

29 March 2019

Property | Real Estate

China Evergrande Group (3333 HK)

Buy (Maintained)

Bargain Hunting Amid Concerns; Keep BUY

Target Price (Return)	HKD33.20 (+29%)
Price:	HKD25.80
Market Cap:	USD43,132m
Avg Daily Turnover (HKD/USD)	497m/64m

- **Keep BUY and HKD33.20 TP, 29% upside plus 7% yield.** Being one of the Top 3 developers in contracted sales, we believe China Evergrande's catalyst will rely on its steady earnings growth, and supported by management's focus of profitability instead of endless scale expansion. Any potential progress on the proposed A-share listing, and/or resuming dividend payout should be additional catalysts. No doubt there is concern on its higher gearing, but we think it could resume a downtrend in FY19F-21F.

- **Dividend postponement not an issue.** The halting on the final dividend in FY18 may have been disappointing. Management explained its decision to delay dividend distribution to July, after the AGM is held. We think it demonstrates management's determination to materialise the A-shares listing. Judging from past experience, Evergrande should probably resume dividend payout once there is more visibility and certainty on this proposal, with the payout ratio at 40-50% to our estimated core profit.

- **Rising leverages and non-core businesses posted little concern.** As we see it, Evergrande's financial burden will not be lighter, given it may resume dividend distributions in FY19F, the rising short-term debt, and the full-year impact on financing expenses from its high-yield bonds. Also, its diversified businesses are not likely to have meaningful earnings at least in the near term. However, considering the company is not spending aggressively in its core businesses, and assuming no further significant investment is required, especially in new energy vehicles (NEV) segment, we expect its gearing to resume a downtrend in FY19F-21F.

- **FY18 earnings met, but focus has turned to dividend and leverages.** FY18 core earnings rose 66% YoY, in line with our forecast (1% above) despite slightly missing Street by 5%. We think Evergrande performed well in revenue bookings and GPM, but the halt of the final dividend, and return of increasing leverages stole the show. Net gearing (treating perpetual as debt) reached 152%, declined from 184% as of end-FY17. However, it still represented an increase from 128% as at end-1H18.

- **Maintain BUY.** We fine tune FY19F-20F earnings by 0% and 9%, as we introduce FY21F earnings with 25% YoY growth, representing a 22.1% CAGR for FY18-21F. On valuation side, we factor the value of its non-core investments, but also offset the higher leverages. As a result, we leave our end-FY19F ENAV unchanged at HKD44.20. Maintaining a 25% discount to ENAV (+2SD from sector average), we reiterate our TP of HKD33.20.

Analyst

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	9.6	6.0	11.0	17.1	4.9
Relative	11.4	0.6	12.9	3.6	(4.1)
52-wk Price low/high (HKD)	17.9 – 30.2				



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (CNYm)	311,022	466,196	576,784	676,064	782,883
Recurring net profit (CNYm)	25,915	42,939	51,240	62,600	78,179
Recurring net profit growth (%)	437.2	65.7	19.3	22.2	24.9
Recurring EPS (CNY)	1.95	3.27	3.90	4.77	5.96
Recurring P/E (x)	11.3	6.7	5.6	4.6	3.7
P/BV (x)	2.5	2.2	1.8	1.4	1.2
DPS (CNY)	1.11	0.00	1.56	1.91	2.38
Dividend Yield (%)	5.1	0.0	7.1	8.7	10.9
ROAE (%)	22.6	32.3	31.3	31.1	31.5
Net debt to equity (%)	183.7	151.9	138.3	122.2	114.6
Interest coverage (x)	2.6	2.5	2.5	2.6	3.0

