



## Evergrande (3333 HK) Got scale; now seeking profitability

- FY16 core profit rose 89% YoY to RMB 20.8bn. Excluding one-off disposal gains and accounting for perpetual distribution, the increase was lower at 53% YoY to RMB 3.0bn
- Net gearing rose 118ppt YoY to 432% if one considers perpetual instrument as debt
- Management plans to redeem ~50% of PCI in 1H17, which should improve profitability
- Maintain **BUY** and raise TP to HK\$ 7.80 (from HK\$ 6.60), based on a 60% discount to NAV

**From scale to profitability.** Evergrande's FY16 core profit rose 89% YoY to RMB 20.8bn. Excluding one-off disposal gains from consumer business and accounting for perpetual distribution (+109%YoY to RMB10.6bn), core profit was up 53%YoY to RMB 3,045mn. Gross margin remained stable at 28.1%. Net gearing surged 26ppt to 120% in Dec 2016; however, if one considers perpetual capital instrument (PCI) as debt, gearing would be up 118ppt YoY to 432%. Since distribution to PCI has eroded a significant portion of profit attributable to ordinary shareholders, and management plans to redeem ~50% of PCI in 1H17. Also, the Group's net gearing should be lowered by the RMB 30bn capital raised from the strategic investors for its proposed A-share spin-off (Evergrande Real Estate) and another RMB 15bn capital from the SOEs under negotiation. By Dec 2016, RMB13bn of the aforementioned capital were received and was classified as "other payable". Chairman commented Evergrande will focus more on raising profitability, given its landbank has already reached 229mn sqm (+47% YoY) with an average cost of RMB 1,570/sqm. In 2016, the Group acquired 102mn sqm of land at RMB 203bn. Evergrande's sales targets for 2017-19 were RMB450bn, RMB500bn, and RMB550bn, respectively, which represent a significant slowdown in expansion pace (2016 presale: RMB373bn, +85% YoY). With a less aggressive agenda on the property front, profitability may improve on reduced finance cost and perpetual distribution.

**Non-property business takes time to mature.** Similar to its property business, Evergrande's financial business has been growing rapidly. Evergrande Life insurance had a premium income of RMB 56.5bn and total assets of RMB 73.6bn in 2016. Regarding the Internet finance business, registered users of hdfax.com reached 15mn and annual transaction value amounted to RMB 33.9bn. On the balance sheet, loans to 3<sup>rd</sup> party through internet finance (in "other receivables") reached RMB 26.7bn, while investors of internet finance products (in "other payable") reached RMB 27.99bn. As finance cost of these operations cannot be capitalized, the non-property division reported an operating loss of RMB 3bn in 2016.

**Maintain BUY and raise TP to HK\$ 7.80.** We factor in the latest land acquisitions and raise our 2017E NAV estimate to HK\$ 19.44/share (from HK\$ 13.16). We apply a higher discount to NAV of 60% (from 50%) due to the higher-than-expected net gearing and derive a TP of HK\$ 7.80 (from HK\$ 6.60). Maintain **BUY**.

**Risk factors:** 1) Perpetual distribution may reduce profits attributable to ordinary shareholders and understate net gearing ; 2) Increasing losses from non-property business.

### Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	133,130	211,444	343,854	404,215	443,426
Chg (% YoY)	19.5	58.8	62.6	17.6	9.7
Core net profit (RMB mn)	1,992	3,045	8,691	17,939	22,867
Chg (% YoY)	(42.6)	52.9	185.5	106.4	27.5
Core EPS (RMB)	0.14	0.21	0.60	1.24	1.59
Chg (% YoY)	(41.3)	52.9	185.5	106.4	27.5
BVPS (RMB)	8.8	10.9	11.1	11.7	12.4
Chg (% YoY)	24.7	24.0	2.2	5.0	6.3
Core PE (x)	41.2	27.0	9.4	4.6	3.6
P/B (x)	0.6	0.5	0.5	0.5	0.5
ROE (%)	1.6	1.9	5.4	10.6	12.8
ROA (%)	0.3	0.2	0.6	1.2	1.4
DPS(RMB)	0.38	-	0.30	0.62	0.79
Yield (%)	6.7	-	5.3	10.9	13.9
Net gearing (%)	93.5	119.8	181.9	75.6	Net cash

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Mar 29, 2017

Rating: **BUY**

TP: HK\$ 7.80

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Share price (HK\$)	6.38
Est. share price return	22.3%
Est. dividend yield	5.3%
Est. total return	27.6%
Previous Rating & TP	BUY, HK\$6.60
Previous Report Date	Nov 3, 2016

