November 12, 2019

AMTD 尚乘

Equity Research

# Central China Real Estate Limited

## All Set to be the next Shining Star in the Sector, Initiate with Buy

**Distressed valuations of 4.2x P/E, coupled with 61% net profit CAGR and a net debt to equity of 18% sets the stage for CCRE to be the next shining star in the sector. Strong dividend payout in interim results reflects underlying business strength. Initiate with a Buy rating, Target Price of HK$6.0/sh. We add CCRE as one of our top picks of the sector.**

**High dividend payout reflects cashflow strength, initiate with Buy**

Management raised the dividend payout ratio in the 1H19 interim results to 50%, implying an interim dividend yield of ~4%. We believe this reflects management's confidence in the company's operating cashflows, and a gap between accounting profit and actual underlying business. With the stock trading at 4.2x 2020E P/E, ~9% div yield, we believe it offers investors an attractive entry point into a developer whose 2018-2021E net profit CAGR is expected to reach 61%, highest among our coverage universe.

**Chairman Wu acquired 24.09% stake at HK$4.30/sh**

On 29 June 2019, Chairman Wu acquired the 24.09% stake from Capitaland at HK$4.30/sh via a share transfer, with a total cash consideration at HK$2.83bn. As such, Chairman Wu's stake in the company has increased to 74.84% (from 50.75% previously). We believe this also reflects Chairman's confidence in the company's underlying operations.

**18% Net Debt to Equity, lowest among China Property Sector**

CCRE's Net Debt to Equity stood at only 18% at 1H19, as they funded most of their growth with working capital, e.g. Pre-sale proceeds, JV/Asso and trade payables, which are mostly interest free. As such, their Total Assets to Total Equity ratio stands at 11x, towards the high end of the sector. We thus believe that the company has room to leverage up their financial position to maintain their asset growth, if in case contracted sales growth slows down.

**Net Profit to grow at 61% CAGR from 2018-2021E**

Central China's net profit is set to grow by 61% CAGR during 2018-2021E, among the highest across the industry, and much of it has been largely secured through unrecognized sales. They have RMB46bn of contract liabilities on their 1H19 balance sheet, representing 168% of 2019E revenue. Together with sales proceeds at JV/Asso level and contracted sales achieved YTD 2019, we believe earnings for 2019E and 2020E are largely secured and the distress valuation of 4.2x P/E are unwarranted.

**Room for Net Margins to expand, to reflect actual sales growth**

Central China's SG&A Expenses has increased from 13% of revenue in 2017 to 17% and 19% in 2018 and 1H19 respectively, due to the rapid contracted sales growth in the company, resulting in a relatively low core net margins of 5.7% in 2019E. If we measure SG&A Expenses against contracted sales, it is actually stable at ~5-6%. We believe there is room for a net margin expansion when revenue recognition catches up with contracted sales growth.

**Our price target of HK$6.00/sh implies 43% upside potential**

Our price target of HK$6.00/sh (43% upside to current share price) is based on a 6x 2020E P/E ratio, towards the high range of our coverage universe to reflect its strong earnings growth profile. It also implies a 1.57x 2019E P/B.

**Stock code: 0832.HK**

**Rating: Buy**

| Price target (HK$) | 6.00 |
|---|---|
| Previous price target (HK$) | NA |
| Current price (HK$, 7 Nov 2019) | 4.20 |
| Upside/downside % | 43% |
| Market cap (HK$ m) | 11,585 |
| Market cap (US$ m) | 1,481 |
| Avg daily turnover (US$ m) | 2.25 |

Source: Bloomberg, AMTD Equity Research

**Key forecasts**

| (RMB m) | 2018 | 2019e | 2020e | 2021e |
|---|---|---|---|---|
| Revenue | 14,783 | 27,370 | 37,131 | 44,557 |
| yoy % | 6.5% | 85.1% | 35.7% | 20.0% |
| Net profit | 1,415 | 1,906 | 2,995 | 4,039 |
| yoy % | 57.4% | 34.7% | 57.1% | 34.9% |
| Adjusted NP | 784 | 1,554 | 2,443 | 3,294 |
| yoy % | 21.2% | 98.3% | 57.1% | 34.9% |
| Gross margin | 34.4% | 24.0% | 24.0% | 24.0% |
| Net gearing | 20.2% | 30.9% | 31.3% | 51.2% |
| EPS | 0.30 | 0.57 | 0.89 | 1.21 |
| DPS | 0.19 | 0.35 | 0.38 | 0.44 |
| BPS | 3.39 | 3.46 | 3.97 | 4.73 |

Source: Company data, AMTD Equity Research

**Valuation**

| | 2018 | 2019e | 2020e | 2021e |
|---|---|---|---|---|
| P/E | 12.6 | 6.6 | 4.2 | 3.1 |
| P/BV | 1.1 | 1.1 | 1.0 | 0.8 |
| Div. yield | 5.0% | 9.2% | 10.2% | 11.7% |
| ROE | 8.9% | 16.5% | 22.5% | 25.5% |
| ROA | 0.8% | 1.2% | 1.5% | 1.8% |

Source: Bloomberg, AMTD Equity Research

**Share price performance**


Source: Bloomberg


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## Figure 1: Financial Forecasts and key ratios

| PnL, RMB mn | 2017 | 2018 | 2019e | 2020e | 2021e |
|---|---|---|---|---|---|
| Revenue | 13,879 | 14,783 | 27,370 | 37,131 | 44,557 |
| COGS | (10,598) | (9,692) | (20,801) | (28,219) | (33,863) |
| **Gross Profit** | **3,281** | **5,091** | **6,569** | **8,911** | **10,694** |
| Selling and marketing expenses | (697) | (1,188) | (1,402) | (1,683) | (1,767) |
| General and administrative expenses | (1,087) | (1,552) | (1,832) | (2,198) | (2,308) |
| Share of results of JV | (4) | (18) | 33 | 45 | 54 |
| Share of results of Asso | 199 | 16 | 29 | 39 | 47 |
| Reval Gains from Inv Prop | 243 | 606 | - | - | - |
| Others | 414 | 244 | 109 | 147 | 177 |
| Finance costs | (408) | (226) | (422) | (528) | (623) |
| **Profit before tax** | **1,940** | **2,972** | **3,084** | **4,734** | **6,274** |
| Income tax expense | (1,041) | (1,557) | (1,178) | (1,739) | (2,235) |
| **Net profit** | **899** | **1,415** | **1,906** | **2,995** | **4,039** |
| Shareholders' Profit | 811 | 1,154 | 1,554 | 2,443 | 3,294 |
| Minority Interest | 88 | 261 | 351 | 552 | 744 |
| **Shareholders' Core Net Profit** | **647** | **784** | **1,554** | **2,443** | **3,294** |
| Dividends | 243 | 495 | 953 | 1,048 | 1,212 |
| Special Dividends | - | - | - | - | - |
| EPS - basic | 0.33 | 0.44 | 0.57 | 0.89 | 1.21 |
| EPS-underlying | 0.26 | 0.30 | 0.57 | 0.89 | 1.21 |
| DPS - basic | 0.10 | 0.19 | 0.35 | 0.38 | 0.44 |

