

27 March 2019

Property | Real Estate

KWG (1813 HK)

Neutral (Maintained)

Concerns Over Earning Visibility

Target Price (Return)	HKD9.00 (+6%)
Price:	HKD8.52
Market Cap:	USD3,445m
Avg Daily Turnover (HKD/USD)	79m/10m

- **Stay NEUTRAL with a new HKD9 TP from HKD9.80, 6% upside plus 8% yield.** We remain sceptical on KWG's earnings growth story, with its bookings schedule and presales deposits seeming to lag behind contracted sales growth. Moreover, it seems to be losing ground among peers in terms of high-margin status. On a positive note, we believe KWG's continuous contracted sales growth and attractive yield will be major catalysts going forward.
- **Concerns over execution and delivery.** While the delayed completions of several JV projects explained the slower FY18 revenue bookings, we continue to see that its presales deposits are disproportionate vs contracted sales growth. Coupled with the unpredictability of asset-disposal gains, we continue to have concerns over KWG's unclear earnings growth path and if it is able to match with the contracted sales growth.
- **Average GPM ahead.** KWG used to command remarkable GPM, given its strategic location in tier-1 cities in Southern China. But, its reported GPM dropped to 32.8% in FY18 (or 35.5% in proportionate basis), dragged by rising construction costs. Going forward, we expect KWG is able to sustain its GPM at 28-32%, which remains slightly above the sector average. That said, we think KWG may lose its high-margin developer status in the long term.
- **Catch-up of contracted sales growth remains attractive.** KWG's 30% FY19F growth target reaches the top-end of the sector range. We believe the catch-up story starting from FY17 will continue, and forecast KWG to break through the CNY100bn mark in FY20. Also, 72% of its FY19F saleable resources are located in the affluent Greater Bay Area and Yangtze River Delta regions, which should support the sell-through rate, in our view.
- **FY18 results missed, despite a generous dividend payout.** FY18 core earnings (in proportionate basis) rose 8.2% YoY to CNY3.8bn, below our and Street forecast by 6% and 20%. Stripping out the asset disposal gain, we estimate the core profit at CNY2.75bn only. Total revenue dropped 35% YoY, dragged by the aforementioned slower sales bookings. Management emphasised some en-bloc and commercial properties sales that were recorded through associate accountings. On the other hand, KWG raised the payout ratio to 47% from 36%.
- **Maintain NEUTRAL with a new TP.** We align our core earnings in proportionate basis for the purpose of easier comparison with KWG's announced data. We lower FY19F-20F earnings 9% and 4%, and introduce FY21F earnings with 22% YoY growth at a CAGR of 22.6% for FY18-21F. It mainly factors slower revenue bookings. We lower our end-FY19F ENAV 8% to HKD20 from HKD21.80. Maintaining a 55% discount to ENAV (-1SD from sector average mean), we lower our TP to HKD9.

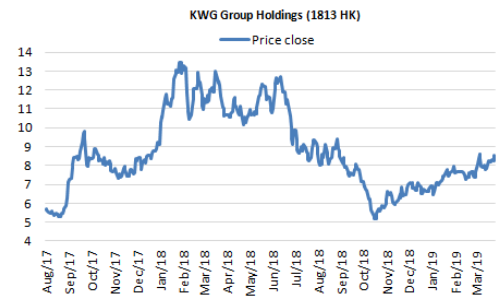
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	22.9	14.8	28.5	13.6	(17.6)
Relative	10.5	(0.7)	11.4	2.7	(6.5)
52-wk Price low/high (HKD)	12.0 – 4.8				



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (CNYm)	11,543	7,477	15,143	19,461	24,351
Recurring net profit (CNYm)	3,523	3,812	4,669	5,778	7,026
Recurring net profit growth (%)	20.6	8.2	22.5	23.8	21.6
Recurring EPS (CNY)	1.14	1.21	1.45	1.77	2.12
Recurring P/E (x)	6.4	6.0	5.0	4.1	3.4
P/BV (x)	0.8	0.8	0.7	0.7	0.6
DPS (CNY)	0.41	0.56	0.58	0.71	0.85
Dividend Yield (%)	5.7	7.7	8.0	9.8	11.7
ROAE (%)	12.8	12.9	14.4	16.1	17.5
Net debt to equity (%)	67.9	64.8	64.5	73.8	83.1
Interest coverage (x)	1.8	1.2	1.2	1.2	1.3