Source: Company data, RHB

29 March 2019

Property | Real Estate

FY18 Results Review

Figure 1: Evergrande's FY18 results vs RHB forecasts

FY end Dec 31 (CNY m)	Actual		2H18	RHB	2H18	Actual		YoY	RHB	Diff (%)	BBG	
	1H18	2H18	YoY	2H18	Diff	FY17	FY18		FY18		Consensus	Diff (%)
Turnover	300,348	165,848	34.8%	185,726	-10.7%	311,022	466,196	49.9%	486,074	-4.1%	497,792	-6.3%
Property sales	294,760	158,004	32.8%	180,276	-12.4%	302,384	452,764	49.7%	475,036	-4.7%		
Property rental and mgmt	2,335	(1,157)	41.4%	2,459	-147.1%	811	1,178	45.3%	4,794	-75.4%		
Other businesses	3,253	9,001	86.0%	2,991	200.9%	7,827	12,254	56.6%	6,244	96.3%		
Cost of sales	(191,489)	(105,760)	35.4%	(121,989)	-13.3%	(198,760)	(297,249)	49.6%	(313,478)	-5.2%		
Gross profit	108,859	60,088	33.7%	63,736	-5.7%	112,262	168,947	50.5%	172,595	-2.1%		
Other income/(expenses)	3,304	10,308	286.2%	(2,332)	N/A	3,239	13,612	320.3%	972	1300.2%		
Selling and marketing exp	(9,334)	(8,752)	-6.8%	(8,894)	-1.6%	(17,210)	(18,086)	5.1%	(18,228)	-0.8%		
Administrative expenses	(6,593)	(8,220)	20.6%	(6,774)	21.3%	(12,246)	(14,813)	21.0%	(13,367)	10.8%		
Operating profit	96,236	53,424	70.0%	45,737	16.8%	86,045	149,660	73.9%	141,973	5.4%		
Revaluation change	2,122	(779)	-131.0%	0	N/A	8,513	1,343	-84.2%	2,122	-36.7%		
Exceptionals	0	(8,741)	174.9%	0	N/A	(10,570)	(8,741)	-17.3%	0	N/A		
Finance cost	(6,219)	(8,404)	203.8%	(175)	N/A	(7,917)	(14,623)	84.7%	(6,394)	128.7%		
Associates & JCEs	1,051	(1,925)	-269.0%	469	N/A	1,402	(874)	N/A	1,520	N/A		
Profit before taxation	93,190	33,575	15.3%	46,031	-27.1%	77,473	126,765	63.6%	139,221	-8.9%		
Taxation	(40,164)	(20,054)	31.9%	(22,235)	-9.8%	(40,424)	(60,218)	49.0%	(62,399)	-3.5%		
Profit after taxation	53,026	13,521	-2.9%	23,796	-43.2%	37,049	66,547	79.6%	76,822	-13.4%		
MI/PCS	(22,221)	(6,936)	-17.3%	(10,410)	-33.4%	(12,677)	(29,157)	130.0%	(32,631)	-10.6%		
Reported net profit	30,805	6,585	18.9%	13,386	-50.8%	24,372	37,390	53.4%	44,191	-15.4%		
Recurring net profit	29,214	13,725	127.3%	13,386	2.5%	25,915	42,939	65.7%	42,600	0.8%	45,115	-4.8%
Basic EPS (CNY)	2.338	0.511	18.0%	0.986	-48.2%	1.833	2.849	55.4%	3.324	-14.3%		
Core EPS (CNY)	2.217	1.054	123.5%	0.987	6.8%	1.949	3.272	67.9%	3.204	2.1%	3.510	-6.8%
DPS (CNY)	0.000	0.000	N/A	0.831	N/A	1.110	0.000	N/A	0.831	N/A	2.308	N/A
BVPS (CNY)	11.063	10.133	17.4%	11.125	-8.9%	8.632	10.133	17.4%	11.125	-8.9%	10.845	-6.6%
Gross margin	36.2%	36.2%		34.3%		36.1%	36.2%		35.5%			
Operating margin	32.0%	32.2%		24.6%		27.7%	32.1%		29.2%			
Effective tax rate	-43.1%	-59.7%		-48.3%		-52.2%	-47.5%		-44.8%			
Net margin	10.3%	4.0%		7.2%		7.8%	8.0%		9.1%			
Recurring net margin	9.7%	8.3%		7.2%		8.3%	9.2%		8.8%			

