



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

China Property Sector

# Positive earnings in 2018

Nov 14, 2017



## Contents

CHINA PROPERTY SECTOR .....	3
POSITIVE EARNINGS FOR 2018 .....	4
2018: MAKING RENTAL HOUSING AS IMPORTANT AS HOME PURCHASING .....	7
PROPERTY MANAGEMENT BUSINESS COULD BE A NEW RISING STAR .....	10
RISING ONSHORE FINANCE COST DRIVEN BY INTEREST HIKE EXPECTATION .....	13
OVERWEIGHT CHINA'S PROPERTY AS MORE DEVELOPERS MAY ENTER THE INDEX .....	14
RISK FACTORS.....	17
EVERGRANDE (3333 HK) .....	18
SUNAC (1918 HK).....	25
DISCLOSURES .....	32



## China Property Sector Positive earnings in 2018

- Gross margin should improve further on higher presales ASP; we expect 2018 core profit to jump 28% YoY for stocks in our coverage universe
- Making rental housing as important as home purchasing is the government's new key initiative; developers with established rental business would gain market share
- Property management business could be a new growth driver
- Weak presales announced by listed developers in Nov-Dec may affect share prices. Stay with low valuation names such as **Times (1233 HK)**, **Yuzhou (1628 HK)** and **CIFI (884 HK)**. We also upgrade **Sunac (1918 HK)** to **BUY** from Sell on strong presales

**Sustainable improvement in GPM and earnings for 2018.** On the back of rising ASP, GPM of the PRC developers rebounded from 26.0% in 1H16 to 31.5% in 1H17. Given presales ASP grew at 11%YoY on average in 10M17, we expect gross margin to increase in 2018-19. Besides, 10M17 presales of major listed developers surged 45% YoY and a substantial proportion would be booked in 2018. Driven by higher margins and increased booking, we estimate core profit to rise by 28%YoY for 2018E (2017E: +37% YoY).

**Making rental housing as important as home purchasing.** In the 19<sup>th</sup> NCCPC, the idea of making rental housing as important as home purchasing was reiterated. The idea, which was first mentioned in the "Beijing residential supply plan in 2017- 2021" announced earlier in 2017, is to promote a healthy rental market by reducing speculative purchases and increasing rental demand. Housing need can be met by renting or purchasing based on one's financial viability. We believe developers with a high mix of rental income would benefit from rapid development of the rental market.

**Property management business could be a new growth driver.** According to China Index Academy, total managed GFA of property management sector reached 18.5bn sqm, up 6% YoY. However, market consolidation is taking place and large players are set to grow much faster. E.g., market share of the top 10 property management companies (PMCs) increased from 4.9% in 2013, to 10.2% in 2016. We believe PMC subsidiaries of major large-cap developers will benefit from the consolidation trend, especially if they can secure a significant number of new projects from parent companies.

**Large developers may continue to outperform.** We are positive on China property sector as the ongoing trend of market consolidation would benefit the larger listed players. Country Garden (2007 HK) will be included into HSI, effective on Dec 4, 2017. Fund managers are highly likely to increase their portfolio weighting in the China property sector. We believe two other large-cap players, Evergrande (3333 HK) and Sunac (1918 HK), may follow the same route to become HSI candidates. We reiterate **BUY** on Evergrande on lower net gearing after HRE's third round of capital increase; we also upgrade **Sunac** to **BUY** from Sell on better-than-expected presales. For small/mid-cap, we suggest investors to stay with the low valuation names such as **Times (1233 HK)**, **Yuzhou (1628 HK)** and **CIFI (884 HK)** for their attractive dividend yield as sector may experience short-term pressure on weak Nov-Dec sales.

## Sector Report Nov 14, 2017 OVERWEIGHT

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### Key Data

Avg.17E P/E (x)	7.7
Avg.17E P/B (x)	1.1
Avg.17E Dividend Yield (%)	4.9

Source(s): Bloomberg, ABCI Securities

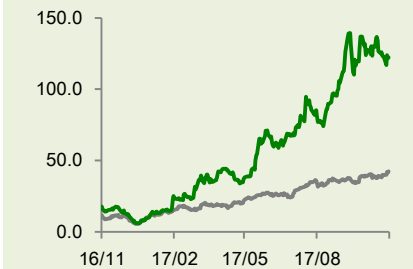
### Sector Performance %

	Absolute	Relative*
1-mth	(3.45)	(6.23)
3-mth	22.18	17.05
6-mth	60.62	44.76

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

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



— HSI  
— Hangseng Mainland Property Index

Source(s): Bloomberg, ABCI Securities

### Sector Valuation Summary (data as of Nov 13, 2017)

Company	Ticker	Current Rating	Previous Rating	TP (HK\$)	FY17A P/E(x)	FY18E P/E (x)	FY17A P/B (x)	FY18E P/B (x)	FY17A Yield(%)	FY18E Yield(%)
<b>Large cap picks</b>										
Evergrande	3333	BUY	BUY	35.80	10.4	11.2	5.3	4.3	-	4.5
Sunac	1918	BUY	SELL	42.20	30.1	14.8	4.2	3.8	1.3	2.7
<b>Small-mid cap picks</b>										
<u>Big Bay Area</u>										
Times	1233	BUY	BUY	11.20	5.7	4.8	1.2	1.0	5.2	6.3
Logan	3380	BUY	BUY	8.80	7.3	5.2	1.6	1.3	5.5	6.6
<u>YRD</u>										
Yuzhou	1628	BUY	BUY	6.90	4.3	3.0	0.9	0.8	7.8	11.7
CIFI	884	BUY	BUY	5.90	6.7	5.5	1.4	1.2	5.0	5.2

Source(s): Bloomberg, ABCI Securities estimates



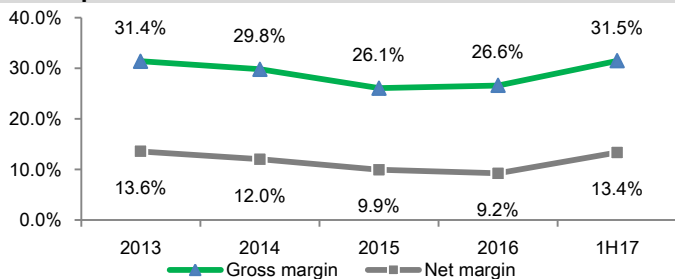
### Positive earnings for 2018

On the back of rising ASP, GPM of the HK-listed PRC developers rebounded from 26.6% in 1H16 to 31.5% in 1H17. Given presales ASP grew by 11% YoY on average in 10M17, we expect gross margin to increase in 2018-19. Besides, 10M17 presales of major listed developers surged 45% YoY and a substantial proportion would be booked in 2018. Driven by margin improvement and increasing sales booking, we estimate core profit (excluding Evergrande and Sunac) to rise by 28%YoY in 2018E (2017E: +37% YoY) for the stocks in our coverage universe.

Average net gearing in 1H17 increased 19.6ppt HoH to 85.0%. Excluding Sunac (1918 HK) and Evergrande (3333 HK), the two outliers who increased their debt levels more significantly than others in 1H17, the figure was still up by 8.9ppt HoH to 68.7%. Despite policy tightening, developers are still expanding their landbank. In particular, Sunac, whose presales soared 142% YoY in 10M17, indicated that over 71% of their landbank was purchased via M&A. As banks are still offering M&A loans to developers, we believe the trend of market consolidation would continue and net gearing of the larger players are unlikely to come down in the near future.

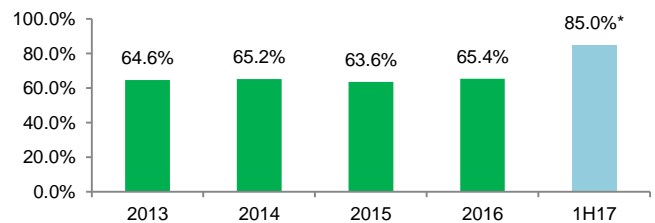
As landbank of the larger players continues to expand and their presales outperform the national average, we believe the HK-listed players may expect a sales target of 5-10%YoY increase for 2018E (vs. a 5-10%YoY decline for our national new home sales forecast). As home purchase restrictions (HPR) showed no signs of abating, we expect a flat presales ASP for 2018 and growth would be driven by increase in GFA.

Exhibit 1: Gross margin trend among the HK-listed PRC developers



Source(s): Companies, ABCI Securities

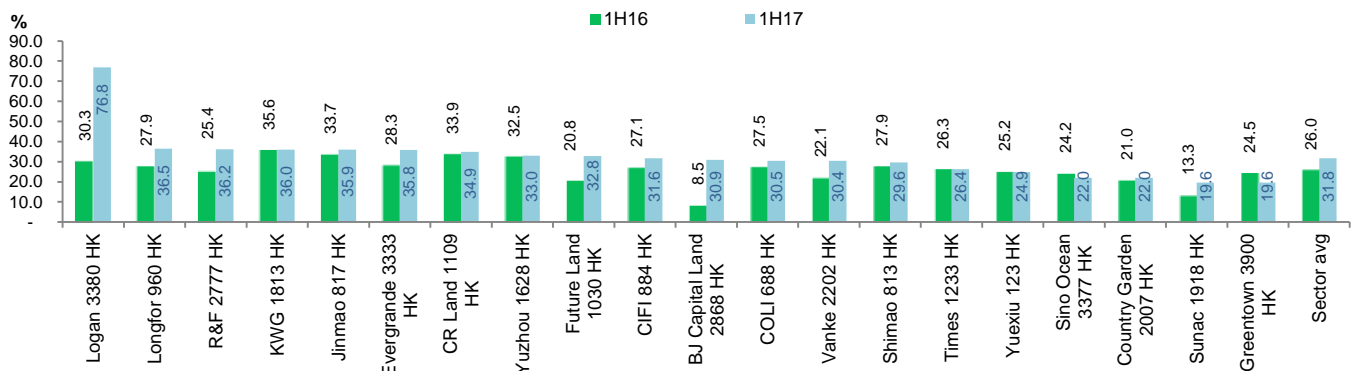
Exhibit 2: Net gearing trend of the HK-listed PRC developers



\*68.7% if we exclude Sunac and Evergrande

Source(s): Companies, ABCI Securities

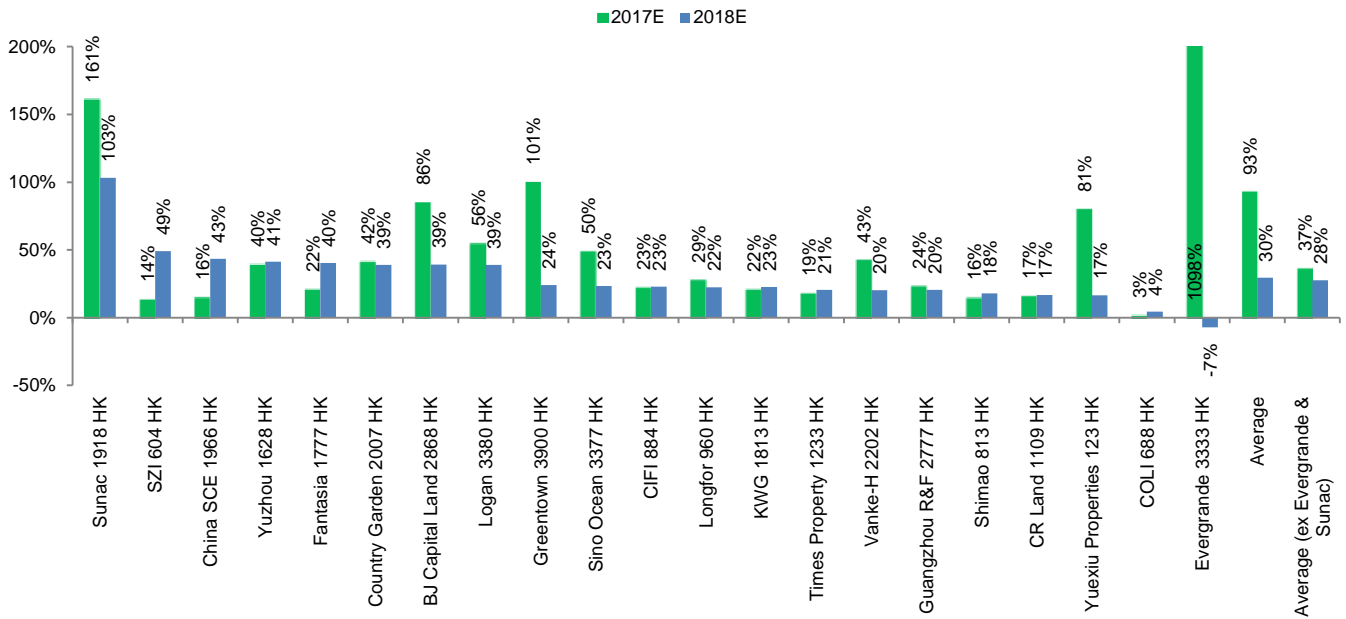
Exhibit 3: Gross margin of the HK-listed PRC developers