| Balance Sheet, RMB mn | 2017 | 2018 | 2019e | 2020e | 2021e |
|---|---|---|---|---|---|
| Investment Properties | 1,297 | 2,916 | 2,916 | 2,916 | 2,916 |
| Interest in JV/Asso | 9,563 | 10,365 | 10,365 | 10,365 | 10,365 |
| PP&E and Others | 4,585 | 6,431 | 6,431 | 6,431 | 6,431 |
| **Non-current assets** | **15,445** | **19,712** | **19,712** | **19,712** | **19,712** |
| Inventories and other contract costs | 24,341 | 50,316 | 73,774 | 98,594 | 121,934 |
| Deposits and prepayments | 6,554 | 9,162 | 10,839 | 13,248 | 14,543 |
| Cash & Cash Equivalents | 11,284 | 14,202 | 17,047 | 19,389 | 19,317 |
| Others | 4,903 | 8,570 | 8,570 | 8,570 | 8,570 |
| **Current assets** | **47,083** | **82,251** | **110,230** | **139,801** | **164,365** |
| Contract Liabilities | 15,088 | 40,830 | 59,180 | 76,914 | 90,215 |
| Bank and Other Borrowings | 4,431 | 5,346 | 5,346 | 5,346 | 5,346 |
| Trade and Other Payables | 22,034 | 28,924 | 33,360 | 40,250 | 44,687 |
| Others | 1,117 | 833 | 833 | 833 | 833 |
| **Current liabilities** | **42,669** | **75,933** | **98,720** | **123,344** | **141,081** |
| Bank and Other Borrowings | 11,153 | 14,505 | 18,745 | 21,745 | 25,745 |
| Others | 231 | 1,254 | 1,254 | 1,254 | 1,254 |
| **Non-current liabilities** | **11,385** | **15,759** | **20,000** | **23,000** | **27,000** |
| Capital and reserves | 7,695 | 8,837 | 9,439 | 10,833 | 12,916 |
| **Shareholders' equity** | **7,695** | **8,837** | **9,439** | **10,833** | **12,916** |
| Non-controlling interests | 778 | 1,433 | 1,784 | 2,336 | 3,080 |
| **Total equity** | **8,473** | **10,270** | **11,223** | **13,169** | **15,996** |

| Cash Flow Statement, RMB mn | 2017 | 2018 | 2019e | 2020e | 2021e |
|---|---|---|---|---|---|
| Profit Before Tax | 1,940 | 2,972 | 3,084 | 4,734 | 6,274 |
| **Operating CF before Working Cap** | **1,811** | **2,626** | **3,084** | **4,734** | **6,274** |
| PUD | (5,109) | (20,513) | (23,458) | (24,820) | (23,340) |
| Deposits & Prepayments | (5,325) | (2,307) | (1,677) | (2,409) | (1,295) |
| Trade & Other Payables | 10,262 | 3,853 | 4,436 | 6,890 | 4,436 |
| Increase in contract liabilities | 7,332 | 23,041 | 18,351 | 17,734 | 13,301 |
| Others | (1,399) | 30 | 1,906 | 2,995 | 4,039 |
| **Net Operating Cashflows** | **5,760** | **4,103** | **(443)** | **390** | **(2,860)** |
| **Net Investing Cashflows** | **(4,729)** | **(3,238)** | **-** | **-** | **-** |
| Bank & Other Borrowings | (1,213) | (1,202) | 4,240 | 3,000 | 4,000 |
| Others | 1,752 | 3,228 | (953) | (1,048) | (1,212) |
| **Net Financing Cashflows** | **540** | **2,026** | **3,287** | **1,952** | **2,788** |
| **Net Cash Flows** | **1,571** | **2,891** | **2,844** | **2,342** | **(71)** |

| Key Ratios, RMB mn | 2017 | 2018 | 2019e | 2020e | 2021e |
|---|---|---|---|---|---|
| GP Margins | 24% | 34% | 24% | 24% | 24% |
| Net Margins | 6% | 10% | 7% | 8% | 9% |
| Core Attri Net Margins | 5% | 5% | 6% | 7% | 7% |
| ROE | 8% | 9% | 16% | 23% | 26% |
| ROA | 1% | 1% | 1% | 2% | 2% |
| Net Debt / Total Equity | 26% | 20% | 31% | 31% | 51% |
| Net Debt / Shareholders' Equity | 28% | 23% | 37% | 38% | 63% |
| Total Assets / Total Equity | 738% | 993% | 1158% | 1211% | 1151% |
| Total Assets / Shareholders' Equity | 813% | 1154% | 1377% | 1472% | 1425% |
| Asset Turnover (Contracted Sales) | 49% | 53% | 49% | 48% | 43% |

Source: Company data, AMTD Equity Research

# Mispriced stock presents buying opportunity

**~4.2x P/E, 61% Net Profit CAGR, 9% Div Yield, 18% Net Gearing, Initiate with Buy**

We expect to see Central China's (00832.HK) net profit to grow at record high levels of a 61% 2018-2021E CAGR, underpinned by the pre-sold properties set to be delivered. The company has RMB46bn of contract liabilities on 1H19 balance sheet, representing 168% of 2019E revenues. Contracted sales YTD Oct remains solid, rising 26% YoY. We believe market is yet to reflect the strong earnings growth outlook with the stock trading at distressed valuation of 4.2x 2020E P/E and a 2019E dividend yield of ~9% and thus offers an attractive buying opportunity into the stock.

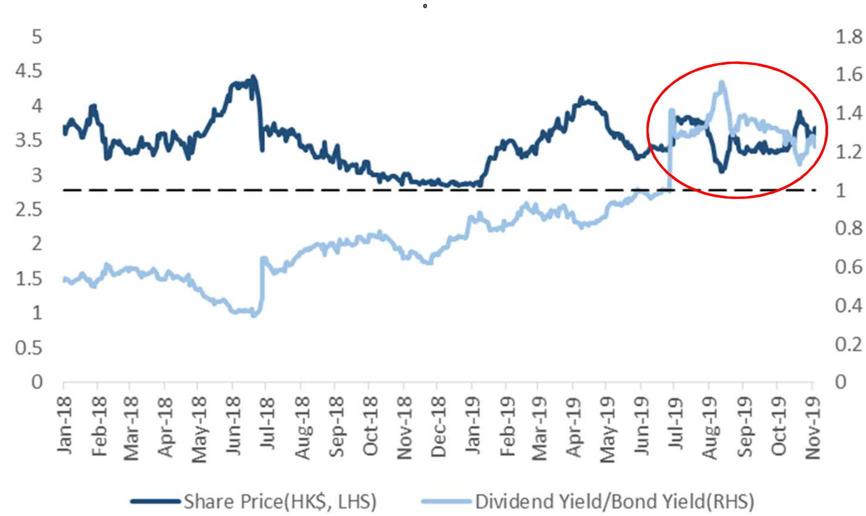
Central China's contracted sales grew by 51% and 76% YoY respectively during 2017 and 2018. We expect these contracted sales to be recognized as revenues onto the company's financial statements during 2019-2020 as the pre-sold properties are delivered to homebuyers. We expect consensus to revise their 2020E-2021E earnings upwards over the next 12 months, which will drive the share price higher.

**Distressed valuations – Dividend Yield is trading above Bond Yield**

We expect Central China's 2019E full year dividend yield to reach ~9%, assuming Central China maintains their 50% dividend payout ratio into full year 2019E. This implies that the stock is trading at such attractive valuation that their dividend yield is now significantly higher than the ~7.0% YTM that their 2021 6.75% senior notes are trading at. Since the end of June 2019, the dividend yield of CCRE is higher than the bond yield.

Div Yield doesn't often trade above bond yield due to the growth prospects, and thus we believe this reflects a mispricing in the stock compared to its bonds. Market maybe concerned with the sustainability of the earnings growth and thus dividend, but we believe such concerns are unfound as the earnings growth and dividend is backed by solid contracted sales achieved. The stock should thus trade higher to close this gap to Bond Yield. We thus have our target price at HK$6.0/sh, based on a 6x 2020 P/E, offering 43% upside to the current share price levels.

**Figure 2: Dividend Yield vs Bond Yield of CCRE**



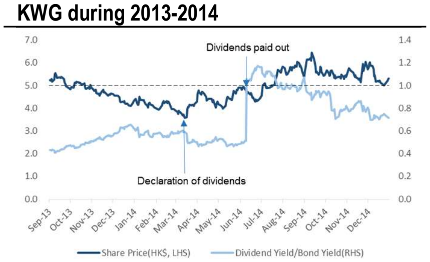

Source: Bloomberg; AMTD Equity Research

## Share Prices to rally subsequently to drive Dividend Yield down

Such opportunities do not happen very often, especially if the outlook on the company's earnings forecasts are largely secured by solid contracted sales secured on balance sheet.

