農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Company Report

KWG (1813 HK) – Buy

Real Estate Development Industry

12-month target price at HK$5.55(Previous HK$5.65)

Key data

Share price (HK$)	4.32
Target price (HK$)	5.55
Upside potential (%)	28.5
52Wk H/L(HK$)	5.40 / 2.28
Issued shares (mn)	2,893
Market cap (HK$mn)	12,498
30-day avg vol (HK$mn)	34.01
Auditors	Ernst&Young
Major shareholder (%):	
Kong jianmin	60.49

Source: Company, Bloomberg, ABCI Securities

Revenue composition in 1H12 (%)

Property development	96.8
Property investment	1.4
Property management	1.1
Hotel operation	0.7

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	0.5	(5.4)
3-mth	1.2	(5.6)
6-mth	(4.0)	2.3

Source: Bloomberg
**Relative to Hang Seng Index*

1 year price performance

Source: Bloomberg

Analyst
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Previous report
Date: 30 Apr, 2012
Rating: Hold

Key takeaways from analyst meeting

KWG, a proven up market player registered a sweet gross profit margin of 43.8% for 1H12. A later than expected margin erosion makes us revise up 2012/13E EPS by 15% and 11% respectively to Rmb0.754 and Rmb0.743.Also NAV is appraised up by 8% at HK$9.25. Key weakness, low asset turnover should not see big improvement in the short term, but it is priced at 4.65x 12E PE, 2s.d. below mean it deserves long term investors' accumulation. Raise our rating from HOLD to BUY.

1H12 result broadly in line, GP margin is the highlight: Revenue for 1H12 fell 10.1%YoY to Rmb4.6bn on lower GFA delivered, as expected. Core net profit came in at Rmb783mn(core EPS Rmb0.271), down 15.6%YoY. Delivery schedule skewing to 2H12, the group maintain full year target at 0.9mn sq.m. Major highlight was GP margin, maintaining above 40%. We expect margin pressure will get to the group later than the industry, making it the envy of the peers.

Gearing ratio maintains high but should come down by end-12; good cash position: Net gearing by end-Jun was at 71.2%, compared with 61.8% by end-11 as trust loan was reclassified as debt. We forecast it to have Rmb0.7bn positive cash flow from operation by end-12 on a conservative collection ratio assumption, 70%. The gearing should come down to below 65% at end-12. The group has Rmb7.0bn cash (including restricted cash) by end-Jun, rose 30.4% compared with end-11.

Lack of near term catalyst but valuation is convincing: The management targets a policy shift to increase turnover, but in our view, it takes time to factor into business. The stock lacks of positive catalyst in the short term. It retreated 13.9% since our initiation in late April, trading at 4.65x 12E PE, or 2s.d. below mean, the valuation is more convincing now. Applying 6.0x forward PE and based on our revised core EPS of Rmb0.754 for FY2012, we set our TP at HK$5.55, representing 40% discount to our revised NAV. Raise our rating from HOLD to BUY.

Risk factors: Slower-than-expected sales progress in 2H12; high gearing; unfavorable government policy.

Forecast and valuation

FY ended Dec 31	FY09A	FY10A	FY11A	FY12E	FY13E
Core NP^ (Rmbmn)	675	1,279	1,859	2,192	2,159
YoY chg(%)	*74.7*	*69.9*	*44.8*	*17.9*	*-1.5*
Core EPS (Rmb)	0.260	0.442	0.640	0.754	0.743
YoY chg(%)	*74.7*	*69.9*	*44.8*	*17.9*	*-1.5*
BVPS(Rmb)	4.01	4.00	4.64	5.18	5.73
PE(x)	-	-	5.48	4.65	4.72
PB(x)	-	-	0.76	0.68	0.61
Dividend yield (%)	1.6	3.1	6.3	5.4	5.3
ROAE(%)	7.2	11.6	14.8	15.4	13.6

^Core net profit :excluding revaluation G/L on investment property; @Rmb0.8121/HK$
Source: Company data, Bloomberg, ABCI Securities estimates

Key takeaways from analyst meeting

GFA delivered dropped but full year target maintained

Revenue for 1H12 fell 10.1%YoY to Rmb4.6bn on lower GFA delivered, as expected. Core net profit came in at Rmb783mn(core EPS Rmb0.271), down 15.6%YoY, apart from lower delivered GFA, a slightly surging SG&A cost also weighted in the bottom line.

GFA delivered was down 24.5%YoY to 0.38mn sq.m. in 1H12, accounting for 40% of full year delivery schedule, but the group highlighted full year target was unchanged at 0.9mn sq.m.. The delivery schedule will skew to 2H12.

