AMTD 尚乘
Fixed Income Research

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Chinese High Yield Properties

2018 outlook

Donald Yu
Analyst
+852 3163 3384
Donald.Yu@amtd.com.hk

Michelle Li
Analyst
+852 3163 3383
Michelle.Li@amtd.com.hk

Please contact AMTD Asset Management Limited at (852) 3163 3288 for further product information.
Please read the Important Disclosures and General Disclosures on Page 19.

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Chinese high yield properties overview

The story in 2017 is playing safely & holding for carry. Asian bond market continued to enjoy abundant liquidity while Chinese funding contributing increasing shares. Supplies from property sector dominate the Chinese HY names due to depressed onshore bond issuance and a strong physical property market in China. This has compressed the yields.

For 2018, we expect policy tightening to continue in physical market. We don't think Chinese HY properties will continue to tighten against Chinese HY industrials and Chinese HY consumers. Chasing new issuances which have higher coupon should be safe in a very tight secondary market. Among Chinese HY property names, we prefer B rating names over BB names. Our top picks are CENCHI 8.75 21 & FTHDGR 7.357 21.

The physical property market has a wonderful year in 2017. But turning point appeared in 2H17, stricter policy tightening has come. Growth of contracted sales has slowed down in 3Q17. We estimate the issuers' contracted sale growth in 2018 will be much lower than that of 2017 in a tightening environment. Especially, we expect growth of contracted sales to significantly slowdown in 3rd or lower tier cities.

Lowering funding cost would be a reason for USD bonds issuance in offshore market, compared to onshore bond market. However, developers must acquire approvals from National Development and Reform Commission (NDRC) before USD bond issuance, which will be a barrier for new issuance. Our observation indicated that NDRC prefers to approve refinancing purpose rather than incremental issuance. Therefore, the net issuance should increase, but it will highly depend on approval process of NDRC.

Lastly, in current tightening situation, new approval of bond issuance will reduce significantly in 2018 in domestic market. The trend has shown in 2017. Financing in domestic market will be more challenging in 2018.

2018 Outlook & Our picks

High demand from Chinese funds will continue chasing new issuance of China HY prop. Coupon rate of new issuance might hover around similar level but slightly wider than that of mid-2017. In the meantime, we believe callable bonds will be called in 2017 and 2018 to lower issuers' funding cost. Chasing new issuances which have higher coupon should be safe in a very tight market environment of secondary market, and we see policy risks in physical market and minimum single name risks.

The physical property market has a wonderful year in 2017. Most of developers have achieved over 50% YoY growth of contracted sales; leaders have achieved over 100% YoY growth. Good day comes fast and goes faster. Turning point appeared in 2H17, stricter policy tightening has come: mortgage rate hike, resold restriction, home price cap, more requirements for qualified home buyer in 1st and 2nd tier cities. Growth of contracted sales has slowed down from 3Q17. We estimate sale growth in 2018 will be much lower than that of 2017 in tightening environment. Especially, we expect growth of contracted sales to significantly slow down in 3rd or lower tier cities.

Our view of the impact from US rate hike: higher chance for Fed would be led by dovish chairman. Currently we can see nominees Jerome Powell is dovish, has less comments on monetary policy and supports easing financial regulations. His past speeches showed that he is in support of gradual interest rate increased, which is unchanged of Yellan's path and suitable for Trump's plan of economy simulation. Therefore, our guestimate rate hike may be a gradual process. China HY prop might face less impact.

Overall, although HY China prop's spread pickup over consumers and industrials has narrowed, HY China prop names have more stable cash inflow and better yield over HY industrial and HY consumer. In addition, HY China prop have less concern on single name risk.

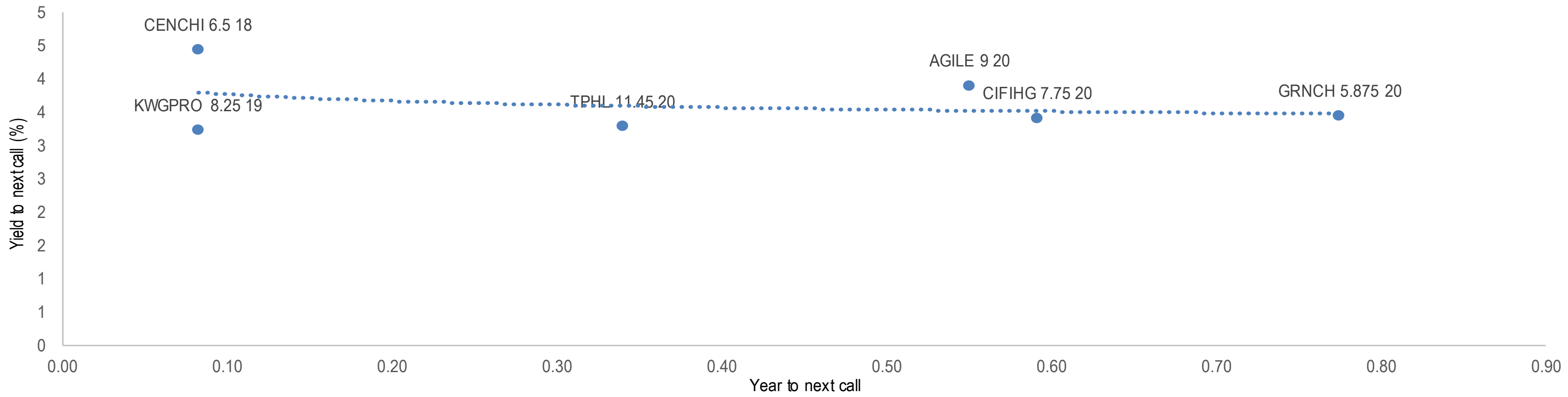
With regard to maturity, we still prefer the short end, although strong demand has partly offset the impact of UST hike expectation. We prefer 3-5 yrs paper rather than over 5 yrs paper to minimize yield curve risk. We prefer B rating names over BB names; the main reason is upgrade probability of BB to BBB is much less than before: 1) profitability is affected by home price cap; 2) mortgage tightening slows down sale-through rate; 3) capex expansion is still ahead).