Source(s): Company, ABCI Securities

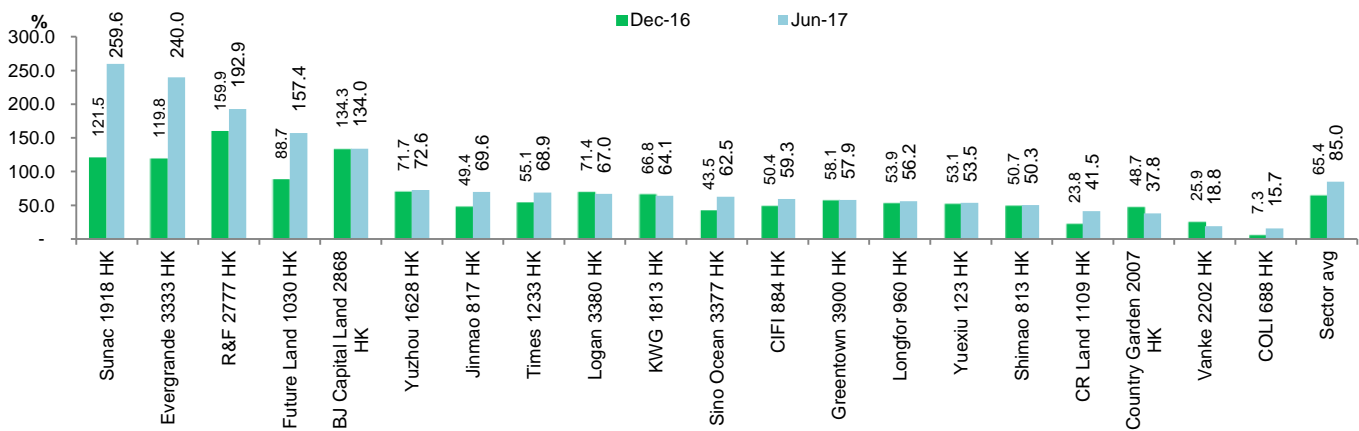


Exhibit 4: Core profit growth for 2017-18



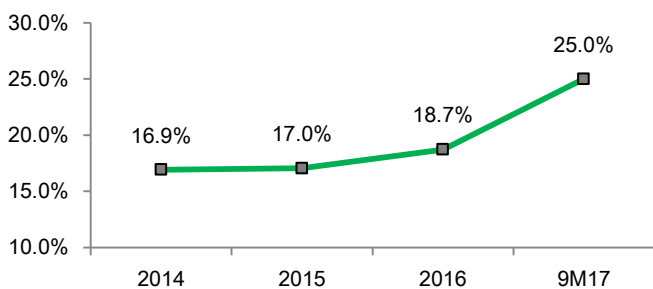
Source(s): Company, ABCI Securities estimates

Exhibit 5: Net gearing of the HK-listed PRC developers



Source(s): Company, ABCI Securities

Exhibit 6: Market share of Top 10 HK-listed PRC developers



Source(s): Company, ABCI Securities



Exhibit 7: 10M17 presale of major HK-listed PRC developers

		10M17					2017		Achievement
		Amount	YoY	GFA	YoY	ASP	YoY		
		RMBbn	%	000 sqm	%	RMB/sqm	%	RMBbn	
1	Sunac	249.0	142%	14,351	198%	17,348	-19%	300.0	83.0%
2	Longfor	140.4	89%	9,131	83%	15,377	4%	150.0	93.6%
3	Country garden	484.8	79%	53,120	60%	9,126	11%	500.0	97.0%
4	CIFI	78.9	70%	4,514	75%	17,471	-3%	80.0	98.6%
5	Yuzhou	32.4	59%	1,896	17%	17,100	36%	40.0	81.0%
6	Aoyuan	30.1	56%	2,951	34%	10,189	17%	33.3	90.3%
7	Sino-Ocean	55.7	45%	2,906	25%	19,164	16%	70.0	79.6%
8	Jinmao	41.7	42%	1,761	39%	23,661	2%	51.0	81.7%
9	Logan	34.9	42%	1,987	1%	17,564	40%	37.0	94.3%
10	Vanke	432.9	39%	29,121	25%	14,865	11%	na	na
11	Shimao	78.6	39%	4,685	15%	16,780	21%	88.0	89.3%
12	Poly-A	237.9	37%	17,017	30%	13,979	5%	na	na
13	Evergrande	422.3	33%	42,473	10%	9,943	21%	450.0	93.9%
14	Times	31.6	32%	1,814	-15%	17,438	55%	32.5	97.3%
15	KWG	24.9	29%	1,559	5%	15,976	23%	28.0	89.0%
16	Yuexiu	32.0	29%	1,843	-10%	17,354	42%	33.0	96.9%
17	R&F	66.1	25%	5,120	27%	12,911	-2%	73.0	90.5%
18	CR Land	112.7	24%	7,352	12%	15,326	11%	120.0	93.9%
19	Beijing Capital	37.9	12%	1,907	11%	19,853	1%	50.0	75.7%
20	Greentown	81.9	4%	3,420	-14%	23,947	22%	90.0	91.0%
21	COLI*	200.6	3%	12,422	4%	16,149	-1%	210.0	95.5%
22	SZI	10.6	-43%	510	-41%	20,827	-4%	19.1	55.6%
<b>Total</b>		<b>2,981.3</b>	<b>45%</b>	<b>227,158</b>	<b>31%</b>	<b>13,124</b>	<b>11%</b>	<b>2,520</b>	<b>91.7%</b>

\*in HK\$

Source(s): Company, ABCI Securities



## 2018: Making rental housing as important as home purchasing

### Highlights from the 19<sup>th</sup> NCCPC: Rental housing development would accelerate

The 19<sup>th</sup> NCCPC work report stated that “houses are built to be inhabited, not for speculation”. Over the past year, HPR have reduced investment demand and speculative activities in the housing market. Such restrictions are likely to continue in the short term. With the tightening measures in place, we expect 2018E ASP for national new home sales to be flat while total GFA sold would decline by 5-10%YoY

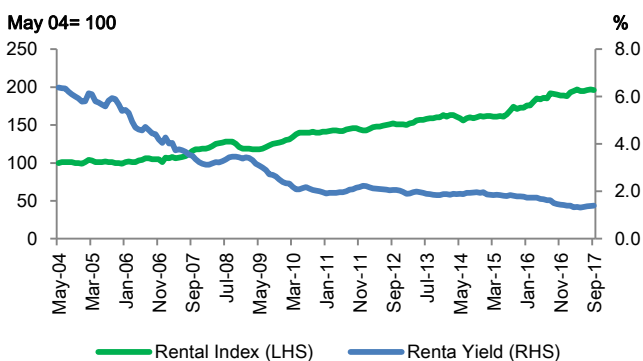
The idea of making rental housing as important as home purchasing is being promoted from the regional to the national level. Such idea was first mentioned in the "Beijing residential supply plan in 2017- 2021" announced earlier in 2017. Shortly after, Guangzhou, Shanghai and Shenzhen announced plans to stimulate the rental market. Policy to support both the home renting and purchasing could become essential in the long-term mechanism of China's property market. The government is aiming to promote a healthy rental market by reducing speculative purchases and increasing rental demand. Housing need can be met by renting or purchasing based on one's financial viability.

### A higher rental yield to boost rental demand

Market statistics that can accurately reflect rental demand, especially those pertaining to the lower-tier cities, is limited. On the supply side, the government can encourage the development of rental housing projects by offering more rental-only land sites. With uncertainties on the demand side, however, we believe policies to support both home renting and purchasing will be piloted in tier-1 or other major cities where mobile and non-local residents form a significant part of the population.

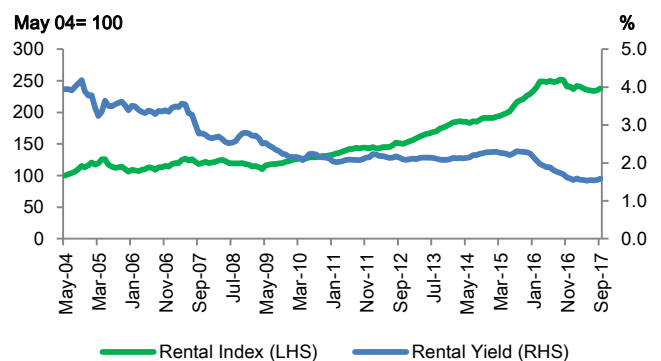
According to Centaline's data in secondary residential market, rental index as at Sep 2017 for tier-1 cities were 77-138% higher than the 2004 level, but rental yield was just 1.39-1.63% (vs. 3.95-7.37% in 2004) as property prices were rising at a much faster rate. Given the current rental yield at 1-2% can hardly cover the financing cost (5-year PBOC rate: 4.9%), property owners have limited incentives to rent out the properties for income. Instead, we believe most property speculators would leave the properties vacant until they are disposed for capital gain. Unless the government offers more incentives to encourage buy-to-rent for individual investors, we believe the government would need to increase rental-only land supply so that the developers would be required to hold the completed properties for rental income. With the increasing land supply for rental housing, land cost may come down and reduce development costs of developers.

Exhibit 8: Rental yield and rental index of Beijing's secondary residential market



Source(s): Centaline, ABCI Securities

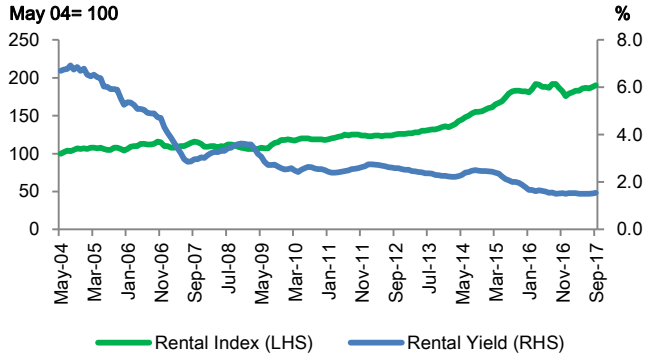
Exhibit 9: Rental yield and rental index of Shanghai's secondary residential market



Source(s): NBS, ABCI Securities

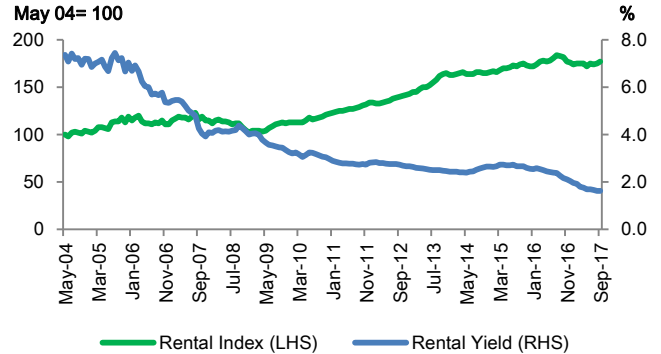


Exhibit 10: Rental yield and rental index of Shenzhen's secondary residential market



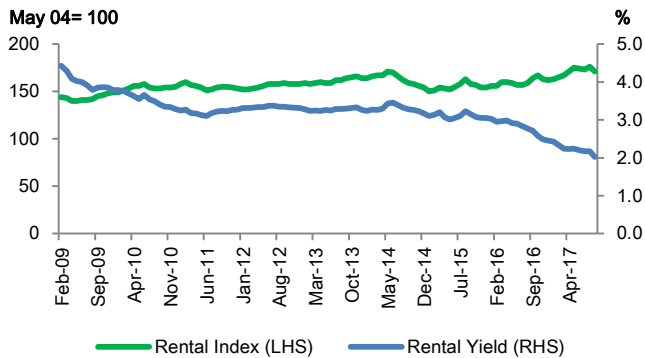
Source(s): Centaline, ABCI Securities

Exhibit 11: Rental yield and rental index of Guangzhou's secondary residential market



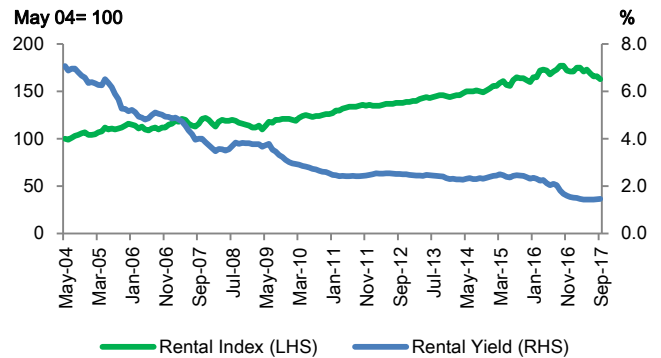
Source(s): NBS, ABCI Securities

Exhibit 12: Rental yield and rental index of Chengdu's secondary residential market



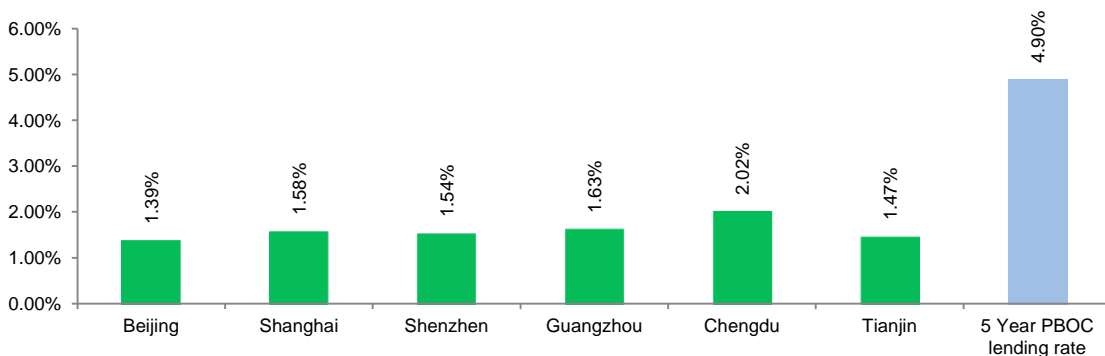
Source(s): Centaline, ABCI Securities

Exhibit 13: Rental yield and rental index of Tianjin's secondary residential market



Source(s): NBS, ABCI Securities

Exhibit 14: Rental yield in tier-1 cities vs. PBOC rate (Sep 2017)



