earnings forecasts, which will drive share prices higher. Our 2019E, 2020E and 2021E net profit forecasts are 10%, 20% and 10% above consensus estimates. We estimate Aoyuan's net profit to grow by 170% during 2018-2020E to reach RMB6.89bn by 2020E. This represents a CAGR of 64%, which is above the 26% industry average. The stock is trading at a low single-digit PE of 3.6x 2020E earnings, reflecting market's concern about earnings sustainability, which we believe will be dispelled as contracted sales are recognized onto the company's P&L.

Reported Financials take up a more important role amid JV projects

The increasing amount of JV projects in the China property space in the past 2-3 years has lowered the information transparency for equity investors. Thus, market has been, and continue will be, reacting upon more concrete audited financial numbers instead of the unaudited but timely monthly contracted sales figures, in our view. This partially explains why Aoyuan's share price has soared 38% during March 2019, as market catches up to the fundamental growth of the company achieved during 2018, in our view. We expect more of the same over the next 12 months, creating opportunities for investors to capitalize on.

YTD contracted sales up 33% YoY, momentum to extend into 2H19

During 1H19, Aoyuan has already achieved contracted sales of RMB53.6bn, growing 33% YoY. We expect the company to continue to maintain the sales momentum into 2H19 and achieve the full year sales target. This will further enhance the earnings visibility for 2020E and 2021E net profit.

1H19 results preview

On the back of the company's positive profit alert, we expect the company to report healthy profit margins, and a solid balance sheet underpinned by the strong contracted sales YTD. Profit margins outlook should also remain stable from 2018 considering the stable cost of land bank and contracted ASP achieved from contracted sales.

Price Target of HK\$14.2/sh implies 4.8x 2020E P/E, 2.25x 2019x P/B

Our price target of HK\$14.2/sh (39% upside to current share price) is based on a 4.8x 2020E P/E ratio, largely in-line with the 2019 P/E that the stock is currently trading at. It also implies a 2.25x 2019E P/B, which is justified by a 33% 2019E ROE.

Stock code: 3883.HK
Rating: Buy

Price target (HK\$)	14.20
Previous price target (HK\$)	8.90
Current price (HK\$, 1 Aug 2019)	10.18
Upside/downside %	39%
Market cap (HK\$ m)	27,721
Market cap (US\$ m)	3,577
Avg daily turnover (HK\$ m)	64

Source: Bloomberg, AMTD Equity Research

Key forecasts

(RMB m)	2018	2019e	2020e	2021e
Revenue	31,006	52,146	69,034	91,462
yoy %	62.2%	68.2%	32.4%	32.5%
Net profit	2,415	4,422	6,893	8,782
yoy %	47.4%	83.1%	55.9%	27.4%
Adjusted NP	2,550	4,422	6,893	8,782
yoy %	61.9%	73.5%	55.9%	27.4%
Gross margin	31.1%	31.0%	31.5%	30.5%
Net gearing	63.2%	40.6%	34.8%	26.5%
EPS	0.95	1.65	2.57	3.28
DPS	0.25	0.46	0.71	0.91
BPS	4.43	5.62	7.48	9.85

Source: Company data, AMTD Equity Research

Valuation

	2018	2019e	2020e	2020e
P/E	9.7	5.6	3.6	2.8
P/BV	2.1	1.6	1.2	0.9
Div. yield	2.7%	5.0%	7.7%	9.8%
ROE	23.1%	32.8%	39.3%	37.8%
ROA	1.5%	2.1%	2.6%	2.7%