GP margin holding up well, is the envy of the peers

For 1H12, gross recognized ASP rose 18.3%YoY to Rmb12,470/sq.m.(or Rmb11,785 net business tax), but it was mainly resulted from product mix change and did not yield big margin expansion. GP margin was at 43.8% for 1H12, against 44.3% for 1H11 and 38.3% for 2H12.

As of Jun 12, sold but unbooked ASP was at Rmb14,173/sq.m., we expect that it was a result of heavy contribution from projects in 1st tier cities, such as Shanghai and more prime locations.

On the back of sales skewing to high tier cities and prime locations, thanks to its capability in product development and also due to the group's less aggressiveness in price cut, we expect margin pressure will get to the group later than the industry. For FY2012, GP margin of the group is expected to squeeze by 3.7ppt to 40.5%, considering est. 5-10ppt margin compression of the peers, KWG well maintains its characteristic of high margin as an up market player. The group guided a mid-term GP margin of high thirties.

Gearing ratio maintains at high level but liquidity risk is low

Net gearing by end-Jun was at 71.2%, compared with 61.8% by end-11 as trust loan was reclassified as debt. The group estimates to have Rmb3.4bn positive cash flow from operation (CFO) by end-12 against our forecast Rmb0.7bn, we adopted a conservative assumption on cash collection ratio at 70%. The gearing should come down at end-12 to below 65%, which the group aims to achieve. The group has Rmb7.0bn cash (including restricted cash) on hand at end-Jun, rose 30.4% compared with end-11.

Exhibit 1: Key cash flow items FY2012 (Rmbmn)

Rmbmn	1H12A	2H12E	FY2012E	FY2012 guidance
Contract sales inflow	4,800	5,934	10,734	12,000
Land premium	(550)	(600)	(1,150)	(1,150)
Construction cost	(1,900)	(2,300)	(4,200)	(3,350)
Interest payment	(700)	(777)	(1,477)	(1,450)
SG&A	(40)	(920)	(960)	(900)
Tax	(1,100)	(850)	(1,950)	(1,800)
CFO	**510**	**487**	**997**	**3,350**

Source: company data and ABCI Securities

Maintain prudent in land bank replenishment

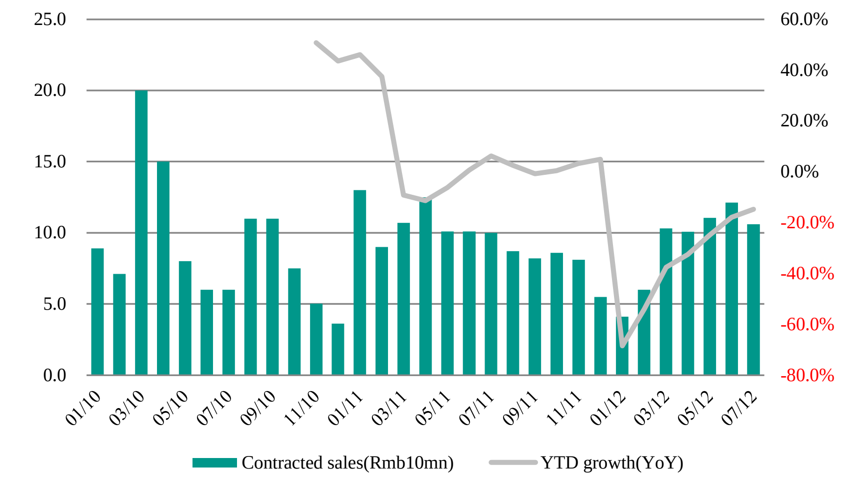
The group didn't buy any land in 1H12. It acquired a small piece of one for commercial use (service apartment and retail) in Jul 12, the project named Guangzhou Biological Island II with GFA 18K sq.m. and AV of Rmb1600/sq.m.. As of Aug, the total attributable land bank amounts to 8.6mn sq.m. , sufficient for 6-7 years development, spreading across 7 cities, including Guangzhou(42.2%), Chengdu(16.5%), Suzhou(11.8%), Hainan(9.0%), Tianjin(8.7%), Shanghai(8.3%), Beijing(3.5%).The management stated that they continue to implement prudent land bank strategy, highly selective in acquisition. They prefer to existing cities, focus on small sites with affordable lump sum amount.

In light of land bank scale and policy uncertainty going forward, we expect land replenishment is not the first priority of the group's agenda but speeding up asset turnover.

Sales progress tracking their full year target but not encouraging
Budget contracted sales are at Rmb12bn for 2012, slightly or 4.3% higher than their realized sales in 2011(Rmb11.5bn).

