Aug 17, 2016
Company Report
Rating: BUY
TP: HK$ 2.70

| | |
|---|---|
| Share price (HK$) | 2.01 |
| Est. share price return | 34.3% |
| Est. dividend yield | 2.8% |
| Est. total return | 37.1% |

| | |
|---|---|
| Previous Rating &TP | BUY ; HK$2.90 |
| Previous Report Date | May 5, 2016 |

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**Key Data**

| | |
|---|---|
| 52Wk H/L(HK$) | 2.75/1.74 |
| Issued shares (mn) | 4,694 |
| Market cap (HK$ mn) | 9,763 |
| 3-mth avg daily turnover (HK$ mn) | 1.46 |
| Major shareholder(s) (%): | |
| Mr WONG Hong King | 75.00 |

Source(s): Company, Bloomberg, ABCI Securities

**FY15 Revenue breakdown (%)**

| | |
|---|---|
| Property development | 47.6 |
| Property investment | 34.1 |
| Comprehensive services | 18.3 |

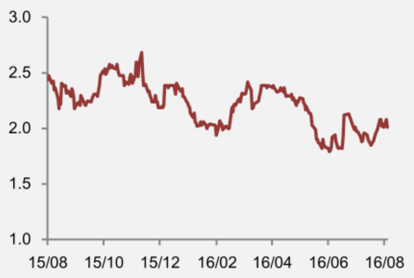
Source(s): Company, ABCI Securities

**Share performance (%)**

| | Absolute | Relative* |
|---|---|---|
| 1-mth | 8.3 | 2.6 |
| 3-mth | (4.1) | (17.9) |
| 6-mth | 2.0 | (16.1) |

*Relative to HSI
Source(s): Bloomberg, ABCI Securities

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




Source(s): Bloomberg, ABCI Securities

# LVGEM (95 HK)

## Huge asset injection potential

- 1H16 core profit was RMB 557mn (vs. RMB 2mn loss in 1H15) due to profit-booking of Hongwan Garden upon completion
- Gross margin remained high at 42.8% due to its involvement in urban redevelopment scheme; however, effective tax rate was high at 59% as a result
- Potential landbank of 12mn sqm to be injected by the parent group
- Maintain **BUY** with revised TP of HK$ 2.70 (from HK$2.90) based on a 50% discount to NAV

**1H16 reported net profit jumped 765% YoY to RMB 565mn.** LVGEM's 1H16 revenue surged 613%YoY to RMB 3,764m mainly due to the booking of its major project, Hongwan Garden, in Futian, Shenzhen. Gross margin dropped 13.0ppt YoY to 45.2% mainly due to change in revenue mix. Gross margin from the property sales segment improved from 38.0% in 1H15 to 42.8% in 1H16, much higher than industry average of 27%. Core profit (excluding fair value change in investment properties) was RMB 557mn, implying a net margin of 14.8%. As the Hongwan Garden is obtained via the urban redevelopment scheme, the low land cost resulted in a high land appreciation tax. Overall effective tax rate is 59% in 1H16, pressuring the overall net margin. Net gearing rose by 4.9ppt HoH to 73.4% in June 2016, as LVGEM received RMB 395mn in presales as of June 2016 by selling the remaining units. Presales of the next flagship project, Mangrove Bay No.1, with an estimated value of RMB 9.5bn, should commence in 4Q16. The Group is confident in achieving its presales target of RMB 4.5bn by end-2016.

**Landbank of 12mn sqm to be injected by the parent group.** For the first time**,** LVGEM quantified the size of the urban redevelopment projects held under its parent group, who is engaging in preliminary work of urban renewal projects with a total area of 12 mn sqm across Shenzhen and key cities in PRD. We believe some of these sites would be injected to LVGEM by 2017E upon approval by relevant authorities.

