

25 March 2019

Property | Real Estate

## China Overseas Grand Oceans (81 HK)

**Buy** (from Neutral)

### Improvements On All Fronts, U/G To BUY

Target Price (Return)	HKD4.50 (+14%)
Price:	HKD3.96
Market Cap:	USD1,728m
Avg Daily Turnover (HKD/USD)	22m/3m

- **Upgrade to BUY from Neutral with a new HKD4.50 TP from HKD2.60, 14% upside plus 5.6% yield.** We believe China Overseas Grand Oceans has differentiated itself from other low-tier cities developers and is immune to the sluggish outlook in such cities. Riding on its strategic city selection focus – helped by the property portfolio acquired from its parent – COGO has levelled profit margins and contracted sales growth alongside other nationwide developers. TP is raised mainly by narrowing our target ENAV discount to 45% from 65%.

- **Elimination of low-profit margins era.** COGO's outstanding GPM was the spotlight for the strong beat in FY18's results. Despite the geographical diversification with its China Overseas Land & Investment (COLI) (688 HK, BUY, TP: HKD36.10) parent to focus on tier-3&4 cities, according to management, COGO adapted the strategy. It is concentrating on low-tier cities with strong upgrading potential. Moreover, we estimate that some of the projects within the property portfolio acquired from COLI have started to register revenue bookings. With FY18 and 2H18 GPMs of 29.1% and 32.5%, we see COGO surpassing other low-tier cities players and is now virtually no different from other nationwide developers.

- **Steady contracted sales growth on enlarged landbank.** For the aforementioned strategic selection of low-tier cities – and with the help of the acquired property portfolio, which contributed 26% of total contracted sales in FY18 – COGO achieved a 36% YoY surge in contracted sales revenue last year. Looking ahead, we expect robust contracted sales growth (14-29%) for FY19-21F.

- **FY18 results beat.** FY18 core earnings rose 115% YoY and beat our and Street forecasts by 30% and 24%. This was largely attributed to its aforementioned outstanding GPM. Additionally, following the completion of the rights issue, COGO recorded a net cash position, as it has raised the cash balance 40%, with only a 19% increase in gross debt.

- **We raise our FY19F-20F earnings 16% and 13%,** mainly driven by more presales proceeds for revenue bookings and higher GPM assumptions. We introduce FY21F earnings with 28% YoY growth and at a CAGR of 16.8% for FY18-21F. Accordingly, we boost our end-FY19F ENAV 8% to HKD8.10 from HKD7.50, given the aforementioned factors and improved financial war chest. We narrow the ENAV discount to 45% from 65%, representing its historical mean from -1SD. Consequently, we raise our TP to HKD4.50.

#### Analyst

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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	53.7	26.2	57.4	47.9	(6.4)
Relative	12.5	0.9	12.9	4.0	(6.4)
52-wk Price low/high (HKD)	4.3 – 2.3				

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Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (HKDm)	20,278	25,571	31,242	40,111	51,157
Recurring net profit (HKDm)	1,126	2,425	2,527	3,012	3,869
Recurring net profit growth (%)	25.1	115.3	4.2	19.2	28.5
Recurring EPS (HKD)	0.48	0.73	0.76	0.91	1.16
Recurring P/E (x)	8.3	5.4	5.2	4.4	3.4
P/BV (x)	0.7	0.7	0.4	0.4	0.3
DPS (HKD)	0.04	0.14	0.22	0.26	0.34
Dividend Yield (%)	1.0	3.6	5.6	6.7	8.6
ROAE (%)	7.8	12.0	11.2	11.9	13.4
Net debt to equity (%)	25.4	(2.9)	5.0	12.2	20.5
Interest coverage (x)	8.6	6.4	4.2	3.0	2.3

