

# Shenzhen Investment (604.HK)

## Broadly Completed The Exit From Lower Tier Cities

Hong Kong | Property | Company report

17 October 2017

### Investment Summary

- Significant rise in gross profit margin, primarily contributed by the recognition of the sales of properties in Shenzhen, whose gross profit margin can be as high as 66% (Overall GPM of Shenzhen: 50.7%)
- Taking advantage of the recovery of property market in Tier 3 and Tier 4 cities, the company further decreased its exposure in these cities and significantly decreased the proportion of these in cities in the land bank to 34%

### Business Overview

**The 1H2017 revenue declined but net profit surged:** The revenue of Shenzhen Investment in 1H2017 declined 14.6% to HK\$5,454Mn. The decline is primarily caused by the tight regulation in Shenzhen and the fact that several projects in Shenzhen will only be recognised in 2H2017 and FY2018, thereby affecting the revenue in 1H2017. Despite the drop in revenue, gross profit rose 1.9% to HK\$2,197Mn in 1H2017 due to the rise in gross profit margin from 33.8% in 1H2016 to 40.3% in 1H2017. The large increase in gross profit margin is caused by the increase in the revenue contribution by Shenzhen, whose contribution was 69.4% in 1H2017 and gross profit margin was 50.7%. The profit attributable to the shareholders in 1H2017 rose 119.3%, primarily caused by the disposal gain of the projects in Tier 3 and Tier 4 cities, which amounted to HK\$3,325Mn (Before attribution to shareholders and minority interest). Despite the increase in earnings, the dividend per share remained at HK\$0.07 per share.

**Further optimised the land bank:** Shenzhen Investment continued to enhance the quality of its land bank by disposing land in Tier 3 and Tier 4 cities. In 1H2017, the company disposed 5 projects located in Sanshui, Taizhou, and Jiangyan through public listing for sales, allowing the company to achieve an after tax gain of HK\$3.33Bn. Coupled with the disposal of land in Heyuan in FY2017, the disposal of these projects signals the broad completion of the company's exit in the Tier 3 and Tier 4 cities, with the contribution to the land bank by these cities dropping from 49% in FY2016 to 34% in 1H2017, significantly enhancing the quality of the land bank. The company also expanded its land bank and obtained a residential land in Tuen Mun, Hong Kong (GFA: 43,938 square metres, 50% Interest) with Road King Infrastructure.

<b>Land Bank Composition As At (Capacity GFA):</b>	<b>31/12/2016</b>	<b>30/6/2017</b>
Shenzhen	31%	40%
Hong Kong	--	1%
Tier 2 Cities	20%	25%
Tier 3 Cities	49%	34%
<b>Total</b>	<b>100%</b>	<b>100%</b>
<b>Attributable Capacity GFA (Sq. M.)</b>	<b>5.49Mn</b>	<b>4.11Mn</b>

Source: Shenzhen Investment

### Accumulate

CMP: HKD 3.66

(Closing price as at 13 Oct 2017)

TARGET: HKD 4.05 (+10.66%)

#### COMPANY DATA

O/S SHARES (MN) :	7,948
MARKET CAP (HKDMN) :	29,139
52 - WK HI/LO (HKD):	3.98 / 2.85

#### SHARE HOLDING PATTERN • %

Shum Yip Holdings Company Limited	61.48
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#### PRICE PERFORMANCE • %

	1M	3M	1Y
Shenzhen Inv	0.55	4.57	0.83
HSI	2.09	8.09	19.39

#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

HKD mn	FY15	FY16	FY17E	FY18E
Net Sales	18,428	21,354	13,871	17,560
Net Profit	3,088	3,471	3,510	3,419
EPS, HKD	0.4056	0.4236	0.4025	0.3920
PER, x	8.68	8.57	9.56	10.46
BVPS, HKD	4.5132	4.2895	4.4720	4.4615
P/BV, x	0.78	0.85	0.86	0.92
ROE, %	8.6	9.7	9.0	8.8

Source: Company reports, Phillip Securities Est.

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

### Contracted sales in first 9 months was weak in comparison with peers:

Shenzhen Investment's accumulated contracted sales in the first 9 months of FY2017 amounted to CNY10.24Bn, representing a YoY drop of 43%. The accumulated contracted sales area in the same period was 480,079 square metres, representing a YoY drop of 37%. Recognised revenue in 1H2017 dropped 14.6% to HK\$5,454Mn. The drop in revenue is primarily contributed by the tightened regulations in China especially those in Shenzhen. According to the 1H2017 report, 76% of the contracted sales in the first half of FY2017 were contributed by Shenzhen. Since Shenzhen projects usually have high profit margins, we expect the reduction in the contracted sales could be partially offset by the improvement in the overall profit margins.