Source(s): Centaline, ABCI Securities

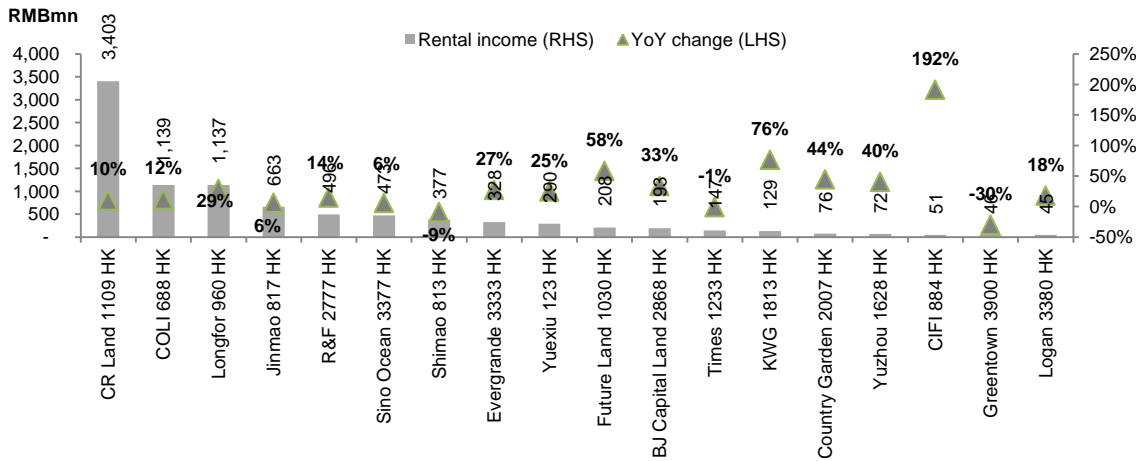




Developers with established rental team will be the winners

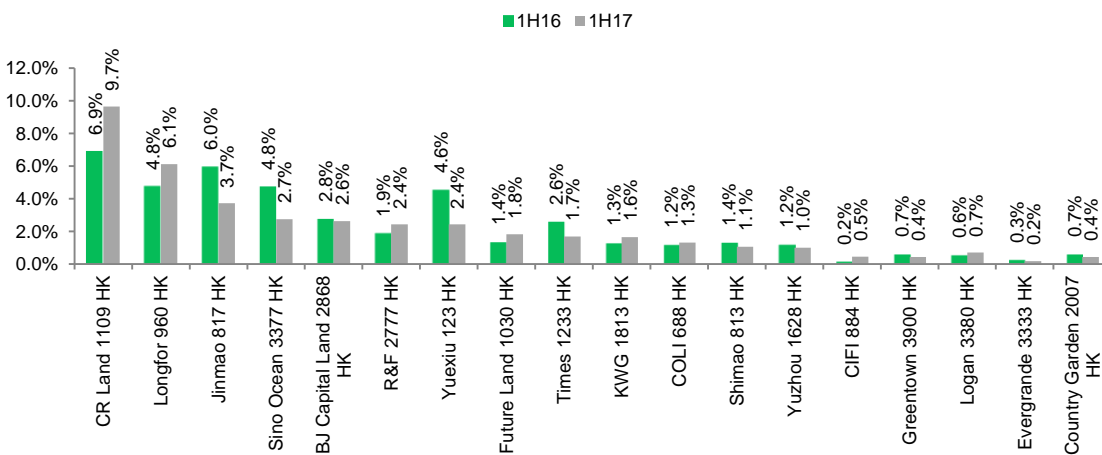
We believe developers with a high mix of rental income such as Jinmao (817 HK, BUY), Longfor (960 HK, UNRATED), CR Land (1109 HK, UNRATED) would benefit from development in the rental market. On the other hand, developers that adopt a high asset turnover model, such as Sunac and Evergrande, may lose market share in the future because they have relatively less experience in rental property development.

Exhibit 15: Rental income of PRC developers (1H17)



Source(s): Company, ABCI Securities

Exhibit 16: Rental income as a percentage of total income (1H17)



Source(s): Company, ABCI Securities

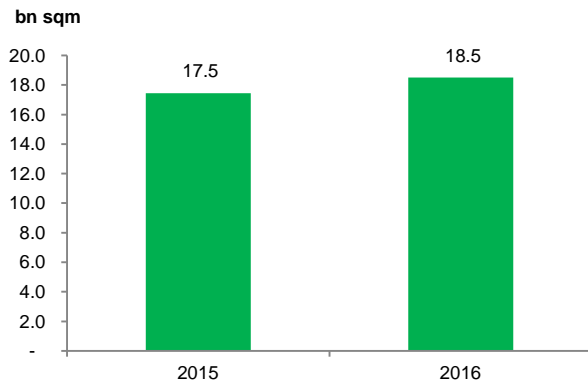


## Property management business could be a new rising star

### Market consolidation on the way

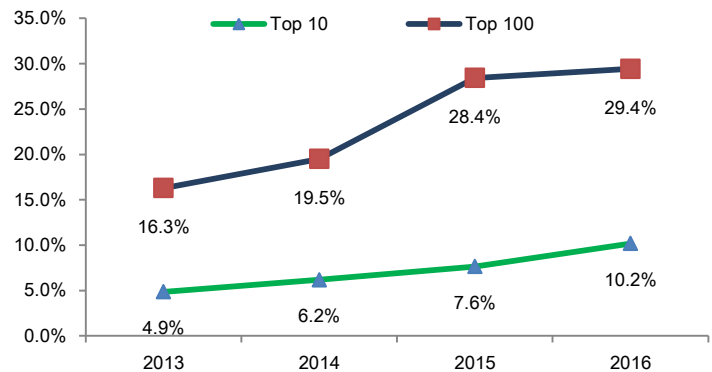
The policy of making rental housing as important as home purchasing may eventually transform developers to focus on recurring revenue. Also, property management fees could become another major source of recurring revenue. According to China Index Academy, total managed GFA of property management sector reached 18.5bn sqm, up 6% YoY. However, we observe that market consolidation has been taking place and large players are set to grow faster. E.g., market share of the top 10 PMCs increased from 4.9% in 2013, to 10.2% in 2016; the averaged managed GFA and revenue of these PMCs also increased by 41.3% YoY and 41.6% YoY to 188mn sqm and RMB3.14bn in 2016. We believe PMC subsidiaries of major large-cap developers will benefit from the consolidation trend, especially for those who can secure a large volume of projects from the parent companies.

**Exhibit 17: Total managed GFA of the property management sector**



Source(s): China Index academy, ABCI Securities

**Exhibit 18: Market share of the top 10 and top 100 PMCs by managed GFA**



Source(s): China Index academy, ABCI Securities

**Exhibit 19: Average managed GFA and revenue of top 100 PMCs (2016)**

	Average managed GFA		Average revenue	
	mn sqm	YoY %	RMBmn	YoY %
Top 10	188.39	41.3%	3,140	41.6%
Top 11-30	37.05	21.1%	1,038	22.0%
Top 31-50	16.23	1.5%	399	1.5%
Top 51-100	11.47	0.5%	246	0.7%

Source(s): China Index academy, ABCI Securities

**Exhibit 20: Management fee of top 100 PMCs by property type**

(RMB/sqm/mth)	2016	2015	YoY change
Office	7.86	7.89	-0.4%
Commercial	7.04	6.96	1.1%
Residential	2.31	2.24	3.1%
School	3.38	3.7	-8.6%
Hospital	6.87	6.76	1.6%

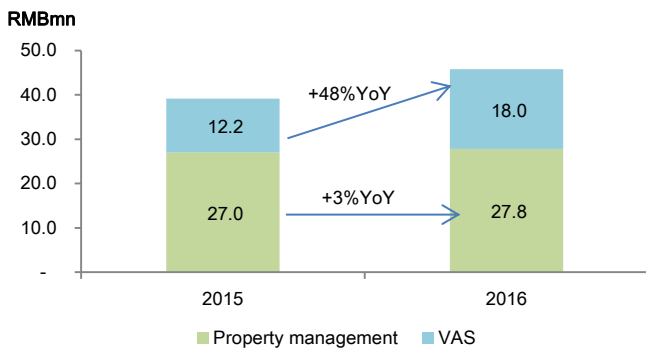
Source(s): China Index academy, ABCI Securities



### VAS revenues could become margin driver

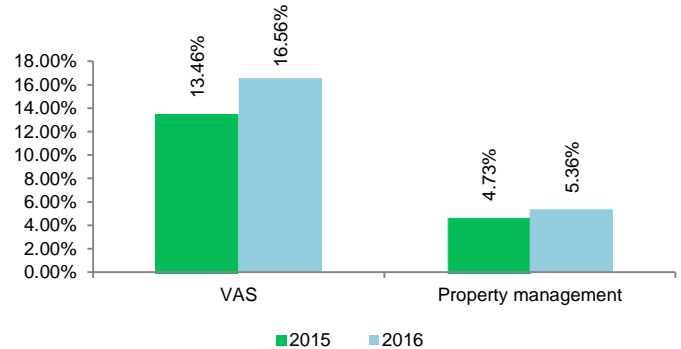
Property management sector has been pressured by rising labor cost pressure as PMCs can increase their management fee by a small margin upon contract renewal. However, with O2O business has been growing rapidly with the rising penetration of smartphones, margin of PMCs could improve. In 2016, average net profit from VAS business among the top 100 PMCs grew 48% YoY vs. 3%YoY growth for traditional property management business; net margin of VAS business among the top 100 PMCs went up 3.1ppt YoY to 16.56%, compared to 5.36% for the traditional property management business. Sizeable PMCs, with access to a much larger group of potential O2O users from their projects under management, will see higher increase in VAS revenue.

Exhibit 21: Net profit breakdown of Top 100 PMCs



Source(s): China Index academy, ABCI Securities

Exhibit 22: Net margin by business of Top 100 PMCs

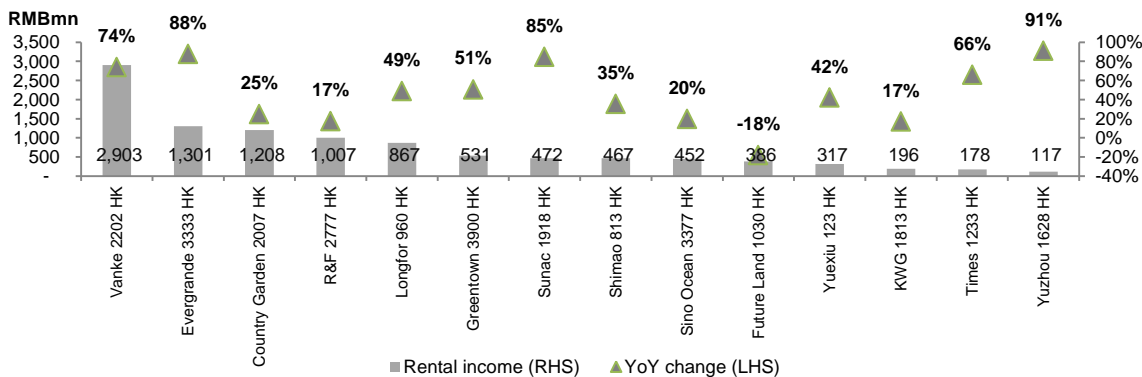


Source(s): China Index academy, ABCI Securities

### Property management business: some like it better

Developers deriving a higher proportion of revenue from property management have allocated more resources in this previously low-margin business. We believe these players will be in a better position to third-party management contracts and identify M&A opportunities. Developers with more non-residential projects (e.g. Office and commercial) under management would enjoy a higher management fee rate. The office management fees of the top 100 PMCs are averaged at RMB 7.86/sqm/mth in 2016, compared to RMB 2.31/sqm/mth much higher for residential properties. We believe property management business of R&F (2777 HK) and Longfor (960 HK) would have better growth potential than peers.

Exhibit 23: Property management revenue of Chinese developers (1H17)

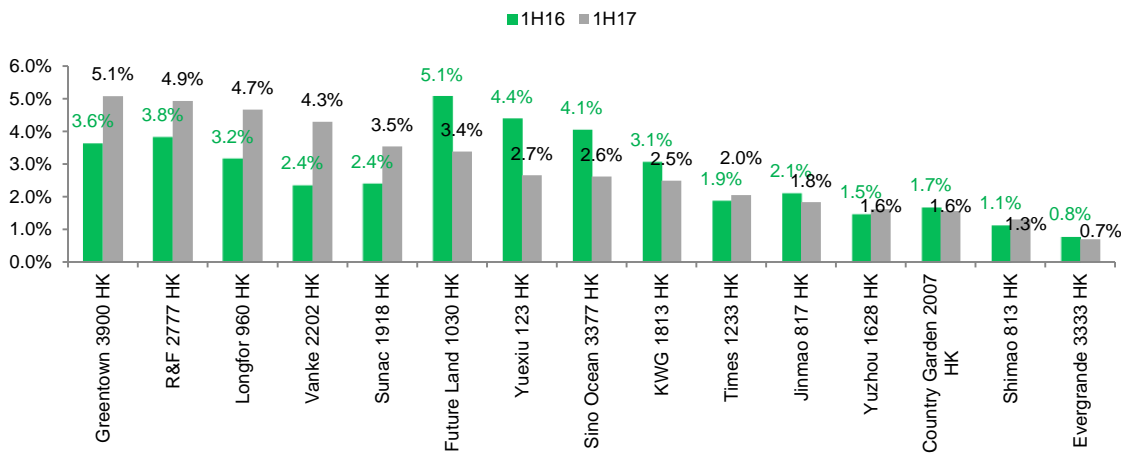


\* We only included the major HK-listed PRC developers with separate disclosure on property management business

Source(s): Company, ABCI Securities



Exhibit 24: Property management revenue as a percentage of total income (1H17)



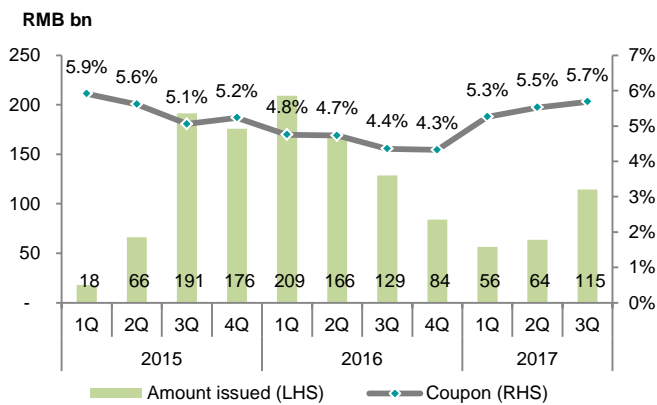
Source(s): Company, ABCI Securities



### Rising onshore finance cost driven by interest hike expectation

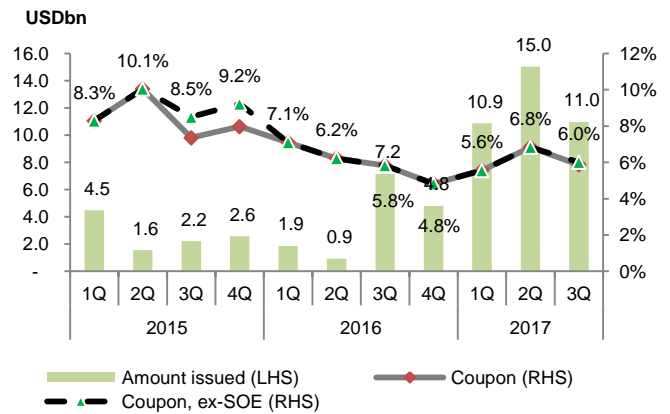
Onshore financing cost of developers has been on the uptrend since 4Q16. In 3Q17, PRC developers issued a total of RMB 115bn onshore corporate bond, up 80% QoQ, but down 11% YoY. Average coupon rate increased for the past three quarters and reached 5.7% in 3Q17, up 16bps QoQ or 133bps YoY. This could reflect the market's expectation of rising interest rate in the near future. USD bond issuance for PRC developers declined by 27% QoQ but increased by 53% YoY to US\$ 11bn. The average coupon rate of 6.0% in 3Q17 was 97bps lower than 2Q17 but 1.18% higher than 3Q16. Interest hike expectation is reflected both in onshore and offshore coupon rates. Rising interest rate implies higher finance costs for developers and lowers affordability of mortgage buyers.