Source: Company data, RHB

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## FY18 Results Review

Figure 1: COGO's FY18 results vs RHB forecasts

FY end Dec 31 (HKD m)	Actual		2H18	RHB	2H18	Actual		FY18	RHB		BBG	
	1H18	2H18	YoY	2H18	Diff (%)	FY17	FY18	YoY	FY18	Diff (%)	Consens	Diff (%)
<b>Turnover</b>	<b>11,189</b>	<b>14,383</b>	<b>27.9%</b>	<b>13,790</b>	<b>4.3%</b>	<b>20,278</b>	<b>25,571</b>	<b>26.1%</b>	<b>24,979</b>	<b>2.4%</b>	<b>26,851</b>	<b>-4.8%</b>
Property sales	11,034	14,240	28.3%	13,623	4.5%	20,005	25,274	26.3%	24,656	2.5%		
Property investment	126	97	-9.6%	124	-21.1%	207	223	8.1%	249	-10.5%		
Property mgmt and others	29	45	11.5%	44	1.5%	67	74	11.0%	73	0.9%		
Cost of sales	(8,420)	(9,713)	7.1%	(10,834)	-10.3%	(16,209)	(18,134)	11.9%	(19,254)	-5.8%		
<b>Gross profit</b>	<b>2,768</b>	<b>4,669</b>	<b>114.4%</b>	<b>2,957</b>	<b>57.9%</b>	<b>4,069</b>	<b>7,438</b>	<b>82.8%</b>	<b>5,725</b>	<b>29.9%</b>		
Other income and expenses	160	120	-6.0%	(108)	-210.3%	191	280	46.0%	52	441.4%		
Selling and distribution exp	(343)	(498)	28.5%	(464)	7.4%	(676)	(841)	24.5%	(807)	4.2%		
Administrative expenses	(312)	(410)	16.0%	(360)	13.8%	(610)	(722)	18.4%	(672)	7.4%		
<b>Operating profit</b>	<b>2,272</b>	<b>3,881</b>	<b>148.1%</b>	<b>2,025</b>	<b>91.7%</b>	<b>2,974</b>	<b>6,154</b>	<b>106.9%</b>	<b>4,297</b>	<b>43.2%</b>		
Revaluation change	3	(3)	-101.8%	0	N/A	192	0	N/A	3	N/A		
Exceptionals	0	2	45.2%	0	N/A	1	2	N/A	0	N/A		
Finance cost	(17)	(75)	341.7%	136	-155.3%	(33)	(92)	183.9%	119	N/A		
Associates and JCEs	115	164	165.2%	109	49.6%	47	278	488.5%	224	24.2%		
<b>Profit before taxation</b>	<b>2,374</b>	<b>3,969</b>	<b>120.2%</b>	<b>2,270</b>	<b>74.8%</b>	<b>3,182</b>	<b>6,343</b>	<b>99.3%</b>	<b>4,644</b>	<b>36.6%</b>		
Taxation	(1,293)	(2,548)	104.2%	(1,261)	102.1%	(1,920)	(3,841)	100.0%	(2,554)	50.4%		
<b>Profit after taxation</b>	<b>1,080</b>	<b>1,421</b>	<b>156.0%</b>	<b>1,009</b>	<b>40.8%</b>	<b>1,262</b>	<b>2,502</b>	<b>98.3%</b>	<b>2,090</b>	<b>19.7%</b>		
Minority interests	(66)	(8)	-296.0%	(158)	-94.8%	10	(74)	N/A	(224)	-66.9%		
<b>Reported net profit</b>	<b>1,014</b>	<b>1,413</b>	<b>152.6%</b>	<b>851</b>	<b>66.0%</b>	<b>1,271</b>	<b>2,427</b>	<b>90.9%</b>	<b>1,865</b>	<b>30.1%</b>		
<b>Recurring net profit</b>	<b>1,012</b>	<b>1,414</b>	<b>241.2%</b>	<b>851</b>	<b>66.1%</b>	<b>1,126</b>	<b>2,425</b>	<b>115.3%</b>	<b>1,863</b>	<b>30.2%</b>	<b>1,950</b>	<b>24.4%</b>
Basic EPS (HKD)	0.315	0.416	85.2%	0.230	80.8%	0.536	0.731	36.2%	0.545	34.1%		
Core EPS (HKD)	0.314	0.416	154.7%	0.230	80.8%	0.475	0.730	53.6%	0.544	34.2%	0.588	24.2%
DPS (HKD)	0.030	0.112	273.3%	0.052	116.5%	0.040	0.142	255.0%	0.082	73.7%	0.067	111.9%
BVPS (HKD)	5.996	5.854	1.4%	5.688	2.9%	5.771	5.854	1.4%	5.688	2.9%	6.103	-4.1%
Gross margin	24.7%	32.5%		21.4%		20.1%	29.1%		22.9%			
Operating margin	20.3%	27.0%		14.7%		14.7%	24.1%		17.2%			
Effective tax rate	-54.5%	-64.2%		-55.5%		-60.3%	-60.6%		-55.0%			
Net margin	9.1%	9.8%		6.2%		6.3%	9.5%		7.5%			
Core net margin	9.0%	9.8%		6.2%		5.6%	9.5%		7.5%			

Source: Company data, RHB

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## Changes In Earnings Forecasts

