



May 8, 2015  
Company Report  
Rating: HOLD  
TP: HK\$ 6.90

Share price (HK\$) 7.43  
Est. share price return (7.1%)  
Est. dividend yield 3.7%  
Est. total return (3.4%)

Previous Rating & TP BUY; HK\$ 3.80  
Previous Report Date Jan 23, 2015

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**Key Data**

52Wk H/L(HK\$) 8.40/2.89  
Issued shares (mn) 14,589  
Market cap (HK\$ mn) 111,965  
3-mth avg daily turnover (HK\$ mn) 392.6  
Major shareholder(s) (%):  
HUI Ka Yan 70.10

Source(s): Company, Bloomberg, ABCI Securities

**FY14 Revenue breakdown (%)**

Property development 96.5  
Property investment 0.1  
Property management 1.1  
Others 2.3

Source(s): Company, ABCI Securities

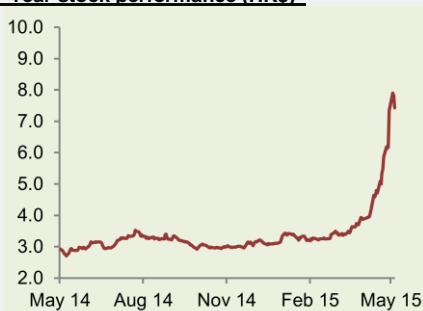
**Share performance (%)**

	Absolute	Relative*
1-mth	96.4	77.2
3-mth	132.3	105.4
6-mth	154.8	115.6

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

**1-Year stock performance (HK\$)**



Source(s): Bloomberg, ABCI Securities

## Evergrande (3333 HK)

### Perpetual distribution to be a potential burden; downgrade to HOLD

- Evergrande's net gearing rose from 70% in Dec 2013 to 86% in Dec 2014, ; adjusted net gearing (perpetual instrument categorized as debt) rose 103ppt YoY to 251%
- Perpetual coupon payment reached RMB 4.3bn in FY14, and should rise further on rising coupon terms
- New consumer business incurred a loss of RMB 3.1bn in FY14
- Downgrade to HOLD from Buy with revised TP HK\$ 6.90 based on a 20% (from 60%) discount to NAV

**Perpetual instruments to become a burden.** As of Dec 2014, Evergrande's perpetual instrument rose 11% YoY to RMB 52.9bn. Although perpetual instrument can be treated as equity based on the current accounting rules, it is not uncommon for investors to consider fixed coupon instrument as debt. Evergrande's net gearing rose from 70% in Dec 13 to 86% in Dec 14, but the adjusted net gearing (perpetual instrument treated as debt) rose 103ppt YoY to 251%. Besides, perpetual instruments usually involve step-up clauses which entail higher coupon terms. We estimate perpetual coupon payment would increase from RMB 4.3bn in FY14 to RMB 6.9bn in FY15E. On the other hand, Evergrande's gross finance cost hit RMB 14.6bn (+81% YoY) in FY14. We forecast total recurring cash outflow to lenders and bond/instrument holders to exceed RMB 20bn by 2015E.

**Generous dividend may not be sustainable.** Evergrande announced a DPS of RMB 0.43/share for FY14; total dividend distribution would be RMB6.3bn. This implies a payout ratio of 50% on core profit (profit after tax excluding revaluation gains of investment properties) of RMB12bn. However, if the adjustments for (a) accounting revaluation gains on its A share investment; (b) disposal of a 50% stake in football business ; (c) distribution to perpetual instruments and minority interest, cash profit attributable to company's shareholders will amount to only RMB 2.3bn, much lower than total dividend distribution of RMB 6.3bn. We think Evergrande's dividend payout is unsustainable in the long run.