Exhibit 25: Onshore RMB bond issuance by quarter



Source(s): Bloomberg, ABCI Securities

Exhibit 26: Offshore USD bond issuance by quarter



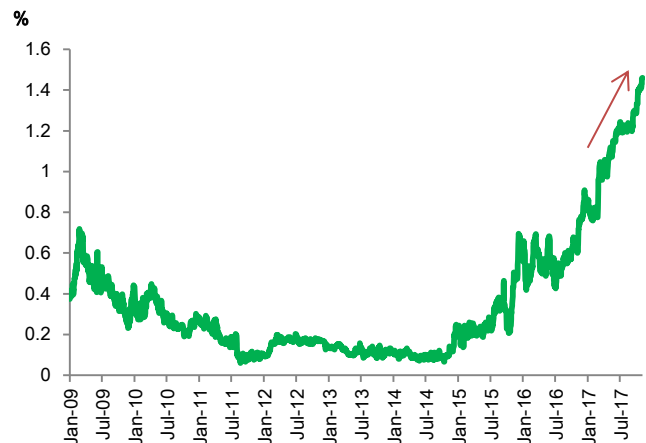
Source(s): Bloomberg, ABCI Securities

Exhibit 27: One-yr Chinese government bond yield



Source(s): Bloomberg, ABCI Securities

Exhibit 28: One-yr US Treasury yield



Source(s): Bloomberg, ABCI Securities

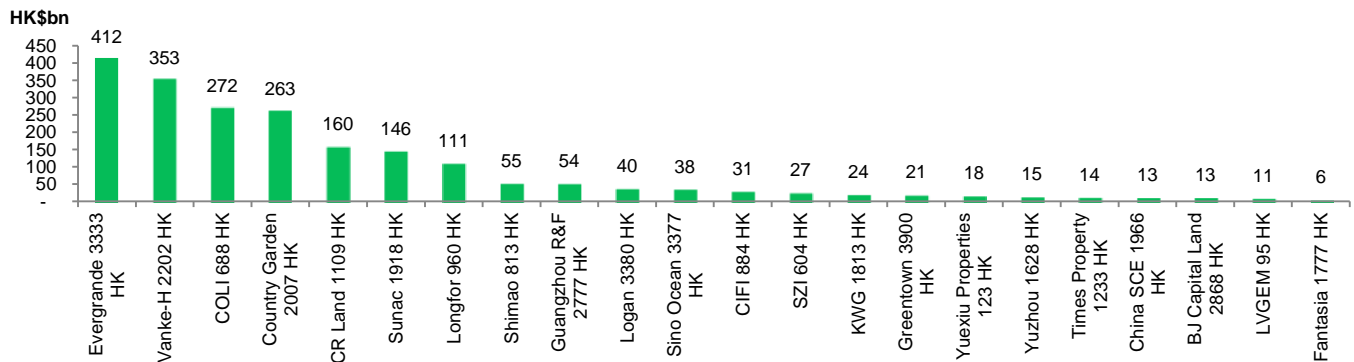


## OVERWEIGHT on China property sector as more developers may enter the index

We maintain positive on China property sector. The sector may suffer from short term pressure due to weak sales performance in Nov in Dec, but ongoing market consolidation trend would benefit the large players over the long run. Based on the monthly presale of the HK-listed PRC developers in 4Q16, growth has been slowing noticeably since Sep and entered the negative territory in Dec 2016. The year-end slowdown can be attributed to developers deferring new launches scheduled for 4Q to the following year after achieving their sales targets. We believe a similar pattern will occur in 2017. Besides, given the sector's impressive share price performance YTD, fund managers may lower its shareholding to lock in profits. Over the last month, the China's property sector dropped 5.4% on average, underperforming HSI that showed a 2.6% increase.

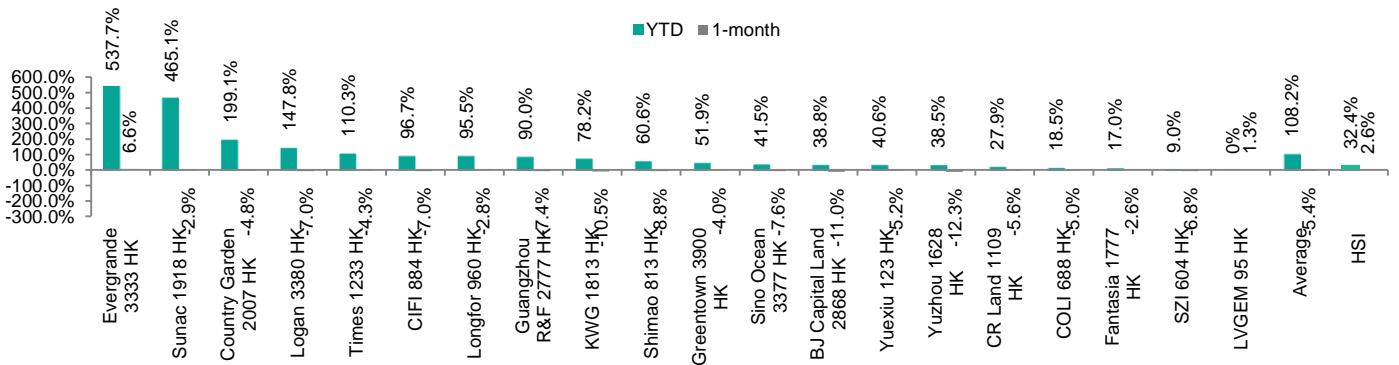
On Dec 4, 2017, Country Garden (2007 HK) will become an HSI constituent along with Sunny Optical (2382 HK). Including COLI and CR Land, there are three China Property constituent stocks in HSI. Fund managers, especially those in the index tracking funds, are likely to increase their portfolio weighting in the China property sector. Evergrande and Sunac, with a similar market cap and higher average daily turnover than County Garden, could be the next HSI candidates. In fact, the three large-caps (Evergrande, Sunac and Country Garden) are sought after by investors- their share prices have rallied by 199%-538% YTD (sector average: 108%), or -4.8% to +6.6% (sector average: -5.4%) over the last month.

Exhibit 29: Market cap of HK listed Chinese developers



Source(s): Bloomberg, ABCI Securities

Exhibit 30: Share price performance of HK-listed PRC developers

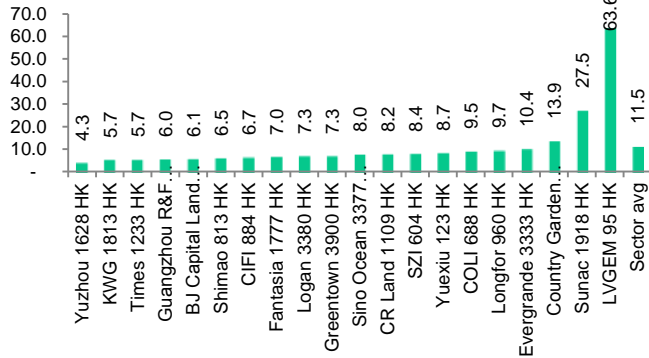


Source(s): Bloomberg, ABCI Securities



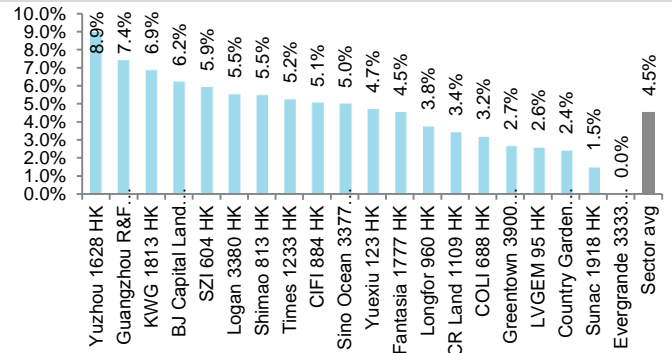
The market will continue to favor the large-cap names. We reiterate our **BUY** rating for **Evergrande (3333HK)** on substantial net gearing reduction after the third round of capital increase in Hengda Real Estates. We also upgrade **Sunac (1918 HK)** from Sell to **BUY** on its better-than-expected presales amid the year-end slowdown across the sector. For small/mid caps, we prefer counters trading at low valuations such as **Times (1233 HK)**, **Yuzhou (1628 HK)** and **CIFI (884 HK)** for their attractive dividend yields. We also roll forward our NAV estimate to 2018 and adjusted our TP accordingly.

Exhibit 31: FY17 P/E of HK-listed PRC developers



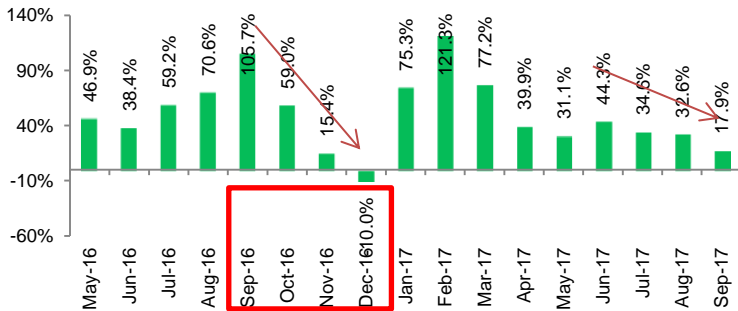
Source(s): Bloomberg, ABCI Securities

Exhibit 32: FY17 dividend yield of HK-listed PRC developers



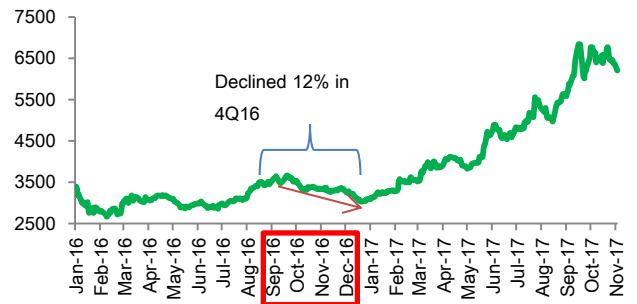
Source(s): Bloomberg, ABCI Securities

Exhibit 33: Major HK-listed PRC developers- monthly sales YoY growth



Source(s): Companies, ABCI Securities

Exhibit 34: Hang Seng Mainland Property Index



Source(s): Bloomberg, ABCI Securities

Exhibit 35: TP changes in our China property coverage universe

Company	Ticker	Rating		NAV (HK\$)		Discount (%)		TP (HK\$)		
		Previous	Current	Previous	Current	Previous	Current	Previous	Current	Change (%)
Times	1233	BUY	BUY	17.64	22.43	50%	50%	8.80	11.20	27.3%
SZI	604	BUY	BUY	10.49	12.31	60%	60%	4.20	4.90	16.7%
Logan	3380	BUY	BUY	16.60	14.67	50%	40%	8.30	8.80	6.0%
Yuzhou	1628	BUY	BUY	13.78	13.76	50%	50%	6.90	6.90	0.0%
CIFI	884	BUY	BUY	10.37	11.89	50%	50%	5.20	5.90	13.5%
Jinmao	817	BUY	BUY	8.51	9.10	50%	50%	4.25	4.55	7.0%
LVGEM	95	BUY	BUY	6.33	6.28	60%	50%	2.50	3.10	24.0%
COLI	688	BUY	BUY	37.78	43.56	20%	20%	30.20	34.90	15.6%
Fantasia	1777	BUY	BUY	3.41	3.63	60%	60%	1.37	1.45	5.8%
Evergrande	3333	BUY	BUY	40.61	39.73	30%	10%	28.40	35.80	26.1%
Sunac	1918	SELL	BUY	24.14	60.26	60%	30%	9.70	42.20	335.1%
Greentown	3900	HOLD	HOLD	18.90	22.35	60%	60%	7.60	8.90	17.1%