**Steady launch of presale to capture the property price rally.** Given the uncertain timing of asset injection by its parent, LVGEM launches its presale at a steady pace to avoid landbank depletion. Besides, with the rising Shenzhen property prices, we believe the Group could enjoy a better ASP and margin if they defer project sales. In particular, ASP of Hongwan Garden soared 17%YoY to RMB 54,500/sqm in 1H16. Hence, they delay sale of the remaining units (with saleable value of RMB 3bn) to 4Q16 and 2017 despite the project was completed in1H16. (Continue next page)

**Results and Valuation**

| FY ended Dec 31 | 2014A | 2015A | 2016E | 2017E | 2018E |
|---|---|---|---|---|---|
| Revenue (RMB mn) | 4,851 | 1,210 | 5,530 | 11,626 | 11,202 |
| *Chg (%,YoY)* | 146.2 | (75.0) | 357.0 | 110.2 | (3.6) |
| Core net profit (RMB mn)[1] | 1,200 | 63 | 1,126 | 2,545 | 2,244 |
| *Chg (%,YoY)* | 340 | (95) | 1,687 | 126 | (12) |
| Underlying EPS (RMB) | 0.26 | 0.01 | 0.14 | 0.31 | 0.28 |
| *Chg (%,YoY)* | 340 | (97) | 1,687 | 126 | (12) |
| BVPS (RMB) | 1.48 | 0.97 | 1.05 | 1.24 | 1.40 |
| *Chg (%,YoY)* | 33.1 | (34.4) | 8.5 | 17.6 | 13.2 |
| Underlying PE (x) | 6.7 | 219.2 | 12.3 | 5.4 | 6.2 |
| P/B (x) | 1.1 | 1.8 | 1.6 | 1.4 | 1.2 |
| ROE (%) | 17.3 | 0.8 | 13.2 | 25.3 | 19.7 |
| ROA (%) | 5.9 | 0.3 | 3.8 | 8.0 | 6.0 |
| DPS(HK$) | - | 0.01 | 0.06 | 0.13 | 0.11 |
| Yield (%) | - | 0.5 | 2.8 | 6.4 | 5.6 |
| Net gearing[2] (%) | 88.5 | 68.6 | 127.2 | 107.8 | 67.0 |

[1]Core net profit =Net profit - revaluation gain of investment properties and one-off items
[2]Net gearing=Net debt/Shareholders' equity
Source(s): Bloomberg, ABCI Securities estimates

**Maintain BUY with revised TP of HK$ 2.70.** We lower our 2016 core profit forecast by 18% to RMB1.1bn to reflect higher-than-expected effective tax rate and possible delay in profit-booking for the remaining units in Hongwan garden. We cut our NAV forecast to HK$ 5.48 (from HK$ 5.86) and TP to HK$2.70 (from HK$ 2.90), still based on 50% discount to NAV. Despite its relatively small landbank, the real potential of LVGEM lies on the huge asset injection potential by its parent company. We favor LVGEM for its expertise in urban redevelopment that enables high margins and profitability, which differentiates the Group from other listed developers aiming to attain a high asset turnover by sacrificing margins. Maintain **BUY.**

**Risk factors:** 1) Long relocation process; 2) Complicated regulations governing the redevelopment process; 3) Uncertain timing regarding asset injection from parent; 4) High effective tax rate; 5) Low shares daily turnover; 6) Dilution effect on convertible preference shares (3,143mn shares at HK$2.06)

**Exhibit 1: Upcoming project to be launched in Shenzhen (Jun 2016)**

| Project | GFA<br>000 sqm | Saleable value<br>RMB bn | Remarks |
|---|---|---|---|
| Mangrove Bay No.1 | 305 | 9.50 | Presales to launch in 4Q16 |
| Liguang | 156 | 3.60 | Construction start in 2018 |
| Meijing | 97 | 2.20 | Construction start by 2016 end |