**New consumer business – still a cash burner.** Evergrande has entered various new businesses in 2014; the Group will focus on 4 main consumer-related products/services in 2015:

- Spring water:** This is one of the first consumer products launched by Evergrande; so far, RMB 5.54bn has been invested. The division generated RMB 1.09bn in sales and incurred a loss of RMB2.37bn in 2014, mostly due to high advertising and marketing expenses. In 2015, production capacity is expected to increase from 2.2mn tons to 4.0mn tons.
- Grain and oil:** Evergrande entered into the grain & oil business in Aug 2014 and invested RMB570 during the year. The Group acquired 7 processing factories with an annual capacity of 150k ton for rice and 50k ton for edible oil. (Continue next page)

### Results and Valuation

FY ended Dec 31	2013A	2014A	2015	2016E	2017E
Revenue (RMB mn)	93,672	111,398	157,862	188,842	190,736
Chg (% YoY)	43.5	18.9	41.7	19.6	1.0
Underlying Net Income (RMB mn) <sup>1</sup>	7,703	2,340	6,532	8,675	10,489
Chg (% YoY)	24.2	(69.6)	179.1	32.8	20.9
Underlying EPS (RMB)	0.48	0.16	0.44	0.59	0.71
Chg (% YoY)	16.1	(66.9)	179.1	32.8	20.9
BVPS (RMB)	4.6	7.1	7.3	7.6	7.9
Chg (% YoY)	79.7	53.7	3.1	4.0	4.7
Underlying PE (x)	12.4	37.4	13.4	10.1	8.4
P/B (x)	1.3	0.8	0.8	0.8	0.8
ROE (%)	10.5	2.3	6.1	7.8	9.0
ROA (%)	2.2	0.5	1.4	1.8	2.1
DPS(HK\$)	0.43	0.43	0.22	0.29	0.36
Yield (%)	7.2	7.2	3.7	4.9	6.0
Net gearing <sup>2</sup> (%)	69.5	85.9	76.8	56.3	25.7

<sup>1</sup> Underlying net income = Net profit - revaluation gain of investment properties and one-off items

<sup>2</sup> Net gearing = Net debt / Total equity

Source(s): Bloomberg, ABCI Securities estimates



- **Dairy:** Evergrande acquired Cowala Dairy in New Zealand in 2014 with an annual production capacity of 30k-ton for formula milk powder. *(continue next page)*
- **Health:** The group purchased a 74.99% stake in New Media (708 HK) at HK\$ 950mn. The acquired company will change its name to “Evergrande Health Industry Group Limited” to become the Group’s listed platform in health business.

Evergrande’s Other business registered a loss of RMB3.1bn in 2014. Although the Group believes these businesses will turn profitable in 2015, we remain cautious and only expect the loss to narrow to RMB 2bn, as consumer sector has seen slower same-store-sales and profit decline since last year.

**Favored by mainland investors.** Evergrande’s share price rose 88% between April 8 and May 6 and 127% in the past 3 months (Feb-May). Apart from its attractive dividend payout, we believe the rising interest in southbound stocks under the HK-SH connect could be another driver. In Mar 2015, Evergrande was the 5<sup>th</sup> most traded southbound stock on the HK-SH connect platform. Besides, many mainland investors are familiar with Evergrande’s trust products. With a dividend yield of 7.2% (or a yield of 13.5% before rally in April), the Group’s shares has a similar appeal as its trust products for the mainland investors. We expect Evergrande’s share price to remain resilient if trading in HK-SH connect continues to expand.

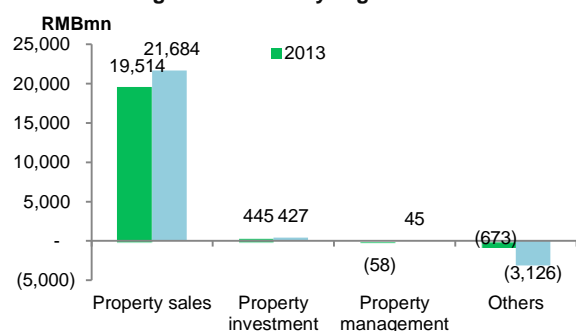
**Downgrade to HOLD from Buy with revised TP at HK\$6.90.** We lower our 2015E-16E core EPS forecasts by 40-50% to factor in higher distribution to perpetual instrument. We also adjust down our NAV estimate from HK\$9.5 to HK\$ 8.61. However, we lift our TP to HK\$ 6.90 (from HK\$3.80) as we reduce the NAV discount from 60% to 20%, based on the reasoning that valuation may rise on the increasing inflow of southbound capital. We think the counter’s upside is limited after the recent rally and its fundamentals are deteriorating. Thus, we downgrade Evergrande to **HOLD** from Buy.