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	7.09/4.62
Issued shares (mn)	13,798
Market cap (HK\$ mn)	86,883
3-mth avg daily turnover(HK\$ mn)	193.75
Major shareholder(s) (%)	
HUI Ka Yan	70.1%

Source(s): Bloomberg, ABCI Securities

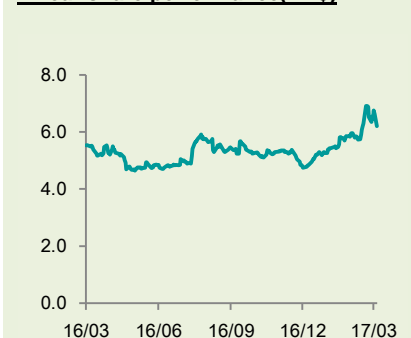
### Share Performance

	Absolute	Relative*
1-mth	6.4	4.9
3-mth	32.6	18.8
6-mth	18.1	14.6

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

### 1-Year share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



Exhibit 1: Evergrande's FY16 results

P&L	FY16	FY15	YoY
	RMB mn	RMB mn	(%)
<b>Turnover</b>	211,444	133,130	59
Cost of Sales	(152,022)	(95,717)	59
<b>Gross Profit</b>	59,422	37,413	59
<b>Gross Margin (%)</b>	<b>28.1</b>	<b>28.1</b>	<b>0.0</b>
Selling and distribution costs	(15,983)	(13,325)	20
Administrative expense	(12,261)	(7,216)	70
<b>EBIT</b>	31,178	16,872	85
<b>EBIT Margin (%)</b>	<b>14.7</b>	<b>12.7</b>	<b>+2.1ppt</b>
Other income	4,937	2,262	118
Fair Value gains on IP and others	356	12,859	(59)
Other one-off items	6,986	651	na
Share of profit from JCE/ Assoc.	(203)	(392)	0
Finance cost	(6,392)	(807)	1,300
<b>Profit before tax</b>	36,862	31,445	17
<b>Tax</b>	(19,245)	(14,105)	36
- LAT	(8,359)	(4,453)	88
- Enterprise tax	(10,886)	(9,652)	13
<b>Profit after tax</b>	17,617	17,340	2
Perpetual capital instrument	(10,646)	(5,088)	109
Minority Interest	(1,880)	(1,792)	5
<b>Net profit</b>	5,091	10,460	(51)
<b>Core net profit</b>	20,810	11,000	89
<b>Core net profit- post MI, perpetual and ex. disposals</b>	3,045	1,992	53

Operating statistics	FY16	FY15	YoY
			%
Contracted GFA (mn sqm)	44.7	25.5	75.2
Contracted ASP (RMB/sqm)	8,355	7,892	5.9
<b>Contracted Sales (RMB mn)</b>	373,372	201,340	85.4
GFA Delivered (mn sqm)	25.6	17.2	48.3
Booked ASP (RMB/sqm)	7,975	7,334	8.7
<b>Booked sales (RMB mn)</b>	203,890	126,449	61.2
<b>Balance sheet</b>	<b>Dec-16</b>	<b>Dec-15</b>	<b>YoY</b>
	RMB mn	RMB mn	
Gross debt	535,070	296,906	80
Cash	304,329	164,022	86
<b>Net debt</b>	230,741	132,884	74
<b>Net gearing (%)</b>	120	93	26
<b>Net gearing- PCI as debt (%)</b>	432	314	118
<b>EBIT by division</b>	<b>FY16</b>	<b>FY15</b>	<b>YoY</b>
	RMB mn	RMB mn	
Property development	38,560	22,928	68
Property investment	282	213	32
Property management	362	39	828
Other business (ex.disposal)	(3,083)	(4,481)	NA

Source(s): Company, ABCI Securities



**Exhibit 2: Evergrande's 2017E 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	2%	DCF with WACC of 9.3%	950
Liaoning	13.2	11,200	2%		847
Jiangsu	12.9	11,088	2%		858
Hebei	11.7	10,884	2%		927
Shangdong	10.8	10,071	1%		934
Anhui	10.0	8,152	1%		818
Henan	7.7	6,839	1%		889
Hunan	5.4	4,713	1%		880
Others	261.2	486,887	68%		1,864
<b>Subtotal</b>	<b>347.7</b>	<b>563,944</b>	<b>78%</b>		
Investment Properties		132,115	18%	1x PB	
Football business		1,200	0%	50% stake sold to Jack Ma at RMB1.2bn	
Financial investment		22,213	3%	Market value of Shengjing Bank & Vanke	
<b>Total 2017E GAV</b>		<b>719,472</b>	<b>100%</b>		
2017E Net cash/ (debt)		(357,312)	-50%		
Perpetual capital instrument		(112,079)	-16%		
<b>Total 2017E NAV</b>		<b>250,080</b>	<b>35%</b>		
No. of share outstanding (diluted)		14,411			
<b>NAV per share (RMB)</b>		<b>17.35</b>			
Ex rate		1.12			
<b>NAV per share (HKD)</b>		<b>19.44</b>			
Target discount (%)		60%			
<b>Target Price (HKD)</b>		<b>7.80</b>			
<b>WACC</b>					
Cost of debt		8.2%			
Cost of equity		20.0%			
<b>Debt/ ( Debt + Equity)</b>		<b>70%</b>			

