



Evergrande(3333) - BUY

Key Data

Industry	Properties & Construction
Price(28/2/2012)	HK\$4.94
1-yr TP	HK\$5.65
Upside potential	14.4%
52Wk H/L(HK\$)	6.27/2.13
Issued shares(mn)	14,896.7
Market Cap(HK\$m)	73,589.6
15-day avg vol(mn)	117.4
Auditors	PwC
Major shareholder:	
Xu Jiayin*	68.1%

*The founder and Chairman of the group

Source: Company data & Bloomberg



Report Date: 29 Feb, 2011

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Related report:

Evergrande(3333) initial report on 5/7/2011
Evergrande(3333) 1H2011 results review on 15/9/2011

Investment highlights

Proven track record in tough market: Contracted sales amount grew 59.5% YoY to Rmb80.4bn in 2011, a tough period for China developers, beating the group's target (Rmb70.0bn) by 14.9% and ranked the 3rd in our comparable peers in terms of growth rate.

Volume driven growth in 2012: The budget sales target is Rmb80bn this year. The volume growth will play a key role in 2012 sales as we predict ASP to soften this year. Our base case analysis indicates the group is to achieve contract sales of Rmb81.9bn (up 1.9% YoY) this year with ASP down 5.0% YoY and GFA sold up 7.3% YoY.

High gearing remains our concern: We estimate net debt/equity ratio will increase from 70.0% at end of FY2011 to 74.5% at the end of FY2012. Our analysis indicates the refinancing risk is low. However, insolvency risk will increase if the contract sales this year is more than 19.6% lower than the budget.

Earnings outlook: Owing to revenue recognition policy, the record contract sales in 2010-2011 will positively affect the top and bottom lines of the group for FY2011-FY2012. As contract sales growth will slow down this year and ASP is softening, its bottom line will be adversely affected for FY2013. We forecast core EPS to surge by 81.7% YoY and 39.8% YoY to Rmb0.61 and Rmb0.85 respectively for FY2011-FY2012 and decline by 3.9% YoY to Rmb0.82 for FY2013.

Key risks: Lower than expected sales performance; GFA under-construction and/or delivered delay; insolvency risk.

Valuation: An expected continued decline in discount factor will trigger upward re-valuation. We set our 1-yr TP at HK\$5.65, representing 7.5x 11E PE, 5.4x 12E PE and 2.4x 11E P/B. The underlying WACC is at 12.7%, with the group's 1-yr average bond yield 12.0% as reference for the cost of debt. Maintain our BUY rating on the stock.

Results and forecast

	2010A	2011E	2012E	2013E
Revenue	45,801	62,029	87,939	89,199
Chg(YoY)	-	35.4%	41.8%	1.4%
Core net profit^	5,076	9,097	12,715	12,214
Core EPS (Rmb)	0.34	0.61	0.85	0.82
Chg(YoY)	-	81.7%	39.8%	-3.9%
PE(x)	11.9	6.6	4.7	4.9
DPS (HK\$)	3.2%	3.3%	4.3%	4.1%
Yield	3.3%	3.5%	4.5%	4.3%
NBV/share(Rmb)	1.37	1.93	2.65	3.30
Chg(YoY)	59.5%	41.1%	37.3%	24.5%
PB(x)	2.94	2.08	1.52	1.22

^Excluding revaluation G/L on investment property; @Rmb0.8121/HK\$

Source: Companies' announcements and ABCI Securities estimates



Proven track record in tough market

2011 was a tough period for China developers. The home purchase restriction curbs the investment activity and the expectation on the price downward trend cast a shadow on the real demand.

Despite of falling 10% behind our expectation, the group's contracted sales came at Rmb80.4bn in the year, beating the group's target (Rmb70.0bn) by 14.9%. The group's contracted sales grew 59.5% YoY in 2011, ranking the 3rd in our comparable peers. The growth was supported by 3.1% YoY increase in ASP and 54.7% YoY increase in GFA sold. We attribute the out-performance to high exposure in lower tier cities, quick asset turnover strategy and strong execution power of management. We believe the group will continue to possess the existing competitive advantages, and help to sustain its growth during the down cycle going forward.