**Downside risks:** 1) Rising litigation risks across sector; 2) Major shareholders may sell shares to take profit after recent rally. **Upside risks:** 1) Stronger-than-expected presales performance; 2) Continuation of high dividend payout.

**Exhibit 1: Evergrande’s FY14 results**

<u>P&amp;L</u>	FY14	FY13	YoY Chg	<u>Operating statistics</u>	FY14	FY13	YoY Chg
	RMB mn	RMB mn	(%)				
<b>Turnover</b>	<b>111,398</b>	<b>93,672</b>	<b>19</b>	Presales GFA (mn sqm)	18.2	14.9	22
Cost of Sales & direct operating costs	(79,615)	(66,023)	21	Presales ASP (RMB/sqm)	7,227	6,741	7
<b>Gross Profit</b>	<b>31,784</b>	<b>27,649</b>	<b>15</b>	<b>Presales amount (RMBm)</b>	<b>131,517</b>	<b>100,400</b>	<b>31</b>
<b>Gross Margin (%)</b>	<b>28.5</b>	<b>29.5</b>	<b>(1.0)</b>	GFA Delivered (mn sqm)	18.1	15.0	21
Selling and distribution costs	(9,154)	(4,310)	112	Booked ASP (RMB/sqm)	5,935	6,166	(4)
Administrative expense	(5,435)	(5,152)	5	<b>Property sales booked (RMBmn)</b>	<b>107,450</b>	<b>41,289</b>	<b>160</b>
<b>EBIT</b>	<b>17,195</b>	<b>18,187</b>	<b>(5)</b>				
<b>EBIT Margin (%)</b>	<b>15.4</b>	<b>19.4</b>	<b>(4.0)</b>	<b>Balance sheet</b>	<b>Dec 14</b>	<b>Dec 13</b>	<b>HoH %</b>
Other income, gains and losses	1,431	699	105	<b>RMBm</b>	<b>RMBm</b>		
Fair value gain of investment properties	9,393	5,815	62	Gross debt	156,065	108,817	43
Other one-off items	4,292	729	na	Cash	59,498	53,653	11
Share of profit from JCE/ Associates	(104)	0	0	<b>Net debt</b>	<b>96,566</b>	<b>55,164</b>	<b>75</b>
Finance cost	(1,015)	(34)	2,892	<b>Net gearing- PCI as equity (%)</b>	<b>86</b>	<b>70</b>	<b>16</b>
<b>Profit before tax</b>	<b>31,191</b>	<b>25,396</b>	<b>23</b>	<b>Net gearing- PCI as debt (%)</b>	<b>251</b>	<b>148</b>	<b>103</b>
<b>Tax</b>	<b>(13,175)</b>	<b>(11,687)</b>	<b>13</b>				
- LAT	(4,223)	(4,872)	(13)				
- Enterprise tax	(8,952)	(6,816)	31				
<b>Profit after tax</b>	<b>18,016</b>	<b>13,709</b>	<b>31</b>				
Minority Interest and perpetual capital instrument	(5,412)	(1,097)	393				
<b>Net profit</b>	<b>12,604</b>	<b>12,612</b>	<b>(0)</b>				
<b>Core net profit</b>	<b>12,000</b>	<b>10,300</b>	<b>17</b>				
<b>Core net profit- post MI, perpetual and disposals</b>	<b>2,340</b>	<b>7,703</b>	<b>(70)</b>				

Source(s): Company, ABCI Securities

**Exhibit 2: Evergrande's EBIT by segment**


Source(s): Company, ABCI Securities

**Exhibit 3 : 2015E guidance for Consumer business**

	Total	2014 actual		2015 guidance	
		Investment	Sales	Profit/ (loss)	Sales
	RMBmn	RMBmn	RMBmn	RMBmn	RMBmn
Spring water	5,540	1,090	(2,370)	4,000	make profit
Grain & oil	570	NA	NA	2,500	make profit
Dairy	310	73	7	500	make profit
Health	HK\$950mn	NA	NA	NA	NA