We don't suggest to fish B names with >5 yrs maturity, mainly due to yield curve of HY china prop is flattened, (Figure 2). We suggest undervalued names with >2 yrs maturity, more assets in 1st and 2nd tier cities of China. Look for new issuance with higher coupon is safer in current tight market condition.

Outperform on FTHDGR 7.375 21: FTHDGR 21 (Moody's B3) has 160 bps yearly pick up of z spread over PWRLNG 20 (Moody's B2); and some value at 122 bps of z spread over PWRLNG 21. The company will launch its new projects in Shenzhen in 4Q17, which should improve its cash inflow.

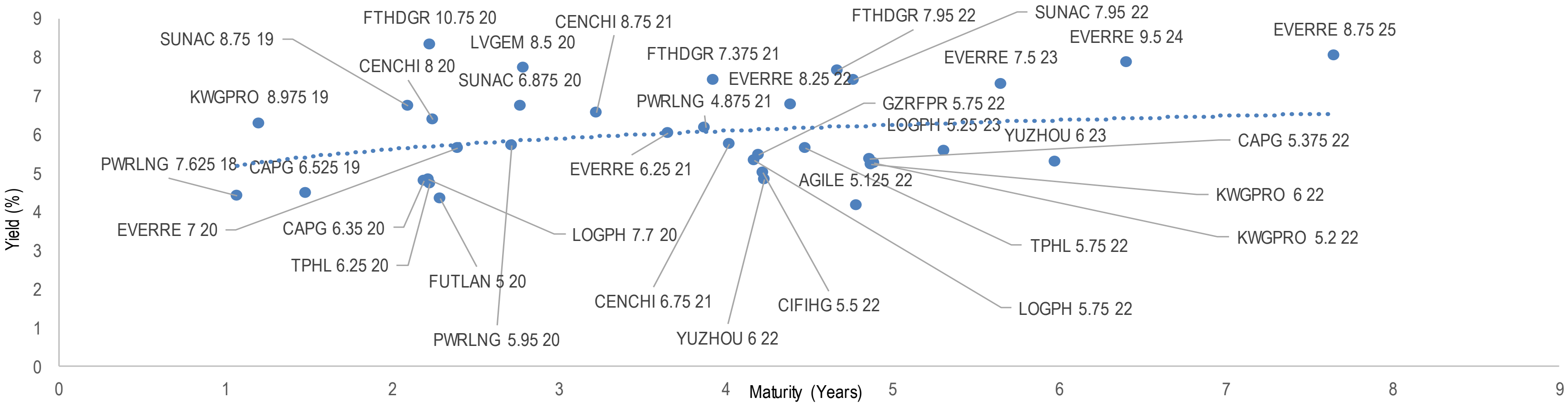
Outperform on CENCHI 8.75 21: For the Moody's Ba3 rating, CENCHI 21 have some value at 112 bps over GRNCH 20. Comparing with CAPG 20 (Moody's B2), CENCHI has comparable sales scale, similar gross profit margin, better rating and 78 bps yearly pickup.

Figure 1: Relative valuation of callable in 2017 and 2018



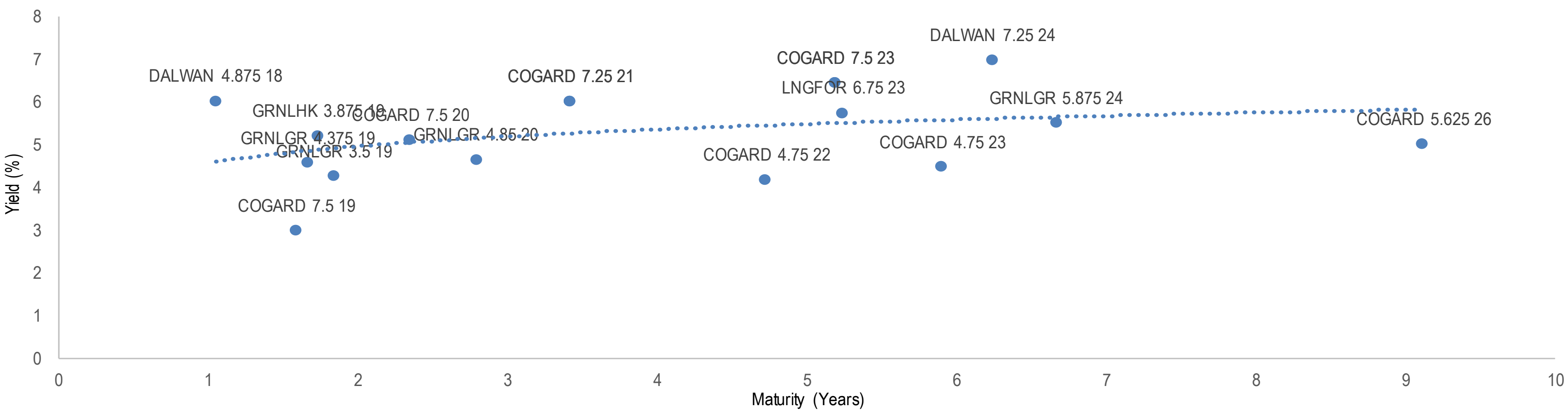
Source: Bloomberg, AMTD Fixed Income Research