Source(s): Company, ABCI Securities

**Exhibit 2: LVGEM's 1H16 results**

| P&L | 1H16 | 1H15 | *YoY Chg* |
|---|---|---|---|
| | RMBmn | RMBmn | *(%)* |
| **Turnover** | **3,764** | **528** | ***613.3*** |
| Cost of Sales | (2,063) | (220) | *835.7* |
| **Gross Profit** | **1,701** | **307** | ***453.7*** |
| ***Gross Margin (%)*** | ***45.2*** | ***58.2*** | ***-13.0ppt*** |
| | | | |
| Selling and distribution costs | (26) | (15) | *75.3* |
| Administrative expense | (170) | (126) | *35.3* |
| **EBIT** | **1,505** | **167** | ***802.9*** |
| ***EBIT Margin (%)*** | ***40.0*** | ***31.6*** | ***+8.4ppt*** |
| | | | |
| Other income | 29 | 43 | *(32.3)* |
| Fair Value gains on IP | 1 | 89 | *NA* |
| Share of profit from JV | - | (0) | *(100.0)* |
| Finance cost | (150) | (120) | *25.4* |
| **Profit before tax** | **1,385** | **179** | *672.9* |
| | | | |
| **Tax** | **(815)** | **(109)** | ***646.6*** |
| ***Effective tax rate*** | ***59%*** | ***61%*** | ***-2ppt*** |
| - LAT | (621) | (25) | *2,421.5* |
| - Enterprise tax | (194) | (84) | *129.3* |
| | | | |
| **Profit after tax** | **570** | **70** | *714.0* |
| Minority Interest | (5) | (5) | *11.7* |
| **Net profit** | **565** | **65** | *765.2* |
| **Core net profit** | **557** | **(2)** | *NA* |
| ***Core net margin*** | ***14.8%*** | ***-0.4%*** | ***NA*** |

| **Balance sheet** | **June-16** | **Dec-15** | *YoY chg* |
|---|---|---|---|
| Gross debt | 10,262 | 8,234 | *24.6* |
| Cash | 3,926 | 2,768 | *41.8* |
| **Net debt** | **6,336** | **5,466** | *15.9* |
| **Net gearing (%)** | **73.4%** | **68.6%** | *+4.9ppt* |

| **Revenue breakdown** | **1H16** | **1H15** | **YoY Chg** |
|---|---|---|---|
| | RMBmn | RMBmn | **%** |
| - Property Sales | 3,446 | 221 | *1,461.3* |
| - Property leasing | 210 | 201 | *4.6* |
| - Comprehensive services | 108 | 106 | *1.8* |
| **Total** | **3,764** | **528** | ***613.3*** |

| **Gross margin** | **1H16** | **1H15** | **YoY Chg** |
|---|---|---|---|
| | **%** | **%** | **ppt** |
| - Property Sales | 42.8% | 38.0% | *12.7* |
| - Property leasing | 82.6% | 84.6% | *(2.4)* |
| - Comprehensive services | 48.1% | 50.4% | *(2.3)* |

Source(s): Company, ABCI Securities

**Exhibit 3: LVGEM's FY16E NAV**

| | Attr. GFA (Mn sqm) | Net assets value (RMB mn) | % of total | Valuation Method | Implied value per sqm (RMB) |
|---|---|---|---|---|---|
| Shenzhen | 1.5 | 16,916 | 44% | | 11,236 |
| Maoming | 2.5 | 2,826 | 7% | DCF at WACC of 10.4% | 1,137 |
| Others | 0.2 | 764 | 2% | | 3,764 |
| HK | 0.0 | 436 | 1% | Book value | 24,370 |
| Property development | **4.2** | **20,942** | **54%** | **DCF at WACC of 10.4%** | **4,995** |
| Property investment & management | 0.25 | 16,684 | 43% | 3% cap rate of 2016E rental income | 67,617 |
| Comprehensive services | | 1,029 | 3% | 10x 2016E PE | |
| **Total 2016E GAV** | | **38,655** | **100%** | | |
| | | | | | |
| Convertible preference share | | (5,959) | -15% | | |
| 2016E Net cash/ (debt) | | (10,989) | -28% | | |
| | | | | | |
| **Total 2016E NAV** | | **21,707** | **56%** | | |
| No. of share outstanding (diluted) | | 4,694 | | | |
| **NAV per share (RMB)** | | **4.62** | | | |
| Ex rate | | 1.18 | | | |
| **NAV per share (HKD)** | | **5.46** | | | |
| Target discount (%) | | 50% | | | |
| **Target Price (HKD)** | | **2.70** | | | |

| | |
|---|---|
| **WACC** | **10.4%** |
| Cost of Debt | 8.5% |
| Cost of Equity | 15.0% |
| **Debt/ ( Debt + Equity)** | **54%** |