Figure 2: Changes to our forecasts

(HKD m)	FY19F			FY20F		
	Original	New	chg (%)	Original	New	chg (%)
Revenue	29,299	31,242	7%	36,864	40,111	9%
Cost of goods sold	(22,669)	(23,342)	3%	(28,578)	(30,195)	6%
<b>Gross profit</b>	<b>6,630</b>	<b>7,900</b>	<b>19%</b>	<b>8,286</b>	<b>9,916</b>	<b>20%</b>
Selling and distribution exp	(1,158)	(1,071)	-8%	(1,459)	(1,453)	0%
Administrative expenses	(965)	(935)	-3%	(1,216)	(1,279)	5%
Interest expense	(88)	(141)	61%	(148)	(240)	62%
Interest income	195	333	71%	216	322	49%
JCE & Associate items	322	287	-11%	405	370	-9%
Others	57	(119)	-309%	62	(122)	-296%
<b>Profit before tax</b>	<b>4,992</b>	<b>6,254</b>	<b>25%</b>	<b>6,148</b>	<b>7,515</b>	<b>22%</b>
Taxation	(2,496)	(3,440)	38%	(3,074)	(4,133)	34%
Minority interests	(322)	(287)	-11%	(405)	(370)	-9%
<b>Reported net profit</b>	<b>2,175</b>	<b>2,527</b>	<b>16%</b>	<b>2,669</b>	<b>3,012</b>	<b>13%</b>
<b>Recurring net profit</b>	<b>2,175</b>	<b>2,527</b>	<b>16%</b>	<b>2,669</b>	<b>3,012</b>	<b>13%</b>
Gross profit margin (%)	22.6%	25.3%	2.7ppts	22.5%	24.7%	2.2ppts
Reported net profit margin (%)	7.4%	8.1%	0.7ppts	7.2%	7.5%	0.3ppts
Recurring net profit margin (%)	7.4%	8.1%	0.7ppts	7.2%	7.5%	0.3ppts

Source: RHB

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Figure 3: COGO's annual P&amp;L (FY17-21F)

FY end Dec 31 (HKD m)	FY17	FY18F	FY19F	FY20F	FY21F
Property sales	20,005	25,274	30,914	39,750	50,759
Property investment	207	223	246	271	299
Property mgmt and others	67	74	81	89	98
<b>Total revenue</b>	<b>20,278</b>	<b>25,571</b>	<b>31,242</b>	<b>40,111</b>	<b>51,157</b>
Cost of sales	(16,209)	(18,134)	(23,342)	(30,195)	(38,604)
<b>Gross profit</b>	<b>4,069</b>	<b>7,438</b>	<b>7,900</b>	<b>9,916</b>	<b>12,552</b>
Other income	13	(115)	(119)	(122)	(126)
Selling and marketing exp	(676)	(841)	(1,071)	(1,453)	(1,719)
Administrative expenses	(610)	(722)	(935)	(1,279)	(1,513)
Revaluation change	0	0	0	0	0
Exceptionals	0	0	0	0	0
Finance cost - net	146	303	192	82	(62)
Associates and JCEs	47	278	287	370	437
<b>Profit before taxation</b>	<b>2,989</b>	<b>6,340</b>	<b>6,254</b>	<b>7,515</b>	<b>9,571</b>
Taxation	(1,920)	(3,841)	(3,440)	(4,133)	(5,264)
<b>Profit after taxation</b>	<b>1,068</b>	<b>2,499</b>	<b>2,814</b>	<b>3,382</b>	<b>4,307</b>
Minority interests	10	(74)	(287)	(370)	(437)
<b>Reported net profit</b>	<b>1,078</b>	<b>2,425</b>	<b>2,527</b>	<b>3,012</b>	<b>3,869</b>
<b>Recurring net profit</b>	<b>1,126</b>	<b>2,425</b>	<b>2,527</b>	<b>3,012</b>	<b>3,869</b>
Reported EPS (HKD)	0.455	0.730	0.761	0.907	1.165
Recurring EPS (HKD)	0.475	0.730	0.761	0.907	1.165
DPS (HKD)	0.040	0.142	0.221	0.264	0.339
<b>Profit margin:</b>					
Gross margin	20.1%	29.1%	25.3%	24.7%	24.5%
Reported net margin	5.3%	9.5%	8.1%	7.5%	7.6%
Recurring net margin	5.6%	9.5%	8.1%	7.5%	7.6%
<b>YoY growth:</b>					
Turnover	18.6%	26.1%	22.2%	28.4%	27.5%
Booked property sales revenue	18.4%	26.3%	22.3%	28.6%	27.7%
Reported net profit	19.8%	124.9%	4.2%	19.2%	28.5%
Recurring net profit	25.1%	115.3%	4.2%	19.2%	28.5%
Reported EPS	15.3%	60.4%	4.2%	19.2%	28.5%
Recurring EPS	20.5%	53.6%	4.2%	19.2%	28.5%