Figure 2: B relative valuation



Source: Bloomberg, AMTD Fixed Income Research

Figure 3: BB relative valuation



Source: Bloomberg, AMTD Fixed Income Research

2017 Review

Keep holding & play safely, less volatility & less opportunity in secondary market

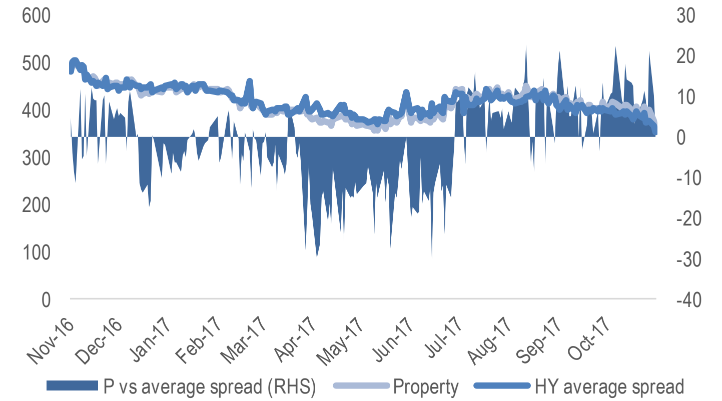
2017 has a prosaic beginning. **From 4Q16 to 2Q17, HY China prop, B and BB, has modest tightening**. In Figure 4, Z spread of HY China prop was slightly higher than average HY Z spread, which is only 3 bps higher. The spread difference between HY China prop B and BB maintained at around 125 bps (Figure 5) from 4Q16 to 2Q17.

From 3Q17, Z spread of BB was widened rapidly to around 250 bps; while Z spread of B further compressed to around 310 bps. Z spread difference between B and BB compressed from 125 bps in 2Q17 to only around 55 bps in 4Q17. High yield China industrial (HY industrial) used to have lower spread than that of HY China prop. However, after the widening from 3Q17, Z spread of HY China prop over HY industrial has slightly widened from 2Q17 negative spread.

Regarding High Yield China Consumer (HY Consumer), HY consumer has higher spread in 4Q16, but it reversed in 4Q17. HY China property has 40 bps spread difference over HY consumer.

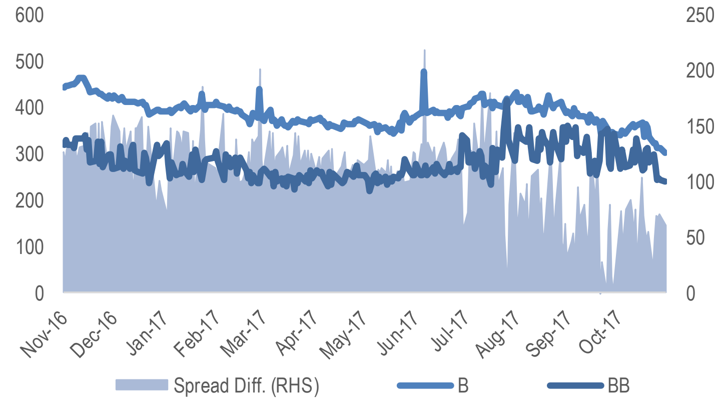
A flagrant contrast of Figure 4 and Figure 5 indicated strong demand of China High Yield. Trend of UST 3yrs and UST 5yrs continues widen in 4Q17, while HY China prop B keep compressing. HY industrial and HY consumer have similar trend as well. It partly indicated the strong demand from China chasing USD asset in Hong Kong market.

Figure 4: Spread comparison (HY China prop Z spread v.s. HY average Z spread; bps)



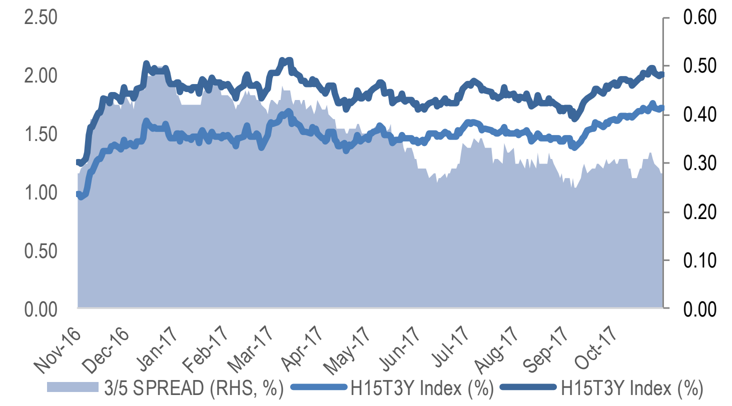
Source: Bloomberg

Figure 5: Spread comparison (HY property single B Z spread v.s. double B Z spread; bps)



