

Red Star Macalline (1528.HK)

Nationwide Home Furnishing Malls Operator

Hong Kong | Property | Company report

22 December 2016

Nationwide Home Furnishing Malls Operator

Red Star Macalline is the leading developer and operator of shopping malls primarily focusing on home improvement and furnishing retailing sectors. In 1H2016, Red Star Macalline operates 181 malls, with 56 portfolio malls and 125 managed malls. The total operating area for portfolio malls and managed malls are 4,457,050 square metres and 7,357,877 square metres respectively. Moreover, Red Star Macalline has established strategic presence in almost the entire countries, spanning across 27 provinces, municipalities and autonomous regions and across 129 cities across China. According to the chart below, Red Star Macalline's portfolio malls span across the countries, and are mainly located in Tier 1 and Tier 2 Cities. In particular, Red Star Macalline has set up 18 of its portfolio malls in large cities such as Shanghai, Beijing, Tianjin and Chongqing, with total operating area 1,507,803 square metres, contributing to about 34% of the total operating area of the portfolio malls.

Buy

CMP: HKD 7.10

(Closing price as at 20 Dec 2016)

TARGET: HKD 9.40 (+32.4%)

COMPANY DATA

O/S SHARES (MN) :	3,624
MARKET CAP (HKDMN) :	7,546
52 - WK HI/LO (HKD):	10.02 / 5.97

SHARE HOLDING PATTERN , %

Candlewood Investment SRL	31.81
Springwood Investment SRL	17.05

PRICE PERFORMANCE , %

	1M	3M	1Y
RS Macalline	(8.97)	(6.33)	(28.57)
HIS	(1.86)	(3.37)	3.88

PRICE VS. HSI



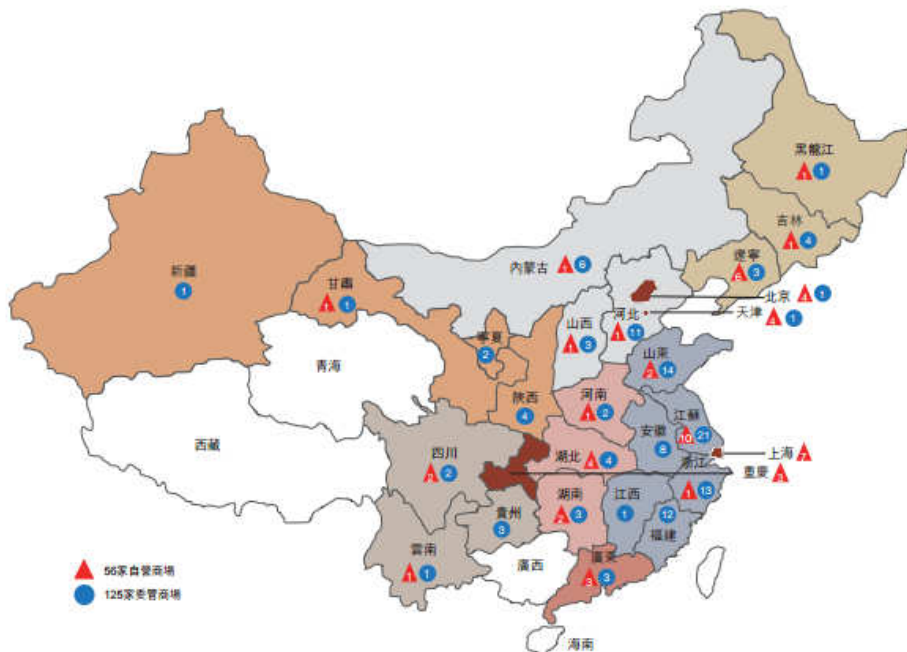
Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY `Mn	FY15	FY16E	FY17E
Net Sales	8,756	9,207	9,682
Net Profit	4,514	4,552	4,570
EPS, HKD	1.4348	1.4068	1.4123
PER, x	--	5.91	6.66
BVPS, HKD	13.3530	14.2675	15.1855
P/BV, x	--	0.58	0.62
ROE, %	9.96	15.12	13.41

Source: Company reports, Phillip Securities Est.

Geographical Distribution of Red Star Macalline



Source: Company Reports, Phillip Securities

At the same time, Red Star Macalline has been actively expanding to the whole country by establishing managed malls across the countries. Shopping malls are established in provinces or autonomous regions such as Fujian, Anhui and Xinjian. In contrast to portfolio malls, managed malls have a lower strategic presence in large Tier 1 and Tier 2 cities, as evident in Shanghai, Beijing, Tianjin and Chongqing having only 109,693 square metres of operating area, contributing only 1.49% of the total operating area of managed malls.