Source(s): Company, ABCI Securities estimates

**Exhibit 4: The 10 most traded southbound HK-SH connect counters (Mar 2015)**

Rank	Stock Code	Stock Name	Buy Trades (HK\$ mn)	Sell Trades (HK\$ mn)	Turnover (Buy & Sell) (HK\$ mn)
1	566 HK	Haneng	2,670	2,288	4,958
2	1186 HK	China Railway Construction	608	340	948
3	6837 HK	Haitong Securities	587	307	894
4	2883 HK	China Oilfield	552	305	857
5	3333 HK	Evergrande	519	188	708
6	390 HK	China Railway	391	263	654
7	700 HK	Tencent	425	205	630
8	1336 HK	NCI	315	286	601
9	3800 HK	GCL-Poly Energy	482	113	595
10	2727 HK	SH Electric	373	200	573

Source(s):HKEx, ABCI Securities

**Exhibit 5: Evergrande's FY15E NAV**

	Attr. GFA (mn sqm)	Net assets value (RMB mn)	% of total	Valuation Method	Implied value per sqm (RMB)
<b>Property development</b>					
Guangdong	14.8	14,108	6%	DCF at WACC of 11.0%	950
Liaoning	13.2	11,200	5%		847
Jiangsu	12.9	11,088	5%		858
Hebei	11.7	10,884	4%		927
Shangdong	10.8	10,071	4%		934
Anhui	10.0	8,152	3%		818
Henan	7.7	6,839	3%		889
Hunan	5.4	4,713	2%		880
Others	64.2	97,042	40%		1,511
<b>Subtotal</b>	<b>150.8</b>	<b>174,099</b>	<b>72%</b>		
Investment Properties		61,857	25%		1x Book value
Football business		1,200	0%	50% stake sold to Jack Ma at RMB1.2bn	
Huaxia Bank		5,728	2%	Mkt value of 4.5% stake	
Water business		-	0%		
<b>Total 2015E GAV</b>		<b>242,884</b>	<b>100%</b>		
2015E Net debt		(88,541)	-36%		
Perpetual capital instrument		(52,852)	-22%		
<b>Total 2015E NAV</b>		<b>101,491</b>	<b>42%</b>		
No. of share outstanding (diluted)		14,742			
<b>NAV per share (RMB)</b>		<b>6.88</b>			
Ex rate		1.25			
<b>NAV per share (HKD)</b>		<b>8.61</b>			
Target discount (%)		20%			
<b>Target Price (HKD)</b>		<b>6.90</b>			
<b>WACC</b>	<b>11.0%</b>				
Cost of Debt	11.1%				
Cost of Equity	15.0%				
<b>Debt/ (Debt + Equity)</b>	<b>59%</b>				