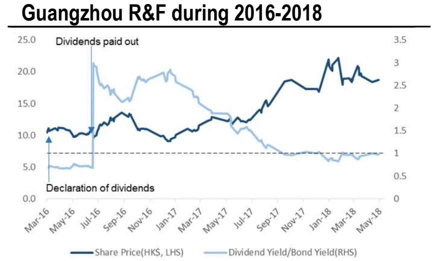
We highlight two instances in the China Property sector where a stock's dividend yield exceeded its bond yield, KWG (1813.HK, NR) of 2014 and R&F (2777.HK, NR) of 2016-2018. In both instances, share price rallied subsequently to narrow the dividend yield.

**Figure 3: Dividend Yield vs Bond Yield of KWG during 2013-2014**




Source: Bloomberg; AMTD Equity Research

**Figure 4: Dividend Yield vs Bond Yield of Guangzhou R&F during 2016-2018**




Source: Bloomberg; AMTD Equity Research

**KWG Properties (1813.HK, NR) 2013-2014:** KWG declared final dividends of FY2013 on 17th Mar 2014 and the dividends was paid out on 11th June 2014, the ratio of dividend yield and bond yield exceeded 1.0. The share price increased by **21.9%/22.2%/29.1%** respectively in one/two/three months from the declaration date.

**R&F Properties (2777.HK, NR) 2016-2018:** Similarly, R&F Properties declared final dividends of FY2015 on 11th Mar 2016 and the dividends was paid out on 29th June 2016, the ratio of dividend yield and bond yield exceeded 2.0. The share price increased by **-4.0%/2.7%/21.7%** respectively in two/four/six months from the declaration date. Moreover, the company had a growth in 1H16 with a revenue YOY of 75.32%, compared to 28.75% in 1H15 and -3.19% in 1H14.

**Rare investment opportunity into a high growth business**

As such, we believe the ratio of dividend yield and bond yield of Central China shows a rare investment opportunity into a high growth business. We believe the relatively high interim payout ratio of 50%, reflects gap between accounting profit and actual underlying business, while there is also room for consensus to further upgrade their earnings forecasts, in our view.

# New CEO hire in 2017 revived CCRE

**Central China (0832.HK)** has made a few key appointments over the past 3 years which is fueling their multi-year contracted sales growth, which we believe will continue to extend into the future.

Since Mr. Yuan Xujun's appointment in 2017 as the company's CEO, he has enhanced the company's operational efficiencies, bringing his experience from his previous roles as General Manager of China Vanke.

As a result, Central China's contracted sales has grown 76% YoY in 2018 and we expect the company grow by another ~20% YoY in 2019E (~26% YOY in YTD Oct 2019). We expect such pre-sold properties will be driving a 61% CAGR in 2018-2021E Net Profit and thus, stock performance.

**Figure 5: Central China: Major Senior Management Changes/Appointments**


Source: HK Stock Exchange; AMTD Equity Research

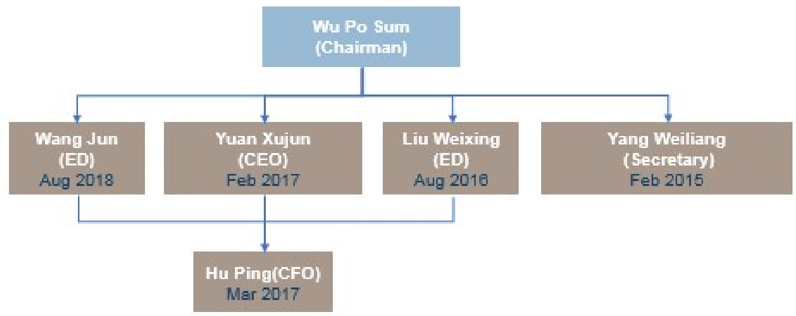
In Central China Real Estate, there were five senior managers joining the company in the past five years. Three of them once served for renowned companies in property industry and others are professional in financial, investment and capital market field.

Mr. Yuan Xujun, ED and CEO, held several positions in Vanke from 1994 to 2017 with his last position as general manager and legal representative of the companies under Vanke before joining the group in Feb 2017.

Mr. Wang Jun, ED since August 2018, served as the head of investor relations and a senior manager of the finance department in Country Garden Holdings Company Limited; and from 2011 to 2018, he served in Morgan Stanley Asia Limited with the latest position as an executive director.

Mr. Hu Ping, CFO since April 2019, held several positions in Vanke from 2006 to 2017 with his last position as manager of the companies under Vanke before joining the company in Mar 2017.

**Figure 6: Management Organisation Chart of CCRE**




Source: Company Data; AMTD Research
Note: 1. Blue number is the date when the person joined the company.
2. Brown mark means that the individual has joined the company in the past 5 years.

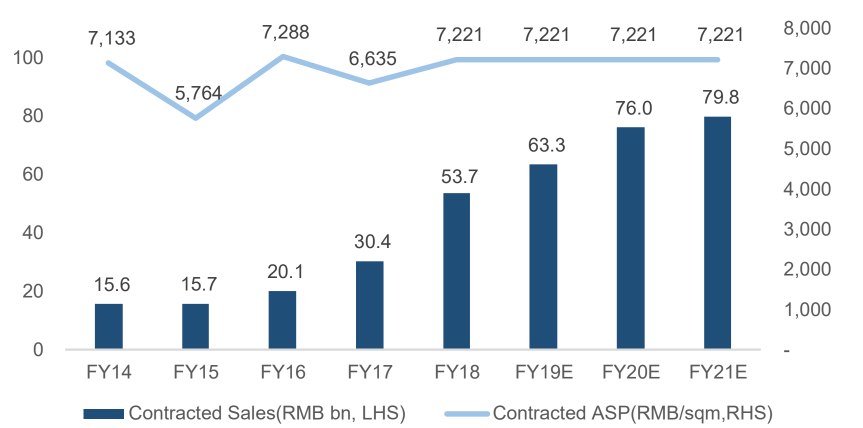
## Project Deliveries to drive net profit and share price in 2019E-2021E

CCRE's contracted sales has maintained their momentum in 2019, rising 26% YoY in YTD Oct 2019 and we expect full year contracted sales to reach RMB63.3bn, which would represent a 20% YoY growth. This follows the strong 76% YoY contracted sales growth of RMB53.7bn achieved in 2018.

As a result of the strong contracted sales, the developer has accumulated RMB46bn of contract liabilities (unrecognized sales) on their 1H19 balance sheet, which represents 168% of 2019E revenues.

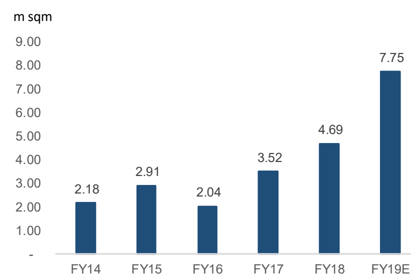
According to development plan, the company estimates to deliver 3.73mn sqm in 2H19 and the total delivered GFA would be 6.20mn sqm in 2019. Thus we estimate the GFA of completed properties will be 7.75mn sqm during 2019, which will be a 65% YoY growth.