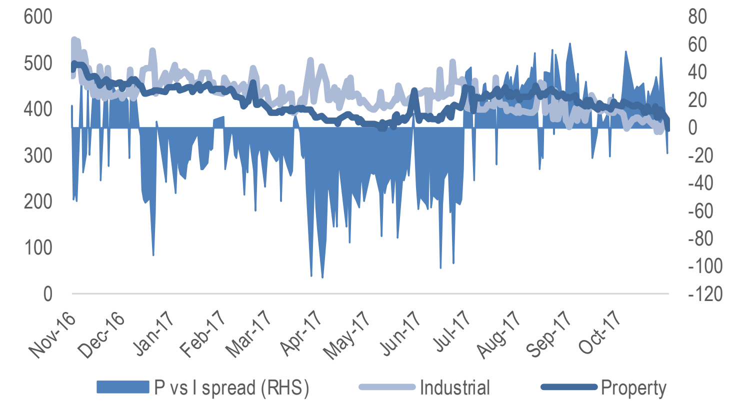
Source: Bloomberg

Figure 6: UST 3yrs vs 5 yrs



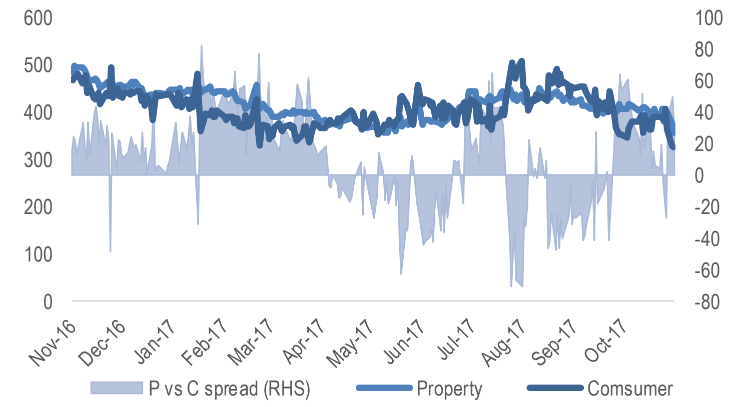
Source: Bloomberg

Figure 7: Spread comparison (HY China prop Z spread v.s. HY China Industrial; bps)



Source: Bloomberg

Figure 8: Spread comparison (HY China prop Z spread v.s. HY China Consumer; bps)



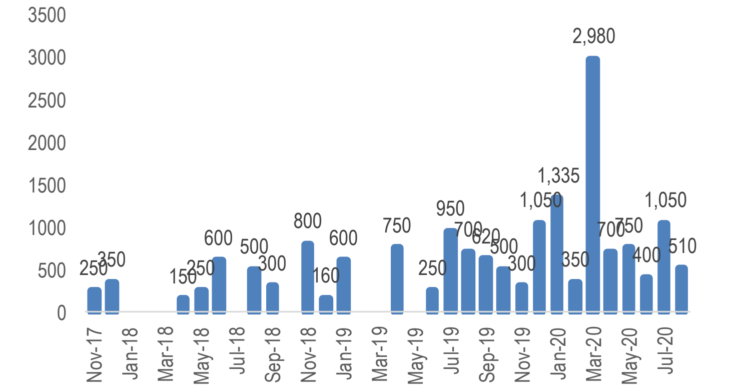
Source: Bloomberg

Refinancing peak will appear in 2020

Outstanding HY China prop bond maturing in 2017 and 2018 are only US$600 million and US$3060 million, respectively. Refinancing peak will come over in 2019 and 2020, while there are US$5620 million and US$9965 million will come due, respectively. Besides, as tightening keep going in domestic market and funding cost is expected to hover or even be higher than current level, lowering funding cost would be a reason for USD bonds issuance in offshore market. Land replenishment also a main driver for new bond issuance.

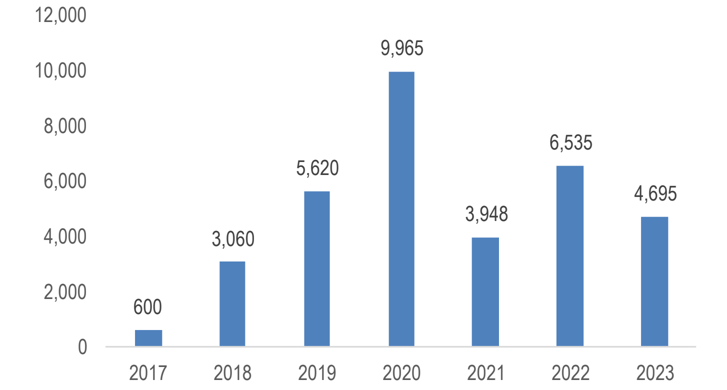
However, developers must acquire approvals from National Development and Reform Commission (NDRC) before USD bond issuance, which will be a barrier for new issuance. Our observation indicated that NDRC prefers to approve refinancing purpose rather than incremental issuance. Therefore, the net issuance should increase, but it will depend on approval process of NDRC.

Figure 9: HY China prop bond maturing from 2017-2019 by month (USD million)



Source: Bloomberg

Figure 10: HY China prop bond maturing from 2017-2023 (USD million)



Source: Bloomberg

Onshore issuance dropped & offshore supplies surged in 2017

Onshore bond issuance dropped significantly

As yield hiked in onshore market and stricter restrictions were put on bond issuance of real estate developers, onshore bond issuance dropped significantly in YTD 2017. Comparing with same period in 2016, onshore issuance YTD 2017 dropped 69% YoY to only RMB 317 bn, which was 1,037 bn in the same period of 2016. The total issuance of 2016 was RMB 1,088 bn.