Source: Company data, RHB

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FY18 Results Review

Figure 1: KWG's FY18 results vs RHB forecasts

FY end Dec 31 (CNY m)	Actual	Actual	2H18	RHB	2H18	Actual	Actual	FY18	RHB		BBG	
	1H18	2H18	YoY	2H18	Diff	FY17	FY18	YoY	FY18	Diff (%)	Consensus	Diff (%)
Turnover	3,464	4,014	8.9%	10,090	-60.2%	11,543	7,477	-35.2%	13,553	-44.8%	15,511	-25.6%
Property sales	2,853	3,211	3.6%	9,278	-65.4%	10,432	6,064	-41.9%	12,132	-50.0%		
Property investment	135	245	138.7%	166	47.5%	231	379	64.1%	301	26.2%		
Property mgmt and hotels	476	558	14.9%	645	-13.5%	880	1,034	17.5%	1,121	-7.8%		
Cost of sales	(2,386)	(2,640)	5.9%	(7,069)	-62.7%	(7,523)	(5,026)	-33.2%	(9,455)	-46.8%		
Gross profit	1,078	1,373	15.2%	3,020	-54.5%	4,020	2,451	-39.0%	4,098	-40.2%		
Other income and expenses	1,673	1,029	N/A	121	750.0%	131	2,702	1960.1%	1,794	50.6%		
Selling and marketing exp	(208)	(324)	57.3%	(405)	-20.0%	(433)	(532)	23.0%	(613)	-13.2%		
Administrative expenses	(546)	(768)	58.4%	(832)	-7.8%	(937)	(1,314)	40.2%	(1,379)	-4.7%		
Operating profit	1,996	1,311	156.3%	1,904	-31.2%	2,782	3,307	18.9%	3,900	-15.2%		
Revaluation change	1,186	529	-53.6%	(1,186)	N/A	1,205	1,715	42.3%	0	N/A		
Exceptionals	0	0	N/A	0	N/A	0	0	N/A	0	N/A		
Finance cost	(642)	(428)	128.1%	268	N/A	(330)	(1,070)	224.7%	(374)	186.1%		
Associates and JCEs	385	1,054	-28.1%	1,843	-42.8%	1,898	1,440	-24.1%	2,229	-35.4%		
Profit before taxation	2,926	2,465	-15.9%	2,829	-12.9%	5,555	5,391	-2.9%	5,755	-6.3%		
Taxation	(762)	(475)	-46.0%	(956)	-50.3%	(1,950)	(1,236)	-36.6%	(1,718)	-28.0%		
Profit after taxation	2,164	1,991	-2.9%	1,873	6.3%	3,605	4,155	15.3%	4,037	2.9%		
Minority interests	7	(127)	N/A	12	N/A	15	(119)	N/A	20	N/A		
Reported net profit	2,171	1,864	-9.7%	1,886	-1.1%	3,620	4,035	11.5%	4,057	-0.5%		
Recurring net profit	1,961	1,851	-11.2%	2,096	-11.7%	3,523	3,812	8.2%	4,057	-6.0%	4,386	-19.7%
Basic EPS (CNY)	0.688	0.588	-10.8%	0.602	-2.3%	1.169	1.276	9.2%	1.290	-1.1%		
Core EPS (CNY)	0.622	0.584	-12.3%	0.669	-12.7%	1.137	1.205	6.0%	1.290	-6.6%	1.415	-19.6%
DPS (CNY)	0.250	0.310	0.0%	0.266	16.5%	0.410	0.560	36.6%	0.516	8.5%	0.531	-22.8%
BVPS (CNY)	9.054	9.350	4.9%	10.178	-8.1%	8.911	9.350	4.9%	10.178	-8.1%	9.763	-8.7%
Gross margin	31.1%	34.2%		29.9%		34.8%	32.8%		30.2%			
Operating margin	57.6%	32.7%		18.9%		24.1%	44.2%		28.8%			
Effective tax rate	-26.0%	-19.3%		-33.8%		-35.1%	-22.9%		-29.8%			
Net margin	62.7%	46.4%		18.7%		31.4%	54.0%		29.9%			
Core net margin	56.6%	46.1%		20.8%		30.5%	51.0%		29.9%			