Source: RHB

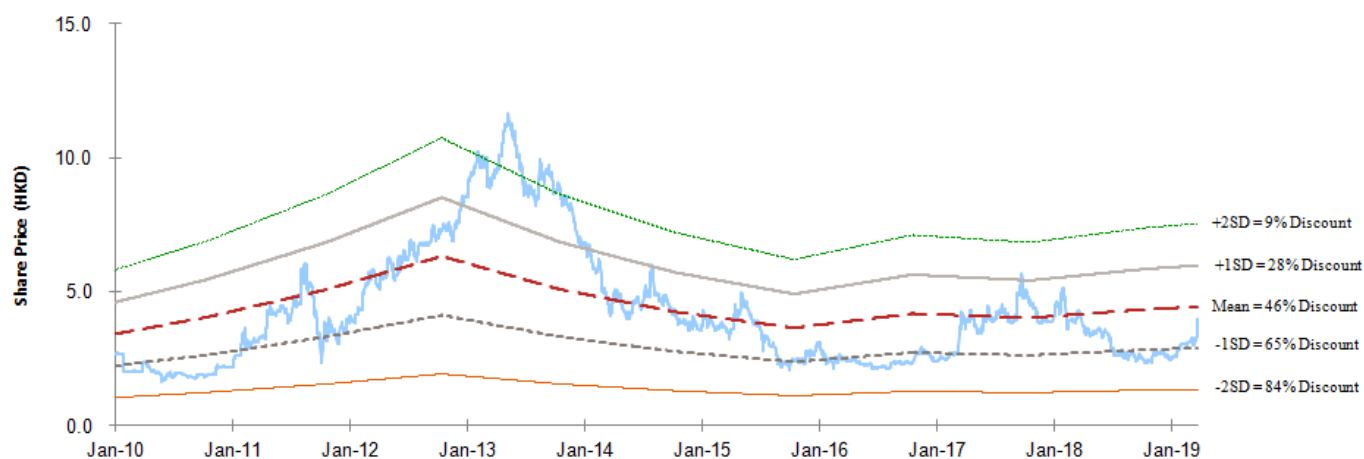
## Valuations

Figure 4: COGO's end-FY19F ENAV

Details	Total HKD m	HKD/share	% of Total
Landbank and properties under development	25,953	7.6	93.5%
Investment properties	2,934	0.9	10.6%
Net debts as of end-FY19F	(1,123)	(0.3)	-4.0%
<b>Total</b>	<b>27,764</b>	<b>8.1</b>	<b>100.0%</b>

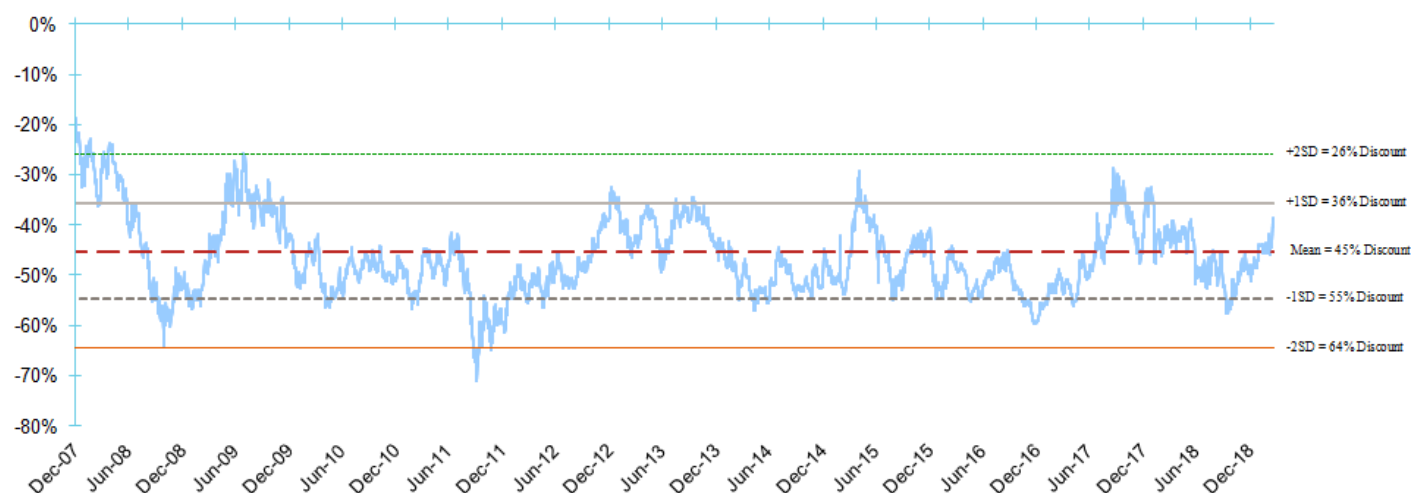
Source: RHB

Figure 5: COGO'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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