Source: Bloomberg, AMTD Equity Research

Share price performance



Source: Bloomberg

Michelle Li
Analyst

+852 3163 3383

michelle.li@amtdgroup.com

Figure 1: Financial Forecasts and key ratios

PnL, RMB mn	2017	2018	2019e	2020e	2021e	Cash Flow Statement, RMB mn	2017	2018	2019e	2020e	2021e
Revenue	19,115	31,006	52,146	69,034	91,462	Operating activities					
Sales of properties	17,960	29,740	50,753	67,502	89,777	Profit before income tax	3,626	6,954	9,936	13,999	17,835
Cost of sales	(14,004)	(21,372)	(35,981)	(47,288)	(63,566)	Operating CF before Working Cap	3,483	6,719	10,673	14,811	18,700
Gross profit	5,111	9,634	16,165	21,746	27,896	Increase in inventories	(94)	54	-	-	-
Selling expenses	(926)	(1,432)	(2,607)	(3,107)	(4,116)	Increase in properties for sale	(13,507)	(16,380)	(33,850)	(45,295)	(59,248)
Administrative expenses	(800)	(1,736)	(2,920)	(3,865)	(5,121)	Increase in Contracted Liabilities	8,459	22,571	22,325	29,692	39,491
Share of results of asso	0	(2)	(2)	(2)	(2)	Cash (used in) from operations	(3,443)	14,548	8,233	6,240	9,066
Share of results of jv	(116)	37	37	39	43	PRC income tax paid	(1,313)	(2,385)	(4,408)	(6,210)	(7,912)
Finance costs	(268)	(411)	(737)	(812)	(865)	Interest paid	(2,007)	(3,576)	(2,948)	(3,247)	(3,460)
Profit before tax	3,626	6,954	9,936	13,999	17,835	Net Operating Cashflows	(6,763)	8,588	877	(3,217)	(2,305)
Income tax expense	(1,673)	(4,015)	(4,408)	(6,210)	(7,912)	Net Investing Cashflows	(9,944)	(16,963)	3,360	2,678	3,561
Net profit	1,952	2,939	5,528	7,789	9,923	Financing activities					
Core attr. net profit	1,575	2,550	4,422	6,893	8,782	New bank and other borrowings raised	24,663	28,480	-	-	-
Dividends	259	670	1,228	1,913	2,438	Repayment of bank and other borrowings	(5,000)	(17,373)	-	-	-
Special Dividends	142	-	-	-	-	Net Financing Cashflows	31,046	16,370	984	521	157
EPS - basic	0.61	0.90	1.65	2.57	3.28	Net Cash Flows	14,339	7,995	5,220	(18)	1,413
EPS-underlying	0.59	0.95	1.65	2.57	3.28	Effect of foreign exchange rate changes	(41)	173	-	-	-
DPS - basic	0.15	0.25	0.46	0.71	0.91						
BVPS	3.80	4.43	5.62	7.48	9.85						

Balance Sheet, RMB mn	2017	2018	2019e	2020e	2021e	Key Ratios, RMB mn	2017	2018	2019e	2020e	2021e
Non-current assets	9,696	17,051	17,051	17,051	17,051	GPM	26.7%	31.1%	31.0%	31.5%	30.5%
Current assets	116,110	171,808	219,268	271,039	341,049	NPM	8.6%	7.8%	8.5%	10.0%	9.6%
Properties held under development	77,069	114,894	148,744	194,039	253,287	Core NPM	8.2%	8.2%	8.5%	10.0%	9.6%
Pledged bank deposits	1,771	2,281	2,281	2,281	2,281	ROA	1.7%	1.5%	2.1%	2.6%	2.7%
Bank balances and cash	24,769	36,012	41,232	41,215	42,628	ROCE	3.3%	3.1%	4.9%	7.2%	8.6%
Others	12,501	18,620	27,010	33,504	42,853	ROE	16.5%	23.1%	32.8%	39.3%	37.8%
Current liabilities	75,573	121,033	164,931	210,827	273,351	Total Debt / EBITDA	10.6x	8.0x	5.4x	3.9x	3.1x
Contract Liabilities	34,760	59,966	82,291	111,984	151,475	Total Debt / Equity	148.8%	187.8%	164.8%	141.1%	119.3%
Senior note and bond	7,118	4,470	4,470	4,470	4,470	Total Debt / Capitalization	59.8%	65.3%	62.2%	58.5%	54.4%
Borrowings	13,371	19,261	20,000	20,000	20,000	Net Debt / EBITDA	3.6x	2.7x	1.3x	1.0x	0.7x
Others	20,323	37,334	58,169	74,373	97,406	Net Debt / Equity	51.0%	63.2%	40.6%	34.8%	26.5%
Non-current liabilities	23,106	37,092	36,353	36,353	36,353	Net Debt / Capitalization	20.5%	22.0%	15.3%	14.4%	12.1%
Borrowings	14,423	21,490	33,251	33,251	33,251	Current Ratio	153.6%	142.0%	132.9%	128.6%	124.8%
Senior notes	5,457	12,500	-	-	-	Cash / Total Assets	21.1%	20.3%	18.4%	15.1%	12.5%
Others	3,226	3,102	3,102	3,102	3,102	Inventory / Total Assets	61.4%	60.9%	63.0%	67.4%	70.7%
Capital and reserves	27,126	30,734	35,034	40,910	48,395	Net debt / Net Inventory	17.9%	16.9%	9.5%	7.3%	5.1%
Shareholders' equity	10,155	11,872	15,067	20,047	26,391	Quick Ratio	118.5%	110.3%	106.6%	107.9%	108.3%
Non-controlling interests	16,971	18,862	19,967	20,863	22,004	Cash Ratio	35.1%	31.6%	26.4%	20.6%	16.4%
Total equity	27,126	30,734	35,034	40,910	48,395						