Source: Company data, RHB

Changes In Earnings Forecasts

Figure 2: Changes to our forecasts

(CNYm)	FY19F			FY20F		
	Original	New	chg (%)	Original	New	chg (%)
Revenue	19,506	15,143	-22%	25,116	19,461	-23%
Cost of goods sold	(13,691)	(10,586)	-23%	(17,677)	(14,007)	-21%
Gross Profit	5,814	4,557	-22%	7,439	5,454	-27%
Selling expense	(820)	(612)	-25%	(1,042)	(664)	-36%
General & admin expense	(1,923)	(1,638)	-15%	(2,559)	(1,959)	-23%
Other income and expenses	1,441	1,780	24%	1,410	2,072	N/A
Revaluation gains	0	0	N/A	0	0	N/A
Interest Income	287	482	68%	330	566	72%
Interest Expense	(450)	(1,092)	143%	(541)	(1,297)	140%
JCE & Associate items	3,208	2,916	-9%	4,131	3,747	-9%
Profit before taxation	7,557	6,392	-15%	9,167	7,919	-14%
Taxation	(2,463)	(1,568)	-36%	(3,157)	(1,939)	-39%
Minority Interests	25	(155)	-710%	33	(202)	-710%
Reported net profit	5,119	4,669	-9%	6,044	5,778	-4%
Recurring net profit	5,119	4,669	-9%	6,044	5,778	-4%
Gross profit margin (%)	29.8%	30.1%	0.3ppts	29.6%	28.0%	-1.6ppts
Reported net profit margin (%)	26.2%	30.8%	4.6ppts	24.1%	29.7%	5.6ppts
Recurring net profit margin (%)	26.2%	30.8%	4.6ppts	24.1%	29.7%	5.6ppts

Source: RHB

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Figure 3: KWG's annual P&L (FY17-21F)

FY end Dec 31 (CNY m)	FY17	FY18F	FY19F	FY20F	FY21F
Property development	10,432	6,064	13,390	17,294	21,655
Property investment	231	379	531	717	968
Hotel operation	424	468	515	566	623
Property management	455	566	707	884	1,105
Total revenue	11,543	7,477	15,143	19,461	24,351
Property development	1,999	2,225	3,223	3,819	4,481
Property investment	213	279	478	645	871
Hotel operation	147	204	224	247	272
Property management	99	117	161	192	240
EBIT	2,458	2,825	4,087	4,903	5,863
Revaluation change	1,205	1,715	0	0	0
Net Interest income/ (Expense)	(6)	(588)	(610)	(731)	(910)
Associates and JCEs	1,898	1,440	2,916	3,747	4,689
Profit before taxation	5,555	5,391	6,392	7,919	9,642
Taxation	(1,950)	(1,236)	(1,568)	(1,939)	(2,354)
Profit after taxation	3,605	4,155	4,824	5,980	7,288
Minority interests	15	(119)	(155)	(202)	(262)
Reported net profit	3,620	4,035	4,669	5,778	7,026
Recurring net profit	3,523	3,812	4,669	5,778	7,026
Reported EPS (CNY)	1.169	1.276	1.454	1.774	2.125
Recurring EPS (CNY)	1.137	1.205	1.454	1.774	2.125
DPS (CNY)	0.410	0.560	0.581	0.709	0.849
Profit margin:					
Gross margin	34.8%	32.8%	30.1%	28.0%	26.8%
EBIT margin	21.3%	37.8%	27.0%	25.2%	24.1%
Reported net margin	31.4%	54.0%	30.8%	29.7%	28.9%
Recurring net margin	30.5%	51.0%	30.8%	29.7%	28.9%
YoY growth:					
Turnover	30.2%	-35.2%	102.5%	28.5%	25.1%
Booked property sales revenue	31.7%	-41.9%	120.8%	29.2%	25.2%
Reported net profit	4.5%	11.5%	15.7%	23.8%	21.6%
Recurring net profit	20.6%	8.2%	22.5%	23.8%	21.6%
Reported EPS	1.9%	9.2%	14.0%	21.9%	19.8%
Recurring EPS	17.6%	6.0%	20.7%	21.9%	19.8%

