

8 March 2019

Property | Real Estate

## Country Garden (2007 HK)

**Buy** (Maintained)

### Trimming Earnings Forecast But Keep BUY

Target Price (Return)                   HKD17.00 (+52%)  
 Price:   HKD11.20  
 Market Cap:                                 USD30,997m  
 Avg Daily Turnover (HKD/USD)       400m/51m

- **Maintain BUY, new HKD17.00 TP from HKD20.00, 52% upside, with 5% yield.** We lower our earnings forecast on Country Garden (CG) by 9-14% for FY18-20F, ahead of the results announcement on 18 March, reflecting higher operating expenses but partially offset by solid GPM. Since its earnings growth remains attractive – along with steady contracted sales growth and a healthy financial position – we believe CG is still the investors’ pick for a high-beta leader to tap into the improving sentiment on the sector. We trim its end-FY19F ENAV to HKD25.70 (from HKD26.80), but widen our target discount to 35% (from 25%, still at +2SD) to arrive at our new TP.

- **Transforming from scale expansion to profitability.** With 31% YoY growth in attributable contracted sales revenue, we believe CG incurred higher operating expenses in FY18, which was the major reason for our earnings cut. However, given the solid contracted ASP and its low land cost strategy, we believe it was able to keep GPM at 25-26% for FY18, which partially offset the impact from higher operating costs. As we expect to see normalising growth for contracted sales going forward, we believe the developer will be able to rein in the increase of operating expenses as well. Accordingly, we lower our earnings forecast by 14%/12%/9% for FY18-20F. That said, we think CG is still able to record decent earnings growth among its peers (35% for FY18F, and 24.2% CAGR for FY17-20F).

- **5-10% contracted sales growth in FY19F.** CG has not shared its contracted sales targets since FY18, and we expect the same practice to continue this year. That said, we expect it to book a 14% YoY decline in contracted sales revenue for 2M19 – but it should also be able to post a 5-10% YoY increase in full-year revenue. Even though we expect CG and other top-tier developers to achieve mild and normalised contracted sales growth in FY19, they should also still grow their market shares, amidst a consolidating property market.

- **May benefit from policy easing and monetary loosening.** Trading-wise, given CG’s strategy of a high asset turnover and balancing the mix of its land bank between top-tier and low-tier cities, we believe CG is a candidate that could benefit from any policy loosening in low-tier cities, as well as from supportive policies on the development of the Greater Bay Area (GBA).

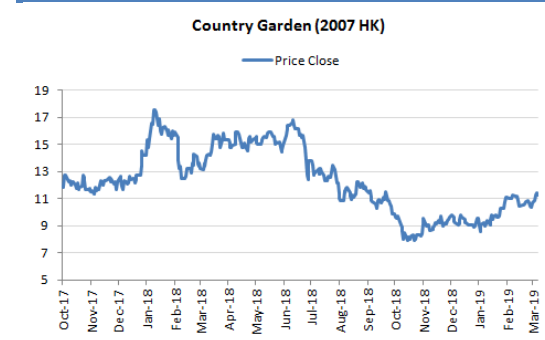
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	17.9	1.6	21.6	4.1	(16.1)
Relative	11.4	2.8	10.4	6.7	(4.7)
52-wk Price low/high (HKD)	16.9 – 7.7				



Source: Bloomberg

Forecasts and Valuation	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYm)	153,087	226,900	349,372	439,065	499,888
Recurring net profit (CNYm)	11,985	24,690	33,247	41,820	47,342
Recurring net profit growth (%)	22.3	106.0	34.7	25.8	13.2
Recurring EPS (CNY)	0.54	1.10	1.48	1.86	2.10
Recurring P/E (x)	17.6	11.2	10.0	9.0	8.0
P/BV (x)	3.0	2.3	1.6	1.5	1.0
DPS (CNY)	0.17	0.40	0.47	0.58	0.65
Dividend Yield (%)	1.8	4.2	4.9	6.0	6.8
ROAE (%)	17.7	30.1	29.2	29.8	26.6
Net debt to equity (%)	48.7	56.9	58.5	58.6	57.2
Interest coverage (x)	3.7	6.8	6.7	8.4	8.7