Another reason of issuance reduction is that coupon rate hiked in 2017. Onshore AAA rating issuers' 3 yrs coupon rate was in the range of 4.55-5.69% in 2017, while it was only ranged 3.22-4.80% in 2016. We believe that coupon rate in onshore market will maintain at similar level or even higher in future. Developers will go offshore for cheaper funding rather.

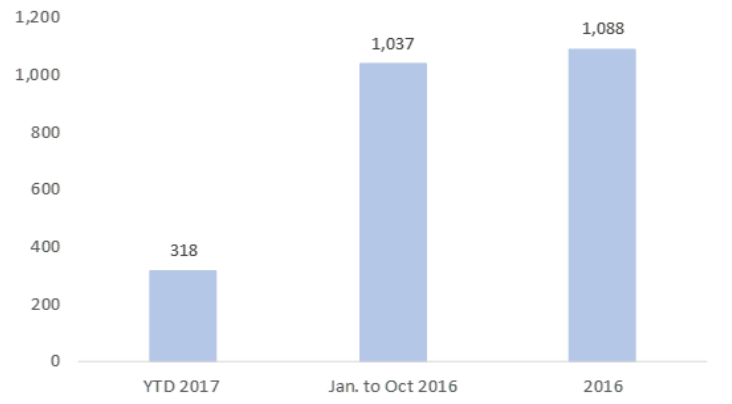
Lastly, we believe tightening in China will continue. New approval of bond issuance will reduce significantly in 2018. The trend has shown in 2017.

Lower yield boost refinancing

Issued amount of HY China prop from Jan. to Sept. 2017 amounted to USD 28.9 bn, which is higher than the total issued amount in 2014, 2015 & 2016 (Figure 12). Higher onshore coupon rate has pushed developers to offshore market for funding; on the other hand, refinancing is another reason for developers to issue new bonds this year. In addition, more Chinese funds are chasing USD China HY bonds, further compressed yield of HY China prop.

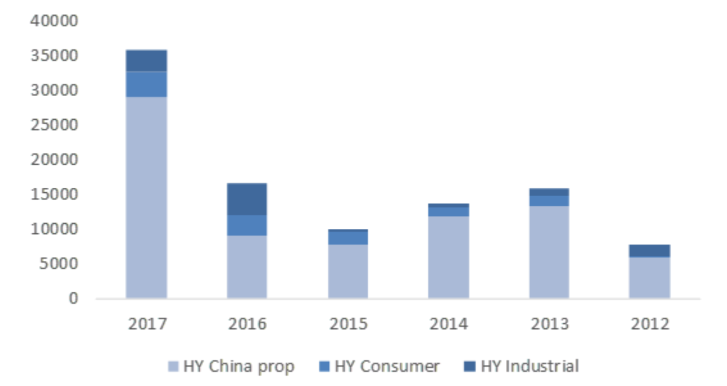
As result, developers have issued new bonds for much lower coupon rate. (E.g: Aoyuan 3 yrs paper from 10.875 to 6.35; Agile 5 yrs paper from 8.375 to 5.125; Powerlong 5 yrs paper from 11.25 to 4.875, 3 yrs paper from 7.625 to 5.95). Regarding to approval from National Development and Reform Commission (NDRC), we believe NDRC should approve developers' refinancing to lower their financing cost.

Figure 11: New bond issuance in onshore market (RMB billions)



Source: Wind

Figure 12: New supplies of HY China prop/Consumers/Industrials (USD millions)



Source: Bloomberg

Figure 13: Coupon rate trend of USD HY property in 2012-2017

	Cpn	Issue Date	Maturity	BBG Composite		Cpn	Issue Date	Maturity	BBG Composite
Aoyuan	**5.375**	**9/13/2017**	**5**	**B**	**Jingrui**	**7.75**	**4/12/2017**	**3**	**NR**
	6.35	**1/11/2017**	**3**	**B**		13.25	4/30/2015	3	CCC
	6.525	4/25/2016	3	B+		13.625	8/8/2014	5	NR
	10.875	5/26/2015	3	B+	**KWG**	**5.2**	**9/21/2017**	**5**	**NR**
Agile	**5.125**	**8/14/2017**	**5**	**B+**		**6**	**3/29/2017**	**5**	**NR**
	9	5/21/2015	5	B+		**6**	**3/15/2017**	**5**	**B+**
	8.375	2/18/2014	5	NR		**6**	**1/11/2017**	**5**	**B+**
Evergrande	**7.5**	**6/28/2017**	**6**	**B-**		8.25	8/5/2014	5	B
	8.75	**6/28/2017**	**8**	**B-**		8.975	1/14/2014	5	B
	6.25	**6/28/2017**	**4**	**B-**		8.625	2/5/2013	7	NR
	9.5	**3/29/2017**	**7**	**B-**		13.25	3/22/2012	5	NR
	8.25	**3/23/2017**	**5**	**B-**	**Logan**	**5.25**	**5/23/2017**	**6**	**B+**
	7	**3/23/2017**	**3**	**B-**		**5.75**	**1/3/2017**	**5**	**B+**
	8	1/15/2016	3	NR		7.7	1/19/2016	4	B+
	7.8	1/8/2016	3	NR		9.75	12/8/2014	3	NR
	12	2/17/2015	5	NR	**Modern Land**	**6.5**	**7/5/2017**	**1**	**NR**
SCE	**5.875**	**3/10/2017**	**5**	**B-**		**6.5**	**6/1/2017**	**1**	**NR**
	10	7/2/2015	4	B-		6.875	10/20/2016	3	B
CIFI	**5.5**	**1/23/2017**	**5**	**NR**		12.75	7/31/2014	5	NR
	7.75	6/5/2015	5	B+	**Powerlong**	**5.95**	**7/19/2017**	**3**	**B-**
	8.875	1/27/2014	5	NR		4.875	9/15/2016	5	B-
Future Land	**5**	**2/16/2017**	**3**	**B+**		7.625	11/26/2015	3	B-
	6.25	11/12/2015	2	B+		11.25	1/25/2013	5	NR
	10.25	7/21/2014	5	NR					