Source(s): Company, ABCI Securities estimates



**Consolidated income statement (2014A-2019E)**

FY Ended Dec 31 (RMB mn)	2014A	2015A	2016A	2017E	2018E	2019E
<b>Revenue</b>	111,398	133,130	211,444	343,854	404,215	443,426
Cost of sales	(79,615)	(95,717)	(152,022)	(258,626)	(299,742)	(329,882)
<b>Gross Profit</b>	31,784	37,413	59,422	85,228	104,473	113,544
SG&A expenses	(14,588)	(20,541)	(28,244)	(35,506)	(37,549)	(40,770)
<b>EBIT</b>	17,195	16,872	31,178	49,722	66,925	72,774
Finance cost	(1,015)	(807)	(6,392)	(7,524)	(6,479)	(5,434)
Share of profit of associates	(104)	(392)	(203)	1,364	1,515	1,515
Other income/ (expenses)	1,431	2,262	4,937	4,646	5,088	7,573
Fair value gain of investment properties	9,393	12,859	356	0	0	0
Disposal/one-off items	4,292	651	6,986	0	0	0
<b>Profit before tax</b>	31,191	31,445	36,862	48,208	67,049	76,428
Tax	(13,175)	(14,105)	(19,245)	(26,230)	(34,915)	(38,477)
<b>Profit after tax</b>	18,016	17,340	17,617	21,978	32,133	37,951
Minority interest	(1,073)	(1,797)	(2,745)	(433)	(433)	(433)
Perpetual coupon distribution	(4,339)	(5,083)	(9,781)	(12,854)	(13,761)	(14,652)
<b>Reported net profit</b>	12,604	10,460	5,091	8,691	17,939	22,867
Less: exceptional items	(9,134)	(8,469)	(2,047)	0	0	0
<b>Underlying net profit</b>	3,470	1,992	3,045	8,691	17,939	22,867
<b>Per share</b>						
Underlying EPS (RMB)	0.24	0.14	0.21	0.60	1.24	1.59
DPS (RMB)	0.43	0.38	-	0.30	0.62	0.79
Payout ratio (%)	183%	275%	0%	50%	50%	50%
BVPS (RMB)	7.05	8.79	10.91	11.15	11.71	12.44
<b>Growth %</b>						
Revenue	18.9%	19.5%	58.8%	62.6%	17.6%	9.7%
Gross Profit	15.0%	17.7%	58.8%	43.4%	22.6%	8.7%
EBIT	-5.5%	-1.9%	84.8%	59.5%	34.6%	8.7%
Underlying net profit	-54.9%	-42.6%	52.9%	185.5%	106.4%	27.5%
<b>Margin %</b>						
Gross margin	28.5%	28.1%	28.1%	24.8%	25.8%	25.6%
Gross margin (post-LAT)	25.6%	26.1%	25.0%	21.3%	22.3%	22.4%
EBIT margin	15.4%	12.7%	14.7%	14.5%	16.6%	16.4%
Core net margin	7.1%	5.7%	5.8%	6.0%	7.6%	8.2%
<b>Key assumptions</b>						
Contracted Sales (RMB mn)	131,510	201,340	373,372	478,392	507,993	554,685
GFA sold (mn sqm)	18.20	25.51	44.69	57.31	60.85	67.77
ASP (RMB/sqm)	7,228	7,892	8,355	8,348	8,348	8,185
Booked Sales (RMB mn)	107,450	126,449	203,890	334,624	392,849	429,328
GFA delivered (mn sqm)	16.84	17.24	4.12	13.71	20.29	23.08
Booked ASP (RMB/sqm)	6,382	7,334	49,527	24,406	19,364	18,598

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2014A-2019E)