Source(s): Company, ABCI Securities



Exhibit 36: Valuation of China property sector

China Property	Ticker	Rating	TP	Mkt cap (HKD bn)	Share Price (local ccy)	Performance			Discount to NAV	Valuation									
						3M	YTD	2015		P/E			Yield (%)			P/B			
						% Chg	% Chg	% Chg	2016A	2017E	2018E	2016A	2017E	2018E	2016A	2017E	2018E		
<b>Residential :</b>																			
1	Evergrande	3333 HK	BUY	35.80	405.1	30.80	66	538	(23)	(22.48)	124.9	10.4	11.2	0.0	0.0	4.5	8.6	5.3	4.3
2	Vanke-H	2202 HK	NR		345.5	27.60	25	56	30	19.80	13.9	9.7	8.0	3.3	4.3	5.2	2.3	2.0	1.7
3	COLI	688 HK	BUY	34.90	266.8	24.35	(4)	18	(22)	(44.11)	9.8	9.5	9.1	3.2	3.2	3.4	1.1	1.1	1.0
4	Country Garden	2007 HK	NR		276.4	12.98	35	199	43	(36.40)	19.8	13.9	10.0	1.6	2.4	3.1	3.0	2.9	2.4
5	CR Land	1109 HK	NR		154.6	22.30	(2)	28	(20)	(37.43)	9.6	8.2	7.0	3.1	3.5	4.1	1.3	1.2	1.0
6	Sunac	1918 HK	BUY	42.20	151.0	36.45	99	465	13	(39.51)	78.6	30.1	14.8	0.8	1.3	2.7	5.2	4.2	3.8
7	Longfor	960 HK	NR		113.5	19.24	4	96	(11)	(26.68)	12.5	9.7	8.0	2.8	3.7	4.6	1.5	1.4	1.2
8	Guangzhou R&F	2777 HK	NR		57.4	17.82	17	90	12	(23.58)	7.5	6.0	5.0	6.6	7.0	7.9	1.1	0.9	0.8
9	Shimao	813 HK	NR		55.1	16.28	18	61	(21)	(44.81)	7.6	6.5	5.5	4.5	5.5	6.1	0.9	0.8	0.7
10	Logan	3380 HK	BUY	8.80	39.9	7.26	1	148	17	(50.50)	11.3	7.3	5.2	3.4	5.5	6.6	1.8	1.6	1.3
11	Sino Ocean	3377 HK	NR		37.1	4.91	22	41	(27)	(53.46)	11.9	8.0	6.5	4.2	5.1	6.3	0.7	0.7	0.6
12	CIFI	884 HK	BUY	5.90	31.1	4.11	(3)	97	30	(65.43)	8.3	6.7	5.5	4.1	5.0	5.2	1.6	1.4	1.2
13	SZI	604 HK	BUY	4.90	27.0	3.39	0	9	(9)	(72.46)	9.6	8.4	5.6	6.5	6.0	8.9	0.8	0.7	0.6
14	KWG	1813 HK	NR		24.7	7.84	46	78	(18)	(52.77)	7.0	5.7	4.7	6.0	6.6	7.9	0.8	0.8	0.7
15	Greentown	3900 HK	HOLD	8.90	20.7	9.54	(5)	52	(18)	(57.32)	14.6	7.3	5.9	1.5	2.7	3.4	0.7	0.7	0.6
16	Yuexiu Properties	123 HK	NR		18.5	1.49	9	41	(17)	(42.25)	15.8	8.7	7.5	4.4	4.7	5.7	0.5	0.5	0.5
17	Yuzhou	1628 HK	BUY	6.90	15.7	3.74	(16)	39	39	(72.83)	6.0	4.3	3.0	5.9	7.8	11.7	1.2	0.9	0.8
18	Times Property	1233 HK	BUY	11.20	14.6	7.97	32	110	49	(64.47)	6.8	5.7	4.8	4.6	5.2	6.3	1.4	1.2	1.0
19	China SCE	1966 HK	NR		13.0	3.41	(7)	56	37	(62.85)	6.7	5.8	4.0	4.3	5.3	7.3	1.1	1.0	0.9
20	BJ Capital Land	2868 HK	NR		12.2	4.04	7	39	(11)	(26.55)	11.4	6.1	4.4	5.8	6.4	8.4	0.6	0.7	0.6
21	LVGEM	95 HK	BUY	3.10	11.3	2.40	14	0	(1)	(61.79)	27.7	63.6	14.2	2.1	1.0	4.4	1.9	1.9	1.8
22	Fantasia	1777 HK	BUY	1.45	6.4	1.11	5	17	13	(69.46)	8.5	7.0	5.0	4.5	4.5	6.3	0.5	0.5	0.5
<b>HK Listed Avg (ex Evergrande, Sunac LVGEM)</b>							13	77	5	(47.48)	10.6	7.7	6.1	4.3	4.9	6.1	1.2	1.1	1.0
<b>- Large cap (&gt;HKD50b, ex Evergrande and Sunac)</b>							13	78	1	(27.60)	11.5	9.1	7.5	3.6	4.2	4.9	1.6	1.5	1.3
<b>- Small-mid cap (&lt;HKD50b), ex LVGEM</b>							13	77	7	(57.41)	10.2	7.1	5.5	4.6	5.2	6.7	1.0	0.9	0.8
<b>Commercial:</b>																			
1	SOHO China	410 HK	NR		24	4.58	24	20	20	(42.75)	na	67.2	61.9	0.0	6.4	4.8	0.6	0.6	0.6
2	HLP	101 HK	NR		78	17.36	(12)	6	(2)	(51.37)	12.4	14.0	16.0	4.3	4.3	4.3	0.6	0.6	0.6
3	China South City	1668 HK	HOLD	1.60	16	1.99	24	23	(5)	(37.98)	15.3	10.3	7.7	2.2	3.2	4.3	0.6	0.6	0.5
4	Hui Xian REIT	87001 HK	NR		20	3.03	(1)	(4)	3	na	22.7	14.8	14.8	8.5	8.9	8.9	0.6	0.6	0.7
5	Jinmao	817 HK	BUY	4.55	39	3.61	8	73	(18)	(60.33)	17.1	12.7	8.9	2.5	5.4	4.5	1.3	1.3	1.2
6	Shui On Land	272 HK	NR		16	1.97	8	18	(20)	(73.73)	7.6	7.4	7.4	2.6	2.8	2.9	0.4	0.3	0.3
7	Yuexiu REIT	405 HK	NR		15	4.96	(0)	21	5	na	30.9	NA	NA	6.7	6.6	6.8	0.9	1.0	1.0
<b>Commercial Avg</b>							7	22	(3)	(53.23)	17.7	21.1	19.4	3.8	5.4	5.2	0.7	0.7	0.7

Source(s): Bloomberg, ABCI Securities estimates





## Risk factors

- **Placement risks:** given the sector has rallied 108% YTD, developers have great incentives to raise fund by new share placement
- **Further policy tightening:** the government may tighten the property sector further if property price showed no sign of stabilizing.
- **M&A risks:** M&A has become a major source of land acquisition, but post M&A integration may lead to higher SG&A costs.
- **FX risks:** as developers return to the offshore USD bond market, FX risk exposure increases.
- **Rental housing policy may affect landbank replenishment of developers:** as the government is determined to increase rental housing supply, developers may find it difficult to replenish saleable resources, which will eventually affect presale.
- **Tougher financing environment onshore:** As corporate bond rate continues to rise, banks may apply a higher rate for developers' construction loan. Moreover, with HPR remaining in place, banks may turn more reluctant on mortgage lending in 2018.
- **Expansion into non-property business:** many developers have invested into non-property businesses. E.g, Evergrande invests in insurance business while Sunac acquires stakes in Leshi, an internet media in China. Without expertise in relevant industry, these developers may suffer from operating losses and impairments on investment cost.



## Evergrande (3333 HK) Deserves premium valuation

- The third round of capital increase to Hengda Real Estate (HRE) raised RMB 60bn; the three rounds of capital subscription raised a total of RMB 130bn
- Evergrande raised HRE's net profit forecasts in the performance undertaking to RMB 50bn (from 30.8bn) for 2018, RMB 55bn (from RMB 33.7bn) for 2019 and RMB 60bn for 2020
- Maintain **BUY** and raise TP to HK\$ 35.80 (from HK\$ 28.40) based on a 10% discount to 2018E NAV

**Third round of capital increase raised RMB 60bn.** In Nov 2017, Evergrande raised RMB 60bn from the third round of new share issuance of its property subsidiary, Hengda Real Estates (HRE), pending to be listed on the A-share market. A total of six investors subscribed 14.11% of HRE's enlarged capital, implying a pre-money valuation of RMB 365.19bn, 74% higher than the valuation of RMB 210bn after the second round of capital increase in June 2017. Among the six investors, Suning Electrical Appliance, one of the leading electrical appliance retailers, subscribed RMB 20bn for a 4.7% stake. Also, Evergrande raised HRE's net profit forecasts (after deducting non-recurring gains and losses) in the performance undertaking to RMB50bn (from RMB30.8bn) for 2018, RMB55bn (from RMB33.7bn) for 2019 and RMB60bn (previously unstated) for 2020, implying increased optimism over future profitability.

**Net gearing to improve more and sooner than expected.** During the interim results meeting, Evergrande announced the goal to slash net gearing to 140% by June 2018, 100% by June 2019, and 70% by June 2020 and beyond via: 1) a 5-10% annual reduction in land reserves until June 2020; 2) making the third tranche of strategic investment (RMB30-50bn) in HRE; 3) improving profitability further to increase equity base. Results of the third round of capital increase were higher than the RMB30-50bn guidance. We expect Evergrande's net gearing to come down to 55% by 2018E, two years ahead of schedule.

**Deserves premium valuation; maintain BUY and raise TP to HK\$35.80.** Evergrande's interim results surprised the market with its higher-than-peer gross margin. It tops the attributable presales in 9M17 and core profit rankings in 1H17. Its average daily turnover of HK\$1.1bn in the past three months is the highest in sector. With significant reduction in net gearing, we think Evergrande deserves a valuation towards the high-end range among peers. We roll forward our NAV forecast to 2018 and lower NAV to HK\$ 39.73/share (from HK\$40.61/share) mainly due to the dilution impact resulted from HRE's capital increase. However, TP is raised to HK\$ 35.80 (from HK\$ 28.4) due to a reduced NAV discount of 10% (from 30%). We believe the lower discount is justified given its remarkable presales, profitability, and trading liquidity. Maintain **BUY**.

### Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	133,130	211,444	381,088	456,641	499,378
Chg (% YoY)	19.5	58.8	80.2	19.8	9.4
Core net profit (RMB mn)	1,992	3,045	34,319	31,854	35,620
Chg (% YoY)	(42.6)	52.9	1,027.3	(7.2)	11.8
Core EPS (RMB)	0.14	0.21	2.53	2.35	2.63
Chg (% YoY)	(41.3)	52.9	1,098.0	(7.2)	11.8
BVPS (RMB)	3.5	3.1	4.9	6.1	7.4
Chg (% YoY)	2.1	(13.3)	60.7	23.8	21.5
Core PE (x)	191.0	124.9	10.4	11.2	10.0
P/B (x)	7.5	8.6	5.3	4.3	3.6
ROE (%)	1.6	1.9	51.3	38.5	35.4
ROA (%)	0.3	0.2	2.2	1.8	1.8
DPS(RMB)	0.38	-	-	1.17	1.31
Yield (%)	1.4	-	-	4.5	5.0
Net gearing (%)	93.5	119.8	97.4	55.4	45.2

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Nov 14, 2017

Rating: **BUY**

TP: **HK\$ 35.8**

Analyst : **Kenneth Tung**

Tel: **(852) 2147 8311**

**kennethtung@abci.com.hk**

Share price (HK\$)	30.80
Est. share price return	16.2%
Est. dividend yield	0.0%
Est. total return	16.2%
Previous Rating & TP	BUY, HK\$28.40
Previous Report Date	Sep 5, 2017

Source(s): Bloomberg, ABCI Securities

### Key Data

52Wk H/L(HK\$)	32.50/4.73
Issued shares (mn)	13,694
Market cap (HK\$ mn)	403,832
3-mth avg daily turnover(HK\$ mn)	1,126.27
Major shareholder(s) (%)	
HUI Ka Yan	70.1%

Source(s): Bloomberg, ABCI Securities

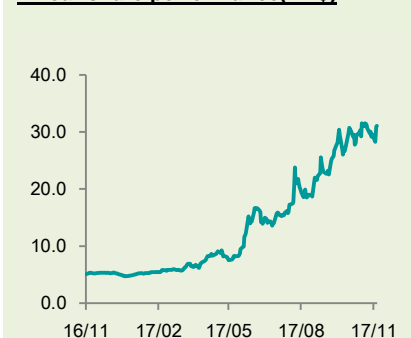
### Share Performance

	Absolute	Relative*
1-mth	4.2	2.0
3-mth	65.9	53.2
6-mth	270.0	219.4

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

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



Source(s): Bloomberg, ABCI Securities



**Risk factors:** 1) The amount of charity and public donations by the Group may vary greatly from one year to another (FY16: RMB 1,434mn, +28% YoY); 2) Financial division may remain in loss.