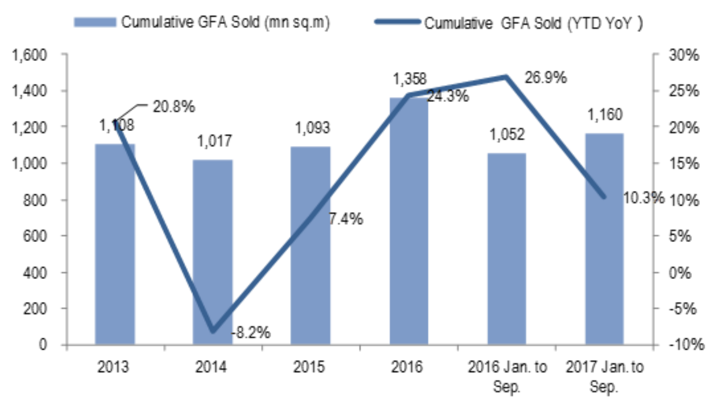
Source: Bloomberg, AMTD Fixed Income Research

Fundamental review

Robust sales, capex expansion ahead

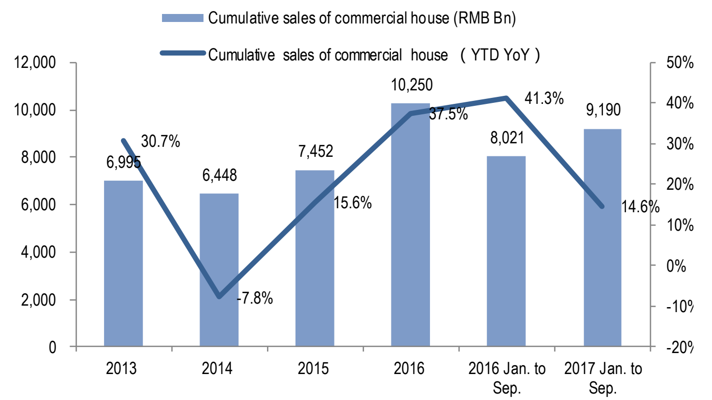
After strong demand released from 4Q2016, home sales continue growing in 2017. From Jan. to Sept. 2017, the cumulative GFA sold increased by 10.3%; while cumulative home sales increased by 14.6%. we believe home sales growth is contributed by 1) policy encourages destocking in 3rd tier cities; 2) 3rd tier cities contributed more home sales with home price surged in 2017; 3) growth of long term consumption loan was 26.9% from Jan. to Sept. 2017 even though the growth was slowing down. The growth is still higher than those of 2011-2015.

Figure 14: Cumulative GFA sold



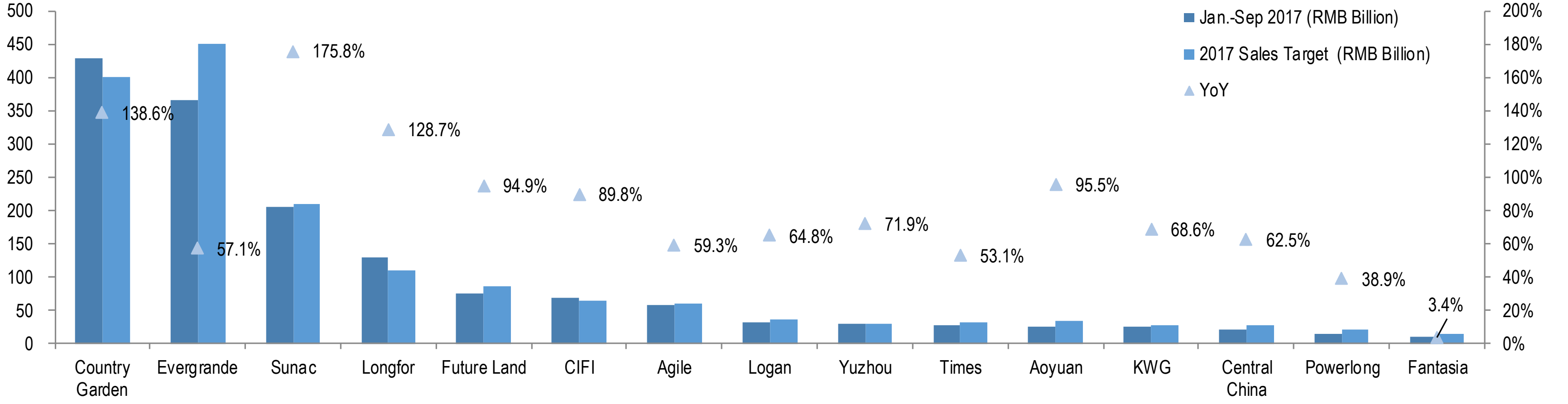
Source: National Bureau of Statistics of China

