

Kerry Properties (683.HK)

Sustainable Dividend Level Given Stable Recurring Income

Hong Kong | Property | Company report

9 October 2017

Investment Summary

- The Bloomsway, with accumulated contracted sales of HK\$6.8Bn as at July 2017, is set to be completed in 2H2017, occupation permit has been obtained in July 2017
- Martin Heights, which was recognised in 1H2017, has an unsold portion of 47% as at June 2017, providing sizable upward potential to revenue and profit
- Current level of dividend is sustainable because of the stable and recurring investment property income, whose growth is assured by the new projects in both Hong Kong and China

Business Overview

1H2017 result is in line our expectation: Kerry Properties achieved extremely strong result in 1H2017. Revenue rose 220% from HK\$5,537Mn in 1H2016 to HK\$17,742Mn in 1H2017. The massive increase is caused by the recognition of a Hong Kong project, Martin Height, whose occupation permit was obtained in March 2017 and therefore the associated revenue and cash flow were recognised in 1H2017. Despite the rapid growth in revenue, gross profit increased only 57% from HK\$2,612Mn in 1H2016 to HK\$4,102Mn in 1H2017, primarily caused by the change in the property mix in the recognition, causing a drop of gross profit margin from 47% in 1H2016 to 23% in 1H2017. In 1H2017, Hong Kong property development segment, whose gross profit margin was only 11.7% in 1H2017 (1H2017 China Property Development Segment GPM: 21.7%), contributes 57% of the total revenue but it only contributes 4% of the total revenue in 1H2016, thereby lowering the overall gross profit margin. Underlying profit attributable to shareholders increased 98% from HK\$1,434Mn in 1H2016 to HK\$2,833Mn in 1H2017, with an underlying earnings per share being HK\$1.96. In 1H2017, the company declared an interim dividend of HK\$0.45 per share, a 50% increase in comparison with that of 1H2016.

Property development project pipeline can still last for 4 years: Kerry Properties currently has a few property development projects in Hong Kong and China, with expected completion date up to FY2020. The expected GFA of properties primarily for sales and going to be completed in the next few years amount to 5.1Mn Sq. Ft.. In particular, this figure does not include completed projects, such as Martin Heights (GFA: 1,142,168 Sq. Ft., 53% sold as at 30/6/2017). We conservatively value the remaining unsold portion at about HK\$10Bn and this will continue to provide upward potential to the revenue of the company in FY2017. Besides, the other project, The Bloomsway, is expected to be completed in 2H2017. As at 30/6/2017, about 83% of the units at The Bloomsway was sold and the GFA of the project is 939,600 Sq. Ft.. As at 31/7/2017, the accumulated contracted sales of The Bloomsway amounted to HK\$6.8Bn and occupation permit has been obtained in July 2017, allowing the company to recognize the associated revenue and cash flow in 2H2017 and providing a boost to both the revenue and the profit. Major property development projects in both Hong Kong and China are as follow:

Buy

CMP: HKD 33.80

(Closing price as at 4 Oct 2017)

TARGET: HKD 36.70 (+8.58%)

COMPANY DATA

O/S SHARES (MN) :	1,444
MARKET CAP (HKDMN) :	48,797
52 - WK HI/LO (HKD):	34.25 / 20.40

SHARE HOLDING PATTERN • %

Kerry Group Limited	58.96
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PRICE PERFORMANCE • %

	1M	3M	1Y
Kerry Properties	9.80	28.24	32.28
HSI	2.29	11.76	21.79

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

HKD mn	FY15	FY16	FY17E	FY18E
Net Sales	10,393	12,991	28,066	25,264
Net Profit	6,070	7,735	5,091	5,218
EPS, HKD	3.8300	4.5300	3.5278	3.6156
PER, x	5.48	5.93	9.99	10.15
BVPS, HKD	56.2666	57.3361	59.5639	61.7795
P/BV, x	0.47	0.37	0.59	0.59
ROE, %	6.8	7.9	5.9	5.9

Source: Company reports, Phillip Securities Est.

