

# KWG Property (1813.HK)

## Quality Developer of Top Tiers Cities

Hong Kong | Property | Company report

24 November 2016

KWG Property has an improved result in 1H2016. Total revenue increased 38.9%, from CNY3,921Mn in 1H2015 to CNY5,448Mn in 1H2016. Net profit rose 3.64% in 1H2016 to CNY1,421Mn. By October 2016, the company has achieved 88% of its targeted pre-sale in 2016, with a total achieved pre-sale value of CNY19.3Bn. The improved result is caused by the increased amount of GFA delivered to clients and the rising sales price per square metres.

**Buy**

CMP: HKD 4.38

(Closing price as at 22 Nov 2016)

TARGET: HKD 5.90 (+34.7%)

### Developer in Top Advanced Cities

KWG Property has strong presence in top tier cities in China and has 33 projects in Tier 1 Cities, namely, Beijing, Shanghai, and Guangzhou, with a total GFA of 4.75 million square metres in these cities. In particular, projects in Tier 1 Cities contribute to 48% of the revenue in pre-sale and the remainder was contributed by Tier 2 Cities, mainly Hangzhou and Nanning. KWG Property has 60 development projects with 10.4 million square metres of GFA attributable to the company, which is sufficient for development use in the next 4 to 5 years. KWG Property's development projects are well-positioned in the major cities in China, with huge population as well as economic development, both of which are the fundamental drivers of housing demand. Therefore, despite the recent adoptions of property market regulations, we expect the sales of property to continue to grow moderately for KWG Property, and the company would still benefit from these macro drivers of property market growth.

#### COMPANY DATA

O/S SHARES (MN) :	3,054
MARKET CAP (HKDBN) :	13.38
52 - WK HI/LO (HKD):	6.04 / 4.21

#### SHARE HOLDING PATTERN , %

Kong Jiannan	58.86%
Kong Jiantao	58.89%
Kong Jianmin	61.15%
Plus Earn Consultants Limited	56.40%

#### PRICE PERFORMANCE , %

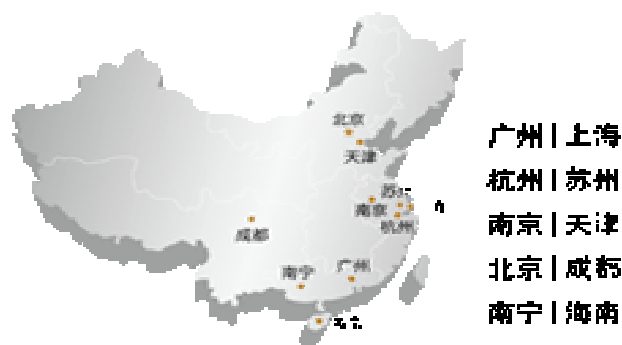
	1M	3M	1Y
KWG Property	(6.21%)	(19.19%)	(24.48%)
HSI	(3.22%)	(1.09%)	(0.36%)

#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

### Geographical Distribution of KWG Property's Projects



Source: KWG Property

### Excellent Location Selection for Property Development

According to the graph below, throughout the last twelve months, property price for newly built apartment in Shanghai, Beijing and Guangzhou rose 25.7%, 17.2% and 13.4% respectively. This will certainly benefit KWG Property since Shanghai, Beijing and Guangzhou are at the core of company's strategy. Another strategic objective of KWG Property is to expand into advanced Tier 2 Cities from the strategic base of Guangzhou and the company has already set its foot in a few of the Tier 2 Cities, such as Hangzhou, Nanjing, Chengdu and Suzhou. At the same time although the property price of newly built apartment in Tier 2 Cities is not rising as rapidly as those in Tier 1 Cities do, the property price in the Tier 2 Cities is still rising steadily, benefiting the sales of KWG Property especially the other 52% of the pre-sale are from the Tier 2 Cities.