2011 Sales performance of China developers (Ranked by YoY contracted sales value growth)

Code	Name	Contracted sales		GFA sold		ASP	
		Rmbbn	YoY	Ksqm.	YoY	Rmb/sqm.	YoY
1918	Sunac	17.7	150.0%	1,122	67.5%	15,775	49.3%
1777	Fantasia	7.0	80.0%	746	95.0%	9,364	-7.7%
3333	Evergrande	80.4	59.5%	12,203	54.7%	6,589	3.1%
1638	Kaisa Group	15.3	52.0%	2,178	149.0%	7,022	-39.0%
119	Poly HK	15.8	39.0%	2,150	51.0%	7,3449	-7.9%
2007	Country Garden	43.2	31.0%	6,870	15.0%	6,288	13.9%
688	China Overseas	87.1	29.8%	5,582	5.3%	15,604	23.3%
960	Longfor Properties	38.3	14.8%	3,286	33.9%	-	-14.3%
1224	C C Land	6.4	10.0%	741	-9.1%	8,608	21.1%
813	Shimao Property	30.7	0.7%	2,390	-5.5%	12,845	6.5%
3383	Agile Property	31.5	-2.5%	3,100	9.5%	10,161	-11.0%
2868	Beijing Capital Land	11.0	-11.4%	1,179	-0.9%	9,364	-10.6%
2777	R&F Properties	28.5	-11.5%	2,188	-11.6%	13,040	0.0%
000002	Vanke A-share	121.5	12.4%	10,752	19.8%	9,716	-6.2%
600048	Poly A-share	73.2	10.7%	6,503	-5.5%	10,818	17.2%
600383	Gemdale A-share	30.9	9.1%	2,236	-2.4%	15,342	11.8%

Source: Companies' announcements and ABCI Securities estimates

Volume driven growth in 2012

We lower our 2012 ASP forecast to Rmb6,261/sqm, representing 5.0% YoY decrease, as the home price correction in China is spreading to lower tier cities according to the Jan data released by NBSC. In our bearish case scenario, the 2012 ASP may be down further to Rmb5,932/sqm, representing 10.0% YoY decline. Even in the optimistic case, a 2.0% YoY decrease in ASP, which is at Rmb6,459/sqm, is projected. We expect that the volume will be the main growth driver for the contracted sales in 2012.

With strong supportive of sales resources, we expect that the GFA sold for the group will grow 7.1% YoY to 13,083K sqm. in 2012. We see



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potential upside risk to our current GFA sold area given the estimate implies only 45.0% sell through rate to its 2012E pipe line. Supported by the better supply and demand dynamic in lower tier cities and the government stance in protecting genuine end users, we expect that the GFA sold may rise 26.0% YoY to 15,364K sqm. The implied sell thought rate is at 50.5%, in line with our estimated level for 2011.

Case Scenario analysis of 2012E contracted sales

	GFA sold		ASP		2012E contracted sales	
	K sqm.	Chg(YoY)	Rmb/sqm.	Chg(YoY)	Rmbbn	Chg(YoY)
Bearish	12,170	-0.2%	5,932	-10.0%	72.2	-10.2%
Base	13,083	7.3%	6,261	-5.0%	81.9	1.9%
Optimistic	15,364	26.0%	6,459	-2.0%	99.2	23.4%

Source: ABCI Securities estimates

In our base case scenario, the contracted sales amount is estimated at Rmb81.9bn, up 1.9% YoY and 2.3% higher than the group target (Rmb80.0bn). Combining bearish and optimistic cases, we expect that the group will achieve contracted sales amount ranging from 72.2-99.2bn for 2012, representing growth rate of -10.2% YoY to +23.4% YoY.

Funding gap analysis

We estimate net debt/equity ratio will increase from 70.0% at end of FY2011 to 74.5% at the end of FY2012. Gearing ratio will stay high as the group needs construction loan to finance its projects which most of them will be sold this year but are scheduled to complete and deliver next year.

2012E funding gap analysis

	2012E Rmbbn
Cash balance in the beginning of year	33.0
Cash inflow from contract sales(75% cash collection ratio assumed for 2011-2012)	81.6
Loan repayment	-18.5
Land premium payment	-17.5
Construction cost payment	-38.9
Financial expense	-8.1
SG&A	-7.0
Others	-8.6
Buffer before refinancing	16.0
	(or 19.6% of expected cash flow from contract sales)

Source: ABCI Securities estimates

However our funding analysis shows that despite the likely high-gearing ratio by the end FY2012, the group is not expected to be subject to refinancing risk. We conduct scenario analysis based on our estimated contract sales this year. If the group is unable to raise loans, the cash flow generated from the expected contract sales is sufficient



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to service outstanding payments this year. However, insolvency risk will increase if the contract sales this year is more than 19.6% lower than the budget.