Source: RHB

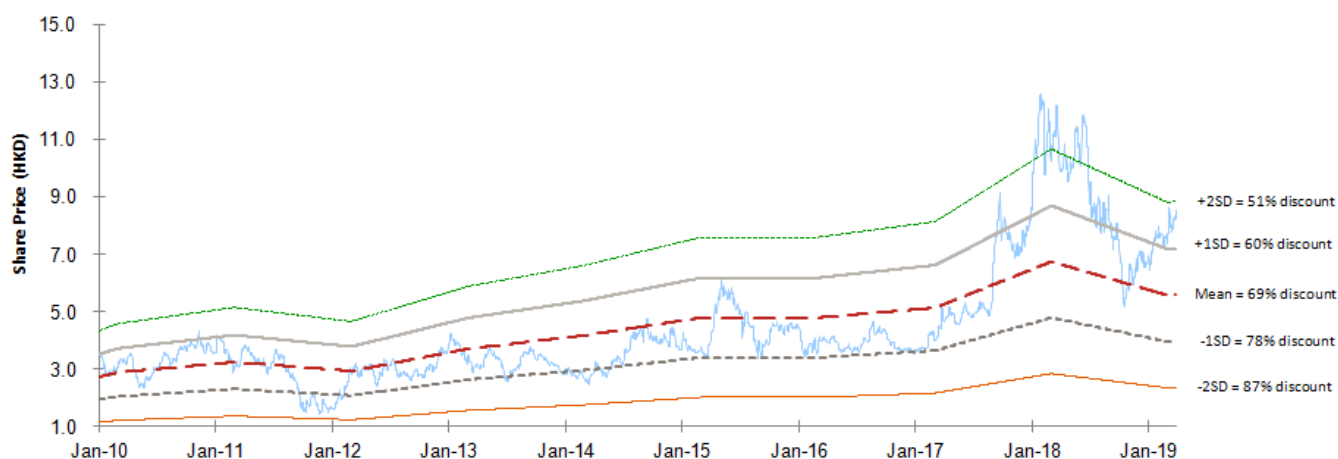
Valuations

Figure 4: KWG's end-FY19F ENAV

Details	Total HKDm	HKD/share	% of Total
Landbank and properties under development	67,699	21.3	106.7%
Investment properties	22,675	7.1	35.8%
Net debts as of end-FY19F	(26,949)	(8.5)	-42.5%
Total	63,425	20.0	100.0%

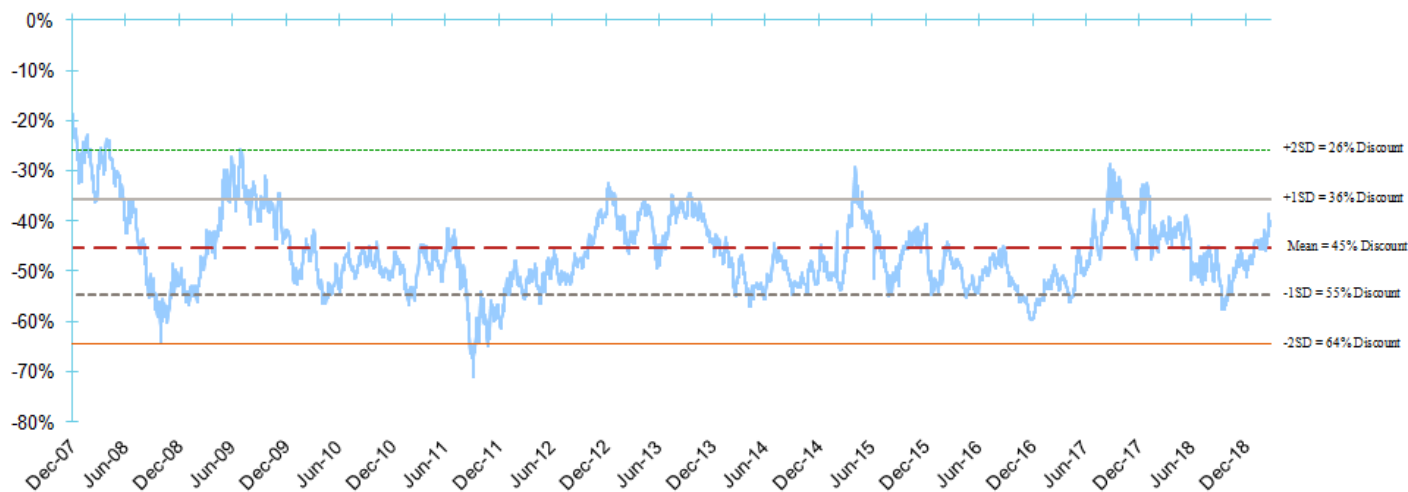
Source: RHB

Figure 5: KWG's 5-year rolling forward ENAV band



Source: Bloomberg, RHB

Figure 6: China property sector – 10-year ENAV discount band



Source: Bloomberg, RHB

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