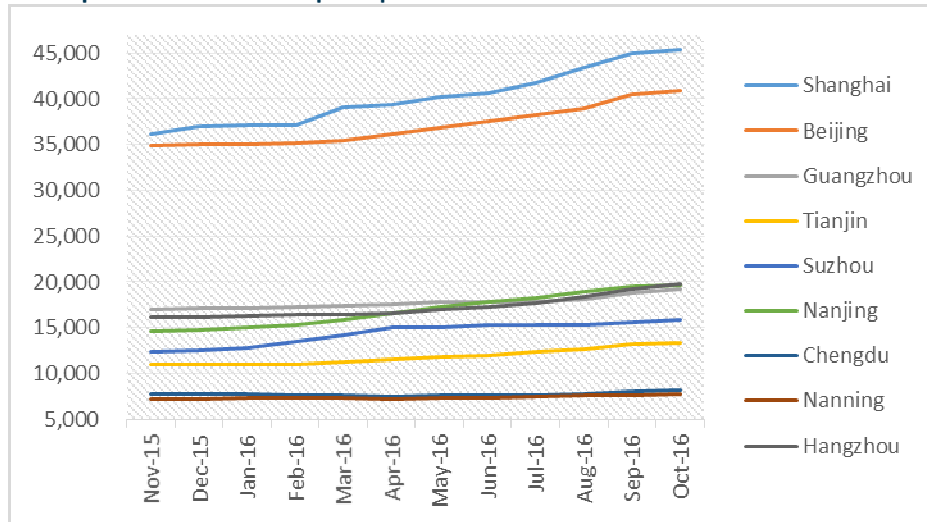
#### KEY FINANCIALS

CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	10,466	8,340	10,740	11,107
Net Profit	3,268	3,413	3,623	3,747
EPS, HKD	1.3976	1.3525	1.4357	1.4848
PER, x	3.75	3.21	3.58	3.97
BVPS, HKD	8.6473	8.7689	9.8457	10.9593
P/BV, x	0.61	0.50	0.52	0.54
ROE, %	16.03	15.29	14.58	13.54

Source: Company reports, Phillip Securities Est.

Research Analyst  
**John Wong**  
 +852 2277 6527  
 johnycwong@phillip.com.hk

### New Apartment Sales Price per Squared Metres across Cities



Source: Fang.com

### Government Intervention on the Property Market

In October, the Chinese government has adopted several property market tightening policies, which affect almost all of the cities where KWG Property engages in. The policies consist of both measures suppressing the purchasing power of the consumers as well as that of the developers. In particular, the Chinese government increased the statutory down payment ratio, debit limit and purchase limit. From the developer's perspective, the government has adopted policies such as decreasing the credit period for land premium payment in places such as Shenzhen and Hangzhou, and allowing only equity financing in land acquisition in places such as Nanjing and Guangzhou. The government is expected to further enhance the tightening policy by further raising the down payment ratio, limiting the purchase by both internal and external citizens of the provinces, and limiting the use of the debt in the property market.

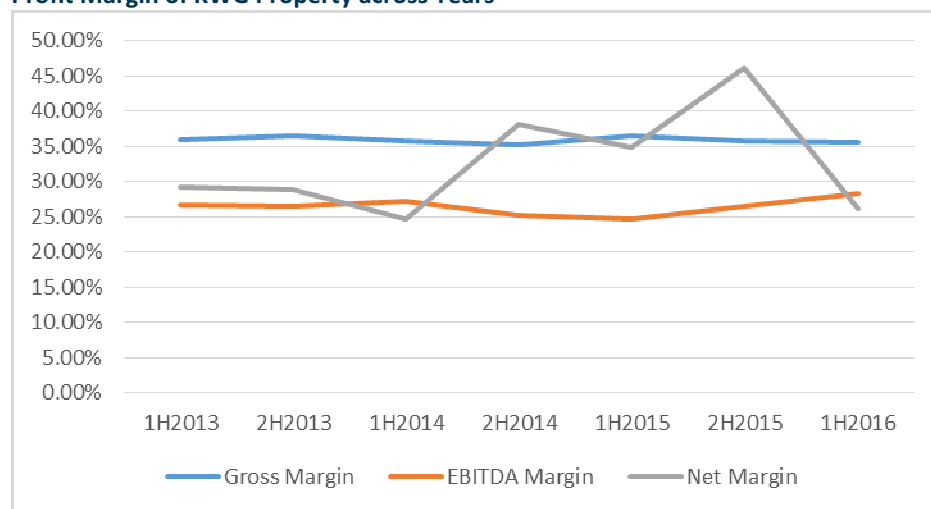
These tightening policies have led to the recent adjustment in the sales price in top tier cities and the decrease in transaction volume. Moreover, land premium is a major contributor to the rising property price and property development companies usually pay the majority of the land premium using debt financing. Allowing only equity financing in land acquisition will put pressure on land price, thereby suppressing the property price ultimately.