Source: Company data, AMTD Equity Research

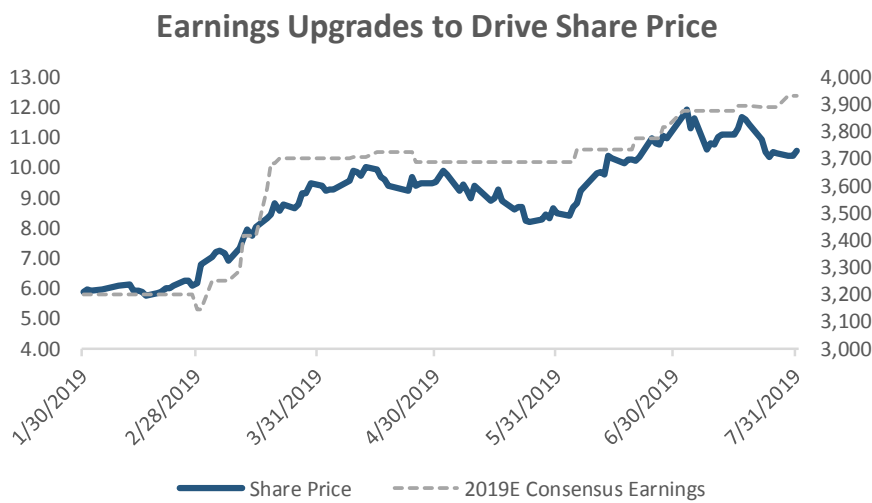
Leveraged up for Growth

We expect consensus earnings to revise upwards, driving share price higher

Our 2019E, 2020E and 2021E net profits are 10%, 20% and 10% above consensus respectively. Our net profit CAGR of 64% during 2018-2020E for Aoyuan, implies an earnings growth profile which is above industry average (26%), thus should also warrant a P/E valuation above industry average. We believe that market has not fully factoring in the net profit earnings growth, presenting an opportunity to invest in the stock.

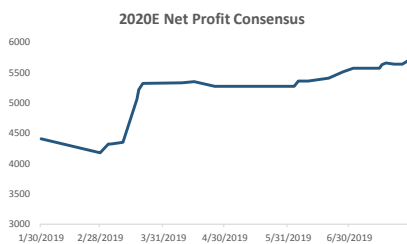
We expect consensus to continue to revise their earnings upwards and eventually the share price will reflect the earnings growth potential.