Source(s): Company, ABCI Securities estimates



**Consolidated income statement (2013A-2017E)**

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2013A</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
<b>Revenue</b>	<b>93,672</b>	<b>111,398</b>	<b>157,862</b>	<b>188,842</b>	<b>190,736</b>
Cost of sales	(66,023)	(79,615)	(111,286)	(131,866)	(128,114)
<b>Gross Profit</b>	<b>27,649</b>	<b>31,784</b>	<b>46,576</b>	<b>56,976</b>	<b>62,622</b>
SG&A expenses	(9,462)	(14,588)	(19,062)	(22,975)	(22,696)
<b>EBIT</b>	<b>18,187</b>	<b>17,195</b>	<b>27,515</b>	<b>34,001</b>	<b>39,927</b>
Finance cost	(34)	(1,015)	(1,168)	(1,136)	(1,136)
Share of profit of associates	0	(104)	0	0	0
Other income/ (expenses)	699	1,431	1,032	1,113	1,199
Fair value gain of investment properties	0	0	0	0	0
Disposal/one-off items	6,545	13,685	0	0	0
<b>Profit before tax</b>	<b>25,396</b>	<b>31,191</b>	<b>27,378</b>	<b>33,978</b>	<b>39,990</b>
Tax	(11,687)	(13,175)	(14,181)	(17,562)	(20,704)
<b>Profit after tax</b>	<b>13,709</b>	<b>18,016</b>	<b>13,197</b>	<b>16,415</b>	<b>19,286</b>
Minority interest	(1,097)	(5,412)	(6,665)	(7,740)	(8,797)
<b>Reported net profit</b>	<b>12,612</b>	<b>12,604</b>	<b>6,532</b>	<b>8,675</b>	<b>10,489</b>
<i>Less: exceptional items</i>	<i>(4,908)</i>	<i>(10,264)</i>	<i>0</i>	<i>0</i>	<i>0</i>
<b>Underlying net profit</b>	<b>7,703</b>	<b>2,340</b>	<b>6,532</b>	<b>8,675</b>	<b>10,489</b>
<b>Per share</b>					
Underlying EPS (RMB)	0.48	0.16	0.44	0.59	0.71
DPS (RMB)	0.43	0.43	0.22	0.29	0.36
Payout ratio (%)	90%	271%	50%	50%	50%
BVPS (RMB)	4.59	7.05	7.27	7.57	7.92
<b>Growth %</b>					
Revenue	43.5%	18.9%	41.7%	19.6%	1.0%
Gross Profit	51.8%	15.0%	46.5%	22.3%	9.9%
EBIT	59.1%	-5.5%	60.0%	23.6%	17.4%
Underlying net profit	24.2%	-69.6%	179.1%	32.8%	20.9%
<b>Margin %</b>					
Gross margin	29.5%	28.5%	29.5%	30.2%	32.8%
Gross margin (post-LAT)	24.7%	25.6%	25.8%	26.4%	28.5%
EBIT margin	19.4%	15.4%	17.4%	18.0%	20.9%
Core net margin	9.4%	7.1%	8.4%	8.7%	10.1%
<b>Key assumptions</b>					
Contracted Sales (RMB mn)	100,400	131,517	156,379	188,805	183,954
GFA sold (m sqm)	14.89	18.20	21.69	25.57	23.43
ASP (RMB/sqm)	6,741	7,227	7,209	7,384	7,853
Booked Sales (RMB mn)	92,235	107,450	150,723	180,465	180,609
GFA delivered (mn sqm)	14.96	18.10	21.05	24.59	23.30
Booked ASP (RMB/sqm)	6,166	5,935	7,159	7,339	7,752