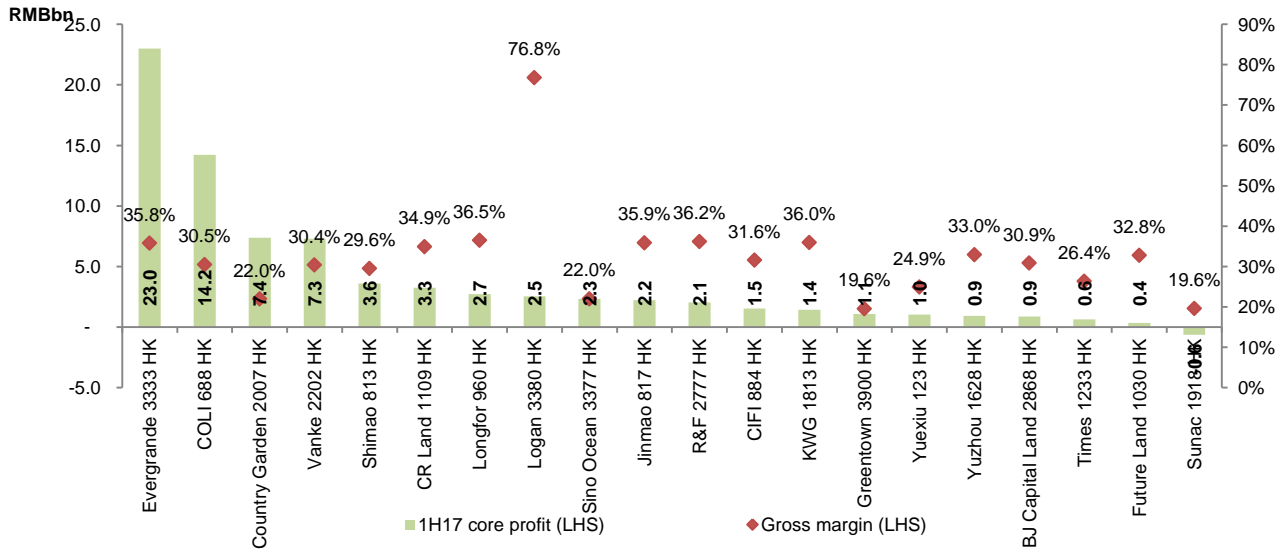
**Exhibit 1: HRE's investors in the three rounds of capital increase**

Company	Amount RMBbn	% of enlarged	Background
<b>First round</b>			
1 CITIC Juheng	5.0	2.19%	Engage in investment in industrial enterprises
2 Guangtian	5.0	2.19%	Engage in the assets management
3 Huajian	5.0	2.19%	Engage in investment in industrial enterprises
4 Zhongrong	3.0	1.32%	Engage in investment in industrial enterprises
5 Shandong Highway	3.0	1.32%	Engage in assets management
6 Ruican Investment	3.0	1.32%	Engage in the venture capital
7 Meitou	3.0	1.32%	Engage in venture capital
8 Guangdong Weimei	3.0	1.32%	Engage in industrial investment
<b>1st round total</b>	<b>30.0</b>	<b>13.17%</b>	
<b>Second round</b>			
1 Maanshan Maowen	5.5	2.05%	Subsidiary of SZI (604 HK)
2 Shenzhen Baoxin	5.0	1.87%	Controlled by controlling shareholder of Baoying Group (002047)
3 Jiangxi Huada Property	5.0	1.87%	Engage in property development
4 Shenzhen Qixiang	5.0	1.87%	Engage in investment of industrial enterprises
5 Shenzhen Jiancheng	3.5	1.31%	Engage in establishment of industrial enterprises
6 Suzhou Industrial Park Ruican	3.5	2.43%	Engage in venture capital business
7 Ningbo Minyin Jintou	3.0	1.12%	Engage in investment management
8 Jiaxing Yumin	2.0	0.75%	Engage in investment management
9 Weifang Golden Orange	2.0	0.75%	Engage in industrial projects investment
10 Jiayu Vehicle Accessories	2.0	0.75%	Engage in trading of vehicles
11 Shenzhen Zhongyi	1.0	0.37%	Engage in investment in industrial enterprises
12 Shanghai Haoren Property Management	1.0	0.37%	Engage in property management
13 Qingdao Yonghe Jinfeng	1.0	0.37%	Engage in investments in manufacturing industry
<b>2nd round total</b>	<b>39.5</b>	<b>15.86%</b>	
<b>Third round</b>			
1 Shandong Highway	20.0	4.70%	Engage in assets management
2 Suning Electrical	20.0	4.70%	Engage in retail, real estates and other industries
3 Shenzhen Amer	5.0	1.18%	Engage in production and sales of new material
4 Jiayu	5.0	1.18%	Engage in trading of vehicles
5 Guangzhou Yehoo	5.0	1.18%	Engage in investment management
6 Ding Xiang Sichuan	5.0	1.18%	Engage in equity investment
<b>3rd round total</b>	<b>60.0</b>	<b>14.11%</b>	

Source(s): Company, ABCI Securities

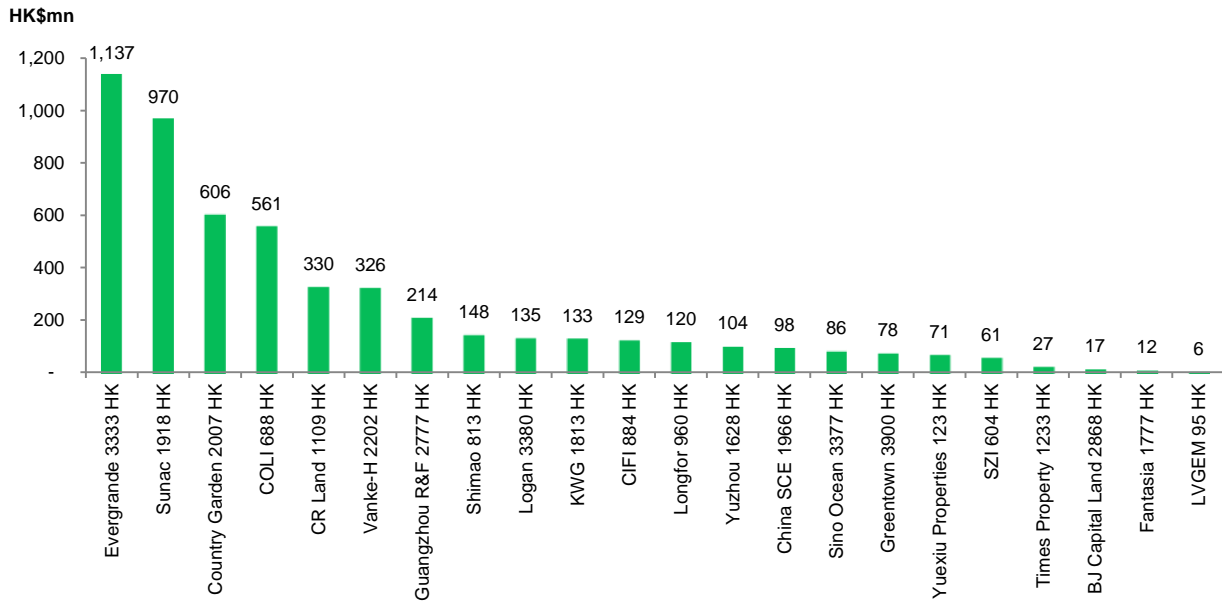


Exhibit 2: 1H17 core profit by developer



Source(s): Company, ABCI Securities

Exhibit 3: Three-month average daily turnover (Nov 2017)



Source(s): Bloomberg, ABCI Securities



Exhibit 4: Evergrande's 2018E NAV

	Attr. GFA (mn sqm)	Net assets value (RMB mn)	% of total	Valuation Methodology	Implied value (RMB/sqm)
Hengda Real Estates (63.46% stake) - property developments	176	511,578	85%	DCF at WACC of 6.8%	2,918
Hengda Real Estates (63.46% stake)- Investment properties		83,840	14%	1x PB	
Football business		1,200	0%	50% stake sold to Jack Ma at RMB1.2bn	
Financial investment		5,721	1%	Market value of Shengjing Bank	
<b>Total 2018E GAV</b>		<b>602,340</b>	<b>100%</b>		
2018E Net debt		(145,763)	-24%		
Perpetual capital instrument		-	0%		
<b>Total 2018E NAV</b>		<b>456,577</b>	<b>76%</b>		
No. of share outstanding (diluted)		13,561			
<b>NAV per share (RMB)</b>		<b>33.67</b>			
Ex rate		1.18			
<b>NAV per share (HKD)</b>		<b>39.73</b>			
Target discount (%)		10%			
<b>Target Price (HKD)</b>		<b>35.80</b>			
<b>WACC</b>	<b>6.8%</b>				
Cost of Debt	8.2%				
Cost of Equity	10.0%				
<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	381,088	456,641	499,378
Cost of sales	(79,615)	(95,717)	(152,022)	(251,279)	(297,629)	(324,460)
<b>Gross Profit</b>	31,784	37,413	59,422	129,809	159,012	174,917
SG&A expenses	(14,588)	(20,541)	(28,244)	(36,850)	(43,662)	(50,763)
<b>EBIT</b>	17,195	16,872	31,178	92,959	115,350	124,155
Finance cost	(1,015)	(807)	(6,392)	(5,382)	(4,298)	(3,394)
Share of profit of associates	(104)	(392)	(203)	1,364	1,515	1,515
Other income/ (expenses)	1,431	2,262	4,937	6,157	6,269	6,501
Fair value gain of investment properties	9,393	12,859	356	0	0	0
Disposal/one-off items	4,292	651	6,986	(7,073)	0	0
<b>Profit before tax</b>	31,191	31,445	36,862	88,025	118,835	128,776
Tax	(13,175)	(14,105)	(19,245)	(49,493)	(64,238)	(69,459)
<b>Profit after tax</b>	18,016	17,340	17,617	38,532	54,597	59,317
Minority interest	(1,073)	(1,797)	(2,745)	(5,736)	(22,743)	(23,697)
Perpetual coupon distribution	(4,339)	(5,083)	(9,781)	(3,781)	0	0
<b>Reported net profit</b>	12,604	10,460	5,091	29,015	31,854	35,620
Less: exceptional items	(9,134)	(8,469)	(2,047)	5,305	0	0
<b>Underlying net profit</b>	3,470	1,992	3,045	34,319	31,854	35,620
<b>Per share</b>						
Underlying EPS (RMB)	0.24	0.14	0.21	2.53	2.35	2.63
DPS (RMB)	0.43	0.38	-	-	1.17	1.31
Payout ratio (%)	183%	275%	0%	0%	50%	50%
BVPS (RMB)	3.47	3.54	3.07	4.93	6.11	7.42
<b>Growth %</b>						
Revenue	18.9%	19.5%	58.8%	80.2%	19.8%	9.4%
Gross Profit	15.0%	17.7%	58.8%	118.5%	22.5%	10.0%
EBIT	-5.5%	-1.9%	84.8%	198.2%	24.1%	7.6%
Underlying net profit	-54.9%	-42.6%	52.9%	1027.3%	-7.2%	11.8%
<b>Margin %</b>						
Gross margin	28.5%	28.1%	28.1%	34.1%	34.8%	35.0%
Gross margin (post-LAT)	25.6%	26.1%	25.0%	27.4%	28.1%	28.5%
EBIT margin	15.4%	12.7%	14.7%	24.4%	25.3%	24.9%
Core net margin	7.1%	5.7%	5.8%	11.1%	11.6%	11.6%
<b>Key assumptions</b>						
Contracted Sales (RMB mn)	131,510	201,340	406,667	554,073	614,409	720,383
GFA sold (mn sqm)	18.20	25.51	44.68	60.98	66.20	78.55
ASP (RMB/sqm)	7,228	7,892	9,102	9,087	9,281	9,171
Booked Sales (RMB mn)	107,450	126,449	203,890	371,858	445,275	485,280
GFA delivered (mn sqm)	16.84	17.24	25.57	41.84	49.36	53.94
Booked ASP (RMB/sqm)	6,382	7,334	7,975	8,888	9,022	8,997

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	1,379,595	1,561,731	1,812,712
Cash	29,847	103,090	198,420	165,579	213,398	196,537
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	957,427	1,091,744	1,359,587
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	200,440	200,034	199,588
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	23,708	23,708	23,708
<b>Total Assets</b>	474,462	757,035	1,350,868	1,580,035	1,761,764	2,012,300
<b>Current Liabilities</b>	268,237	456,681	733,394	930,585	1,073,694	1,282,773
Short-term borrowings	79,663	158,744	202,906	157,906	132,906	107,906
Trade & other payables	123,673	191,309	299,905	298,880	297,856	296,831
Pre-sales deposits	47,348	83,061	194,961	438,176	607,310	842,414
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	1,355,527	1,498,636	1,707,715
<b>Net Assets</b>	112,378	142,142	192,532	224,508	263,128	304,585
<b>Shareholders' Equity</b>	51,120	60,613	53,847	66,906	82,833	100,643
Perpetual capital instrument	52,852	66,130	103,337	0	0	0
Minority Interest	8,406	15,399	35,348	157,602	180,295	203,942
<b>Total Equity</b>	112,378	142,142	192,532	224,508	263,128	304,585
<b>Key ratio</b>						
Gross debt (RMB mn)	156,065	296,906	535,070	490,070	465,070	440,070
Net debt (RMB mn)	96,566	132,884	230,741	218,582	145,763	137,624
Net gearing (%)	86%	93%	120%	97%	55%	45%
Contracted sales/ Total assets (x)	0.28	0.27	0.30	0.35	0.35	0.36

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	94,593	116,984	125,789
Change in Working Capital	(52,024)	(25,704)	(169,385)	(26,112)	58,149	(14,530)
Tax payment	(13,175)	(14,105)	(19,245)	(49,493)	(64,238)	(69,459)
<b>Operating cash flow</b>	<b>(46,868)</b>	<b>(21,483)</b>	<b>(155,818)</b>	<b>18,988</b>	<b>110,894</b>	<b>41,799</b>
Purchase of PP&E	(1,532)	(10,246)	(70)	(70)	(70)	(70)
Others	(1,869)	12,905	(18,242)	35,677	6,626	6,897
<b>Investing cash flow</b>	<b>(3,402)</b>	<b>2,659</b>	<b>(18,312)</b>	<b>35,607</b>	<b>6,556</b>	<b>6,827</b>
Debt raised	52,794	115,470	317,887	5,000	5,000	5,000
Debt repaid	(5,000)	(641)	(5,000)	(50,000)	(30,000)	(30,000)
Interest expenses	(14,649)	(21,102)	(32,731)	(35,880)	(28,654)	(22,629)
Equity raised	0	(658)	0	(6,349)	0	0
Dividend to shareholders	(6,339)	(5,476)	0	0	(15,927)	(17,810)
Perpetual securities raised/(repaid)	13,241	(5,083)	(10,646)	(117,157)	0	0
Others	(50)	9,557	(50)	116,950	(50)	(50)
<b>Financing cash flow</b>	<b>39,997</b>	<b>92,067</b>	<b>269,460</b>	<b>(87,435)</b>	<b>(69,631)</b>	<b>(65,489)</b>
<b>Net cash inflow/ (outflow)</b>	<b>(10,272)</b>	<b>73,243</b>	<b>95,330</b>	<b>(32,841)</b>	<b>47,819</b>	<b>(16,862)</b>
Cash- beginning	40,118	29,847	103,090	198,420	165,579	213,398
<b>Cash- year-end</b>	<b>29,847</b>	<b>103,090</b>	<b>198,420</b>	<b>165,579</b>	<b>213,398</b>	<b>196,537</b>

Source(s): Company, ABCI Securities estimates





## Sunac (1918 HK)

### A new adage: High gearing for high growth

- Sunac's 10M17 presales surged 142% YoY to RMB 249bn, higher than the average peer growth of 45% YoY
- 71% of Sunac's landbank was acquired via M&A. Average land cost of RMB 5,130/sqm represents 30% of Sunac's 10M17 presales ASP
- Average daily turnover of Sunac's shares was ranked no.2 among the HK-listed PRC property stocks
- Upgrade to **BUY** from Sell with revised TP of HK\$ 42.20 (from HK\$ 9.70) based on a 30% discount to NAV

**Quantum leap in presales since 2H17.** Sunac's presales growth exceeded 100% YoY for five consecutive months since June 2017. In particular, the monthly figure hit RMB43.0bn (+218%YoY) in Sep 2017 and RMB 43.96bn (+193% YoY) in Oct 2017 from just RMB 8-20bn in 1H17. For 10M17, Sunac's presales grew 142% YoY to RMB 249bn, equivalent to 83% of its annual target of RMB 300bn. For most developers, presales growth slowed in Oct 2017, but Sunac managed to accelerate sales further on increased saleable resources from M&A. We expect Sunac's FY17E presale to reach RMB 322bn (+114% YoY) and RMB 459bn (+42%YoY) for FY18E.