Research Analyst

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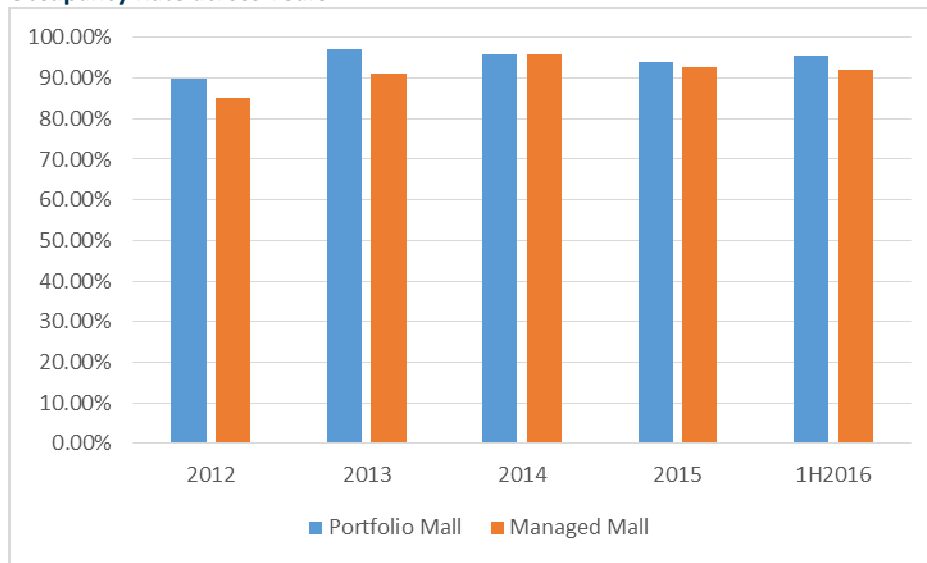
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Huge Project Reserve

The shopping malls of Red Star Macalline regularly achieves high occupancy. Ever since 2013, both portfolio malls and managed malls have achieved an occupancy rate of over 90% consistently. Moreover, the management agreement of the managed malls are usually long term, with most of them lasting as long as 10 years. The long term management contract allows Red Star Macalline to generate stable income in the long term. Moreover, Red Star Macalline also benefits from the incremental increase of rental income as time progresses, enabling it to hedge against the effect of inflation.

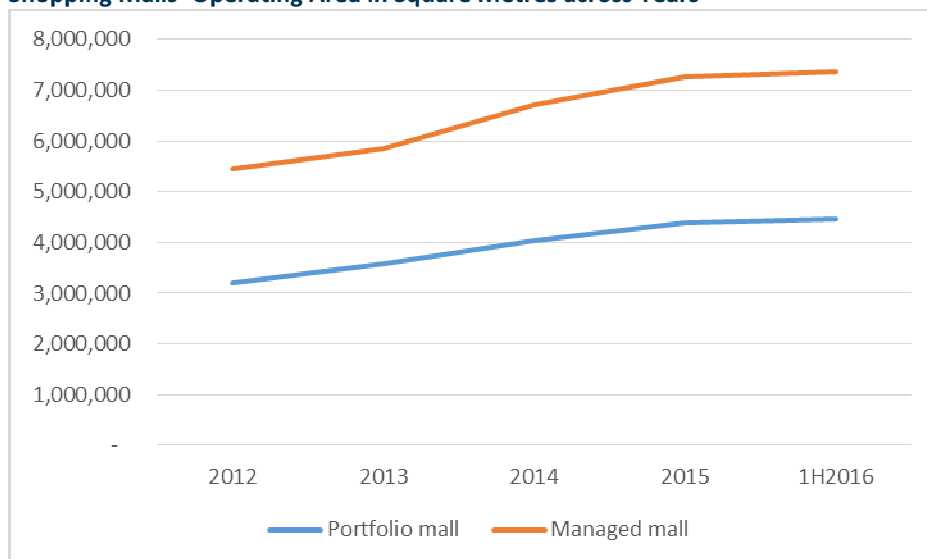
Occupancy Rate across Years



Source: Company Reports, Phillip Securities

The floor area of both portfolio mall and managed mall is rapidly increasing. According to the chart below, the operating area of portfolio mall has increased 39.2% in 3.5 years while the operating area of managed malls has increased 34.9% in 3.5 years.