Figure 2: Consensus earnings Upgrades will continue to drive share price higher



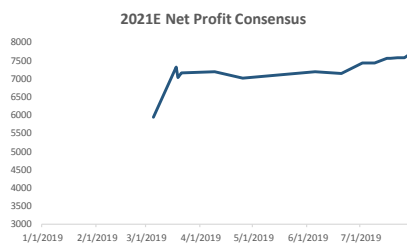
Source: Bloomberg; AMTD Equity Research

Figure 3: 2020E Consensus Net Profit



Source: Bloomberg

Figure 4: 2021 Consensus Net Profit

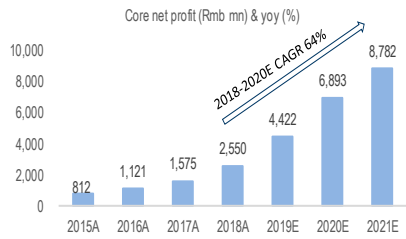


Source: Bloomberg

2018-2020E Net Profit CAGR of 64% and 2019E ROE of 32%

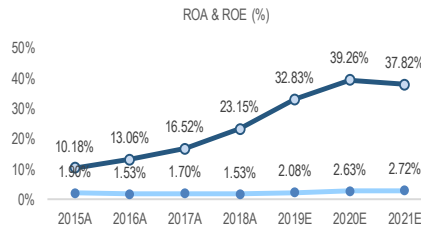
On the back of the 100% and 33% YoY contracted sales growth achieved in 2018 and 1H19 respectively, it will underpin a net profit of CAGR of 64% during 2018-2020E and a 2019E ROE of 32%. Such a net profit growth outlook is above the 26% industry average.

Figure 5: Net Profit CAGR of 64%



Source: Company data

Figure 6: ROE to reach ~32% in 2019E



Source: Company data

Aren't reported earnings backward looking?

The increasingly amount of JV projects have led to market's concerns over the contracted sales numbers reported by property developers, in our view. Minority Interest (Figure 9) has become an increasingly important source of funding for Aoyuan's balance sheet growth over the past 2-3 years.

From a developers' execution perspective, sometimes this is inevitable due to the nature of many land acquisition opportunities through M&A. Moreover, this is also an opportunity for developers to further leverage up their balance sheet to drive growth without affecting the financial metrics on balance sheet, in order to maintain a low funding cost.

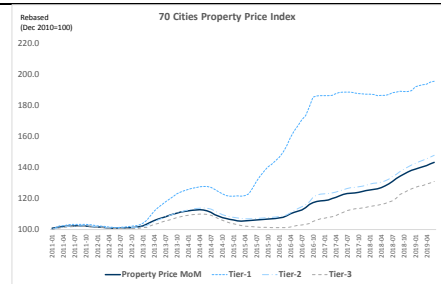
However, this inevitably lowers the information transparency for equity investors in between the financial reporting periods, despite the announcement of monthly contracted sales data. Thus, investors require more certainty (e.g. audited accounts) to compensate for the higher investment risks.

Profit Margins to remain at solid ~31% into 2019E-2020E

With property prices across the country has risen by ~10% on average in 2018 and another ~4% during 1H19, we believe this will underpin the 2019E-2020E gross profit margins, in our view. We thus, expect gross profit margins to remain solid at ~31% in 2019E-2020E.

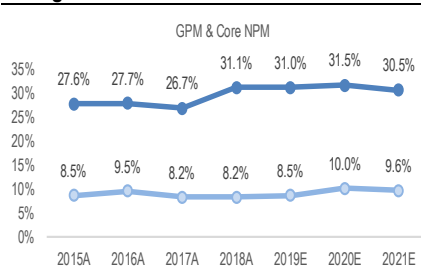
The ASP of Aoyuan in 1H19 stands at RMB10,080/sqm, remaining stable from 2018.

Figure 7: 70 Major Cities' Property Prices risen ~14% since end-2017...



