

30 October 2018

Property | Real Estate

Sunac China Holdings

Buy (Maintained)

Target Price: HKD32.10

Price: HKD20.60

Market Cap: USD11,385m

Bloomberg Ticker: 1918 HK

Positive Transaction

Maintain BUY and HKD32.10 TP, 56% upside plus 2019F yield of 6.5%. Our TP is based on an unchanged 25% discount to end-FY19F ENAV of HKD42.90. On 29 Oct night, Sunac announced that it will acquire the operations management business of Wanda's Tourism and Cultural Park at a total consideration of CNY6.3bn, and to cease a 20-year licensing fee of CNY13bn payable to Wanda following the transaction. Compared to the original scheme, we believe the new terms are positive for Sunac, as we estimate that it may result in a maximum CNY1bn discounted cost reduction over the long run. In addition, Sunac will have full operational control over these projects. We also reckon that Sunac is capable of funding this transaction through its existing cash balance without affecting its deleveraging plans. We maintain our 2018F-2020F earnings estimates as we expect a marginal 2% earnings accretion over the next three years. Downside risks include deterioration in Sunac's sell-through rate at its addressable markets (mainly tier-1 and -2 cities), and inability to refinance at competitive rates.

Acquiring Wanda Cultural Management at CNY6.3bn. On 29 Oct night, Sunac announced that it will acquire:

- i. 75% stake in Chengdu Wanda Theme Cultural Management Co (Wanda Cultural Management) for CNY4.5bn;
- ii. 100% stake in Wanda Culture Travel Innovation Group Co (Wanda BVI) for CNY1.5bn.

The two stakes above will be acquired from Mr Wang Jianlin and Wanda Holdings (Wanda). Sunac also announced the termination of the original commercial arrangement at a consideration of CNY287m with Wanda Commercial Management Group.

Upon the completion of the transaction, Sunac will hold 100% of Wanda Cultural Management and manage the operations and construction of properties under the cultural and tourism projects acquired from Wanda on 19 Jul 2017. The titles for the associated staff and part of the trademarks and copyrights will be transferred to Sunac, while the annual brand-licensing fee of CNY650m will be terminated (see below for details).

Positive deal implication should result in maximum CNY1bn cost reduction. In the announcement dated 11 Jul 2017, Sunac and Wanda entered into an operations and management agreement covering a period of 20 years. During this period, each of the target projects acquired (13 projects in total) shall pay an annual brand-licensing fee of CNY50m to Wanda, which would amount to a total of CNY13bn or CNY7.3bn discounted at Sunac's 1H18 weighted average borrowing cost of 6.74%. Subject to the operational cost structure of the 13 projects under Sunac's management, this should result in a maximum CNY1bn cost reduction (discounted total licensing fee payable of CNY7.3bn minus transaction consideration of CNY6.3bn).

Deleveraging unaffected. During YTD 2018, Sunac has been relatively disciplined in its land replenishment and has lowered its debt level – total debt declined to CNY210bn as at end-1H18 from CNY220bn as at end-FY17. Management also indicated in its 1H18 analyst briefing that the company has revised its IRR requirement upwards to 50% for new development projects to be acquired, and will be very cautious in the land market. Furthermore, thanks to a cash balance of CN87.4bn as at end-1H18, we believe Sunac is capable of funding this transaction without incurring new debt. We maintain our projections for Sunac's net gearing ratio of 228%, 180%, and 144% as at end-2018F-2020F.

Maintain BUY with the same HKD32.10 TP, based on an unchanged 25% discount to end-FY19F ENAV of HKD42.90. The shares are now trading at a 54% discount to NAV, which we believe have more than factored in the expected downturn in China's housing market, given Sunac's resilient sell-through rate and strong contracted sales performance YTD (+56% YoY, the highest among top-5 players). We remain assured that the investment merits for Sunac remain intact – 40% earnings CAGR for 2017-2020F, and a deleveraging theme. Downside risks to our call are deterioration in the company's sell through rate at its addressable markets – mainly tier-1 and -2 cities – and the inability to refinance at competitive rates.

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	13,994	21,978	31,172
Recurring net profit (CNYm)	2,373	11,120	13,994	21,978	31,172
Recurring net profit growth (%)	(29.7)	368.6	25.8	57.1	41.8
Recurring EPS (CNY)	0.68	2.79	3.51	5.45	7.66
DPS (CNY)	0.26	0.50	0.70	1.09	1.91
Recurring P/E (x)	30.6	7.5	4.8	3.1	2.2
P/B (x)	3.1	1.9	1.2	0.9	0.7
Dividend Yield (%)	1.2	2.4	4.2	6.5	11.4
Return on average equity (%)	11.2	33.2	28.2	33.7	35.4
Return on average assets (%)	1.2	2.4	2.1	2.9	3.5
Net debt to equity (%)	208.2	256.7	227.9	179.7	143.9
Our vs consensus EPS (adjusted) (%)			12.9	10.1	16.3

Source: Company data, RHB

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