As of end-Jul, KWG achieved Rmb6.4bn contracted sales or 53.5% of budget, down 15%YoY. They launched 4 new projects during the period, bringing the total contributing projects numbers to 16. For the remaining of the year, another 4 new projects are scheduled to launch, together with the existing projects, they totally have 1mn sq.m. or est. Rmb15bn sellable resources, meeting full year target is not a tough job for KWG. However, such a sales progress is not attractive, in view of its relative big land bank among mid-cap developers, which should mean more ample sellable resources and higher target sales. In addition, developers with higher tier city exposure should see stronger pend-up demand release on interest rate cut cycle. Comparable peers, Shimao(813) and R&F(2777) both reversed their weakness in 2011 , reporting 51%YoY and 3%YoY growth for year to Jul sales. KWG's low achievement is expected to be resulted from its sales strategy, continuous less wiliness in offering price discount.

Exhibit 2: Monthly contracted sales of KWG



Source: Company data and ABCI Securities

We do not think that increasing turnover at the expense of profit margin squeezing is a best way to achieve growth, but for KWG achieving a balance in margin and turnover should be a better way in the short term. The group possesses relative scalable land bank and edges in high end market are hindered by HPR.

The management aimed to do so in coming 3-5 years by increasing the number of projects, increasing exposure of cities and standardizing development for mid-end products. These are good initiatives but we don't put too much expectation on that in the short term. The strategy shift and execution should take time to factor into the results.

NAV and earnings estimation revisions

Expecting GP margin to hold up well for 2012 and GFA delivered schedule should be on progress, better than our expected, which lead us to revise up 2012E EPS by 15% to Rmb0.754/share. Moving forward to 2013, as sales so far is on track and margin erosion for current sales should be not as serious as we previous expectation, we revise up 2013E EPS by 11% to Rmb0.654/share. Also factoring the updating development schedule and the small piece of acquisition, our 2012 NAV was appraised at HK$9.25, up 8% compared with HK$8.55 we made in late April.

The stock was trading at 4.65/4.72x 2012/13E PE and 53.3% discount to our revised NAV.

Exhibit 3: Our revisions to revenue and earnings forecasts

Our revisions to revenue and earnings forecasts	**New forecast**		**Old forecast**		**Difference**	
FY ended Dec 31 (Rmbmn)	2012E	2013E	2012E	2013E	2012E	2013E
Revenue	11,471	10,818	9,127	10,659	26%	1%
Gross profit	4,651	3,401	4,120	2,994	13%	14%
Core net profit	2,192	2,159	1,901	**1,949**	15%	11%
FD EPS (Rmb/share)	0.754	0.743	0.654	0.671	15%	11%

Source: ABCI Securities

Exhibit 4: Our revisions against consensus

Our revisions to revenue and earnings forecasts	**New forecast**		**Consensus**		**Difference**	
FY ended Dec 31 (Rmbmn)	2012E	2013E	2012E	2013E	2012E	2013E
Revenue	11,471	10,818	11,263	11,739	2%	-8%
Gross profit	4,651	3,401	4,725	4,619	-2%	-26%
Core net profit	2,192	2,159	2,089	2,298	5%	-6%
FD EPS (Rmb/share)	0.754	0.743	0.719	0.792	5%	-6%

Source: Bloomberg and ABCI Securities

Est. 90.5% of 2H12 revenue locked in

According to the management, KWG had pre-sales of Rmb9.0bn carried forward at end-Jun, together with Jul sales of Rmb1.1bn, total unrecognized contracted sales amounted to Rmb10.1bn, among which we estimated Rmb6.0bn to be booked in 2H12 and 3.0bn in 2013. The revenue lock-in ratio of 2H12 reached 90.5%, providing strong earnings visibility for the group. We also estimated that about 28.6% of 2013E development revenue has been locked.

Exhibit 5: Our revisions against consensus

	Rmbbn
Unrecognized contracted sales as of Jun12	9.0
Contracted sales achieved in Jul12	1.1
Total unrecognized contracted sales as of Jul12	10.1
Est. contracted sales to be booked for 2H12	6.0
Est. contracted sales to be booked for FY2013	3.0
2H12E development revenue	6.7
2013E development revenue	10.5

Lock-in ratio for 2H12	90.5%
Lock-in ratio for FY2013	28.6%

Source: Company data and ABCI Securities

Valuation

Applying 6.0x forward PE and based on our revised core EPS of Rmb0.754 for FY12, we fine-tuned our TP from HK$5.65 to HK$5.55. We admit that the sales this year is unlikely to bring in upside surprise and as is for next year with HPR in place. Meanwhile, land acquisition for KWG, an owner of sizable of 8.7mn land bank should not cheer up market significantly. That is, the stock lack of positive catalyst in the short term. But as we mentioned, we believe the policy curb in China, which hurt the high end market most, will eventually deregulate, mostly likely in 2013. The developer with strong capability in product development, or characterized with sustainable high margin, is more likely to stand out in the long term perspective. The stock retreated 13.9% since our imitation in late April, trading at 4.65x 12E PE, or 2s.d. below mean , the valuation is more convincing now. We raise our rating from HOLD to BUY.