As of Dec 31 (RMB mn)	2014A	2015A	2016A	2017E	2018E	2019E
<b>Current assets</b>	383,650	612,344	1,113,635	1,197,171	1,312,784	1,436,841
Cash	29,847	103,090	198,420	71,849	274,268	498,598
Restricted cash	29,651	60,932	105,909	105,909	105,909	105,909
Trade & other receivables	16,027	21,708	76,434	76,434	76,434	76,434
Property under development	246,476	383,728	658,627	868,734	781,928	681,655
Other current assets	61,649	42,886	74,245	74,245	74,245	74,245
<b>Non-current assets</b>	90,812	144,691	237,233	236,713	236,307	235,861
Property, plant & equipment	15,504	16,720	20,833	19,199	17,565	15,931
Investment properties	61,857	97,146	132,045	132,115	132,185	132,255
Investment in Associate and JCE	1,062	8,580	24,374	25,418	26,576	27,694
Other non-current assets	12,389	22,245	59,981	59,981	59,981	59,981
<b>Total Assets</b>	474,462	757,035	1,350,868	1,433,884	1,549,091	1,672,702
<b>Current Liabilities</b>	268,237	456,681	733,394	812,546	919,265	1,031,925
Short-term borrowings	79,663	158,744	202,906	202,906	202,906	202,906
Trade & other payables	123,673	191,309	299,905	298,880	297,856	296,831
Pre-sales deposits	47,348	83,061	194,961	275,137	382,881	496,565
Other current liabilities	17,553	23,567	35,622	35,622	35,622	35,622
<b>Non-current liabilities</b>	93,847	158,212	424,942	424,942	424,942	424,942
Long-term borrowings	76,401	138,162	332,164	332,164	332,164	332,164
Other payables	0	0	0	0	0	0
Other non-current liabilities	17,446	20,050	92,778	92,778	92,778	92,778
<b>Total Liabilities</b>	362,084	614,893	1,158,336	1,237,488	1,344,207	1,456,867
<b>Net Assets</b>	112,378	142,142	192,532	196,396	204,884	215,836
<b>Shareholders' Equity</b>	51,120	60,613	53,847	58,193	67,163	78,596
Perpetual capital instrument	52,852	66,130	103,337	102,472	101,607	100,743
Minority Interest	8,406	15,399	35,348	35,731	36,114	36,497
<b>Total Equity</b>	112,378	142,142	192,532	196,396	204,884	215,836
<b>Key ratio</b>						
Gross debt (RMB mn)	156,065	296,906	535,070	535,070	535,070	535,070
Net debt (RMB mn)	96,566	132,884	230,741	357,312	154,893	(69,437)
Net gearing (%)	86%	93%	120%	182%	76%	-32%
Contracted sales/ Total assets (x)	0.28	0.27	0.28	0.33	0.33	0.33

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2014A-2019E)

FY ended Dec 31 (RMB mn)	2014A	2015A	2016A	2017E	2018E	2019E
EBITDA	18,332	18,326	32,812	51,356	68,559	74,408
Change in Working Capital	(52,024)	(25,704)	(169,385)	(99,954)	220,221	235,322
Tax payment	(13,175)	(14,105)	(19,245)	(26,230)	(34,915)	(38,477)
<b>Operating cash flow</b>	<b>(46,868)</b>	<b>(21,483)</b>	<b>(155,818)</b>	<b>(74,828)</b>	<b>253,865</b>	<b>271,253</b>
Purchase of PP&E	(1,532)	(10,246)	(70)	(70)	(70)	(70)
Others	(1,869)	12,905	(18,242)	4,966	5,445	7,970
<b>Investing cash flow</b>	<b>(3,402)</b>	<b>2,659</b>	<b>(18,312)</b>	<b>4,896</b>	<b>5,375</b>	<b>7,900</b>
Debt raised	52,794	115,470	317,887	5,000	5,000	5,000
Debt repaid	(5,000)	(641)	(5,000)	(5,000)	(5,000)	(5,000)
Interest expenses	(14,649)	(21,102)	(32,731)	(38,525)	(33,174)	(27,824)
Equity raised	0	(658)	0	0	0	0
Dividend to shareholders	(6,339)	(5,476)	0	(4,346)	(8,969)	(11,433)
Perpetual securities raised	13,241	(5,083)	(10,646)	(13,718)	(14,626)	(15,516)
Others	(50)	9,557	(50)	(50)	(50)	(50)
<b>Financing cash flow</b>	<b>39,997</b>	<b>92,067</b>	<b>269,460</b>	<b>(56,639)</b>	<b>(56,820)</b>	<b>(54,823)</b>
<b>Net cash inflow/ (outflow)</b>	<b>(10,272)</b>	<b>73,243</b>	<b>95,330</b>	<b>(126,571)</b>	<b>202,420</b>	<b>224,330</b>
Cash- beginning	40,118	29,847	103,090	198,420	71,849	274,268
<b>Cash- year-end</b>	<b>29,847</b>	<b>103,090</b>	<b>198,420</b>	<b>71,849</b>	<b>274,268</b>	<b>498,598</b>

Source(s): Company, ABCI Securities estimates

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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

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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