Source: Company data

Figure 8: Underpinning 2019E-2020E profit margins



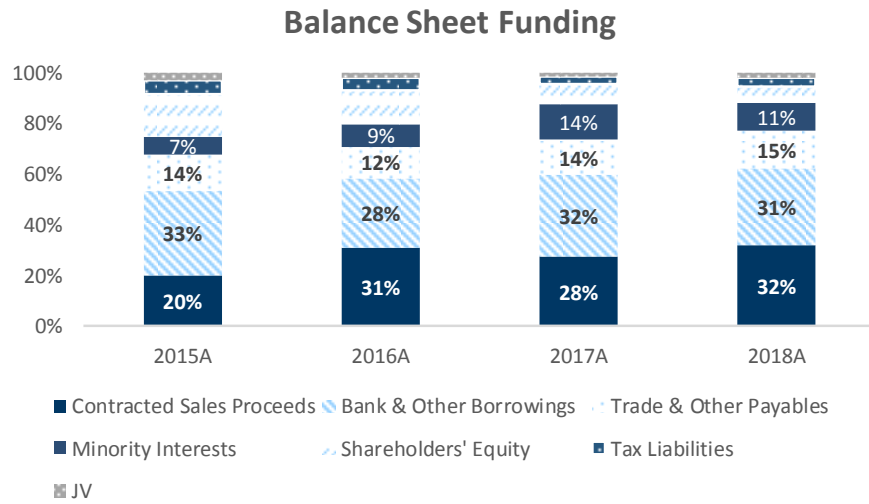
Source: Company data

Low funding cost to support balance sheet growth

The company has successfully issued a senior note recently, with a YTM of 6.5% due 2023, bearing a coupon of 7.95%. This borrowing cost is below the 7.4% average interest rate of 2018, with interest bearing borrowings form ~30% of the company's source of funds, the lower borrowing cost will continue to support the company's growth and drive shareholders' returns (2019E ROE ~32%).

The company's balance sheet is mostly funded on interest-free "contract liabilities", i.e. contracted sales and trade payables, which combine to be around (47% of balance sheet).

Figure 9: Interest Bearing Loans are ~30% of Source of Funding



Source: Company Data; AMTD Equity Research

Valuation & Risks

P/E based valuation metrics

We adopt a P/E valuation methodology to arrive at our 12-months target price of HK\$14.2/sh. This implies a 4.8x 2020E P/E, which is largely in-line with the P/E ratio that the stock is currently trading on 2019E net profit. Such a P/E ratio is in-line with industry average, and we think it is fair as it reflects the company's higher than industry average earnings growth profile for 2018-2021E.

We believe that Chinese property developers are currently operating on a high asset turnover business model, and since sales and earnings growth are the key share price drivers, we believe an earnings based valuation approach is more appropriate compared to asset based approaches such as P/B or Disc. To NAV.

Our target price implies a 2.25x 2019E P/B.