**Figure 7: FY14-FY18 Contracted Sales and ASP**



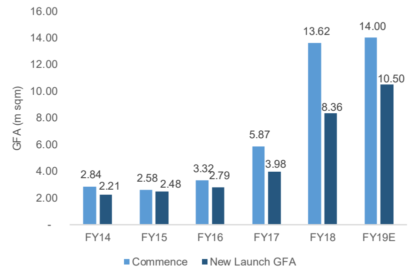

Source: Company Data, AMTD Research Estimates

**Figure 8: GFA Completion to grow 65% YoY in 2019E, driving revenue growth**



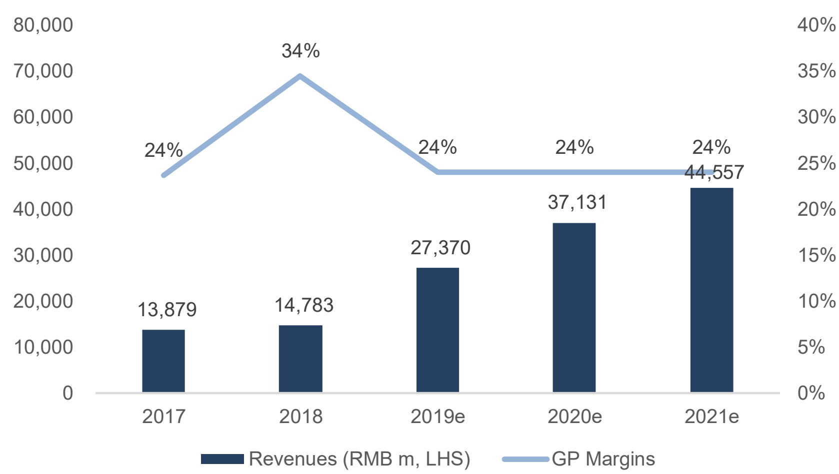

Source: Company Data, AMTD Research Estimates

**Figure 9: Strong growth in GFA new starts drives contracted sales growth**




Source: Company Data, AMTD Research Estimates

**Figure 10: Solid revenue growth driven by delivery of unrecognized sales**



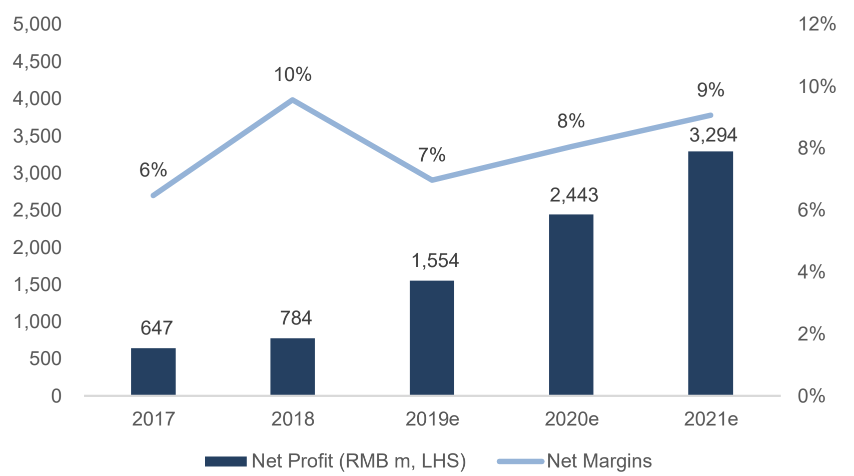

Source: Company Data, AMTD Research Estimates

**Net Margins could expand as Revenue recognition picks up**

Over the next 3 years, we expect it will be the peak of project completion and deliveries of these pre-sold properties which will drive the revenue and net profit growth of the company. We expect net profit to grow at a CAGR of 61% during 2018-2021E, which is highest in our coverage universe.

We expect net margins to expand in during 2019E-2021E as the mismatch in accounting treatment for SG&A and top-line revenues narrow, while revenue recognition accelerates. For China property companies, SG&A are expensed in the year when incurred, while revenues often reflect sales that was achieved 12-24 months ago due to the pre-sales system in China. There is thus a mismatch in the financial statement accounting policies distorting the true picture of the net profit margins.

**Figure 11: FY17-FY21E Net Profit and Net Margins**



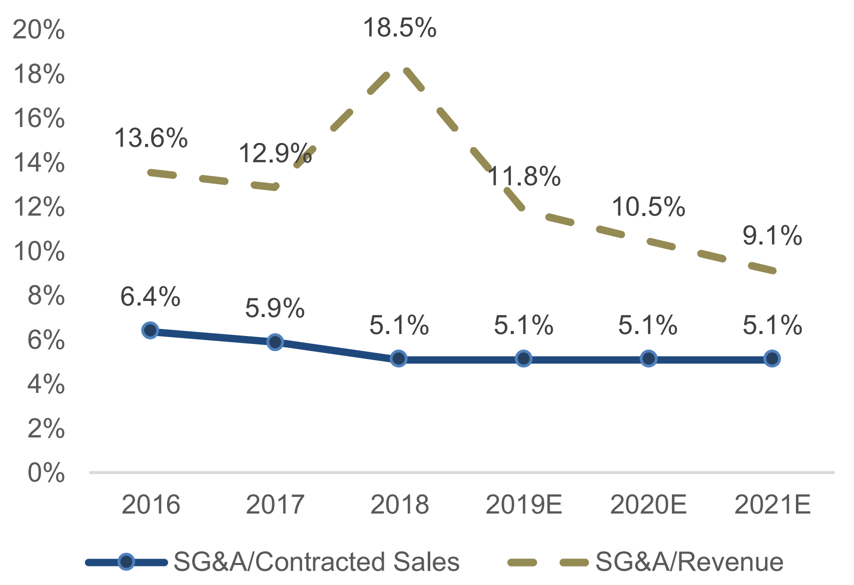

Source: Company Data, AMTD Research Estimates

**SG&A as percentage of contracted sales have remained stable**

Central China's SG&A Expenses has surged from 13% of revenue in 2017 to 19% and 17% in 2018 and 1H19 respectively, which is due to the rapid contracted sales growth in the company. This has resulted in a relatively low core net margins of 7% in 2019E, where the margin compression is due to accounting treatment rather than a true reflection of the business.

In owing to the lag of revenue recognition, SG&A Expenses against contracted is a better reflection of the expense control and the ratio is actually stable at ~5-6%. Therefore, we believe there is room for a net margin expansion to more accurately reflect the actual cashflow profit margins, when revenue recognition catches up with the contracted sales growth.

**Figure 12: SG&A/Contracted Sales & SG&A/Revenue**

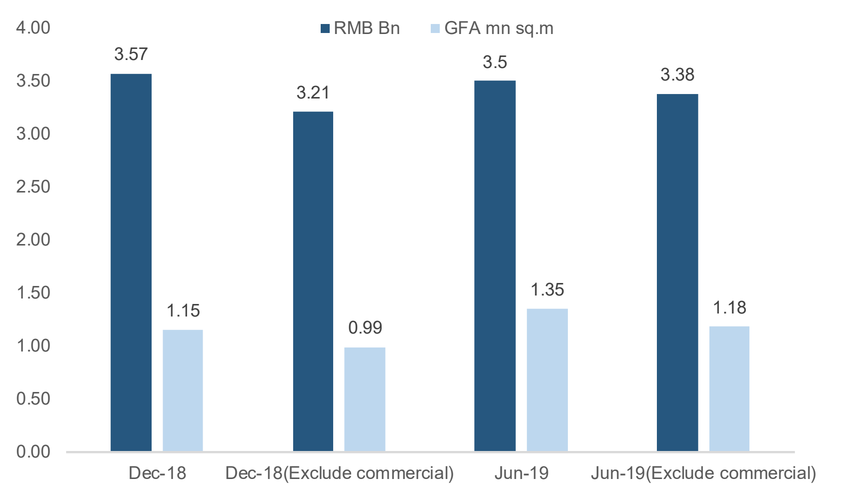



Source: Company Data, AMTD Research Estimates

**Healthy completed inventory levels**

CCRE's completed properties held for sales exclude commercial projects was only RMB3.38bn as of 1H19, which is only 3% of its balance sheet and approximately one month of completed inventory based on current monthly sales. This is healthy and reflects the solid sell-through for the projects that have recently delivered to homebuyers in the past 12-18 months.