Source(s): Company, ABCI Securities estimates

**Exhibit 4: NAV change assuming all convertible preference shares are converted**

| | | RMBmn |
|---|---|---|
| **Total 2016E NAV** | | 21,707 |
| Add: Book value of convertible preference share | | 5,959 |
| **Adjusted 2016E NAV** | **(A)** | **27,666** |
| | | |
| **Fully dilute no. of shares** | **(B)** | **8,107** |
| - Outstanding shares | | 4,694 |
| - Convertible preference share | | 3,413 |
| | | |
| **NAV- assuming full conversion (RMB/share)** | **(C= A/B)** | **3.41** |
| **NAV- assuming no conversion (RMB/share)** | | **4.62** |
| Change | | -26% |

Source(s): Company, ABCI Securities estimates

**Consolidated income statement (2013A-2018E)**

| FY Ended Dec 31 (RMB mn) | 2013A | 2014A | 2015A | 2016E | 2017E | 2018E |
|---|---|---|---|---|---|---|
| **Revenue** | **1,971** | **4,851** | **1,210** | **5,530** | **11,626** | **11,202** |
| Cost of sales | (1,161) | (2,493) | (575) | (2,979) | (5,645) | (5,750) |
| **Gross Profit** | **810** | **2,357** | **635** | **2,551** | **5,981** | **5,453** |
| SG&A expenses | (197) | (193) | (315) | (241) | (463) | (494) |
| **EBIT** | **613** | **2,165** | **320** | **2,311** | **5,518** | **4,959** |
| Finance cost | (206) | (217) | (263) | (365) | (484) | (552) |
| Share of profit of associates | 0 | (0) | (0) | - | - | - |
| Other income/ (expenses) | 8 | 19 | 61 | 25 | 32 | 68 |
| Fair value gain of investment properties | 591 | 895 | - | - | - | - |
| Disposal/one-off items | 0 | - | 473 | - | - | - |
| **Profit before tax** | **1,006** | **2,861** | **591** | **1,971** | **5,066** | **4,475** |
| Tax | (326) | (1,132) | (166) | (845) | (2,434) | (2,081) |
| **Profit after tax** | **680** | **1,729** | **425** | **1,126** | **2,632** | **2,394** |
| Minority interest | 0 | (0) | (7) | - | (87) | (150) |
| **Reported net profit** | **680** | **1,728** | **418** | **1,126** | **2,545** | **2,244** |
| *Less: exceptional items* | *(407)* | *(528)* | *(355)* | *0* | *0* | *0* |
| **Core net profit** | **273** | **1,200** | **63** | **1,126** | **2,545** | **2,244** |
| | | | | | | |
| **Per share** | | | | | | |
| Underlying EPS (RMB) | 0.06 | 0.26 | 0.01 | 0.14 | 0.31 | 0.28 |
| DPS (HK$) | - | - | 0.01 | 0.06 | 0.13 | 0.11 |
| Payout ratio (%) | 0% | 0% | 129% | 41% | 41% | 41% |
| BVPS (RMB) | 1.11 | 1.48 | 0.97 | 1.05 | 1.24 | 1.40 |
| | | | | | | |
| **Growth %** | | | | | | |
| Revenue | 306.3% | 146.2% | -75.0% | 357.0% | 110.2% | -3.6% |
| Gross Profit | 232.9% | 191.1% | -73.0% | 301.6% | 134.4% | -8.8% |
| EBIT | 1475.1% | 253.3% | -85.2% | 621.8% | 138.8% | -10.1% |
| Core net profit | -297.8% | 339.6% | -94.8% | 1687.0% | 126.0% | -11.8% |
| | | | | | | |
| **Margin %** | | | | | | |
| Gross margin | 41.1% | 48.6% | 52.5% | 46.1% | 51.4% | 48.7% |
| Gross margin (post-LAT) | 28.4% | 35.4% | 22.2% | 31.6% | 34.6% | 33.0% |
| EBIT margin | 31.1% | 44.6% | 26.4% | 41.8% | 47.5% | 44.3% |
| Core net margin | 12.0% | 21.8% | 5.8% | 20.4% | 22.6% | 21.4% |
| | | | | | | |
| **Key assumptions** | | | | | | |
| Presales (RMB mn) | | | 3,410 | 4,572 | 9,439 | 12,365 |
| GFA sold (mn sqm) | | | 0.21 | 0.32 | 0.75 | 0.80 |
| ASP (RMB/sqm) | | | 16,621 | 14,498 | 12,664 | 15,384 |
| | | | | | | |
| Booked Sales (RMB mn) | | | 576 | 4,815 | 10,812 | 10,298 |
| GFA delivered (mn sqm) | | | 0.12 | 0.31 | 0.69 | 0.77 |
| Booked ASP (RMB/sqm) | | | 4,713 | 15,442 | 15,744 | 13,400 |