Source: Company data, RHB

## Changes In Earnings Forecasts

Figure 1: Changes to our earnings forecasts

FY end Dec 31 (CNY m)	FY18F			FY19F			FY20F		
	Original	New	chg (%)	Original	New	chg (%)	Original	New	chg (%)
Revenue	351,277	349,372	-1%	440,714	439,065	0%	506,989	499,888	-1%
Cost of goods sold	(263,086)	(258,457)	-2%	(330,600)	(329,366)	0%	(382,280)	(376,940)	-1%
<b>Gross Profit</b>	<b>88,191</b>	<b>90,915</b>	<b>3%</b>	<b>110,115</b>	<b>109,699</b>	<b>0%</b>	<b>124,709</b>	<b>122,948</b>	<b>-1%</b>
Administrative expenses	(11,504)	(13,181)	15%	(14,653)	(14,908)	2%	(17,696)	(16,935)	-4%
Selling and marketing exp	(17,089)	(19,426)	14%	(21,351)	(21,581)	1%	(25,339)	(24,118)	-5%
Other incomes/expenses, inc. exceptionals	1,840	1,840	0%	1,472	1,472	0%	1,178	1,178	0%
Revaluation gains	539	539	N/A	0	0	N/A	0	0	N/A
Interest Expense	(1,064)	(1,064)	0%	(1,243)	(1,243)	0%	(1,320)	(1,320)	0%
Interest Income	1,512	1,512	0%	1,588	1,588	0%	1,588	1,588	0%
JCE & Associate items	772	542	-30%	926	579	-37%	1,056	623	N/A
<b>Profit before tax</b>	<b>63,197</b>	<b>61,677</b>	<b>-2%</b>	<b>76,853</b>	<b>75,606</b>	<b>-2%</b>	<b>84,175</b>	<b>83,963</b>	<b>0%</b>
Taxation	(20,855)	(23,437)	12%	(25,361)	(28,352)	12%	(27,778)	(31,066)	12%
Minority Interests	(3,387)	(4,589)	35%	(4,119)	(5,434)	32%	(4,512)	(5,554)	23%
<b>Reported net profit</b>	<b>38,954</b>	<b>33,651</b>	<b>-14%</b>	<b>47,372</b>	<b>41,820</b>	<b>-12%</b>	<b>51,885</b>	<b>47,342</b>	<b>-9%</b>
<b>Recurring net profit</b>	<b>38,550</b>	<b>33,247</b>	<b>-14%</b>	<b>47,372</b>	<b>41,820</b>	<b>-12%</b>	<b>51,885</b>	<b>47,342</b>	<b>-9%</b>
<b>Gross profit margin (%)</b>	<b>25.1%</b>	<b>26.0%</b>	<b>0.9ppts</b>	<b>25.0%</b>	<b>25.0%</b>	<b>0.0ppts</b>	<b>24.6%</b>	<b>24.6%</b>	<b>0.0ppts</b>
<b>Reported net profit margin (%)</b>	<b>11.1%</b>	<b>9.6%</b>	<b>-1.5ppts</b>	<b>10.7%</b>	<b>9.5%</b>	<b>-1.2ppts</b>	<b>10.2%</b>	<b>9.5%</b>	<b>-0.8ppts</b>
<b>Recurring net profit margin (%)</b>	<b>11.0%</b>	<b>9.5%</b>	<b>-1.5ppts</b>	<b>10.7%</b>	<b>9.5%</b>	<b>-1.2ppts</b>	<b>10.2%</b>	<b>9.5%</b>	<b>-0.8ppts</b>

Source: Company data, RHB

Figure 2: CG's interim P&L

FY end Dec 31 (CNY m)	Actual 1H16	Actual 2H16	Actual 1H17	Actual 2H17	Actual 1H18	RHB 2H18F
<b>Turnover</b>	<b>57,362</b>	<b>95,724</b>	<b>77,738</b>	<b>149,162</b>	<b>131,894</b>	<b>217,478</b>
Property sales	55,406	92,774	74,475	145,683	126,885	212,374
Property mgmt and others	1,956	2,951	3,263	3,479	5,009	5,105
Cost of sales	(45,337)	(75,514)	(60,641)	(107,473)	(96,921)	(161,536)
<b>Gross profit</b>	<b>12,026</b>	<b>20,210</b>	<b>17,097</b>	<b>41,689</b>	<b>34,973</b>	<b>55,942</b>
Other income	134	(98)	243	677	1,758	82
Selling and marketing exp	(1,982)	(5,402)	(3,337)	(6,665)	(4,502)	(14,924)
Administrative expenses	(1,845)	(3,126)	(4,038)	(4,263)	(5,882)	(7,299)
<b>Operating profit</b>	<b>8,334</b>	<b>11,585</b>	<b>9,964</b>	<b>31,438</b>	<b>26,347</b>	<b>33,801</b>
Revaluation change	361	351	159	345	539	0
Exceptional items	130	(121)	1,450	241	0	0
Finance costs	(263)	120	0	(147)	(596)	(468)
Finance income	270	263	830	2,592	777	735
Associates and JCEs	379	(17)	6	(358)	(210)	752
<b>Profit before taxation</b>	<b>9,209</b>	<b>12,181</b>	<b>12,410</b>	<b>34,112</b>	<b>26,857</b>	<b>34,820</b>
Taxation	(3,004)	(4,723)	(4,037)	(13,734)	(10,538)	(12,899)
<b>Profit after taxation</b>	<b>6,205</b>	<b>7,458</b>	<b>8,373</b>	<b>20,378</b>	<b>16,319</b>	<b>21,921</b>
Minority interests	(815)	(1,331)	(872)	(1,816)	(3,380)	(1,209)
<b>Reported net profit</b>	<b>5,390</b>	<b>6,127</b>	<b>7,501</b>	<b>18,562</b>	<b>12,939</b>	<b>20,712</b>
<b>Recurring net profit</b>	<b>5,327</b>	<b>6,657</b>	<b>7,189</b>	<b>17,501</b>	<b>12,950</b>	<b>20,297</b>
Basic EPS (CNY)	0.242	0.280	0.350	0.878	0.600	0.902
Core EPS (CNY)	0.223	0.320	0.335	0.828	0.601	0.883
DPS (CNY)	0.069	0.102	0.150	0.250	0.185	0.280
BVPS (CNY)	3.078	3.177	3.653	4.413	4.869	5.996
Gross margin	21.0%	21.1%	22.0%	27.9%	26.5%	25.7%
Operating margin	14.5%	12.1%	12.8%	21.1%	20.0%	15.5%
Effective tax rate	-32.6%	-38.8%	-32.5%	-40.3%	-39.2%	-37.0%
Net margin	9.4%	6.4%	9.6%	12.4%	9.8%	9.5%
Core net margin	9.3%	7.0%	9.2%	11.7%	9.8%	9.3%

