

KWG

Seeking balance between scale and profitability

Downgrade to ‘HOLD’ and revise down TP to HK\$12.50: 2017 result missed our estimation; core net profit dropped by 19% YoY, expansion execution takes times to testify.

Revenue increased by 30% from RMB 8.87 bn in 2016 to RMB 11.54 bn in 2017. GPM slightly improved by 0.2ppt to 35%. SG&A to contracted sales further compressed to only 3.6%, down from 5.8% in 2016. However, finance cost doubled in 2017 and income tax expense increased by 83% YoY to RMB 20 bn. These led core net profit to decline 19% to 2.71bn in 2017, which is 22% below our estimation. Key takeaways from result meeting: 1) 30-40% growth of revenue will be delivered from 2018; 2) GPM will stay above 30% in next 3 years; 3) land acquisition in last 2 years will bear fruit in next 3 years. The company has acquired land plots with relatively low cost in 2017. Low cost land acquisition is the first step for developer, and the key step is to sell products as schedule. KWG’s execution in new cities takes time to testify. We downgrade its rating to ‘HOLD’ and revise down TP to HK\$12.50.

70% YoY growth target of contracted sales

The company has announced its sales target of RMB 65 bn in 2018, which implies 70% YoY increase. Comparing with peers, the company’s growth target is very aggressive. The management explained that the company had prepared for years and over RMB 110 bn of saleable resource would be launched. In addition, the company has entered 21 new cities in 2017. We are cautious on its execution with rapid expansion.

More redevelopment projects ahead & incentive scheme

The company is looking for redevelopment projects in Guangzhou, thanks to Guangzhou’s accelerated redevelopment pace in 2018. The company has entered 8 villages in Guangzhou and one redevelopment in Guangzhou will be acquired by KWG in 2018. The company will look for more redevelopment projects in order to maintain its profitability. Regarding to incentive scheme, the scheme has reduced pre-launch time from 12 months to 10 months and delivery time from 20 months to 15 months, which is still slow comparing with large-scale developers. We believe the company will further accelerate its turnover to boost its sales. KWG was a profit-oriented developer in the past, rather than a scale-oriented. We believe the company is looking for a balance between rapid expansion and profitability. However, the strategy change will be much easier for scale-oriented developer to slow down, much harder for profit-oriented developer to speed up.

We expect GPM to be above 30%

We believe the company will deliver over 30% GPM in next 3 years, as en-bloc sales and high profitable commercial projects will be gradually delivered in next 3 years. Additionally, contracted sales with low land cost in 1st and 2nd tier cities will contribute high GPM in future. We expect GPM will be 35%/35%/34% in 2018/2019/2020, respectively.

Revise down price target to HK\$12.50, 13% upside, ‘Hold’

We are disappointed at 2017 result. And we believe the company will take time to find a sweet spot between profitability and sales scale. Expanding to 34 cities also takes times to testify its execution. Therefore, we revised down its price target to HK\$12.50. Our price target implies 40% discount to Dec-18 NAV, 9.2x 2018e core PE and 6.4x 2019e core PE. The stock is trading at 49% discount to Dec-18 NAV, 8.1x 2018e core PE and 1.0x 2018e PB.

Stock code: 1813.HK

Rating: HOLD

Price target (HK\$)	12.50
Previous target(HK\$):	15.79
Current price (HK\$, 26 Mar 2018)	11.08
Upside/downside %	13%
Market cap (HK\$ m)	34,959
Market cap (US\$ m)	4,455
Avg daily turnover (HK\$ m)	139.6

Source: Bloomberg, AMTD Equity Research

Key forecasts

(RMB m)	2017	2018e	2019e	2020e
Revenue	11,543	16,408	22,320	29,535
yoy %	30%	42%	36%	32%
Attr NP	3,620	3,784	5,438	6,379
yoy %	4%	5%	44%	17%
Core Attr NP	2,716	3,784	5,438	6,379
yoy %	-19%	39%	44%	17%
Gross margin	34.8%	34.9%	34.5%	34.4%
Net gearing	67.9%	92.2%	83.6%	59.2%
EPS	0.88	1.22	1.76	2.06
DPS	0.41	0.43	0.61	0.72
BPS	8.91	10.13	11.89	13.95

Source: Company data, AMTD Equity Research

Valuation

	2017	2018e	2019e	2020e
P/E	11.4	8.2	5.7	4.8
P/BV	1.1	1.0	0.8	0.7
Div. yield	4.2%	4.3%	6.2%	7.2%
ROE	10.5%	12.8%	15.9%	15.9%
ROA	2.7%	2.2%	2.6%	2.4%

