

23 July 2018

Property | Real Estate

## Sunac China Holdings

**Neutral** (Maintained)

### Positive Profit Alert In Line With Expectation

Target Price: HKD31  
 Price: HKD24.20  
 Market Cap: USD13,575m  
 Bloomberg Ticker: 1918 HK

On 23 Jul before market open, Sunac issued a positive profit alert, for net profit (before adjustment for non-recurring items) increasing a significant >200% YoY to CNY3.9bn, from CNY1.3bn in 1H17. While it looks like a major earnings surge, it is actually in line with our FY18 recurring earnings growth estimate of 172% (after stripping out exceptional items in 1H17). The substantial improvement in 1H18 earnings was due to the 200% YoY increase in revenue from property sales in the same period; IFRS 15 implementation – which should accelerate developers’ revenue recognition from property presales; and further GPM expansion. While the alert reaffirms our view on Sunac’s sector-leading earnings growth, we are concerned about valuations suffering from prevailing concerns as to the credit crunch and refinancing risks. Maintain NEUTRAL, but with TP under review pending Sunac’s interim results (currently HKD31, offering 28% upside). In the property space, we prefer Shimaos, Country Garden and CIFI.

**Positive profit alert in line with expectation.** Before market open today, Sunac China guided that 1H18 reported net profit (before adjusting for non-recurring items) will increase over 200% YoY to CNY3.9bn (1H17: CNY1.3bn). Assuming some adjustments for non-recurring and non-cash items, the guided 200% YoY increase in 1H18 net profit is roughly in line with our FY18 recurring earnings growth estimate of 172% (CNY12.8bn).

As for FY17, we included both the CNY25bn in gains from asset acquisitions from Wanda and provision of CNY16.5bn for the investment in Leshi, in order to arrive at recurring net profit of CNY11.1bn. Stripping out these two items, core FY17 net profit would be CNY4.7bn.

#### The earnings surprise was driven by:

- i. A 200% YoY increase in revenue from property sales in the same period;
- ii. Implementation of International Financial Reporting Standard (IFRS) 15 – which should accelerate developers’ revenue recognition from property presales;
- iii. A further increase in GPM.

Whilst the implementation of IFRS 15 ought to quicken developers’ revenue booking pace, we observe the strong booked revenue growth as being mostly the result of vigorous contracted sales growth of CNY365bn in FY17 (or +135% YoY from FY16’s CNY155bn). Also, we believe the GPM increase is in line with our forecast, where we expect GPM to improve to 22.5% in FY18 (FY17: 20.7%).

**Maintain NEUTRAL**, with our TP under review pending the interim results. We believe the positive earnings alert supports our view for Sunac’s sector-leading earnings growth outlook over FY18-20. Nevertheless, its sector-high leverage leaves its valuation in a vulnerable position, amid prevailing concerns as to the credit crunch and refinancing risks. Despite its progress in deleveraging and GPM improvement, its weak margin and high leverage remain our major concerns. Our current TP is based on a 25% discount to our end-FY18F ENAV of HKD41.30.

The key downside risk is a slower-than-expected deleveraging progress; the main upside risk would be larger-than-expected contracted sales growth.

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYm)	35,343	65,874	126,027	180,960	240,020
Reported net profit (CNYm)	2,478	11,004	12,836	21,466	31,045
Recurring net profit (CNYm)	2,373	11,120	12,836	21,466	31,045
Recurring net profit growth (%)	(29.7)	368.6	15.4	67.2	44.6
Recurring EPS (CNY)	0.68	2.79	3.22	5.32	7.62
DPS (CNY)	0.26	0.50	0.64	1.06	1.91
Recurring P/E (x)	30.6	7.5	6.5	3.9	2.7
P/B (x)	3.12	1.91	1.53	1.15	0.85
Dividend Yield (%)	1.2	2.4	3.1	5.1	9.1
Return on average equity (%)	11.7	32.8	26.1	33.6	35.8
Return on average assets (%)	1.2	2.4	2.0	2.8	3.5
Net debt to equity (%)	208.2	256.7	233.8	186.2	153.2
Our vs consensus EPS (adjusted) (%)			(5.6)	0.1	

Source: Company data, RHB

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