**Figure 13: Healthy Completed Inventory levels reflects solid sell-through for delivered projects**




Source: Company Data, AMTD Research

## Asset Light Business Model maturing

In additional to traditional income from properties sales, CCRE also operates asset light business. The company provides project management service without equity/debt investment and charges third party for branding fees, additional management fees and profit share fees. As of 1H19, the company has signed contracts in relation to 131 projects with a planned GFA of approximately 19.91 mn sqm in aggregate. In 1-9 months 2019, the contracted sales of light asset reached RMB20.0bn (YOY 80.7%).

1H19, revenue from the light asset model business was up 62.2% YOY to RMB404mn with GPM of 97%. The developer has entered into management contracts for 131 light asset projects by end-June 2019, with a total GFA under management reaching 19.91m sqm for these projects.

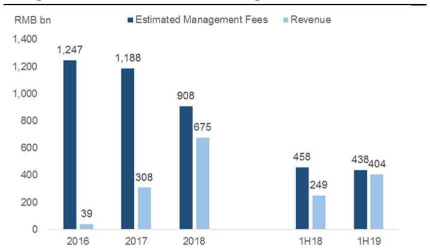
This will not only offer a steady recurring income stream, but will also further strengthen CCRE's brand recognition across Henan province.

**Figure 14: Asset Light Business Model Fees**

| Fee Structure | Pricing |
|---|---|
| Basic management fee | RMB 200 / sq.m for residential; RMB 300 / sq.m for commercial |
| Extra management fee | 10% of selling price premium over pre-agreed ASP |
| Profit sharing fee | Based on selling price premium over pre-agreed ASP |

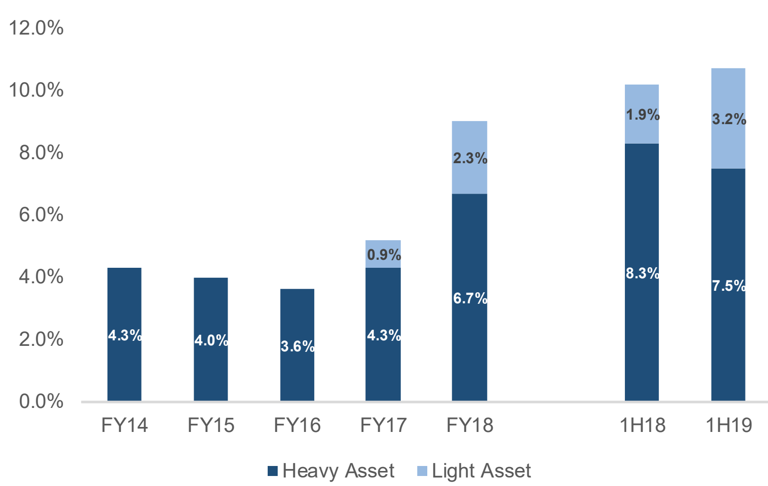
Source: Company Data, AMTD Research

**Figure 15: Estimated Management Fees**




Source: Company Data

**Figure 16: Market Share in Henan Province (by contracted sales)**




Source: Company Data

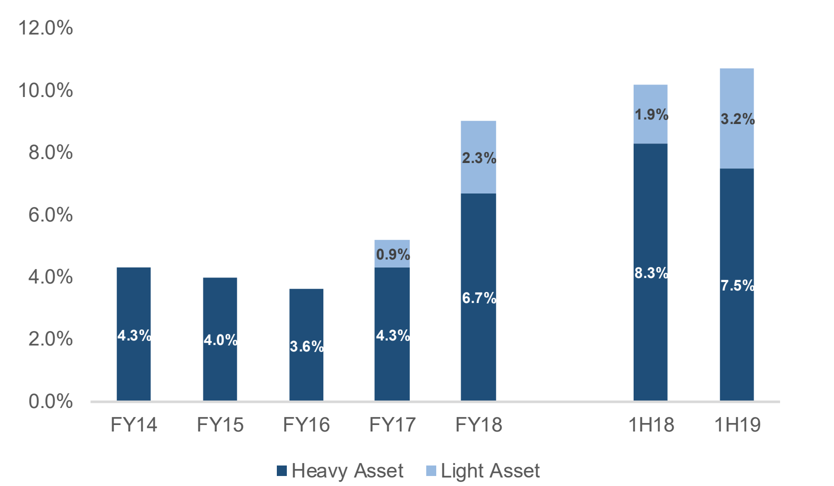
## Leading the Market Consolidation in Henan Province

CCRE market share in Henan Province have risen further up to 7.5% in 1H19 (18: 6.7%), while the light asset projects' market share has also risen 3.2% in 1H19(18: 2.3%). The strategy of focusing their business in Henan province reflects prudent management in not attempting to over stretch themselves to a level that could jeopardize the company's long term health. In our view, such a focused strategy is also a key factor behind the 80% YOY contracted sales growth in 2018.

The company will start to slowly expand to neighbouring cities and provinces and have already recently acquired a land in Hebei, their first equity stake project outside of Henan Province. We believe this will mean expand the market potential and growth potential of the company.

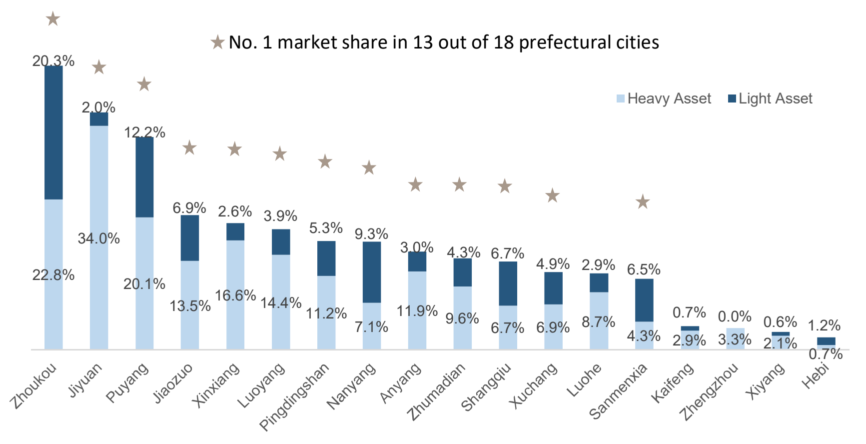
Backed by the population of 109m and a property market of RMB806bn in 2018, management believes that Henan Province is still sufficient for the company's growth and has set their eyes on covering all 210 cities in Henan province as their 10-15 years long term vision. In 1H19, the company is the undoubted market leader in several prefectural cites of Henan province, such as Zhoukou, Jiyuan and Puyang.

**Figure 17: Market Share in Henan Province (by contracted sales)**




Source: Company Data

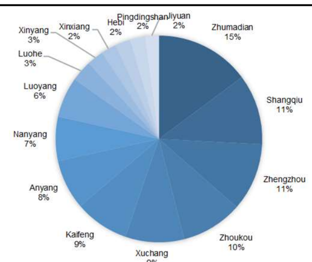
**Figure 18: Market share in 14 prefectural cities by contracted sales in 1H19**




Source: Company Data

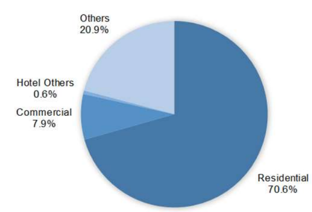
As of 30 June 2019, the total land bank GFA is 47.69mn sqm with a low average land cost of RMB1,180/sq.m. In 1H19, the developer spent RMB9.8bn on land acquisitions, representing a healthy 35% of 1H2019 contracted sales of RMB27.7 bn.