Figure 10: Peers Valuation comparison

Date	7/29/2019	Mkt cap (USD mn)	FY18 P/E	FY19E P/E	FY20E P/E	FY18 P/B	FY19E P/B	FY20E P/B	Div. yield	
Equity	PX_LAST									
China Property Developers										
2202 HK	Vanke	30.55	48,060	10.1x	8.3x	7.3x	2.2x	1.8x	1.6x	3.50%
688 HK	COLI	27.55	38,592	8.1x	6.6x	5.6x	1.1x	0.9x	0.8x	3.27%
3333 HK	Evergrande	21.10	35,416	7.4x	5.4x	4.9x	2.1x	1.7x	1.4x	0.00%
1109 HK	CR Land	33.95	30,085	10.3x	8.7x	7.4x	1.5x	1.3x	1.2x	3.70%
2007 HK	Country Garden	10.88	30,131	6.9x	5.7x	4.9x	1.9x	1.5x	1.2x	4.49%
960 HK	Longfor	29.55	22,515	13.4x	10.5x	8.7x	2.1x	1.9x	1.6x	3.35%
1918 HK	Sunac	36.85	20,916	10.8x	6.7x	5.1x	2.9x	2.1x	1.6x	2.24%
813 HK	Shimao	21.95	9,265	7.2x	5.8x	4.7x	1.1x	0.9x	0.8x	5.61%
884 HK	CIFI	5.23	5,270	6.3x	5.1x	4.2x	1.4x	1.1x	0.9x	4.46%
3380 HK	Longan	12.10	8,481	9.7x	6.9x	5.5x	2.5x	2.0x	1.6x	4.30%
2777 HK	R&F	14.36	5,916	4.9x	3.7x	3.1x	0.7x	0.6x	0.5x	8.57%
3383 HK	Agile	10.20	5,108	5.6x	5.0x	4.4x	1.0x	0.8x	0.8x	8.48%
1233 HK	Times	14.36	3,565	6.3x	5.2x	4.2x	1.6x	1.2x	1.0x	4.79%
123 HK	Yuexiu	1.79	3,543	7.9x	8.2x	7.2x	0.7x	0.6x	0.6x	4.47%
3883 HK	Aoyuan	10.40	3,577	9.1x	5.6x	3.6x	2.3x	1.6x	1.2x	2.70%
1813 HK	KWGW	7.52	3,052	6.2x	4.8x	3.8x	0.8x	0.7x	0.6x	7.45%
1638 HK	Kaisa	3.24	2,519	4.2x	5.8x	4.4x	0.9x	0.8x	0.7x	2.78%
6158 HK	Zhenro	4.69	2,472	9.8x	6.0x	4.4x	1.4x	1.2x	1.0x	3.20%
1238 HK	Powerlong	4.86	2,484	N/A	5.5x	4.3x	0.7x	0.7x	0.6x	4.18%
1628 HK	Yuzhou	3.70	2,277	4.7x	4.1x	3.3x	1.0x	0.8x	0.7x	7.37%
3301 HK	Ronshine	10.28	2,265	7.4x	4.5x	3.4x	1.3x	1.1x	0.7x	3.11%
1966 HK	China SCE	4.31	2,274	7.6x	5.5x	4.2x	1.1x	1.0x	0.8x	4.16%
272 HK	Shui On Land	1.72	1,773	5.1x	7.3x	7.2x	0.4x	0.3x	0.3x	6.14%
1098 HK	Roadking	16.46	1,577	N/A	N/A	N/A	0.8x	N/A	N/A	6.06%
3900 HK	Greentown	5.74	1,593	12.4x	4.7x	4.3x	0.4x	0.4x	0.4x	4.01%
119 HK	Poly Prop	2.88	1,348	5.6x	3.4x	3.2x	0.4x	0.4x	0.3x	3.96%
832 HK	CCRE	3.73	1,303	8.4x	6.8x	4.6x	1.2x	1.0x	0.9x	4.86%
1996 HK	Redsun	2.52	1,070	N/A	N/A	N/A	0.7x	N/A	N/A	N/A
6111 HK	Dafa	5.95	630	N/A	N/A	N/A	1.4x	N/A	N/A	2.84%
230 HK	Minmetals	1.23	526	N/A	N/A	N/A	0.4x	N/A	N/A	5.50%
Total			297,602	7.8x	6.0x	4.9x	1.3x	1.1x	0.9x	4.47%

Source: Bloomberg Estimates, *AMTD Equity Research Estimates

Note: As of Jul 31th, 2019

Key Risks

Key risks for the stock includes (1) a slow down in contracted sales; (2) unexpected tightening in monetary policy; (3) government introduction of property tax which curbs property purchase sentiment.

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AMTD Investment Ratings

Stock Rating

Buy	Stock with potential return of over 20% over the next 12 months
Hold	Stock with potential return of -20% to +20% over the next 12 months
Sell	Stock with potential loss of over 20% over the next 12 months

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AMTD Global Markets Limited

Address: 23/F - 25/F, Nexxus Building, No. 41 Connaught Road Central, Central, Hong Kong

Tel: (852) 3163-3288 **Fax:** (852) 3163-3289

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August 1, 2019

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