**Impressive M&A execution.** Sunac's fast-growing presales are driven by its expanding landbank via M&A. As of Aug 2017, Sunac's total landbank was 101mn sqm (39% higher than 72.9mn sqm in Dec 2016), excluding the recent acquisition of Wanda's 13 tourism projects with a GFA of 59mn sqm. About 71% of Sunac's landbank was acquired through M&A and the average land cost is RMB 5,130/sqm, representing only 30% of 10M17 presales ASP. Sunac is renowned for its proficient M&A execution, as proven by its numerous transactions (e.g. Greentown-Sunac JV and the latest Wanda acquisition). As market consolidation of PRC property sector continues, Sunac would capitalize on more M&A opportunities to further expand business.

**Margin recovery on track.** M&A has driven up Sunac's sales growth as well as its margin. GPM rebounded from 12.4% in 2015 to 13.7% in 2016 and 19.6% in 1H17. As Sunac reduces its participation in land auctions, the concern of overpriced land and margin erosion that used to associate with the Group gradually fades away. Regarding to the Wanda acquisition, Sunac acquired a 91% stake in 13 tourism projects at RMB 43.84bn for 49.7mn sqm of saleable GFA and 9.27mn sqm of self-owned GFA. Assuming a project debt of ~RMB 45bn to be taken up by Sunac, the average land cost of the asset portfolio is only ~RMB1,500/sqm. We expect these projects to entail a gross margin of ~40%; profit generated should more than offset the annual management fee of RMB 650mn (RMB 50mn per project) payable to Wanda.

#### Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	23,011	35,343	103,755	185,177	246,508
Chg (% YoY)	(8.2)	53.6	193.6	78.5	33.1
Core net profit (RMB mn)	3,377	1,532	4,100	8,718	14,839
Chg (% YoY)	(9.4)	(54.6)	167.6	112.7	70.2
Core EPS (RMB)	1.02	0.40	1.04	2.11	3.59
Chg (% YoY)	(9.4)	(61.0)	161.4	103.3	70.2
BVPS (RMB)	5.73	6.03	7.38	8.32	10.48
Chg (% YoY)	16.2	5.2	22.4	12.8	25.9
Core PE (x)	30.7	78.6	30.1	14.8	8.7
P/B (x)	5.4	5.2	4.2	3.8	3.0
ROE (%)	17.8	4.6	10.3	19.4	27.5
ROA (%)	2.9	0.5	0.6	0.9	1.3
DPS(RMB)	0.19	0.26	0.42	0.84	1.44
Yield (%)	0.6	0.8	1.3	2.7	4.6
Net gearing (%)	75.9	121.5	451.6	358.0	117.0

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Nov 14, 2017

Rating: **BUY**

TP: HK\$ 42.20

Analyst : Kenneth Tung

Tel: (852) 2147 8311

kennethtung@abci.com.hk

Share price (HK\$)	36.45
Est. share price return	15.7%
Est. dividend yield	1.3%
Est. total return	17.0%
Previous Rating &TP	SELL, HK\$9.70

Previous Report Date May 17, 2017

Source(s): Bloomberg, ABCI Securities

#### Key Data

52Wk H/L(HK\$)	43.55/5.31
Issued shares (mn)	3,857
Market cap (HK\$ mn)	146,472
3-mth avg daily turnover(HK\$ mn)	962.88
Major shareholder(s) (%)	
SUN Hongbin	50.89%

Source(s): Bloomberg, ABCI Securities

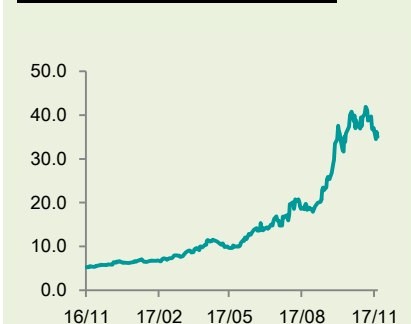
#### Share Performance

	Absolute	Relative*
1-mth	(11.3)	(13.2)
3-mth	92.8	78.0
6-mth	254.6	206.0

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

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

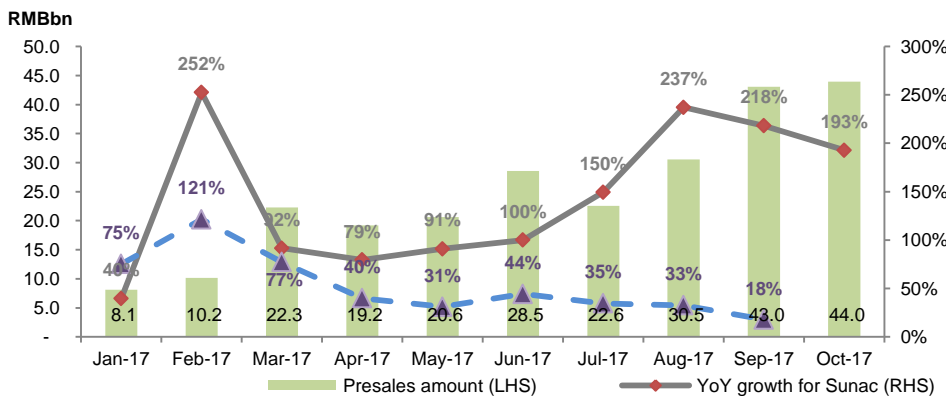


Source(s): Bloomberg, ABCI Securities

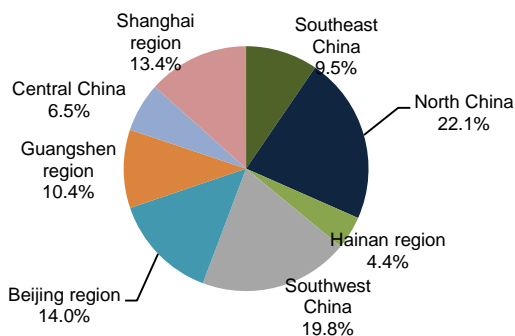
**Market voted “Yes” to Sunac’s highly-leveraged expansion strategy.** Sunac’s highly-g geared balance sheet used to be one of the major investor concerns. The Group’s net gearing soared 138ppt HoH to 260% as at June 2017, up 186ppt HoH to 393% if including perpetual as debt. Nonetheless, the Group’s share price has rallied 55% since its interim results announcement. Average daily turnover of Sunac’s shares in the past three months reached HK\$ 970mn, compared to HK\$ 74mn for 2016. The surging share price and stock trading liquidity is not solely driven by an increasing no. of mainland investors; in fact, stock-holding from China Securities Depository and Clearing (CSRC) via the Shanghai-HK connect declined from 22.58% of total share capital in Aug 2017 to 20.7% as at Nov 2017. We believe overseas investors, similar to the mainland ones, have turned more receptive to its highly-leveraged expansion strategy. On the credit side, Sunac’s bond yield was stable since its interim results announcement despite the dramatic increase in net gearing in 1H17.

**Upgrade to BUY and raise TP to HK\$ 42.2.** Factoring in the latest land acquisition and the Wanda transaction, we raise our 2018E NAV forecast to HK\$ 60.3/share (from HK\$ 24.1/share). We apply a 30% discount (from 60%), in line with the large-cap average discount, to derive our TP of HK\$ 42.20 (from HK\$ 9.70). Upgrade to **BUY** from Sell.

**Risk factors:** **1) Significant increase in SG&A costs:** The Wanda projects include tourism facilities such as Theme park and hotels, which require extra operating costs; **2) Corporate governance:** the listing committee censured Sunac and two Executive Directors for failure in ensuring the announcement regarding the Kaisa acquisition was accurate and complete; **3) Placement risk:** Sunac placed 220mn of new shares at HK\$ 18.33/share in July 2017. Sunac may conduct another round of share placement given the current share price level.

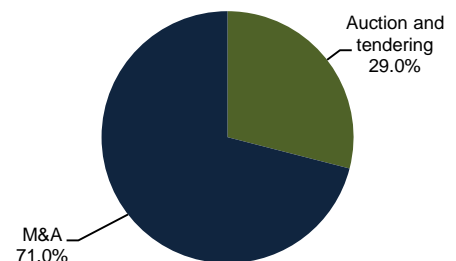
**Exhibit 1: Sunac’s monthly sales in 2017**


Source(s): Company, ABCI Securities

**Exhibit 2: Landbank by region (Aug 25, 2017: 101mn sqm)**


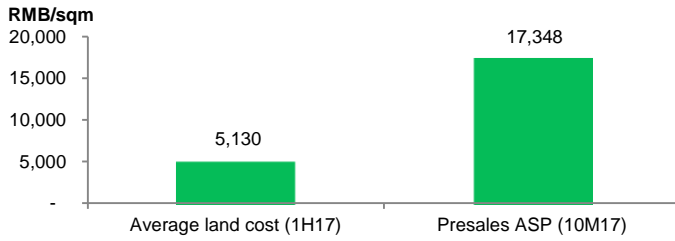
\* Excluded the Wanda acquisition

Source(s): Bloomberg, ABCI Securities

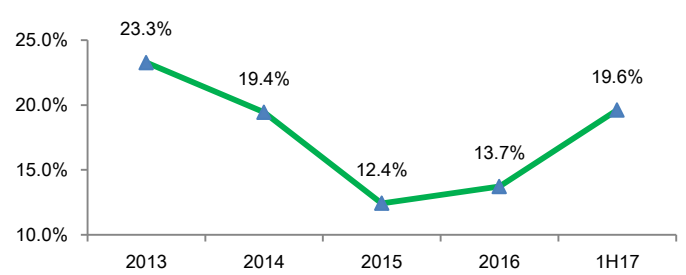
**Exhibit 3: Landbank by acquisition method (Aug 25, 2017: 101mn sqm)**