Shopping Malls` Operating Area in Square Metres across Years



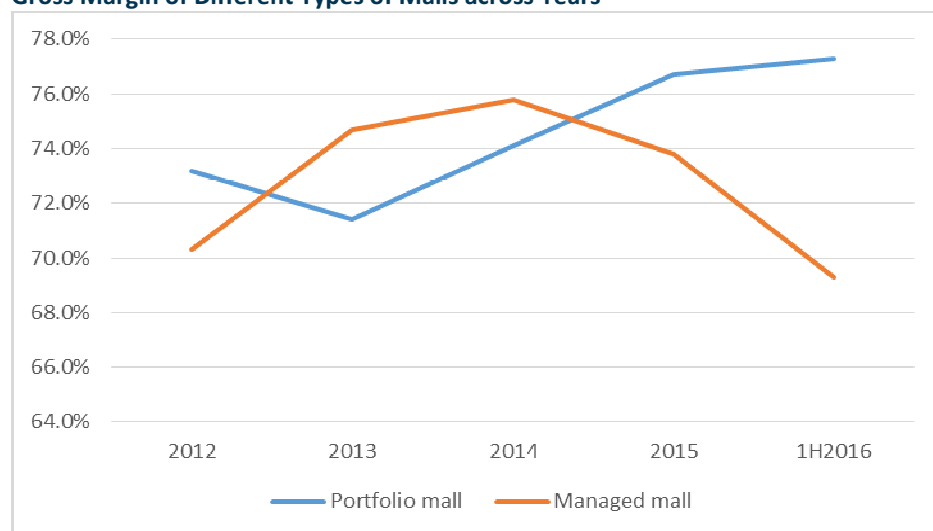
Source: Company Reports, Phillip Securities

Until 1H2016, Red Star Macalline entered into agreement for 488 managed malls, with 279 of the managed malls projects have their land secured. Shopping mall construction is a long term project and is expected to take several years of time to complete the construction. Therefore, we expect the underlying value of the shopping malls only to be realized in the long term.

Financial Outlook

Portfolio malls' gross profit margin increases from the initial 73% in 2012 to 77.3% in 1H2016 while managed malls' one decreased from the highest 75.8% in 2014 to 69.3% in 1H2016, the lowest in recent years. The decrease in gross profit margin of managed malls is caused by the decrease in the opening of new malls, which Red Star Macalline would be able to recognize consultancy fee in construction, usually having higher profit margin than ordinary management fee.

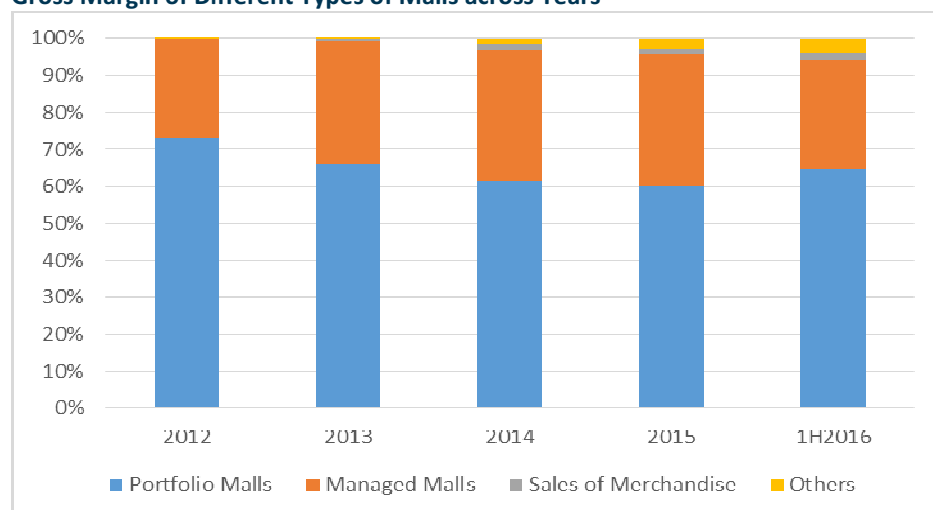
Gross Margin of Different Types of Malls across Years



Source: Company Reports, Phillip Securities

The following graph is the revenue composition by different business segments of Red Star Macalline:

Gross Margin of Different Types of Malls across Years



Source: Company Reports, Phillip Securities

Because of the drop in gross profit margin of managed mall segment, we expect Red Star Macalline would be affected in general, mainly in terms of the short term growth, for the reason as follow:

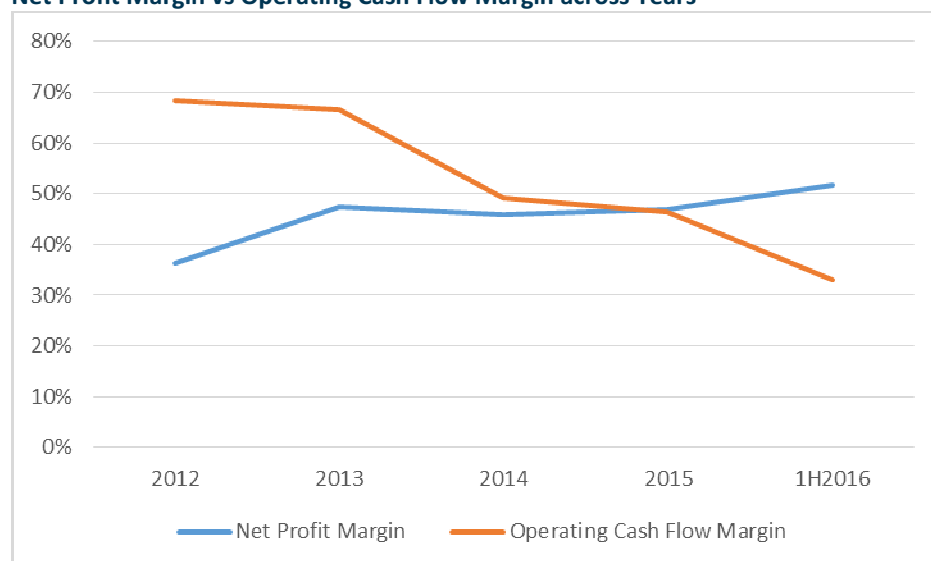
- Mall development is a long term project, implying the high margin consultancy fee income , one of the important driver of growth, taking long time to realise its value
- Managed mall segment contributes to about 30% of the total revenue on average across years

We expect, however, revenue would remain stable at current level because of the nature of the business.

- Management fee and rental income are stable
- At managed mall segment, Red Star Macalline has the priority to collect the fee due to it from the rental payment payable to the landlord before handing over to the landlord

Besides, Red Star Macalline has a stable net profit margin but has a relatively volatile operating cash flow margin. We notice that the reason for such volatility is caused by the drop in working capital, which is in turn caused by an increase in receivable. In particular, bad debt provision is 26.6% of the total receivable in 1H2016. After making provision for the bad debt, most of the receivables are with age less than a year. Since operating cash flow margin has started diverging with the net profit margin, the aging receivable may soon cause a problem in the company's financial position.

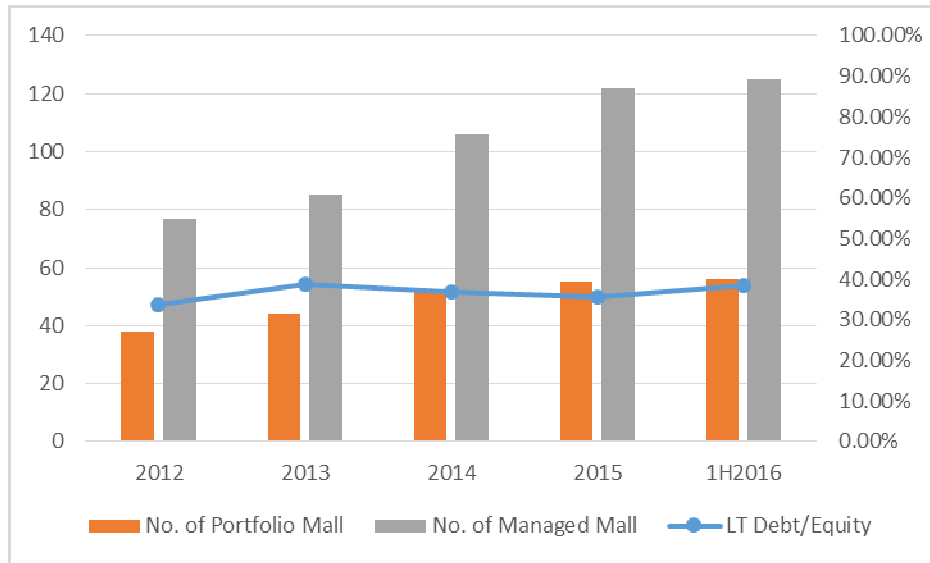
Net Profit Margin vs Operating Cash Flow Margin across Years



Source: Company Reports, Phillip Securities

Healthy Debt Ratio

Although the company has a large proportion of bad debt provision, its gearing ratio is healthy. Red Star Macallin has been actively preparing and launching shopping malls. As at the reporting date of 2015 annual report, Red Star Macallin expects that there will be 9 new additional portfolio mall, and the company will continue its strategy of focusing on Tier 1 and Tier 2 Cities. As at the reporting date of 1H2016 report, the company has entered into agreement for 488 malls.