**Figure 19: 1H19 Land Acquisitions by City**



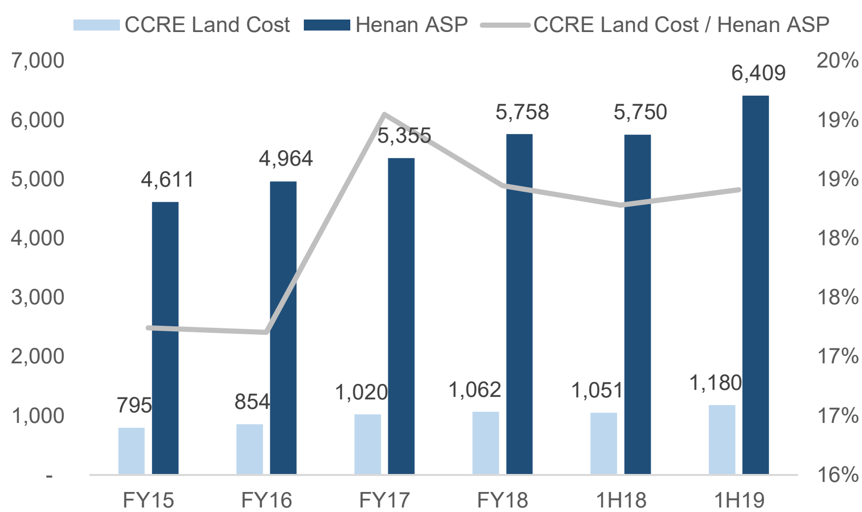

Source: Company Data, AMTD Research

**Figure 20: Land Bank structure by Type As of 1H19**




Source: Company Data, AMTD Research

**Figure 21: Land costs in Henan Province are relatively low**




Source: China Statistical Yearbook 2018 & 1H2019; Company Data; AMTD Research

## Financial Leverage healthy, leverage through working capital

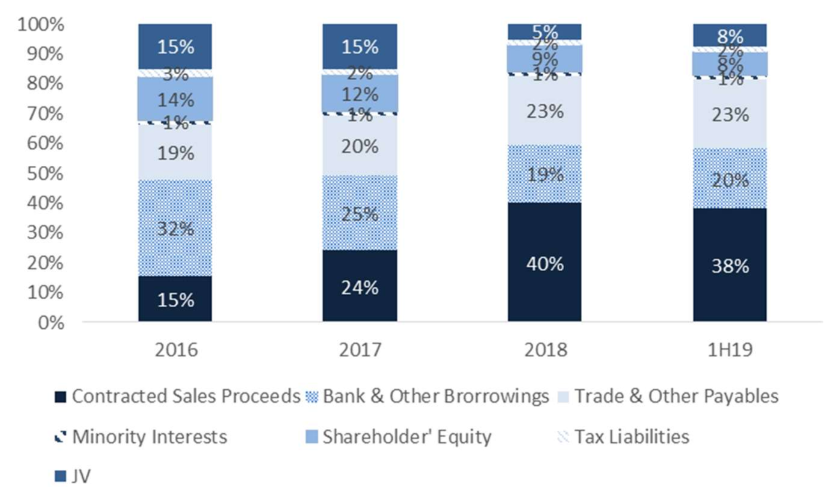
CCRE's Net Debt to Equity was only 18% at 1H19, as they funded most of their growth with working capital, e.g. Pre-sale proceeds, JV/Asso and trade payables, which are mostly interest free. In 1H19 and 2018, the percentage of contracted sales proceeds rose to 38% and 40% respectively from 24% in 2017, and the percentage of trade payables and contracted sales proceeds combined to 61% as of 30th June 2019.

If including the JV & Associate companies, the see-through Net Debt to Equity would be at 55% as of 1H19, which is still below the industry average of 82% per our coverage universe.

As such, their Total Assets to Total Equity ratio stands at 11x towards the high end of the sector. We thus believe that the company has room to leverage up their financial position to maintain their asset growth, if in case contracted sales growth slows down.

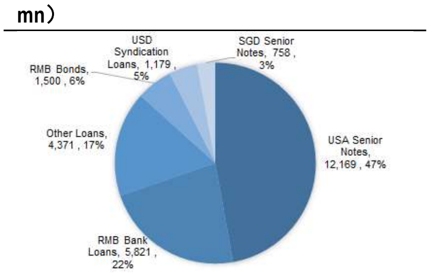
Central China had diversified and balanced funding sources with 45.3% onshore debt and 54.7% offshore debt as of 1H19 with the average debt maturity of 2.1 year.

**Figure 22: Interest Bearing Loans are ~20% of Source of Funding As of 1H19**



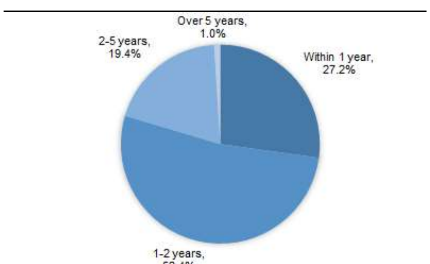

Source: Company Data

**Figure 23: Funding Source As of 1H19（RMB mn）**



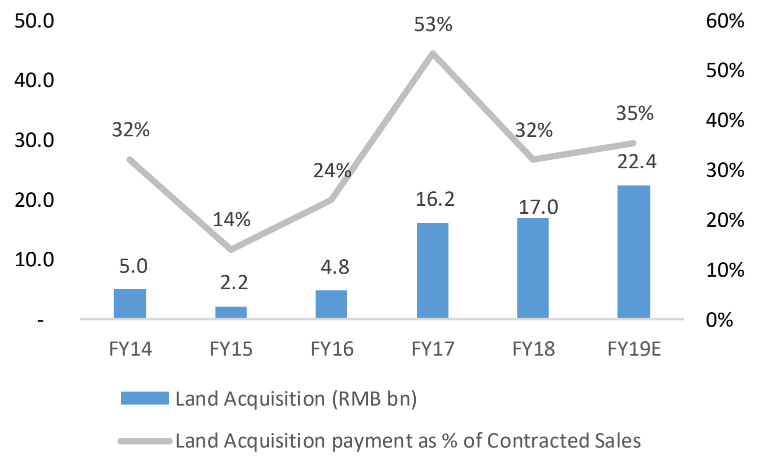

Source: Company Data

**Figure 24: Debt Maturity As of 1H19**




Source: Company Data

**Figure 25: Disciplined land banking, ~35% of contracted sales reinvested in land acquisition**




Source: China Statistical Yearbook 2018 & 1H2019; Company Data; AMTD Research

# Lower Tier Cities is Not Evil

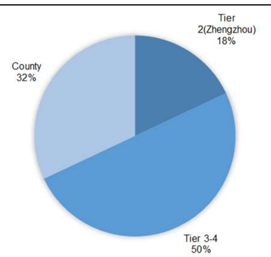
One of investors' key concerns for investing in Central China Real Estate is the higher exposure towards lower-tier cities due to its focused strategy in Henan Province.

However, as we highlighted in our sector report dated 8 October 2019, "Time to ditch Stock Picking methodology based on Tier 1, 2 and 3 exposure", a developers' exposure based on Tier 1, 2, and 3 cities does not determine their success. The more important question is whether the developer has the capabilities to operate in such cities.

In fact, with overall property sales volume reaching a bottle neck, the ASP growth in lower-tier cities has now become one of the key drivers in national sales.

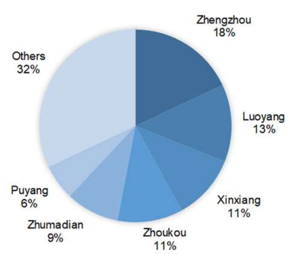
For example, Henan's ASP grew by 11.5% YOY to RMB6,409/sqm higher than nationwide ASP grew by 7.5% YOY to RMB9,329/sqm. ASP growth of several cities in Henan province was above the nationwide growth in 1H2019, such as Kaifeng (23.4%), Anyang (20.5%), Shangqiu (15.1%) and Zhoukou (13.8%). Central China has land reserves in those cities and the recognized ASP might increase in 2020E-2021E because of city mix.