\* Excluded the Wanda acquisition

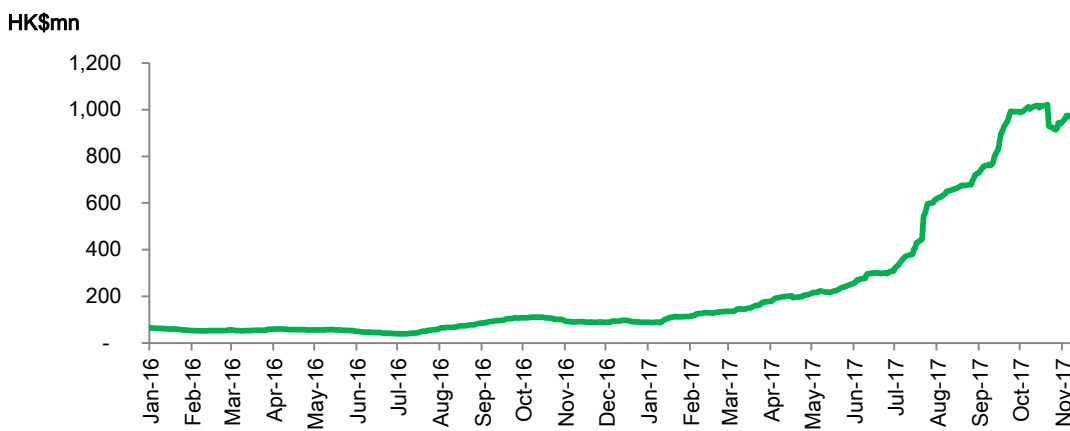
Source(s): Bloomberg, ABCI Securities

**Exhibit 4: Average land cost vs. ASP in 10M17**


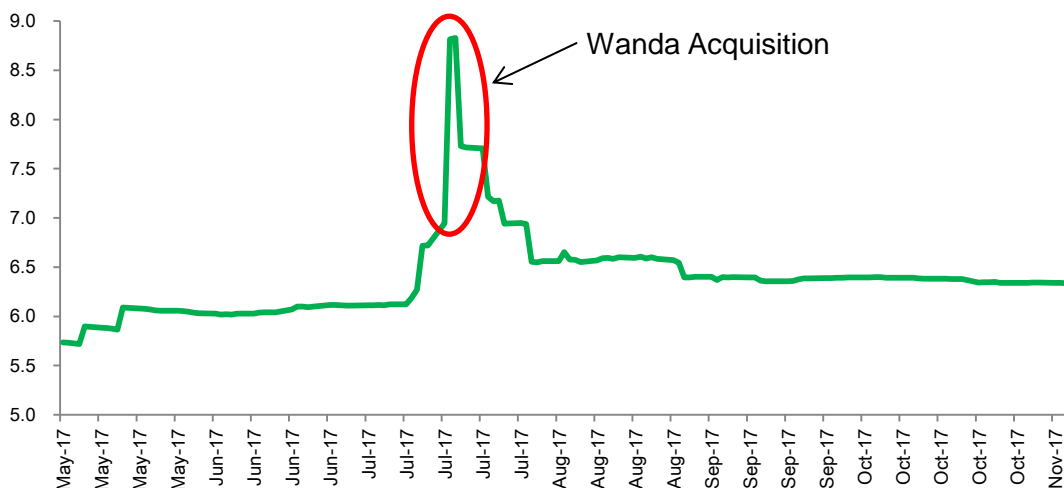
Source(s): Bloomberg, ABCI Securities

**Exhibit 5: Gross margin trend**


Source(s): Bloomberg, ABCI Securities

**Exhibit 6: Three-month average daily turnover for Sunac**


Source(s): Bloomberg, ABCI Securities

**Exhibit 7: Bond yield of Sunac's 8.75% coupon USD bond maturing in 2019**


Source(s): Bloomberg, ABCI Securities



Exhibit 8: Sunac's 1H17 results recap

P&L	1H17	1H16	YoY
	RMB mn	RMB mn	(%)
Turnover	13,333	10,586	25.9
Cost of Sales	(10,717)	(9,180)	16.7
<b>Gross Profit</b>	<b>2,616</b>	<b>1,406</b>	<b>86.0</b>
<b>Gross Margin (%)</b>	<b>19.6</b>	<b>13.3</b>	<b>+6.3ppt</b>
Selling and distribution costs	(779)	(319)	144.7
Administrative expense	(1,017)	(476)	113.7
<b>EBIT</b>	<b>819</b>	<b>612</b>	<b>34.0</b>
<b>EBIT Margin (%)</b>	<b>6.1</b>	<b>5.8</b>	<b>+0.3ppt</b>
Other income	1,026	594	72.6
Share of profit from JCE/ Assoc.	(397)	(236)	68.6
Exceptional items	2,699	1,055	155.8
Exchange losses and others	66	(600)	(111.0)
Finance cost	(2,073)	(979)	111.9
<b>Profit before tax</b>	<b>2,140</b>	<b>447</b>	<b>378.6</b>
<b>Tax</b>	<b>(395)</b>	<b>(344)</b>	<b>14.6</b>
- LAT	(682)	(702)	(2.9)
- Enterprise tax	287	(309)	(192.8)
<b>Profit after tax</b>	<b>1,745</b>	<b>103</b>	<b>1,598.4</b>
Minority Interest	(314)	(30)	951.3
<b>Net profit</b>	<b>1,432</b>	<b>73</b>	<b>1,863.1</b>
<b>Core net profit</b>	<b>(642)</b>	<b>(269)</b>	<b>139.1</b>

Operating statistics	1H17	1H16	YoY
			%
Contracted GFA (mn sqm)	5.95	2.83	110.8
Contracted ASP (RMB/sqm)	18,282	19,841	(7.9)
<b>Contracted Sales (RMB mn)</b>	<b>108,850</b>	<b>56,050</b>	<b>94.2</b>
GFA Delivered (mn sqm)	0.89	0.63	40.7
Booked ASP (RMB/sqm)	14,519	16,424	(11.6)
<b>Booked sales (RMB mn)</b>	<b>12,861</b>	<b>10,337</b>	<b>24.4</b>
<b>Balance sheet</b>	<b>Jun-17</b>	<b>Dec-16</b>	<b>YoY</b>
	RMB mn	RMB mn	
Gross debt	181,297	112,844	60.7
Cash	92,409	69,813	32.4
<b>Net debt</b>	<b>88,888</b>	<b>43,031</b>	<b>106.6</b>
<b>Net gearing (%)</b>	<b>259.6</b>	<b>121.5</b>	<b>+138.1ppt</b>
<b>Net gearing (%) - perpetual</b>	<b>393.9</b>	<b>208.2</b>	<b>+185.7 ppt</b>

Source(s): Company, ABCI Securities

Exhibit 9: Sunac's 2018E NAV

	Attr. GFA (mn sqm)	Net assets value (RMB mn)	% of total	Valuation Method	Implied value per sqm (RMB)
Property development	177.6	400,392	94%	DCF at WACC of 10.5%	2,255
Property investment & management		1,282	0%	6.5% cap rate on 2017E net rental & mgt. fee	
Investment in Leshi		13,941	3%	Historical cost	
Investment in Homelink		2,800	1%	Historical cost	
Investment in Jinke Properties		6,976	2%	Market value	
<b>Total 2018E GAV</b>		<b>425,390</b>	<b>100%</b>		
2018E Net cash/ (debt)		(203,869)	-41%		
2018E Perpetual instrument		(10,609)	-2%		
<b>Total 2018E NAV</b>		<b>210,912</b>	<b>56%</b>		
No. of share outstanding (diluted)		4,130			
<b>NAV per share (RMB)</b>		<b>51.1</b>			
Ex rate		1.18			
<b>NAV per share (HKD)</b>		<b>60.3</b>			
Target discount (%)		30%			
<b>Target Price (HKD)</b>		<b>42.20</b>			
<b>WACC</b>	<b>10.5%</b>				
Cost of debt	8.0%				
Cost of equity	20.0%				
<b>Debt/ (Debt + Equity)</b>	<b>68%</b>				

Source(s): Company, ABCI Securities estimates



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

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2014A</b>	<b>2015A</b>	<b>2016A</b>	<b>2017E</b>	<b>2018E</b>	<b>2019E</b>
<b>Revenue</b>	25,072	23,011	35,343	103,755	185,177	246,508
Cost of sales	(20,197)	(20,154)	(30,495)	(83,120)	(149,677)	(200,769)
<b>Gross Profit</b>	4,875	2,857	4,848	20,635	35,499	45,739
SG&A expenses	(1,378)	(1,364)	(1,649)	(3,985)	(6,330)	(6,009)
<b>EBIT</b>	3,497	1,493	3,199	16,651	29,170	39,730
Finance cost	(1,267)	(1,720)	(2,472)	(4,448)	(6,248)	(6,368)
Share of profit of associates	2,181	1,693	836	1,313	865	516
Other income/ (expenses)	908	1,353	1,584	2,385	2,364	2,626
Fair value gain of investment properties	-	-	-	-	-	-
Disposal/one-off items	(417)	1,745	1,262	-	-	-
<b>Profit before tax</b>	4,902	4,564	4,409	15,901	26,150	36,504
Tax	(1,669)	(955)	(1,470)	(6,969)	(10,484)	(13,383)
<b>Profit after tax</b>	3,233	3,608	2,938	8,931	15,665	23,120
Minority interest	(11)	(311)	(157)	(3,877)	(5,992)	(7,327)
Perpetual coupon distribution	-	-	(303)	(955)	(955)	(955)
<b>Reported net profit</b>	3,222	3,298	2,478	4,100	8,718	14,839
Less: exceptional items	507	79	(946)	-	(0)	(0)
<b>Underlying net profit</b>	3,729	3,377	1,532	4,100	8,718	14,839
<b>Per share</b>						
Underlying EPS (RMB)	1.12	1.02	0.40	1.04	2.11	3.59
DPS (RMB)	0.19	0.19	0.26	0.42	0.84	1.44
Payout ratio (%)	17%	19%	65%	40%	40%	40%
BVPS (RMB)	4.93	5.73	6.03	7.38	8.32	10.48
<b>Growth %</b>						
Revenue	-18.7%	-8.2%	53.6%	193.6%	78.5%	33.1%
Gross Profit	-32.1%	-41.4%	69.7%	325.6%	72.0%	28.8%
EBIT	-42.1%	-57.3%	114.2%	420.5%	75.2%	36.2%
Underlying net profit	5.9%	-9.4%	-54.6%	167.6%	112.7%	70.2%
<b>Margin %</b>						
Gross margin	19.4%	12.4%	13.7%	19.9%	19.2%	18.6%
Gross margin (post-LAT)	16.3%	14.3%	12.0%	16.2%	16.4%	16.3%
EBIT margin	13.9%	6.5%	9.1%	16.0%	15.8%	16.1%
Core net margin	5.4%	2.6%	2.4%	6.4%	7.5%	8.8%
<b>Key assumptions</b>						
Contracted Sales (RMB mn)	65,800	68,143	150,523	333,164	475,903	441,799
GFA sold (mn sqm)	3.10	3.50	7.58	20.73	30.36	29.35
ASP (RMB/sqm)	21,246	19,477	19,865	16,075	15,674	15,052
Booked Sales (RMB mn)	24,719	22,511	34,611	102,986	184,369	245,660
GFA delivered (mn sqm)	1.65	1.39	2.16	6.03	11.40	15.77
Booked ASP (RMB/sqm)	15,009	16,226	16,013	17,086	16,168	15,579

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>	97,467	93,725	252,698	607,041	851,611	1,038,873
Cash	20,657	22,687	52,086	33,450	41,248	164,539
Restricted cash	4,384	4,371	17,727	17,727	17,727	17,727
Trade & other receivables	2,475	970	8,416	8,416	8,416	8,416
Property under development	49,383	49,870	130,621	503,601	740,373	804,344
Other current assets	20,568	15,826	43,847	43,847	43,847	43,847
<b>Non-current assets</b>	14,895	21,784	40,485	60,404	80,849	101,224
Property, plant & equipment	62	69	547	539	20,511	40,483
Investment properties	239	-	656	656	656	656
Investment in Associate and JCE	12,049	15,261	34,553	54,480	54,952	55,356
Other non-current assets	2,546	6,455	4,730	4,730	4,730	4,730
<b>Total Assets</b>	112,362	115,509	293,183	667,445	932,460	1,140,098
<b>Current Liabilities</b>	64,949	64,495	168,594	532,500	786,342	977,798
Short-term borrowings	13,840	14,584	32,644	177,644	182,644	187,644
Trade & other payables	11,616	10,944	41,413	41,413	41,413	41,413
Pre-sales deposits	12,271	13,420	34,376	253,282	502,124	688,581
Other current liabilities	27,223	25,546	60,160	60,160	60,160	60,160
<b>Non-current liabilities</b>	26,431	31,594	89,178	89,178	89,178	89,178
Long-term borrowings	20,544	27,214	80,200	80,200	80,200	80,200
Other payables	-	-	-	-	-	-
Other non-current liabilities	5,887	4,379	8,978	8,978	8,978	8,978
<b>Total Liabilities</b>	91,380	96,089	257,772	621,677	875,519	1,066,976
<b>Net Assets</b>	20,983	19,420	35,411	45,768	56,941	73,122
<b>Shareholders' Equity</b>	16,353	19,005	23,269	29,147	34,378	43,282
Perpetual capital instrument	-	-	9,957	10,609	10,609	10,609
Minority Interest	4,630	415	2,185	6,012	11,954	19,230
<b>Total Equity</b>	20,983	19,420	35,411	45,768	56,941	73,122
<b>Key ratio</b>						
Gross debt (RMB mn)	34,384	41,799	112,844	257,844	262,844	267,844
Net debt (RMB mn)	9,342	14,740	43,031	206,668	203,869	85,578
Net gearing (%)	45%	76%	122%	452%	358%	117%
Contracted sales/ Total assets (x)	59%	59%	51%	50%	51%	39%

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	3,522	1,521	3,227	16,679	29,198	39,758
Change in Working Capital	6,227	4,204	(43,290)	(143,695)	26,649	137,345
Tax payment	(1,669)	(955)	(1,470)	(6,969)	(10,484)	(13,383)
<b>Operating cash flow</b>	<b>8,080</b>	<b>4,770</b>	<b>(41,534)</b>	<b>(133,985)</b>	<b>45,363</b>	<b>163,719</b>
Purchase of PP&E	(20)	(20)	(20)	(20)	(20,000)	(20,000)
Addition of Investment Properties	-	-	-	-	-	-
Others	1,353	6,319	(1,847)	(16,229)	2,755	2,739
<b>Investing cash flow</b>	<b>1,333</b>	<b>6,299</b>	<b>(1,867)</b>	<b>(16,249)</b>	<b>(17,245)</b>	<b>(17,261)</b>
Debt raised	10,760	9,057	74,017	150,000	10,000	10,000
Debt repaid	(9,214)	(15,000)	(5,000)	(5,000)	(5,000)	(5,000)
Interest expenses	(3,036)	(2,948)	(4,479)	(14,828)	(20,828)	(21,228)
Equity raised	-	-	2,478	3,417	-	-
Dividend to shareholders	(630)	(643)	(991)	(1,640)	(3,487)	(5,935)
Others	(50)	495	6,775	(353)	(1,005)	(1,005)
<b>Financing cash flow</b>	<b>(2,170)</b>	<b>(9,039)</b>	<b>72,800</b>	<b>131,597</b>	<b>(20,319)</b>	<b>(23,168)</b>
<b>Net cash inflow/ (outflow)</b>	<b>7,243</b>	<b>2,030</b>	<b>29,399</b>	<b>(18,636)</b>	<b>7,799</b>	<b>123,291</b>
Cash- beginning	13,414	20,657	22,687	52,086	33,450	41,248
<b>Cash- year-end</b>	<b>20,657</b>	<b>22,687</b>	<b>52,086</b>	<b>33,450</b>	<b>41,248</b>	<b>164,539</b>

Source(s): Company, ABCI Securities estimates



## Disclosures

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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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