Although the property market has experienced short term fluctuation, as evident in the current price adjustment in property market such as the one in Shenzhen, we believe these policies will create a healthier and more realistic environment for the property market in China.

## Financial Position of the Company

The profitability of KWG Property remains to be strong, with gross profit margin remaining stable at about 35%, and EBITDA margin staying above 25% across the years. In particular, in 1H2016, the gross profit margin reached 35.6% while EBITDA margin reached 28.3%, implying that the company has stable and improving cash flow generating ability. As shown from the graph below, the difference between gross margin line and EBITDA line have been relatively stable whilst the net margin line has been quite volatile, implying the non-operating gain or loss has been causing some variation to the company net result.

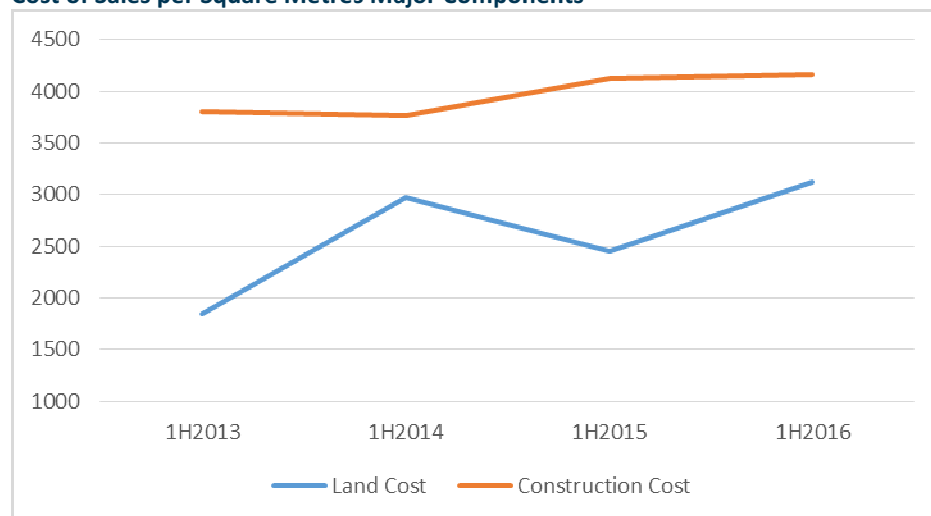
### Profit Margin of KWG Property across Years



Source: Thompson Reuters Eikon

The main reason for the discrepancy between net profit and EBITDA is the share of profit by the company's associates and joint ventures well as the interest expenses. With the adoption of land acquisition policy allowing only equity financing, we believe the company's debt ratio has reached its maximum especially the company has a large land reserve, which is enough for the development projects in the next 4-5 years.