Source: Company data, RHB

Changes In Earnings Forecasts

Figure 2: Changes to our forecasts

(CNYm)	FY19F			FY20F		
	Original	New	chg (%)	Original	New	chg (%)
Revenue	570,623	576,784	1%	657,123	676,064	3%
Cost of goods sold	(373,768)	(376,927)	1%	(437,005)	(447,901)	2%
Gross Profit	196,855	199,857	2%	220,118	228,163	4%
Selling expense	(15,692)	(20,646)	32%	(11,500)	(22,171)	93%
General and admin expenses	(9,986)	(17,750)	78%	(4,928)	(20,129)	308%
Interest expense	(14,673)	(16,357)	11%	(14,229)	(17,695)	24%
Interest income	7,078	4,093	-42%	7,552	4,052	-46%
JV/Associates incomes, and other income/expenses	2,358	2,368	0%	2,389	2,770	16%
Pre-tax profit	165,940	151,565	-9%	199,401	174,989	-12%
Income tax & LAT	(43,562)	(68,802)	58%	(90,703)	(76,614)	-16%
Minority Interests	(41,322)	(31,524)	-24%	(51,055)	(35,775)	-30%
Reported net profit	51,056	51,240	0%	57,643	62,600	9%
Recurring net profit attri. to shareholders	51,056	51,240	0%	57,643	62,600	9%
Gross profit margin (%)	34.5%	34.7%	0.2ppts	33.5%	33.7%	0.3ppts
Reported net profit margin (%)	8.9%	8.9%	-0.1ppts	8.8%	9.3%	0.5ppts
Recurring net profit margin (%)	8.9%	8.9%	-0.1ppts	8.8%	9.3%	0.5ppts

Source: RHB

29 March 2019

Property | Real Estate

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

FY end Dec 31 (CNY m)	FY17	FY18	FY19F	FY20F	FY21F
Property sales	302,384	452,764	559,731	654,408	755,370
Property rental and mgmt	3,835	5,245	6,819	8,864	11,523
Other businesses	4,803	8,187	10,234	12,792	15,990
Total revenue	311,022	466,196	576,784	676,064	782,883
Cost of sales	(198,760)	(297,249)	(376,927)	(447,901)	(517,997)
Gross profit	112,262	168,947	199,857	228,163	264,887
Other income and expenses	(839)	9,728	577	676	783
Selling and marketing exp	(17,210)	(18,086)	(20,646)	(22,171)	(24,892)
Administrative expenses	(12,246)	(14,813)	(17,750)	(20,129)	(23,310)
Revaluation change	8,513	1,343	0	0	0
Exceptionals	(10,570)	(8,741)	0	0	0
Finance cost - net	(3,839)	(10,739)	(12,264)	(13,643)	(14,980)
Associates and JCEs	1,402	(874)	1,791	2,094	2,417
Profit before taxation	77,473	126,765	151,565	174,989	204,905
Taxation	(40,424)	(60,218)	(68,802)	(76,614)	(85,387)
Profit after taxation	37,049	66,547	82,763	98,375	119,518
MI	(12,677)	(29,157)	(31,524)	(35,775)	(41,339)
Reported net profit	24,372	37,390	51,240	62,600	78,179
Recurring net profit	25,915	42,939	51,240	62,600	78,179
Reported EPS (CNY)	1.833	2.849	3.904	4.770	5.956
Recurring EPS (CNY)	1.949	3.272	3.904	4.770	5.956
DPS (CNY)	1.110	0.000	1.562	1.908	2.383
Profit margin:					
Gross margin	36.1%	36.2%	34.7%	33.7%	33.8%
Reported net margin	7.8%	8.0%	8.9%	9.3%	10.0%
Recurring net margin	8.3%	9.2%	8.9%	9.3%	10.0%
YoY growth:					
Turnover	47.1%	49.9%	23.7%	17.2%	15.8%
Booked property sales revenue	48.3%	49.7%	23.6%	16.9%	15.4%
Reported net profit	378.7%	53.4%	37.0%	22.2%	24.9%
Recurring net profit	437.2%	65.7%	19.3%	22.2%	24.9%
Reported EPS	411.6%	55.4%	37.0%	22.2%	24.9%
Recurring EPS	474.1%	67.9%	19.3%	22.2%	24.9%