Source(s): Company, ABCI Securities estimates

**Consolidated balance sheet (2013A-2018E)**

| As of Dec 31 (RMB mn) | 2013A | 2014A | 2015A | 2016E | 2017E | 2018E |
|---|---|---|---|---|---|---|
| **Current assets** | **7,438** | **7,879** | **10,385** | **15,741** | **17,896** | **23,374** |
| Cash | 653 | 1,099 | 1,515 | 992 | 2,945 | 8,134 |
| Restricted cash | 388 | 742 | 1,253 | 1,253 | 1,253 | 1,253 |
| Trade & other receivables | 772 | 825 | 2,124 | 2,124 | 2,124 | 2,124 |
| Property under development | 5,310 | 4,932 | 5,403 | 11,283 | 11,484 | 11,773 |
| Other current assets | 315 | 280 | 90 | 90 | 90 | 90 |
| | | | | | | |
| **Non-current assets** | **11,133** | **12,630** | **13,607** | **13,674** | **13,742** | **13,809** |
| Property, plant & equipment | 419 | 392 | 333 | 301 | 268 | 235 |
| Investment properties | 9,771 | 11,143 | 11,973 | 11,973 | 11,973 | 11,973 |
| Investment in Associate and JCE | 505 | 522 | 525 | 625 | 725 | 825 |
| Other non-current assets | 438 | 573 | 775 | 775 | 775 | 775 |
| | | | | | | |
| **Total Assets** | **18,571** | **20,509** | **23,992** | **29,415** | **31,637** | **37,183** |
| | | | | | | |
| **Current Liabilities** | **6,975** | **5,065** | **7,193** | **11,950** | **12,578** | **16,644** |
| Short term borrowings | 1,029 | 1,762 | 1,676 | 6,676 | 8,676 | 10,676 |
| Trade & other payables | 1,545 | 1,861 | 1,102 | 1,102 | 1,102 | 1,102 |
| Pre-sales deposits | 4,177 | 679 | 3,627 | 3,383 | 2,011 | 4,078 |
| Other current assets | 225 | 762 | 788 | 788 | 788 | 788 |
| | | | | | | |
| **Non-current liabilities** | **6,345** | **8,464** | **8,825** | **8,825** | **8,825** | **8,825** |
| Long term borrowings | 4,464 | 6,254 | 6,558 | 6,558 | 6,558 | 6,558 |
| Other payables | - | - | - | - | - | - |
| Other non-current assets | 1,881 | 2,210 | 2,268 | 2,268 | 2,268 | 2,268 |
| | | | | | | |
| **Total Liabilities** | **13,320** | **13,529** | **16,019** | **20,775** | **21,403** | **25,469** |
| | | | | | | |
| **Net Assets** | **5,251** | **6,980** | **7,973** | **8,640** | **10,235** | **11,714** |
| | | | | | | |
| **Shareholders' Equity** | **5,226** | **6,954** | **1,982** | **2,649** | **4,156** | **5,486** |
| Convertible preference share | - | - | 5,860 | 5,860 | 5,860 | 5,860 |
| Minority Interest | 26 | 26 | 92 | 92 | 179 | 329 |
| **Total Equity** | **5,251** | **6,980** | **7,934** | **8,601** | **10,195** | **11,675** |
| | | | | | | |
| **Key ratio** | | | | | | |
| Gross debt (RMB mn) | 5,493 | 8,016 | 8,234 | 13,234 | 15,234 | 17,234 |
| Net debt (RMB mn) | 4,452 | 6,175 | 5,466 | 10,989 | 11,036 | 7,846 |
| Net gearing (%) | 85% | 88% | 69% | 127% | 108% | 67% |
| Presales/ Total assets (x) | 0% | 0% | 14% | 16% | 30% | 33% |