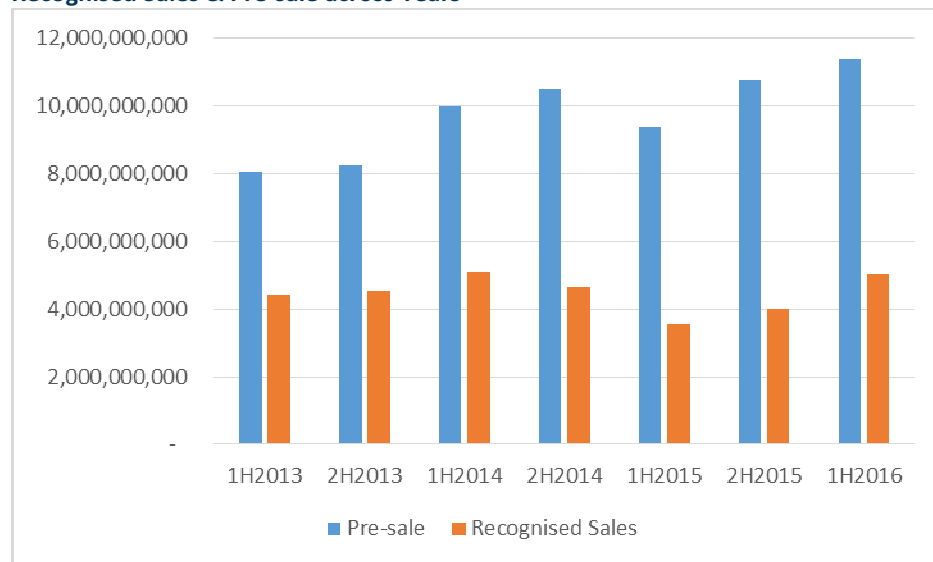
### Cost of Sales per Square Metres Major Components



Source: KWG Property

The company's profitability is further assured by the fact that its cost of land in income statement is relatively cheap, as evident by the cost of land only reaching CNY3,100 per square metre for the first time in 1H2016. In particular, in Guangzhou, the primary operating area of KWG Property, the recent land acquisitions performed by Agile Property and Yuexiu Property implied a cost of CNY35,000 and CNY34,000 per square metre respectively, which are more than 10 times larger than the current cost of KWG Property.

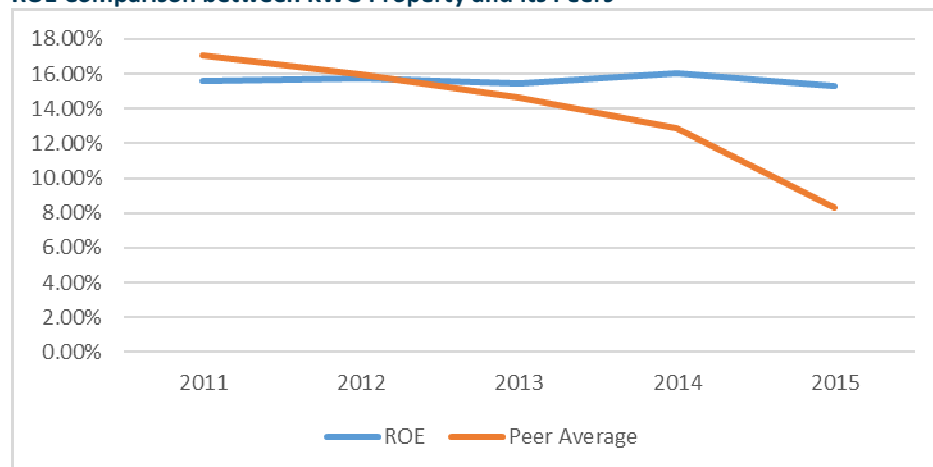
### Recognised Sales & Pre-sale across Years



Source: HKEXnews & KWG Property

KWG Property also has strong sales in almost every year. In particular, their pre-sales regularly exceed the recognised sale. In recent years, pre-sale is more than double of the recognised sales, allowing the company to generate revenue in advance of the actual completion of the property. Therefore, despite the tightening regulations, we believe that the short term fluctuation of the property price and transaction would not affect KWG Property significantly because of the strong pre-sale and stable profit margins.