Source: RHB

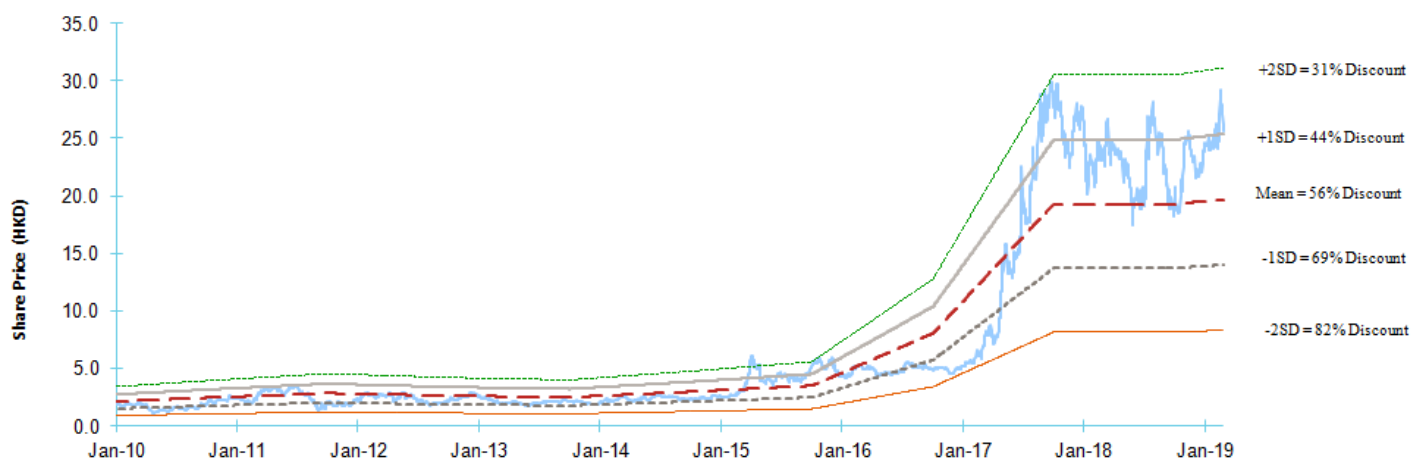
Valuation

Figure 4: Evergrande's end-FY19F ENAV

Details	Total HKDm	HKD/share	% of Total
Landbank and properties under development (Hengda Real Estate & Tourism)	1,143,744	87.2	197%
Investment properties	154,050	11.7	27%
Hotel and other investments	118,658	9.0	20%
Net debts as of end-FY19F	(836,041)	(63.7)	-144%
Total	580,410	44.2	100%

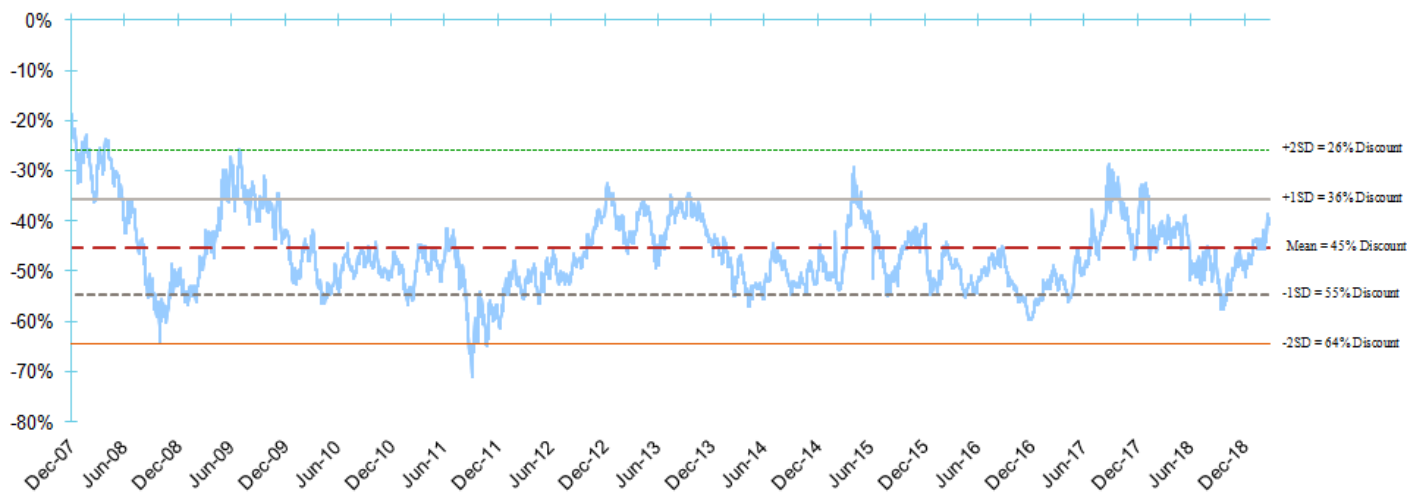
Source: RHB

Figure 5: Evergrande'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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