Source(s): Company, ABCI Securities estimates

**Consolidated cash flow statement (2013A-2018E)**

| FY ended Dec 31 (RMB mn) | 2013A | 2014A | 2015A | 2016E | 2017E | 2018E |
|---|---|---|---|---|---|---|
| EBITDA | 661 | 2,213 | 373 | 2,363 | 5,571 | 5,012 |
| Change in Working Capital | (53) | (2,774) | 195 | (5,575) | (848) | 2,605 |
| Tax payment | (176) | (219) | (166) | (845) | (2,434) | (2,081) |
| **Operating Cash flow** | **432** | **(780)** | **401** | **(4,057)** | **2,288** | **5,536** |
| | | | | | | |
| Purchase of PP&E | (40) | (20) | (20) | (20) | (20) | (20) |
| Addition of Investment Properties | (767) | (510) | - | - | - | - |
| Others | (456) | (161) | (39) | (75) | (68) | (32) |
| **Investing Cash flow** | **(1,263)** | **(691)** | **(59)** | **(95)** | **(88)** | **(52)** |
| | | | | | | |
| Debt raised | 3,251 | 4,390 | 10,000 | 10,000 | 10,000 | 10,000 |
| Debt repaid | (1,915) | (1,867) | (9,251) | (5,000) | (8,000) | (8,000) |
| Interest expenses | (375) | (606) | (594) | (912) | (1,210) | (1,380) |
| Equity raised | - | - | - | - | - | - |
| Dividend to shareholders | - | - | (81) | (459) | (1,037) | (915) |
| Others | 10 | 0 | - | (0) | (0) | (0) |
| **Financing Cash flow** | **971** | **1,917** | **74** | **3,629** | **(247)** | **(295)** |
| | | | | | | |
| **Net cash inflow/ (outflow)** | **140** | **447** | **415** | **(523)** | **1,953** | **5,189** |
| | | | | | | |
| Cash- beginning | 513 | 653 | 1,099 | 1,515 | 992 | 2,945 |
| **Cash- year-end** | **653** | **1,099** | **1,515** | **992** | **2,945** | **8,134** |

Source(s): Company, ABCI Securities estimates

# Disclosures

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

**Disclosures of Interests**
ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.

**Definition of equity rating**

| Rating | Definition |
|---|---|
| Buy | Stock return ≥ Market return rate |
| Hold | Market return – 6% ≤ Stock return < Market return rate |
| Sell | Stock return < Market return – 6% |

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months
Market return: 5-year average market return rate from 2009-2013
Time horizon of share price target: 12-month

**Definition of share price risk**

| Rating | Definition |
|---|---|
| Very high | 2.6 ≤180 day volatility/180 day benchmark index volatility |
| High | 1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6 |
| Medium | 1.0 ≤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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