Figure 15: Cumulative home sold



Source: National Bureau of Statistics of China

Figure 16: Contracted sales in YTD 2017



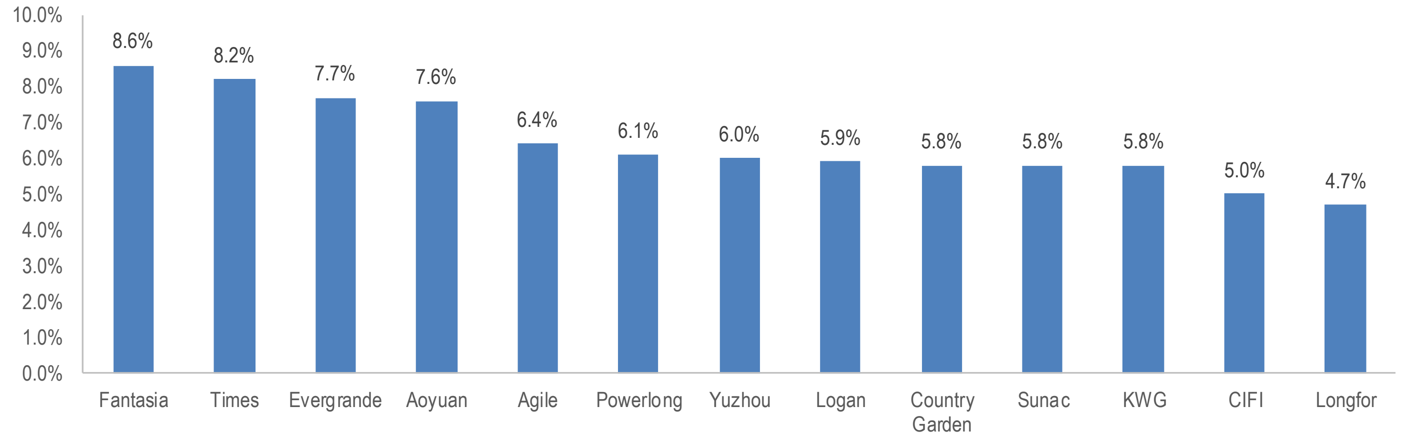
Source: companies, AMTD fixed income research

Developers' contracted sales increased by 80% on average. Contracted sales of Sunac China, Country Garden and Longfor surged by 175.8%, 138.6% and 128.7% YoY, respectively. Destocking by policy driven helps developers have a harvest year.

However, after the harvest year, developers may face harsh environment in 2018. **Firstly, home price would be strictly capped by municipal governments.** Property market is still a crucial part of economic growth engine in China. It is a main downstream sector for expanding internal demand. The more GFA sold, the more demand of raw materials will be released. Selling more GFA with steady price is would benefit economic growth. Therefore, the only factor must be controlled is home price.

Secondly, funding cost in China is raising. In the current situation in domestic market, scale will be a crucial factor for pricing developers' onshore funding cost. Developers must choose scale or profitability. We believe funding cost will maintain at current level in domestic market (3 yrs coupon rate in the range of 4.55-5.69%, construction loan in the range of SHIBOR+10-20%). If developers expand their sales then Capex will be a concern, while home price is capped and profitably might be lower than current level. We estimate offshore market will be a key pipeline for bond issuance in next year, while funding cost is relatively low in offshore market.

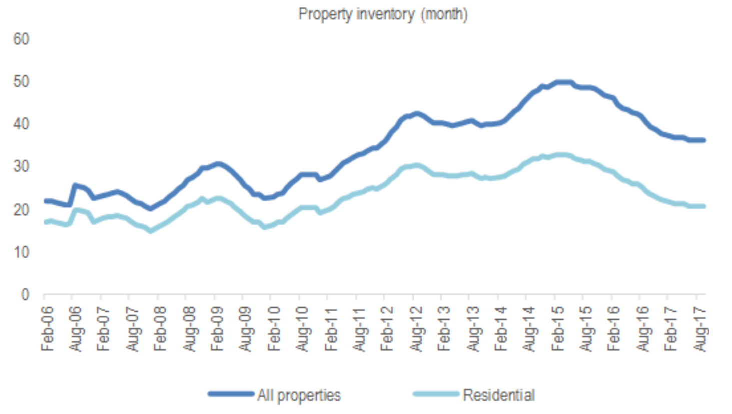
Figure 17: Funding cost comparison



Source: companies, AMTD fixed income research

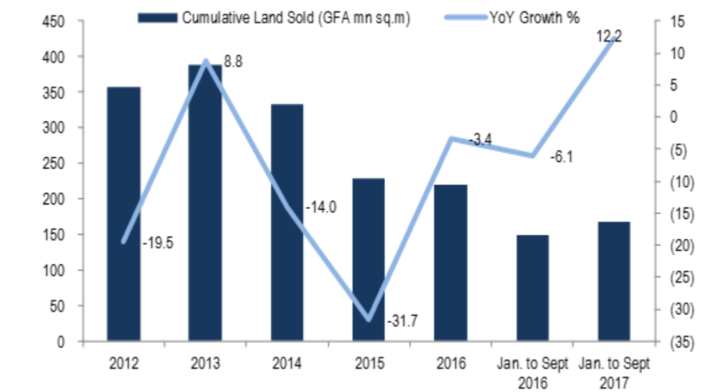
Lastly, Land replenishment will expand Capex in 2018. As strong home sales have digested many inventories in 2016 and 2017, the inventory level comes to a relatively safe level. Saleable residential GFA declined by 22% YoY. In terms of inventory month, residential inventory month has declined to 20.5 months in Sept. 2017, which is the lowest level from 2011. Cumulative land sold from Jan. to Sept. 2017 has increased 12.2% YoY, which is the highest YoY growth from 2012. The low inventories might lead to the next round of Capex expansion in 2018. Some 2nd tier cities will be main targets for developer to replenish its land reserve. Land price is at peak and land replenishment will be keen competition.