Source: RHB

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Figure 3: CG's annual P&amp;L (FY16-20F)

FY end Dec 31 (CNY m)	FY16	FY17F	FY18F	FY19F	FY20F
Property sales	148,180	220,157	339,259	432,845	492,966
Property mgmt and others	4,907	6,742	10,114	6,220	6,922
<b>Total revenue</b>	<b>153,087</b>	<b>226,900</b>	<b>349,372</b>	<b>439,065</b>	<b>499,888</b>
Cost of sales	(120,851)	(168,114)	(258,457)	(329,366)	(376,940)
<b>Gross profit</b>	<b>32,236</b>	<b>58,785</b>	<b>90,915</b>	<b>109,699</b>	<b>122,948</b>
Other income/expenses	1,530	(530)	1,840	1,472	1,178
Selling and marketing exp	(7,384)	(10,002)	(19,426)	(21,581)	(24,118)
Administrative expenses	(4,970)	(8,301)	(13,181)	(14,908)	(16,935)
Revaluation change	712	505	539	0	0
Exceptionals	(1,485)	1,450	0	0	0
Finance cost - net	390	3,276	448	345	267
Associates and JCEs	362	(352)	542	579	623
<b>Profit before taxation</b>	<b>21,391</b>	<b>44,831</b>	<b>61,677</b>	<b>75,606</b>	<b>83,963</b>
Taxation	(7,727)	(17,770)	(23,437)	(28,352)	(31,066)
<b>Profit after taxation</b>	<b>13,663</b>	<b>27,060</b>	<b>38,240</b>	<b>47,254</b>	<b>52,897</b>
Minority interests	(2,146)	(2,688)	(4,589)	(5,434)	(5,554)
<b>Reported net profit</b>	<b>11,517</b>	<b>24,372</b>	<b>33,651</b>	<b>41,820</b>	<b>47,342</b>
<b>Recurring net profit</b>	<b>11,985</b>	<b>24,690</b>	<b>33,247</b>	<b>41,820</b>	<b>47,342</b>
Reported EPS (CNY)	0.522	1.163	1.502	1.859	2.104
Recurring EPS (CNY)	0.543	1.102	1.484	1.859	2.104
DPS (CNY)	0.171	0.400	0.466	0.576	0.652
<b>Profit margin:</b>					
Gross margin	21.1%	25.9%	26.0%	25.0%	24.6%
Reported net margin	7.5%	10.7%	9.6%	9.5%	9.5%
Recurring net margin	7.8%	10.9%	9.5%	9.5%	9.5%
<b>YoY growth:</b>					
Turnover	35.2%	48.2%	54.0%	25.7%	13.9%
Booked property sales revenue	35.4%	48.6%	54.1%	27.6%	13.9%
Reported net profit	24.2%	111.6%	38.1%	24.3%	13.2%
Recurring net profit	22.3%	106.0%	34.7%	25.8%	13.2%
Reported EPS	22.6%	123.0%	29.1%	23.8%	13.2%
Recurring EPS	20.8%	103.0%	34.7%	25.3%	13.2%

