Fixed Income
Credit Commentary

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Tactical RV trade opportunity between CAPG, TPHL and KWGPRO curve

CAPG 23-26s vs. TPHL 23-26s, KWGPRO 23-26s

On April 8 2021, CAPG curve sunk 2-3pts due to market concerns on its balance sheet transparency. The drastic sell-off was also a result of its mixed 2020 financial results, with higher net gearing and minority interest. Having that said, we draw comfort from CAPG's ample sellable resources and its acceleration in URP conversion, which lower its investment needs and support its future deleveraging trend. Its contract liabilities, after recent cash collection in 1Q2021, has increased to cover its 2021's full-year revenue booking target. **The current spread between CAPG and KWGPRO / TPHL has widen to 150-250bps. We see this sell-off as a tactical RV trade opportunity, and prefer the belly of the CAPG curve (i.e. CAPG 23-25s) over the KWGPRO / TPHL curve.**

Sizable minority interest remained as a major concern, but increasing minority interest is a market trend. Aoyuan reported a higher minority interest as percentage of total equity of 66% (+7ppts yoy). Management explained such change is due to 1) introduction of third party into the URPs; 2) consolidation of Aoyuan Beauty Valley (equity interest of only 29.3%); 3) higher cooperation in property development projects. We acknowledged its MI/equity ratio is higher than peers, but we think a rise in MI ratio is an industry trend.

Peer Developers' MI / Equity

CAPG	2019	2020	Change
MI	21,967	35,700	
Equity	36,997	54,253	
MI/Equity	59%	66%	+7%

KWGPRO	2019	2020	Change
MI	2,448	10,382	
Equity	38,243	53,917	
MI/Equity	6%	19%	+13%

TPHL	2019	2020	Change
MI	16,617	17,106	
Equity	35,704	35,883	
MI/Equity	47%	48%	+1%

KAISAG	2019	2020	Change
MI	29,990	46,386	
Equity	55,707	78,719	
MI/Equity	54%	59%	+5%

PRWLNG	2019	2020	Change
MI	6,247	15,061	
Equity	38,907	51,801	
MI/Equity	16%	29%	+13%

LOGPH	2019	2020	Change
MI	8,800	18,268	
Equity	42,994	60,672	
MI/Equity	20%	30%	+10%

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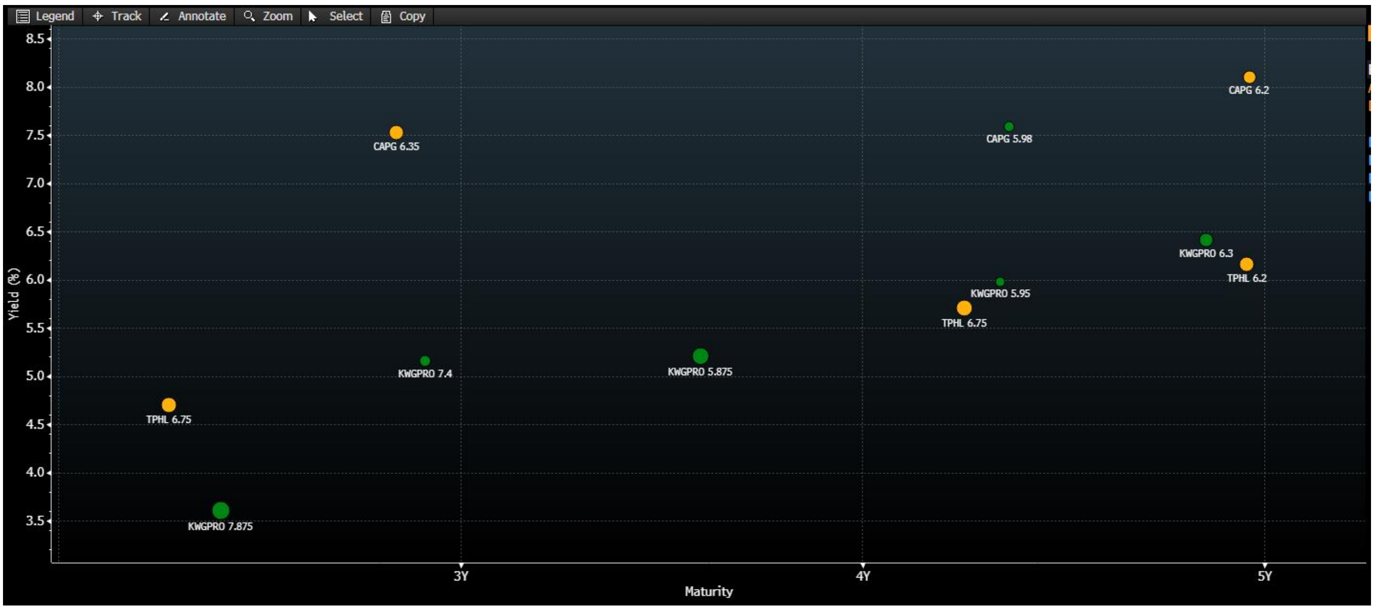
2020 results recap: CAPG grew its contracted sales with decent cash collection. However, its leverage also spiked up due to aggressive new land acquisitions with lower attributable ratio. Management guided a more prudent land budget in 2021. Aoyuan achieved good contracted sales of RMB133bn (+13% yoy) with 85% cash collection and attributable ratio of ~71%. The company spent 52bn in attributable land investment (6.7bn unpaid) on acquiring 20mm sqm GFA (59% attributable). This indicates a cost/ASP ratio of ~33% for a total 243bn sale-able resources. In particular, Aoyuan had taken advantage of its strength in URP and converted 38.2bn into sale-able resources (~16% of total land acquired in 2021). We note the attributable ratio of newly acquired land was lower than that of its existing land bank (~70%). Furthermore, the aggressive land investment has led to a free cash outflow of ~RMB30bn. Net gearing grew to 83% from 75%, due to a rise in total debt. In our view, given its ample land resources, Aoyuan is likely to cut its land investment budget to meet the three-red-line regulation by 2022 (also guided by the company). At the same time, management guided its land acquisition will not exceed 25% of contracted sales.

We think CAPG's deleveraging target is achievable, backed by its rich saleable resources / URP pipeline. Aoyuan guides to cut debts by at least 5% annually, underpinned by 1) sizable unrecognized revenue; 2) abundant saleable resources, which allows company to contain its land acquisition spending to less than 25% of contracted sales; 3) URP will increase saleable resources and profitability. According to our communication with management, its unrecognized revenue as of 2020 amounted to be RMB196bn (RMB40bn in JCE level), while the contract liabilities was RMB69bn. Uncollected pre-sales was guided to be ~RMB70bn by 2020, in which ~RMB30bn of cash has been collected in 1Q'21. With that, we estimate the company has enough sold but unbooked revenue, to meet its 2021 revenue target (25% yoy growth to RMB85bn).

Faster URP conversion will add to its saleable resources, mitigating investment pressure under centralized land supply system and support its profitability. By 2020, the company has a land bank with estimated salable value of RMB621bn, sufficient to support development of ~4yrs. In addition, it targets to convert RMB160bn saleable resources from URP in 3yrs (RMB40bn in 2021). Aoyuan's acceleration in URP conversion, in our view, will help the company to defend its profitability among B+/BB- rated peers, and mitigate investment pressure from competition with other developers in public auction, under the centralized land supply system. Management guided the gross margin from URP is 35-40%, compared to its current unrecognized revenue's gross margin of 26-28%.



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