Figure 18: Properties inventory month



Source: National Bureau of Statistics of China

Figure 19: Cumulative Land Sold (GFA mn sq.m) & YoY



Source: National Bureau of Statistics of China

Profitability improved, but net gearing up

Profitability has improved after strong sales momentum in 2016. Only 2 out of 15 recorded gross profit margin decline. Gross profit margin of 10 developers out of 15 are over 30%. We believe gross profit margin of 2017 will be much better than that of 2016. As we mentioned before, after the strong sales momentum, land replenishment will be the key for future growth. Therefore, only 5 out of 15 companies recorded net gearing ratio decline. More land supplies will be launched in 4Q17 and 2018, we believe developers will replenish more lands in 2018 for grow their scales. Gearing is likely to be increased in 2018.

Figure 20: Profitability comparison

	Gross Margin					Net Income Margin					ROE		
	1H2015	1H2016	1H2017	1H15/1H16 Change	1H16/1H17 Change	1H2015	1H2016	1H2017	1H15/1H16 Change	1H16/1H17 Change	1H2015	1H2016	1H2017
Country Garden	23.2	21.0	22.0	-2.2	1.0	10.4	9.4	9.6	-1.0	0.3	17.3	14.8	18.5
Evergrande	28.4	28.3	35.8	-0.1	7.5	15.5	7.1	10.0	-8.4	2.9	28.7	5.8	29.6
Sunac	11.4	13.3	19.6	1.9	6.3	17.5	0.7	12.4	-16.8	11.7	21.4	13.4	17.4
Longfor	26.5	27.9	36.5	1.4	8.7	22.8	20.3	23.7	-2.5	3.4	18.2	16.6	16.3
CIFI	21.5	27.1	31.6	5.5	4.6	17.3	9.6	19.2	-7.7	9.6	18.4	17.2	28.0
Future Land	16.8	20.8	32.8	4.0	12.0	4.0	5.3	3.1	1.3	-2.1	17.6	14.6	14.2
Agile	29.6	20.0	37.3	-9.6	17.3	6.6	3.5	9.4	-3.1	5.9	10.0	3.1	10.2
Logan	29.8	30.3	39.5	0.6	9.1	20.0	20.1	27.5	0.1	7.4	20.9	20.3	37.9
KWG	36.5	35.6	36.0	-0.8	0.3	35.0	26.1	19.8	-8.9	-6.3	16.9	16.0	15.2
Times property	25.7	26.3	26.4	0.6	0.1	11.3	9.6	5.7	-1.6	-3.9	26.1	23.0	18.5
LGVEM	58.2	45.2	57.8	-13.0	12.6	12.4	15.0	7.3	2.6	-7.7	—	56.3	5.1
Aoyuan	29.4	25.0	26.9	-4.3	1.8	13.7	8.7	9.2	-4.9	0.5	13.6	10.1	11.9
Central China	27.9	38.0	26.3	10.1	-11.6	8.2	10.0	8.0	1.8	-2.0	12.8	11.2	8.1
Powerlong	32.3	37.2	36.2	4.9	-0.9	23.3	18.8	20.1	-4.5	1.2	8.8	10.5	12.7
Fantasia	32.0	27.6	30.5	-4.4	2.9	6.6	5.7	2.2	-0.9	-3.4	15.3	12.8	5.8

Source: Bloomberg, companies, AMTD Fixed Income Research

Figure 21: Net gearing ratio comparison

%	1H2015	1H2016	1H2017	1H15/1H16 Change	1H16/1H17 Change
Country Garden	37.9	63.9	37.8	26.0	-26.1
Evergrande	125.3	295.3	240.0	170.0	-55.3
Sunac	22.0	75.4	216.0	53.4	140.6
Longfor	61.1	62.7	56.2	1.5	-6.4
CIFI	72.5	57.5	59.3	-15.0	1.8
Future Land	53.4	80.3	157.4	26.9	77.1
Agile	93.2	69.3	47.1	-23.9	-22.2
Logan	63.6	69.8	84.5	6.2	14.7
KWG	65.3	58.8	59.9	-6.5	1.0
Times property	89.9	83.5	68.9	-6.3	-14.6
LGVEM	-24.3	73.4	88.4	97.7	15.0
Aoyuan	72.6	56.0	71.1	-16.6	15.1
Central China	66.2	21.0	56.7	-45.2	35.7
Powerlong	63.0	74.9	76.3	11.9	1.4
Fantasia	90.9	78.1	87.2	-12.9	9.1

Source: Bloomberg, companies, AMTD Fixed Income Research. Note: PCS accounted as debt and restricted cash accounted as cash

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AMTD Asset Management 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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