Source: Company, ABCI Securities estimates



**Consolidated balance sheet (2013A-2017E)**

<b>As of Dec 31 (RMB mn)</b>	<b>2013A</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
<b>Current assets</b>	<b>289,378</b>	<b>383,650</b>	<b>390,934</b>	<b>401,361</b>	<b>411,566</b>
Cash	40,118	29,847	37,873	59,282	94,415
Restricted cash	13,535	29,651	29,651	29,651	29,651
Trade & other receivables	9,512	16,027	16,027	16,027	16,027
Property under development	184,833	246,476	245,734	234,751	209,823
Other current assets	41,381	61,649	61,649	61,649	61,649
<b>Non-current assets</b>	<b>58,770</b>	<b>90,812</b>	<b>89,632</b>	<b>88,327</b>	<b>86,884</b>
Property, plant & equipment	11,378	15,504	14,324	13,019	11,577
Investment properties	36,039	61,857	61,857	61,857	61,857
Investment in Associate and JCE	0	1,062	1,062	1,062	1,062
Other non-current assets	11,353	12,389	12,389	12,389	12,389
<b>Total Assets</b>	<b>348,148</b>	<b>474,462</b>	<b>480,566</b>	<b>489,688</b>	<b>498,450</b>
<b>Current Liabilities</b>	<b>188,198</b>	<b>268,237</b>	<b>271,406</b>	<b>276,504</b>	<b>280,334</b>
Short term borrowings	35,796	79,663	79,663	79,663	79,663
Trade & other payables	99,895	123,673	123,673	123,673	123,673
Pre-sales deposits	39,000	47,348	50,517	55,615	59,445
Other current assets	13,506	17,553	17,553	17,553	17,553
<b>Non-current liabilities</b>	<b>80,608</b>	<b>93,847</b>	<b>93,847</b>	<b>93,847</b>	<b>93,847</b>
Long term borrowings	73,021	76,401	76,401	76,401	76,401
Other payables	0	0	0	0	0
Other non-current assets	7,587	17,446	17,446	17,446	17,446
<b>Total Liabilities</b>	<b>268,806</b>	<b>362,084</b>	<b>365,253</b>	<b>370,351</b>	<b>374,181</b>
<b>Net Assets</b>	<b>79,343</b>	<b>112,378</b>	<b>115,313</b>	<b>119,337</b>	<b>124,269</b>
<b>Shareholders Equity</b>	<b>73,614</b>	<b>103,972</b>	<b>107,238</b>	<b>111,575</b>	<b>116,820</b>
Minority Interest	5,729	8,406	8,075	7,762	7,449
<b>Total Equity</b>	<b>79,343</b>	<b>112,378</b>	<b>115,313</b>	<b>119,337</b>	<b>124,269</b>
<b>Key ratio</b>					
Gross debt (RMB mn)	108,817	156,065	156,065	156,065	156,065
Net debt (RMB mn)	55,164	96,566	88,541	67,131	31,998
Net gearing (%)	70%	86%	77%	56%	26%
Contracted sales/ Total assets (x)	0.29	0.28	0.33	0.39	0.37

Source(s): Company, ABCI Securities estimates



**Consolidated cash flow statement (2012A-2016E)**

<b>FY ended Dec 31 (RMB mn)</b>	<b>2013A</b>	<b>2014A</b>	<b>2015E</b>	<b>2016E</b>	<b>2017E</b>
EBITDA	19,214	18,332	28,765	35,376	41,439
Change in Working Capital	(44,409)	(52,024)	19,598	31,331	44,010
Tax payment	(5,850)	(13,178)	(14,181)	(17,562)	(20,704)
<b>Operating Cash flow</b>	<b>(31,045)</b>	<b>(46,871)</b>	<b>34,181</b>	<b>49,144</b>	<b>64,745</b>
Addition of PP&E and IP	(11,782)	(1,532)	(70)	(70)	(70)
Others	(1,353)	(1,869)	1,032	1,113	1,199
<b>Investing Cash flow</b>	<b>(13,134)</b>	<b>(3,402)</b>	<b>962</b>	<b>1,043</b>	<b>1,129</b>
Debt raised	74,368	52,797	5,000	5,000	5,000
Debt repaid	(25,463)	(5,000)	(5,000)	(5,000)	(5,000)
Interest expenses	(7,827)	(14,649)	(16,855)	(16,387)	(16,387)
Equity raised	3,526	0	0	0	0
Dividend to shareholders	(2,292)	(6,339)	(3,266)	(4,337)	(5,244)
Perpetual securities raised	24,367	13,241	(6,946)	(8,003)	(9,060)
Others	(174)	(50)	(50)	(50)	(50)
<b>Financing Cash flow</b>	<b>66,506</b>	<b>40,001</b>	<b>(27,117)</b>	<b>(28,777)</b>	<b>(30,741)</b>
<b>Net cash inflow/ (outflow)</b>	<b>22,327</b>	<b>(10,272)</b>	<b>8,026</b>	<b>21,410</b>	<b>35,133</b>
Cash- beginning	17,789	40,118	29,847	37,873	59,282
<b>Cash- year-end</b>	<b>40,116</b>	<b>29,847</b>	<b>37,873</b>	<b>59,282</b>	<b>94,415</b>

Source(s): Company, ABCI Securities estimates



## Disclosures

### Analyst Certification

I, Tung Yiu Kei, Kenneth, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

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### Definition of equity rating

Rating	Definition
Buy	Stock return $\geq$ Market return rate
Hold	Market return - 6% $\leq$ Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2009-2013

Time horizon of share price target: 12-month

### Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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