City (CNY 'Mn)	1H2017 Contracted Sales	Contribution
Shenzhen	6,839	76.1%
Maanshan	907	10.1%
Changsha	327	3.6%
Changzhou	232	2.6%
Huizhou	203	2.3%
Shunde	146	1.6%
Guangzhou	113	1.3%
Chaohu	70	0.8%
Jiangyan	52	0.6%
Chengdu	32	0.4%
Wuhan	28	0.3%
Dongguan	20	0.2%
Heyuan	13	0.1%
<b>Total</b>	<b>8,982</b>	<b>100%</b>

Source: Shenzhen Investment

Over the next two years, the company has some large properties to release, mostly in FY2019 and with some projects located in prime locations in Shenzhen. We believe these projects will receive good demand despite the tightened regulations in Shenzhen. Examples of these projects include:

Project	City	GFA (Sq. M.)	Completion Date
Shum Yip City Phase 3.2	Shenzhen	129,022	FY2017
Shum Yip Dongling Land Plot 03-01	Shenzhen	457,359	FY2018
Qianhai 19-06-06 Project	Shenzhen	52,900	FY2018
Tanglang City West	Shenzhen	277,557	FY2018
Taifu Square Phase 1 (North)	Shenzhen	100,804	FY2018
Terra Licheng	Shenzhen	116,650	FY2019
Shum Yip UpperHills South (Excl. T2)	Shenzhen	768,009	FY2019
Taifu Square Phase 1 (South)	Shenzhen	206,971	FY2019
Shum Yip Zhongcheng Land Plot 05-01	Shenzhen	338,873	FY2019

Source: Shenzhen Investment

### Investment Thesis, Valuation and Risk

**Our valuation model suggests a target price of HK\$4.05:** Despite the drop in recognised revenue and contracted sales, we maintain our optimistic view to Shenzhen Investment because of its valuable land resources, i.e. those in Shenzhen, and the recent revaluation of China property stocks. We also believe the Shenzhen projects can raise the profit margin, which the improvement in profit margin can offset some of the negative effect on revenue brought by the tightened regulations. Therefore, we have adjusted Shenzhen Investment's target price to HK\$4.05, corresponding to a P/E and P/B of 9.56x and 0.86x, with an 'Accumulate' rating assigned. (Closing price as at 13 Oct 2017)

<i>Downside Risks</i>	(1): Tightening regulations in property market in China (2): Contracted sales continues to slow
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## Financials

FYE	FY2014	FY2015	FY2016	FY2017F	FY2018F
<b>Valuation Ratios</b>					
Price Earnings (P/E)	6.02	8.68	8.57	9.56	10.46
Price to Book (P/B)	0.70	0.78	0.85	0.86	0.92
<b>Per Share Data (HKD)</b>					
EPS	0.5362	0.4056	0.4236	0.4025	0.3920
Book Value Per Share	4.5817	4.5132	4.2895	4.4720	4.4615
Dividend Per Share	0.1600	0.1600	0.2200	0.2200	0.2200
<b>Growth &amp; Margins (%)</b>					
<b>Growth</b>					
Revenue	41.4	33.3	15.9	(35.0)	26.6
Operating Income	1.9	88.8	38.4	(34.7)	35.1
Net Profit	12.7	(11.9)	12.4	1.1	(2.6)
<b>Margins</b>					
Gross Profit Margin	29.5	34.6	38.7	40.7	42.0
Operating Profit Margin	19.2	27.3	32.6	32.8	35.0
Net Profit Margin	25.4	16.8	16.3	19.5	22.5
<b>Key Ratios</b>					
ROE (%)	10.3	8.6	9.7	9.0	8.8
ROA (%)	3.3	3.2	3.3	3.2	3.2
<b>Income Statement (HKD Mn)</b>					
<b>Revenue</b>	13,827	18,428	21,354	13,871	17,560
- Cost of Goods Sold	(9,754)	(12,054)	(13,083)	(8,227)	(10,185)
<b>Gross Income</b>	4,073	6,374	8,271	5,644	7,375
- Operating Expenses	(1,412)	(1,350)	(1,319)	(1,101)	(1,236)
<b>Operating Income</b>	2,661	5,024	6,952	4,543	6,139
- Net Non-Operating Gain	3,194	1,487	1,341	3,321	1,520
<b>Pretax Income</b>	5,855	6,511	8,293	7,864	7,659
- Income Tax Expenses	(2,349)	(3,423)	(4,822)	(4,354)	(4,240)
<b>Net Profit</b>	3,506	3,088	3,471	3,510	3,419

Source: Company, Phillip Securities (HK) Research Estimates  
(Financial figures as at 13 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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**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