### ROE Comparison between KWG Property and Its Peers



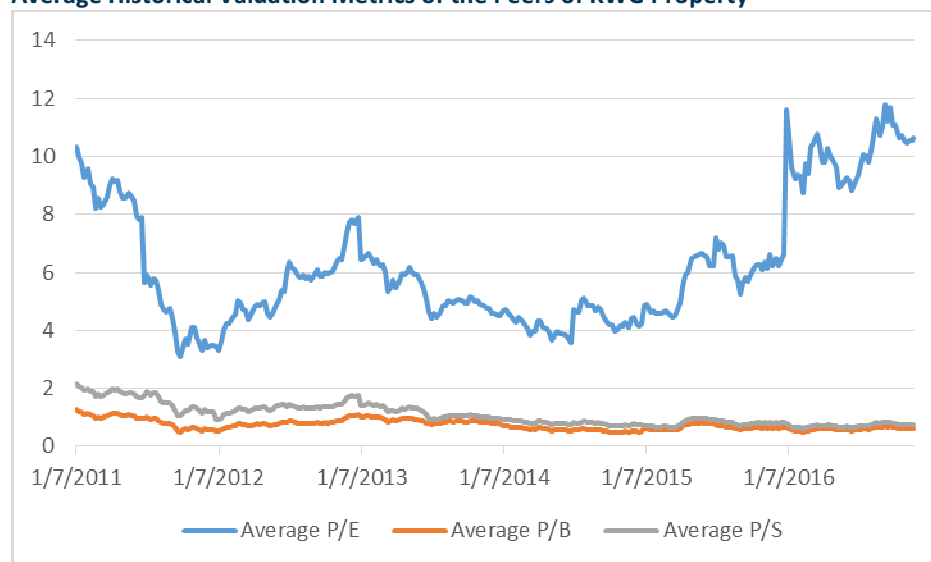
Source: AAstocks

Besides, the company also has better ROE than its peers of similar size in recent years. Financially, it is partly contributed by the levered capital structure of the company, i.e. 132.4% Long Term Debt/Equity, which the company could reduce its income tax expense via debt interest payment.

## Valuation

The tightened regulation has brought short term volatility to the market. However, the housing demand in top tier cities still exist. The ultimate purpose of the regulation is to promote a healthy growth of the property market. With strong sales, stable profitability and good strategic location the company bases in, we expect KWG Property to achieve growth despite the tightening regulation. The average valuation metrics, i.e. P/E, P/B and P/S, of the peers are 6.22x, 0.73x and 1.08x. We assign KWG Property the target price of HK\$5.90, with the “Buy” rating assigned. (Closing price as at 22 Nov 2016)

**Average Historical Valuation Metrics of the Peers of KWG Property**



Source: Bloomberg, Phillip Securities (HK) Research

## Risks

Systematic default of the pre-sales buyers  
Tightened regulations

## Financials

FYE	2013	2014	2015	2016F	2017F
<b>Valuation Ratios</b>					
Price Earnings (P/E)	6.34	3.75	3.21	3.58	3.97
Price to Book (P/B)	0.98	0.61	0.50	0.52	0.54
<b>Per Share Data (HKD)</b>					
EPS	1.2160	1.3976	1.3525	1.4357	1.4848
Book Value Per Share	7.8829	8.6473	8.7689	9.8457	10.9593
Dividend Per Share	0.3712	0.4118	0.3411	0.3589	0.3712
<b>Growth &amp; Margins (%)</b>					
<b>Growth</b>					
Revenue	(2.15%)	10.54%	(20.31%)	28.78%	3.42%
Operating Income	(1.62%)	25.5%	0.30%	35.24%	3.99%
Net Profit	14.27%	19.00%	4.40%	6.15%	3.42%
<b>Margins</b>					
Gross Profit Margin	36.2%	35.5%	36.1%	35.90%	35.90%
Operating Profit Margin	32.0%	29.7%	32.9%	24.66%	24.65%
Net Income Margin	29.0%	31.2%	40.9%	33.73%	33.74%
<b>Key Ratios</b>					
ROE (%)	15.43%	16.03%	15.29%	14.58%	13.54%
ROA (%)	4.46%	4.57%	4.29%	5.32%	5.32%
<b>Income Statement (CNY Mn)</b>					
Revenue	9,468	10,466	8,340	10,740	11,107
- Cost of Goods Sold	(6,036)	(6,748)	(5,330)	(6,884)	(7,120)
<b>Gross Income</b>	3,432	3,718	3,009	3,856	3,987
- Operating Expenses	(1,014)	(1,093)	(1,051)	(1,208)	(1,249)
<b>Operating Income</b>	2,418	2,625	1,958	2,648	2,738
- Net Non-Operating Gain	1,286	2,020	2,704	2,343	2,423
<b>Pretax Income</b>	3,704	4,645	4,662	4,991	5,161
- Income Tax Expenses	(955)	(1,377)	(1,249)	(1,368)	(1,414)
<b>Net Profit</b>	2,749	3,268	3,413	3,623	3,747