We estimate the gearing to peak in FY2012 and drop to 56.0% in FY2013 assuming no land acquisition in FY2012-FY2013.

Major changes in forecast

FY2011- FY2013	Previous	New	Chg
Revenue(Rmbbn)	64.9/105.6/117.3	62.0/87.9/89.2	-4.4%/-16.7%/-24.0%
Reason	<ul style="list-style-type: none"> 10% lower-than-our expectation of 2011 contract sales amount Lower 2012 contract sales projection, down to Rmb81.9bn due to 5% decline in ASP in 2012 		
GP margin	34.1%/33.8%/34.7%	33.9%/32.4%/30.9%	-0.2bp/-1.4bp/-3.8bp
Reason	<ul style="list-style-type: none"> Lower 2012 ASP 		
Core EPS	0.64/0.90/0.96	0.61/0.85/0.82	-6.5%/-23.9%/-15.0%
2012 NAV/share	Rmb7.85	Rmb7.65(HK\$9.42)	-3.0%

@Rmb0.8121/HK\$

Source: ABCI Securities estimates

We expect the group to post 81.7% YoY and 39.8% YoY growth rate for the core EPS in FY2011- FY2012 respectively which are still attractive in our view. However, the growth in FY2013 is expected to decline. We expect the core EPS to decline by 3.9% YoY in FY2013 mainly due to sales slowdown in 2012 and margin squeezing. We expect the gross profit margin to peak in FY2011, which is at 33.9% and down to 32.4% in FY2012 and 30.9% in FY2011. ROAE in FY2011-FY2012 is expected to reach 40.5% and 37.3% respectively while for FY2013 it maintains above 20.0% which is estimated at 27.6%.



Valuation

The current closing, HK\$4.94 implied a 16.0% underlying WACC. We expect to see a decrease in WACC mainly due to drop in cost of debt, which will be driven by 1) an eased policy uncertainty going forward 2) declining in group's bankruptcy risk 3) the group's proven track record in market downturn and the operating risk therefore reduced 4) liquidity improve in the China financial system triggered by BRR cut and expected interest rate slash.

We expect the yield for bond issued by the group provide a good yardstick for market rate of its debt.

Taking 12.0%, the 1-yr average yield for its bond, due on 2016, as cost of debt, we derive the WACC at 12.7%, and the share price will be boosted up to HK\$5.65, representing 40% discount to our revised NAV(HK\$9.42) and 7.5x 11E PE, 5.4x 12E PE and 2.4x 11E P/B. Maintain our BUY rating on the stock.

Our deriving of WACC

Market risk premium	12.5%
Risk-free rate(taking 10 year HK government bond yield as reference)	1.34%
Beta	1.20
Cost of equity	16.3%
Target gearing	50.0%
Marginal tax rate	25.0%
Cost of debt	12.0%
WACC	12.7%

Source: Bloomberg and ABCI Securities estimates



Financial forecast

Consolidated income statement

For the year ended 31/12(Rmbmn)	2010	2011E	2012E	2013E
Revenue	45,801	62,029	87,939	89,199
COGS	(32,432)	(41,018)	(59,431)	(61,673)
Gross profit	13,369	21,010	28,508	27,526
Fair value gains on investment properties	3,351	1,344	-	-
Other gains	184	60	60	60
Selling and marketing costs	(1,574)	(3,235)	(3,828)	(4,253)
Administrative expenses	(1,384)	(2,426)	(3,403)	(2,835)
Other operating expenses	(125)	-	1	-
Operating profit	13,821	16,754	21,337	20,498
Finance income/(costs), net	272	-	1	-
Operating Profit before exceptional	14,093	16,754	21,338	20,498
Exceptional	-	-	-	-
PBT	14,093	16,754	21,338	20,498
Taxation	(6,068)	(6,670)	(8,495)	(8,161)
Net profit	8,025	10,084	12,844	12,337
Attributable to shareholders of the Company	7,589	9,983	12,715	12,214
MI	(436)	(101)	(128)	(123)
Core profit	5,076	9,097	12,715	12,214