Source: RHB

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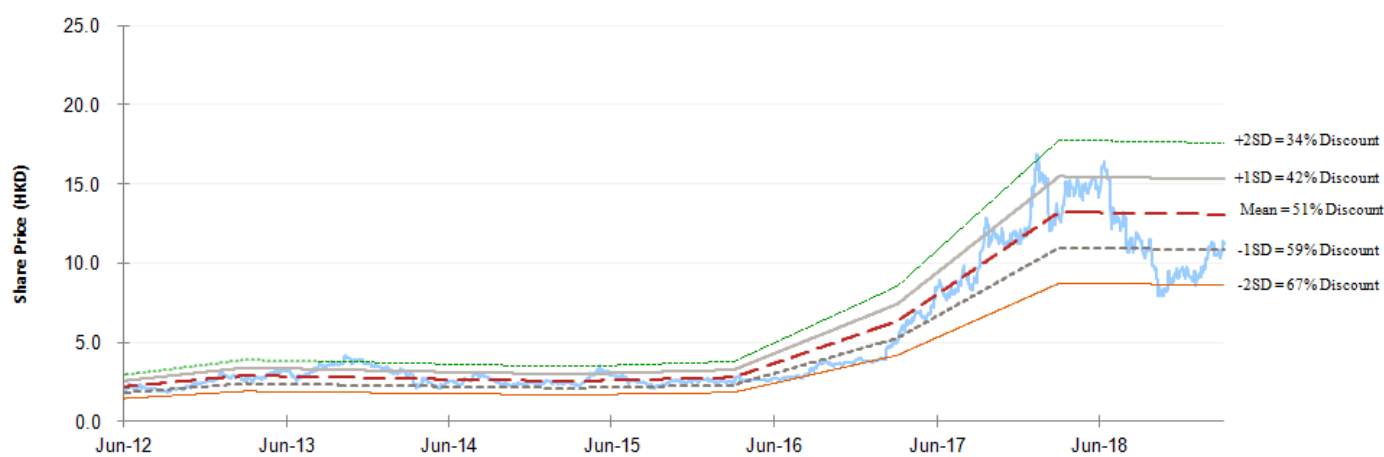
## Valuations

Figure 4: Country Garden's end-FY19F ENAV

Details	Total HKD m	HKD/share	% of total
Landbank - development properties	656,634	30.20	118%
Landbank - investment properties & hotels	16,007	0.74	3%
Net debt as at end-FY19F	(115,249)	(5.30)	-21%
<b>Total</b>	<b>557,712</b>	<b>25.70</b>	<b>100%</b>

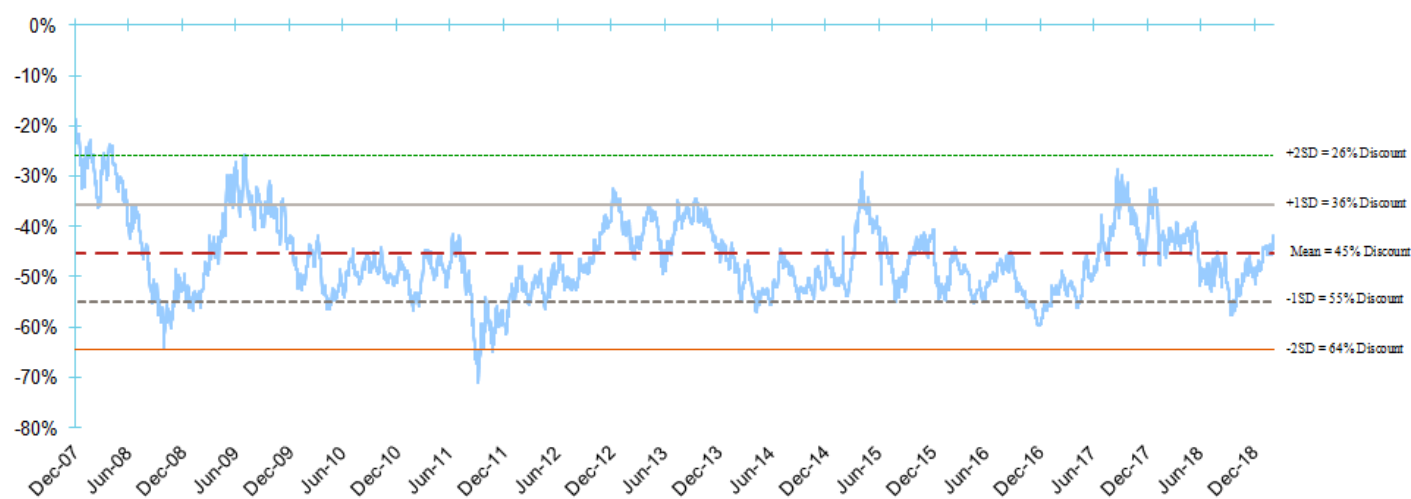
Source: Bloomberg, RHB

Figure 5: Country Garden's 5-year rolling forward ENAV band



Source: RHB

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



Source: RHB

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