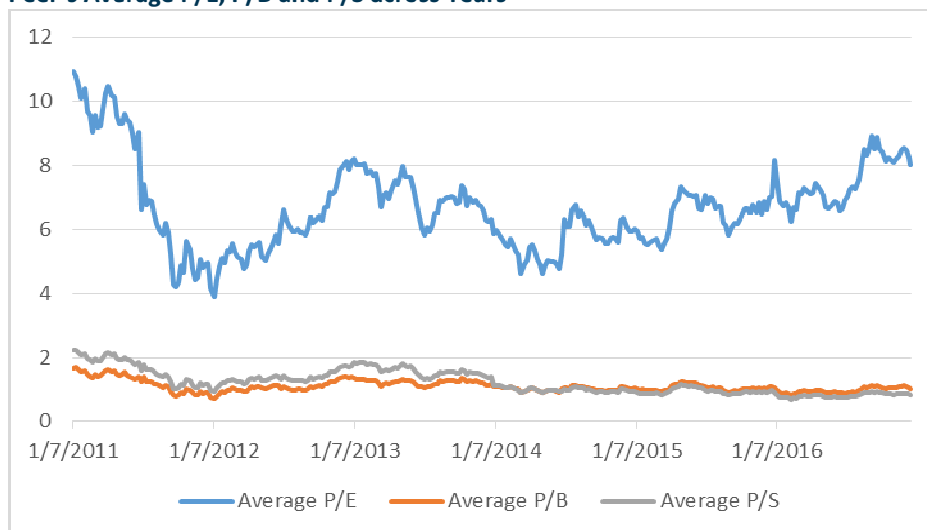
Debt Ratio & Number of Malls across Years


Source: Company Reports, Phillip Securities

Despite its rapid expansion, Red Star Macallin has maintained its gearing ratio well, with long term debt to equity ratio being around 40%. At the same time the total number of malls has increased from 115 malls in 2012 to 181 malls in 1H2016, a 57.4% increase.

Valuation

With the rapid expansion of the company's presence in the country via setting up both portfolio and managed malls, we expect the company to continue growing in the long term particularly because of its project reserve. The peer average P/E, P/B, and P/S are 6.70x, 1.09x, and 1.22x respectively. Red Star Macallin's target price is therefore \$9.40, with Buy rating assigned. (Closing price as at 20 Dec 2016)

Peer's Average P/E, P/B and P/S across Years


Source: Bloomberg, Phillip Securities (HK) Research

Risk

Lag in recognition of growth due to long term project nature
 Bad debt increases

Financials

FYE	2015	2016F	2017F
Valuation Ratios			
Price Earnings (P/E)	--	5.91	6.66
Price to Book (P/B)	--	0.58	0.62
Per Share Data (HKD)			
EPS	1.4348	1.4068	1.4123
Book Value Per Share	13.3530	14.2675	15.1855
Dividend Per Share	0.5528	0.4924	0.4943
Growth & Margins (%)			
Growth			
Revenue	10.3	5.2	5.2
Operating Income	13.6	5.5	1.3
Net Profit	15.1	0.8	0.4
Margins			
Gross Profit Margin	74.4	73.5	74.0
Operating Profit Margin	50.6	50.8	49.0
Net Profit Margin	67.9	66.7	68.1
Key Ratios			
ROE (%)	9.96	15.12	13.41
ROA (%)	5.65	5.49	5.32
Income Statement (CNY `Thou)			
Revenue	8,756,120	9,207,474	9,682,093
- Cost of Goods Sold	(2,241,981)	(2,443,826)	(2,518,386)
Gross Income	6,514,139	6,763,648	7,163,707
- Operating Expenses	(2,079,307)	(2,084,582)	(2,421,859)
Operating Income	4,434,832	4,679,066	4,741,848
- Net Non-Operating Gain	1,507,525	1,460,471	1,421,542
Pretax Income	5,942,357	6,139,537	6,163,390
- Income Tax Expenses	(1,428,167)	(1,587,477)	(1,593,645)
Net Profit	4,514,190	4,552,060	4,569,745

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 20 Dec 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

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