**Figure 26: 1H19 Contracted Sales Breakdown**



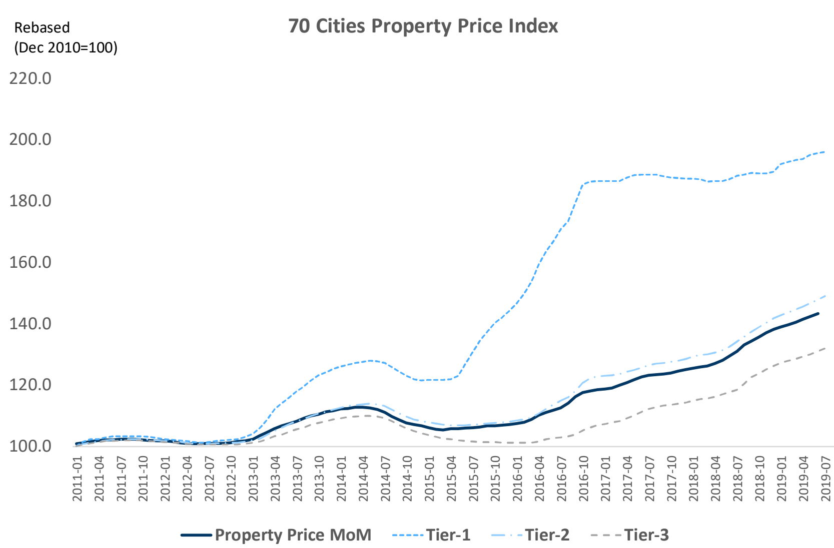

Source: Company Data

**Figure 27: 1H19 Contracted Sales Breakdown**




Source: Company Data

**Figure 28: 70 Major Cities' Property Prices risen ~14% since end-2017; underpinning 2019E-2020E GP Margins**




Source: NBS, Wind; AMTD Equity Research

**Figure 29: National Residential Sales Volume to be flat, ASP growth to drive Industry's Sales Value**

| Residential | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Sales | New Starts | Under Construction | Completion | Real Estate Inv | Sales Value | Avg Const Cost | ASP |
| Unit | m sqm | m sqm | m sqm | m sqm | RMBm | RMBm | RMB/sqm/yr | RMB/sqm |
| 2003 | 285 | 437 | 910 | 322 | 678,241 | 630,385 | 745 | 2,212 |
| 2004 | 338 | 479 | 1,082 | 347 | 883,695 | 861,937 | 817 | 2,549 |
| 2005 | 496 | 540 | 1,277 | 400 | 1,086,093 | 1,456,376 | 850 | 2,937 |
| 2006 | 554 | 636 | 1,515 | 432 | 1,363,841 | 1,728,781 | 900 | 3,119 |
| 2007 | 701 | 781 | 1,865 | 478 | 1,800,542 | 2,556,581 | 966 | 3,645 |
| 2008 | 593 | 799 | 2,167 | 477 | 2,244,087 | 2,119,600 | 1,036 | 3,576 |
| 2009 | 862 | 925 | 2,508 | 577 | 2,561,369 | 3,843,290 | 1,021 | 4,459 |
| 2010 | 934 | 1,295 | 3,149 | 612 | 3,402,623 | 4,412,065 | 1,080 | 4,725 |
| 2011 | 970 | 1,460 | 3,884 | 717 | 4,431,950 | 4,861,939 | 1,141 | 5,011 |
| 2012 | 985 | 1,307 | 4,290 | 790 | 4,937,421 | 5,346,718 | 1,151 | 5,430 |
| 2013 | 1,157 | 1,458 | 4,863 | 787 | 5,895,076 | 6,769,494 | 1,212 | 5,850 |
| 2014 | 1,052 | 1,249 | 5,151 | 809 | 6,435,215 | 6,241,095 | 1,249 | 5,934 |
| 2015 | 1,124 | 1,067 | 5,116 | 738 | 6,459,524 | 7,275,300 | 1,263 | 6,472 |
| 2016 | 1,375 | 1,159 | 5,213 | 772 | 6,870,387 | 9,906,417 | 1,318 | 7,203 |
| 2017 | 1,448 | 1,281 | 5,364 | 718 | 7,514,788 | 11,023,951 | 1,401 | 7,614 |
| 2018 | 1,479 | 1,534 | 5,700 | 660 | 8,519,225 | 12,639,260 | 1,495 | 8,544 |
| 2019E | 1,509 | 1,564 | 6,637 | 627 | 9,919,768 | 13,536,647 | 1,495 | 8,971 |

| YoY Growth | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2004 | 19% | 10% | 19% | 8% | 30% | 37% | 10% | 15% |
| 2005 | 47% | 13% | 18% | 15% | 23% | 69% | 4% | 15% |
| 2006 | 12% | 18% | 19% | 8% | 26% | 19% | 6% | 6% |
| 2007 | 27% | 23% | 23% | 10% | 32% | 48% | 7% | 17% |
| 2008 | -15% | 2% | 16% | 0% | 25% | -17% | 7% | -2% |
| 2009 | 45% | 16% | 16% | 21% | 14% | 81% | -1% | 25% |
| 2010 | 8% | 40% | 26% | 6% | 33% | 15% | 6% | 6% |
| 2011 | 4% | 13% | 23% | 17% | 30% | 10% | 6% | 6% |
| 2012 | 1% | -11% | 10% | 10% | 11% | 10% | 1% | 8% |
| 2013 | 18% | 12% | 13% | 0% | 19% | 27% | 5% | 8% |
| 2014 | -9% | -14% | 6% | 3% | 9% | -8% | 3% | 1% |
| 2015 | 7% | -15% | -1% | -9% | 0% | 17% | 1% | 9% |
| 2016 | 22% | 9% | 2% | 5% | 6% | 36% | 4% | 11% |
| 2017 | 5% | 11% | 3% | -7% | 9% | 11% | 6% | 6% |
| 2018 | 2% | 20% | 6% | -8% | 13% | 15% | 7% | 12% |
| 2019E | 2% | 2% | 16% | -5% | 16% | 7% | 0% | 5% |

Source: NBS, Wind, AMTD Equity Research Estimates

**Policies easing quietly and locally**

Based on property policies in Henan province in 2019, the political environment is relatively easing, or at least not as tight as before. As such, we believe this will also create a more favourable operating environment that may spur on the contracted sales growth of CCRE.

**Figure 30: A summary of policy since 2019 – policies is easing in Henan Province**

| Date | Cities | Tiers | Area | Details |
|---|---|---|---|---|
| 20/10/2019 | Henan | Province | Redevelopment | In Henan province, 10,000 old residential areas in urban areas will be renovated and upgraded in the next three years. |
| 1/7/2019 | Henan | Province | Provident fund system | Multiple cities in Henan have adjust housing fund monthly paymentt base. In downtown Zhengzhou, the upper limit increases to RMB20242 while the lower limit increases to RMB1900. In downtown Luoyang, the upper limit increases to RMB16244 while the lower limit increases to RMB1900. There are also growth in varying degree in other cities. |
| 15/5/2019 | Henan | Province | Land policy | The minimum social security fees for farmers whose land has been expropriated in 2019 has been announced, the lowest in Zhumadian with fees of RMB41100 per mu. |
| 22/3/2019 | Zhengzhou | Tier 2 | Provident fund system | For citizens who buy the first housing, the highest loan amount increases by RMB200 thousand to RMB 600 thousand and 800 thousand under different housing provident fund loan conditions. |
| 19/7/2019 | Kaifeng | Tier 3 | Sales limits | Canceling the transaction time limit (3 years from the date of obtaining the real estate right certificate) of listing and transferring newly built commercial housing; canceling the transaction qualification freezing time limit of cancelled registered housing. |
| 16/1/2019 | Zhumadian | Tier 4 | Hukou system | As long as applicants conform to the framework of household registration in Henan province, their household registration can be moved to Zhumadian without any restrictions. |

Source: GuanDian, Tencent News; Sina News; LeJu; AMTD Research

# Valuation & Risks

**P/E based valuation metrics**

We adopt a P/E valuation methodology to arrive at our 12-months target price of HK$6.00/sh. This implies a 6.0x 2020E P/E, which is largely in-line with the P/E ratio that the stock is currently trading on 2019E net profit. Such a P/E ratio is in-line with industry average, and we think it is fair as it reflects the company's higher than industry average earnings growth profile for 2018-2021E.