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Project to Complete in 2H2017	Location	Attributable GFA (Sq. Ft.)
The Bloomsway	Hong Kong	939,600
Nanjing Jinling Arcadia Court	Nanjing	1,028,802
The Metropolis – Arcadia Court II	Chengdu	369,101 (In Phases)
Total		2,337,503*

Project to Complete in FY2018	Location	Attributable GFA (Sq. Ft.)
Beacon Hill Project (NKIL 6532)	Hong Kong	116,380
Hangzhou Zhijiang Castalia Court II, III	Hangzhou	1,929,593 (In Phases)
Total		2,045,973*

Project to Complete in FY2019	Location	Attributable GFA (Sq. Ft.)
Hing Hon Road Project	Hong Kong	47,962
Beacon Hill Project (NKIL 6533)	Hong Kong	342,769
The Berylville, Ningbo II	Ningbo	308,351
Total		699,082

Project to Complete in FY2020	Location	Attributable GFA (Sq. Ft.)
LaSalle Rd/Boundary St Project	Hong Kong	45,180
Total		45,180

Source: Kerry Properties

*: Actual completed GFA can be different since some properties are being completed in phases

Dividend is sustainable even interim dividend was raised by 50%: The company raised the interim dividend to HK\$0.45 per share in 1H2017. We believe the current level of dividend is sustainable because of the sustainable development pipeline and the stable but growing investment property portfolio. As at 30/6/2017, the attributable GFA of the investment property segment of Kerry Properties in Hong Kong and China are 2.86Mn Sq. Ft. (2016: 2.78Mn Sq. Ft.) and 7.39Mn Sq. Ft. (1H2016: 7.53Mn Sq. Ft.) respectively. Although the total GFA reduced slightly, we expect the GFA to expand because of the large projects being completed in the next few years.

Major Mixed-Use Development	Completion Date	Attributable GFA (Sq. Ft.)
Hangzhou Kerry Centre	2H2017	249,936
Shenyang Kerry Centre	FY2018 (In Phases)	5,261,059
Nanchang Complex Development II	FY2020	495,024
Zhengzhou Complex Development	FY2021 (In Phases)	1,117,355
Total		7,123,374

Other Investment Properties	Completion Date	Attributable GFA (Sq. Ft.)
Jinan Complex Development	2H2017 Onwards	588,906
Kunming Complex Development	FY2019	491,419
Qianhai Complex Development I	FY2019	2,173,844
Putian Hotel Development	FY2020	215,381
Qianhai Complex Development II	FY2021	322,830
Total		3,792,380

Source: Kerry Properties

Investment Thesis, Valuation and Risk

Our valuation model suggests a target price of HK\$36.70: We base our valuation on the Sum-of-Parts approach because of the equally significant impact brought by the investment property and property development segments. We maintain our `Buy` rating on the stock with a target price of HK\$36.70, corresponding to a P/E and P/B of 9.99x and 0.59x respectively. (Closing price as at 4 Oct 2017)

Downside Risks	(1): Tightening policy in Chinese property market (2): Replenishing land bank may require high cost
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Financials

FYE	FY2014	FY2015	FY2016	FY2017F	FY2018F
Valuation Ratios					
Price Earnings (P/E)	6.52	5.52	5.92	9.99	10.15
Price to Book (P/B)	0.51	0.47	0.37	0.59	0.59
Per Share Data (HKD)					
EPS	4.6900	3.8300	4.5300	3.5278	3.6156
Book Value Per Share	55.4310	56.2666	57.3361	59.5639	61.7795
Dividend Per Share	0.9000	0.9000	1.1000	1.3000	1.4000
Growth & Margins (%)					
Growth					
Revenue	5.0	(29.1)	25.0	116.1	10.0
Operating Income	5.3	(42.9)	61.2	21.8	6.2
Net Profit	(17.1)	(22.5)	27.4	(34.2)	2.5
Margins					
Gross Profit Margin	42.3	37.6	45.1	25.0	29.9
Operating Profit Margin	33.9	27.3	35.3	19.9	23.5
Net Profit Margin	53.4	58.4	59.5	18.1	20.7
Key Ratios					
ROE (%)	8.5	6.8	7.9	5.9	5.9
ROA (%)	4.7	3.7	3.8	2.5	2.5
Income Statement (HKD Mn)					
Revenue	14,664	10,393	12,991	28,066	25,264
- Cost of Goods Sold	(8,456)	(6,482)	(7,135)	(21,050)	(17,698)
Gross Income	6,208	3,911	5,856	7,016	7,566
- Operating Expenses	(1,236)	(1,071)	(1,276)	(1,439)	(1,641)
Operating Income	4,972	2,840	4,580	5,577	5,925
- Net Non-Operating Gain	4,562	4,420	5,750	769	663
Pretax Income	9,534	7,260	10,330	6,346	6,588
- Income Tax Expenses	(1,698)	(1,190)	(2,595)	(1,255)	(1,370)
Net Profit	7,836	6,070	7,735	5,091	5,218

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 4 Oct 2017)

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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