Exhibit 6: 12-mth forward rolling PE

Source: Bloomberg and ABCI Securities

Exhibit 7: 12-mth forward rolling PB

Source: Bloomberg and ABCI Securities

Financial forecast

Consolidated income statements

For the year ended 31/12(Rmbmn)	2010	2011	2012E	2013E
Property development	7,221	9,816	11,132	10,460
Property investment	124	139	147	149
Hotel operation	57	70	84	91
Property management	64	98	108	119
Total Turnover	**7,466**	**10,123**	**11,471**	**10,818**
Property development	-	-	4,409	3,149
Property investment	-	-	146	147
Hotel operation	-	-	42	45
Property management	-	-	54	59
SG&A	(657)	(764)	(638)	(669)
Other unallocated income and corporate expenses	40	43	-	-
EBIT	**2,481**	**3,751**	**4,012**	**2,731**
Share of Associates & JV	9	(17)	(27)	944
Exceptionals	4	326	-	-
Pretax Profit	**2,507**	**3,980**	**3,877**	**3,616**
Taxation	(1,226)	(1,876)	(1,693)	(1,432)
Minority Interest	0	1	(8)	25
Net Profit	**1,282**	**2,104**	**2,192**	**2,159**
Core Net Profit	**1,279**	**1,859**	**2,192**	**2,159**
FD EPS(Rmb)	0.4430	0.7238	0.7543	0.7428
Chg	59.6%	63.4%	4.2%	-1.5%
FD Core EPS(Rmb)	0.4420	0.640	0.754	0.743
Chg	69.9%	44.8%	17.9%	-1.5%
PE	-	5.5	4.7	4.7
Target Price/EPS	10.2	7.0	6.0	6.1
DPS(Rmb)	0.110	0.220	0.189	0.187
Dividend Yield	3.1%	6.3%	5.4%	5.3%

Source: company data and ABCI Securities estimates

Financial ratio analysis

As of 31/12(Rmbmn)	2010	2011	2012E	2013E
Profitability				
GP Margin	41.5%	44.2%	40.5%	31.4%
EBITDA Margin	33.7%	37.4%	35.5%	25.9%
EBIT Margin	33.2%	37.1%	35.0%	25.2%
EBT Margin	33.6%	39.3%	33.8%	33.4%
Core net profit margin	17.1%	18.4%	19.0%	20.2%
ROAA	3.7%	5.0%	4.9%	4.9%
ROAE	11.6%	14.8%	15.4%	13.6%
Efficiency ratio				
Asset turnover	21.8%	23.9%	25.6%	24.3%
Liquidity				
Current ratio	1.61	1.48	1.54	1.53
Equity/ Assets	29.0%	30.7%	33.8%	38.2%
Net Debt/ Total Equity	47.7%	61.8%	40.3%	17.6%

Source: company data and ABCI Securities estimates

Consolidated balance sheets

As of 31/12(Rmbmn)	2010	2011	2012E	2013E
PP&E	1,344	1,779	1,731	1,685
Investment properties	3,462	4,234	4,234	4,234
Associates and JV	8,839	8,508	8,481	9,425
Deferred tax assets	604	882	882	882
Other non-current assets	866	1,060	1,042	1,021
Fixed assets	**15,114**	**16,463**	**16,371**	**17,247**
Properties under development	13,730	17,934	16,783	15,636
Completed properties held for sale	2,554	3,023	2,829	2,635
Trade receivables	48	61	75	77
Bank balances & cash	6,804	5,373	7,280	6,803
Other current assets	1,785	1,733	1,733	1,733
Current Assets	**24,920**	**28,123**	**28,699**	**26,884**
Total Asset	**40,034**	**44,586**	**45,070**	**44,131**
Short term loan	2,282	3,410	3,655	1,554
Trade payable	1,671	2,935	3,653	4,171
Other payables and accruals	8,745	7,684	6,311	6,875
Other current liabilities	2,734	4,962	4,962	4,962
Current liabilities	**15,432**	**18,991**	**18,581**	**17,561**
Long term loans	10,050	10,425	9,770	8,216
Other long-term liabilities	2,958	1,478	1,478	1,478
Long term liabilities	**13,008**	**11,903**	**11,248**	**9,694**
Total Liabilities	**28,440**	**30,893**	**29,829**	**27,255**
Minority interests	10	202	194	219
Shareholders' funds	11,584	13,491	15,046	16,657
Total Equity	**11,594**	**13,693**	**15,240**	**16,876**
BVPS(Rmb)	4.00	4.64	5.18	5.73
P/B	0.88	0.76	0.68	0.61
Target Price/BVPS	1.13	0.97	0.87	0.79

Source: company data and ABCI Securities estimates

Disclosures

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