Source: Company, Phillip Securities (HK) Research Estimates  
(Financial figures as at 22 Nov 2016)

**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

**GENERAL DISCLAIMER**

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

**Disclosure of Interest**

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

**Availability**

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2016 Phillip Securities (Hong Kong) Limited

**Contact Information (Regional Member Companies)**

**SINGAPORE**

**Phillip Securities Pte Ltd**  
Raffles City Tower  
250, North Bridge Road #06-00  
Singapore 179101  
Tel : (65) 6533 6001  
Fax : (65) 6535 6631  
Website: [www.poems.com.sg](http://www.poems.com.sg)

**HONG KONG**

**Phillip Securities (HK) Ltd**  
Exchange Participant of the Stock Exchange of Hong Kong  
11/F United Centre 95 Queensway  
Hong Kong  
Tel (852) 22776600  
Fax (852) 28685307  
Websites: [www.phillip.com.hk](http://www.phillip.com.hk)

**INDONESIA**

**PT Phillip Securities Indonesia**  
ANZ Tower Level 23B,  
Jl Jend Sudirman Kav 33A  
Jakarta 10220 – Indonesia  
Tel (62-21) 57900800  
Fax (62-21) 57900809  
Website: [www.phillip.co.id](http://www.phillip.co.id)

**THAILAND**

**Phillip Securities (Thailand) Public Co. Ltd**  
15th Floor, Vorawat Building,  
849 Silom Road, Silom, Bangrak,  
Bangkok 10500 Thailand  
Tel (66-2) 6351700 / 22680999  
Fax (66-2) 22680921  
Website: [www.phillip.co.th](http://www.phillip.co.th)

**UNITED KINGDOM**

**King & Shaxson Capital Limited**  
6th Floor, Candlewick House,  
120 Cannon Street,  
London, EC4N 6AS  
Tel (44-20) 7426 5950  
Fax (44-20) 7626 1757  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**AUSTRALIA**

**PhillipCapital Australia**  
Level 12, 15 William Street,  
Melbourne, Victoria 3000, Australia  
Tel (613) 96188238  
Fax (613) 92002272  
Website: [www.phillipcapital.com.au](http://www.phillipcapital.com.au)

**MALAYSIA**

**Phillip Capital Management Sdn Bhd**  
B-3-6 Block B Level 3 Megan Avenue II,  
No. 12, Jalan Yap Kwan Seng, 50450  
Kuala Lumpur  
Tel (603) 21628841  
Fax (603) 21665099  
Website: [www.poems.com.my](http://www.poems.com.my)

**JAPAN**

**PhillipCapital Japan K.K.**  
Nagata-cho Bldg.,  
8F, 2-4-3 Nagata-cho,  
Chiyoda-ku, Tokyo 100-0014  
Tel (81-3) 35953631  
Fax (81-3) 35953630  
Website: [www.phillip.co.jp](http://www.phillip.co.jp)

**CHINA**

**Phillip Financial Advisory (Shanghai) Co. Ltd**  
No 436 Hengfeng Road,  
Greentech Unit 604,  
Postal code 200070  
Tel (86-21) 51699400  
Fax (86-21) 63532643  
Website: [www.phillip.com.cn](http://www.phillip.com.cn)

**FRANCE**

**King & Shaxson Capital Limited**  
3rd Floor, 35 Rue de la Bienfaisance 75008  
Paris France  
Tel (33-1) 45633100  
Fax (33-1) 45636017  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**UNITED STATES**

**Phillip Futures Inc**  
141 W Jackson Blvd Ste 3050  
The Chicago Board of Trade Building  
Chicago, IL 60604 USA  
Tel +1.312.356.9000  
Fax +1.312.356.9005