We believe that Chinese property developers are currently operating on a high asset turnover business model, and since sales and earnings growth are the key share price drivers, we believe an earnings based valuation approach is more appropriate compared to asset based approaches such as P/B or Disc. To NAV.

Our target price implies a 1.57x 2019E P/B.

**Figure 31: Target Price is based on a 6x 2020E P/E ratio**

| | | Target P/E Multiple (x) | 2018-21E Net Profit CAGR | 1H19 Assets to Equity | 1H19 Net Debt to Equity | Target Price (HK$) |
|---|---|---|---|---|---|---|
| 0095.HK | Lvgem | 7.00 | 35% | 3.82 | 120% | 3.01 |
| 0832.HK | CCRE | 6.00 | 61% | 11.16 | 18% | 6.00 |
| 1238.HK | Powerlong | 6.00 | 42% | 4.18 | 96% | 7.19 |
| 3883.HK | Aoyuan | 5.50 | 41% | 6.58 | 72% | 14.38 |
| 6111.HK | Dafa | 5.50 | 28% | 6.01 | 110% | 6.99 |
| 1996.HK | Redsun | 5.00 | 27% | 5.74 | 76% | 3.33 |
| 1628.HK | Yuzhou | 4.00 | 14% | 6.28 | 88% | 3.97 |
| 0230.HK | Minmetals | 4.00 | 3% | 3.08 | 74% | 1.14 |
| | **Average** | **5.38** | **32%** | **5.86** | **82%** | |

Source: NBS, Wind; AMTD Equity Research Estimates

**Figure 32: Peers Valuation comparison**

| Date / Equity | 7/11/2019 | Share Price (HK$) | Mkt cap (USD mn) | FY18 P/E | FY19E P/E | FY20E P/E | FY18 P/B | FY19E P/B | FY20E P/B | Div. yield |
|---|---|---|---|---|---|---|---|---|---|---|
| **China Property Developers** | | | | | | | | | | |
| 2202 HK | Vanke | 28.75 | 43,027 | 8.6x | 7.0x | 6.1x | 1.8x | 1.6x | 1.3x | 3.72% |
| 688 HK | COLI | 27.45 | 38,015 | 8.6x | 6.7x | 5.7x | 1.1x | 0.9x | 0.8x | 3.28% |
| 3333 HK | Evergrande | 19.92 | 33,801 | 6.3x | 5.3x | 4.9x | 1.8x | 1.5x | 1.2x | 0.00% |
| 1109 HK | CR Land | 35.30 | 31,942 | 11.4x | 9.5x | 8.1x | 1.6x | 1.4x | 1.3x | 3.56% |
| 2007 HK | Country Garden | 11.64 | 31,891 | 6.6x | 5.5x | 4.8x | 1.9x | 1.5x | 1.2x | 4.20% |
| 960 HK | Longfor | 33.40 | 25,187 | 13.7x | 10.9x | 9.0x | 2.2x | 1.9x | 1.7x | 2.96% |
| 1918 HK | Sunac | 38.80 | 22,056 | 10.2x | 5.9x | 4.7x | 2.7x | 1.9x | 1.5x | 2.13% |
| 813 HK | Shimao | 27.90 | 11,687 | 9.8x | 7.5x | 6.0x | 1.4x | 1.2x | 1.1x | 4.41% |
| 3380 HK | Longan | 12.52 | 8,701 | 9.0x | 6.2x | 5.0x | 2.3x | 1.8x | 1.5x | 4.15% |
| 884 HK | CIFI | 5.80 | 5,817 | 7.5x | 5.8x | 4.7x | 1.6x | 1.3x | 1.1x | 4.02% |
| 3383 HK | Agile | 11.30 | 5,607 | 5.5x | 5.2x | 4.5x | 1.0x | 0.8x | 0.7x | 7.65% |
| 2777 HK | R&F | 13.26 | 5,510 | 4.1x | 3.2x | 2.7x | 0.6x | 0.5x | 0.5x | 9.28% |
| 3883 HK | Aoyuan | 11.58 | 3,968 | 11.0x | 6.3x | 4.4x | 2.4x | 1.9x | 1.4x | 2.16% |
| 1233 HK | Times | 15.44 | 3,837 | 6.1x | 5.0x | 4.0x | 1.5x | 1.1x | 0.9x | 4.45% |
| 123 HK | Yuexiu | 1.78 | 3,522 | 7.1x | 7.4x | 6.5x | 0.6x | 0.6x | 0.6x | 4.49% |
| 1813 HK | KWG | 8.55 | 3,477 | 6.4x | 4.8x | 3.9x | 0.8x | 0.7x | 0.6x | 6.55% |
| 6158 HK | Zhenro | 5.39 | 2,947 | 10.1x | 6.7x | 5.1x | 1.5x | 1.2x | 1.1x | 2.78% |
| 1638 HK | Kaisa | 3.51 | 2,730 | 4.1x | 5.3x | 4.1x | 0.9x | 0.8x | 0.6x | 2.56% |
| 1238 HK | Powerlong | 5.44 | 2,643 | 10.5x | 7.8x | 4.5x | 0.7x | 0.7x | 0.6x | 3.73% |
| 3900 HK | Greentown | 8.11 | 2,350 | 15.8x | 6.3x | 6.2x | 0.5x | 0.5x | 0.5x | 2.84% |
| 1628 HK | Yuzhou | 3.64 | 2,341 | 4.1x | 4.4x | 3.7x | 0.8x | 0.8x | 0.7x | 7.49% |
| 3301 HK | Ronshine | 9.71 | 2,118 | 6.3x | 3.9x | 3.0x | 1.1x | 0.9x | 0.7x | 3.29% |
| 1966 HK | China SCE | 3.77 | 1,978 | 5.9x | 4.5x | 3.4x | 0.9x | 0.8x | 0.6x | 4.76% |
| 95 HK | Lvgem | 2.82 | 1,807 | 14.4x | 12.7x | 6.5x | 1.1x | 1.0x | 0.9x | 1.77% |
| 272 HK | Shui On Land | 1.63 | 1,669 | 4.4x | 16.3x | 14.7x | 0.3x | 0.3x | 0.3x | 6.48% |
| 832 HK | CCRE | 4.20 | 1,480 | 12.6x | 6.6x | 4.2x | 1.1x | 1.1x | 1.0x | 4.32% |
| 1098 HK | Roadking | 14.88 | 1,421 | NA | NA | NA | 0.7x | NA | NA | 6.70% |
| 119 HK | Poly Prop | 3.01 | 1,394 | 5.2x | 5.2x | NA | 0.4x | 0.4x | NA | 3.79% |
| 1996 HK | Redsun | 2.59 | 1,099 | 4.1x | 5.6x | 3.9x | 0.4x | 0.6x | 0.5x | 4.13% |
| 6111 HK | Dafa | 5.40 | 570 | 7.3x | 5.2x | 4.2x | 1.0x | 0.9x | 0.8x | 3.13% |
| 230 HK | Minmetals | 1.23 | 526 | 4.2x | 4.6x | 4.3x | 0.4x | 0.4x | 0.4x | 5.50% |
| **Total** | | | **305,115** | **8.0x** | **6.6x** | **5.3x** | **1.2x** | **1.0x** | **0.9x** | **4.20%** |

Source: Bloomberg Estimates, *AMTD Equity Research Estimates
Note: As of 7th Nov, 2019; *Div Yield is Trailing Dividend Yield

### Key Risks

Key risks for the stock includes (1) a slowdown in contracted sales; (2) unexpected tightening in monetary policy; (3) government introduction of property tax which curbs property purchase sentiment.; (4) JV/Asso financial leverage is also a concern

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