Source: Company' announcements and ABCI Securities

Major ratios

For the year ended 31/12(Rmbmn)	2010	2011E	2012E	2013E
Total GP margin	29.2%	33.9%	32.4%	30.9%
Core net profit margin	11.1%	14.7%	14.5%	13.7%
ROAA	6.7%	4.6%	5.7%	5.2%
ROAE	45.3%	40.5%	37.3%	27.6%
Net debt/equity	52.5%	70.0%	74.5%	56.0%
Short term debt/total debt	22.5%	30.5%	45.2%	57.8%
Asset turnover ratio	38.5%	28.6%	39.1%	37.7%

Source: Company' announcements and ABCI Securities



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Consolidated balance sheet

As of 31/12(Rmbmn)	2010	2011E	2012E	2013E
Non-current assets	12,402	13,538	13,398	13,275
Property and equipment/closing account	1,277	1,124	989	870
Land use rights/Closing net book amount	306	306	306	306
Investment properties	10,117	11,461	11,461	11,461
Properties under development	455	-	-	-
Other receivables	324	324	324	324
Intangible assets	37	32	27	23
Deferred income tax assets	340	291	291	291
Current assets	106,660	203,489	211,467	223,520
Properties under development	64,198	150,053	139,554	140,767
Completed properties held for sale	6,213	7,281	16,766	13,172
Financial assets at fair value through profit or loss	-	-	-	-
Trade and other receivables	2,128	4,485	2,290	15,703
Prepayments and advances to third parties	13,964	1,169	1,169	1,169
Income tax recoverable	205	303	303	303
Cash and cash equivalents	12,356	32,603	43,790	44,810
Total asset	119,062	217,026	224,865	236,795
Non-current liabilities	25,656	44,956	47,212	36,500
Borrowings	24,160	42,234	44,490	33,778
Deferred income tax liabilities	1,496	2,722	2,722	2,722
Current liabilities	72,039	142,522	137,256	150,104
Borrowings	7,000	18,519	36,641	46,327
Trade and other payables	36,390	75,308	39,348	53,133
Receipt in advance from customers	24,081	44,128	56,700	46,077
Financial guarantee liabilities	-	-	-	-
Current income tax liabilities	4,568	4,568	4,568	4,568
Total liabilities	97,695	187,478	184,468	186,604
Equity	21,366	29,346	39,936	49,484
Equity attributable to shareholders of the Company	20,635	28,716	39,435	49,105
Non-controlling interests	731	630	502	379

Source: Company' announcements and ABCI Securities



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Consolidated cash flow

For the year ended 31/12(Rmbmn)	2010	2011E	2012E	2013E
Cash (used in)/generated from operations	(8,850)	4,026	9,353	19,097
Tax paid	(1,402)	(6,670)	(8,495)	(8,161)
Interest paid	(1,471)	(4,860)	(8,113)	(6,408)
Cash flows of operating activities	(11,724)	(7,505)	(7,255)	4,528
Purchase of property and equipment	(858)	-	-	-
Purchase of intangible assets	(43)	-	-	-
Interest received	52	60	60	60
Others	74	1	1	1
Cash flows of investing activities	(774)	61	61	61
Net Cash inflow/(outflow) from interest-bearing debt	17,221	29,592	20,379	(1,026)
Issue of shares	-	-	-	-
Share issuance costs	-	-	-	-
Restricted cash pledged for bank borrowings	442	-	-	-
Contribution from non-controlling interests	-	-	-	-
Dividends paid	(105)	(1,902)	(1,997)	(2,543)
Repayments of amounts due to related parties	-	-	-	-
Cash flows of financing activities	17,558	27,690	18,382	(3,569)
Net increase in cash and cash equivalents	5,060	20,246	11,188	1,020
Cash and cash equivalents at beginning of year	7,333	12,356	32,603	43,790
Cash and cash equivalents at end of year	12,356	32,603	43,790	44,810

Source: Company' announcements and ABCI Securities



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Disclosures

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Disclosures of Interests

Li Hong-ying has financial interest in Evergrande Real Estate Group Limited as at 29 February 2012.

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