Source: Bloomberg, AMTD Equity Research

Share price performance



Source: Bloomberg

Donald Yu, Analyst

+852 3163 3385

Donald.Yu@amtdgroup.com

Max Liang, Analyst

+852 3163 3384

Max.Liang@amtdgroup.com

Michelle Li, Analyst

+852 3163 3383

Michelle.Li@amtdgroup.com

Figure 1: Previous forecast vs actual result

PnL, RMB '000	2016	2017	AMTD 2017E	YoY	Actual vs Est
Revenue	8,865,329	11,543,072	12,115,408	30.2%	-4.7%
Sales of properties	7,922,956	10,432,094	11,078,798	31.7%	-5.8%
Cost of sales	(5,794,980)	(7,523,140)	(7,922,168)	29.8%	-5.0%
GPM	35%	35%	35%	0.2 pts	0.2 pts
Gross profit	3,070,349	4,019,932	4,193,240	30.9%	-4.1%
Other income	731,732	632,914	731,732	-13.5%	-13.5%
Fair value gains on investment properties	165,900	1,204,881	-	626.3%	n.a.
Selling expenses	(322,768)	(432,506)	(468,954)	34.0%	-7.8%
Administrative expenses	(969,196)	(936,814)	(1,085,400)	-3.3%	-13.7%
Finance costs	(159,875)	(329,505)	(176,543)	106.1%	86.6%
Profit before tax	4,527,499	5,555,028	4,689,937	22.7%	18.4%
Income tax expense	(1,065,893)	(1,950,015)	(1,219,384)	82.9%	59.9%
Profit for the year	3,461,606	3,605,013	3,470,554	4.1%	3.9%
Adjusted profit for the year	3,337,181	2,701,352	3,470,554	-19.1%	-22.2%
Profit for the year attributable to:					
Owners of the Company	3,464,714	3,620,071	3,473,662	4.5%	4.2%
Non-controlling interests	(3,108)	(15,058)	(3,108)	384.5%	384.5%
Core net profit	3,337,181	2,701,352	3,470,554	-19.1%	-22.2%
Net Debt / Equity	67%	68%	59%	-8.0 pts	0.2 pts
Current Ratio	158%	165%	184%	25.6 pts	-0.1 pts
Interest Coverage	1.7x	1.9x	1.6x	-0.1x	0.2x
ROA	3.13%	2.68%	2.87%	-0.3 pts	-0.1 pts
ROCE	5.91%	4.68%	4.90%	-1.0 pts	0.0 pts
ROE	14.42%	10.48%	13.51%	-0.9 pts	-0.2 pts
GPM	34.63%	34.83%	34.61%	0.0 pts	0.0 pts
NPM	39.08%	31.36%	28.67%	-10.4 pts	0.1 pts
Core NPM	37.64%	23.40%	28.65%	-9.0 pts	-0.2 pts
Total Debt	42,949,970	59,645,171	47,426,204	10.4%	25.8%
Cash	26,901,572	40,467,321	31,258,380	16.2%	29.5%
Net Debt	16,048,398	19,177,850	16,167,824	0.7%	18.6%
ST Debt	4,753,515	3,740,551	1,481,182	-68.8%	152.5%
Properties held under development	38,503,341	30,908,445	44,298,522	15.1%	-30.2%
Advanced proceeds received from customers	4,185,791	6,800,000	6,390,993	52.7%	6.4%

Source: Company data, AMTD Equity Research

Figure 2: P&L forecast and key ratios

PnL, RMB mn	2016	2017	2018e	2019e	2020e	2016	2017	2018e	2019e	2020e
Revenue	8,865	11,543	16,408	22,320	29,535	6.3%	30.2%	42.1%	36.0%	32.3%
Sale of properties	7,923	10,432	15,297	21,209	28,313	4.8%	31.7%	46.6%	38.6%	33.5%
Cost of sales	(5,795)	(7,523)	(10,674)	(14,629)	(19,383)					
Gross profit	3,070	4,020	5,734	7,691	10,153	2.0%	30.9%	42.6%	34.1%	32.0%
Selling expenses	(323)	(433)	(740)	(1,110)	(1,665)	16.7%	34.0%	71.1%	50.0%	50.0%
Administrative expenses	(969)	(937)	(1,528)	(1,950)	(2,633)	25.1%	-3.3%	63.1%	27.7%	35.0%
Share of post-tax loss of an associate	0	(3)	(3)	(3)	(3)					
Share of post-tax (losses)/profits of joint ventures	2,130	1,900	2,522	3,444	3,369					
Finance costs	(160)	(330)	(381)	(437)	(514)	1429.8%	106.1%	15.8%	14.5%	17.8%
Profit before tax	4,527	5,555	5,736	7,768	8,838	-2.9%	22.7%	3.3%	35.4%	13.8%
Income tax expense	(1,066)	(1,950)	(1,967)	(2,344)	(2,475)					
Profit for the year	3,462	3,605	3,769	5,423	6,364	1.4%	4.1%	4.5%	43.9%	17.3%
Profit for the year attributable to:										
Net profit	3,465	3,620	3,784	5,438	6,379	1.4%	4.5%	4.5%	43.7%	17.3%
Core net profit	3,340	2,716	3,784	5,438	6,379	15.8%	-18.7%	39.3%	43.7%	17.3%
Non-controlling interests	(3)	(15)	(15)	(15)	(15)					
Dividends	1,222	1,283	1,324	1,903	2,233					
EPS - basic	1.15	1.17	1.22	1.76	2.06					
EPS-underlying	1.11	0.88	1.22	1.76	2.06					
DPS - basic	0.40	0.41	0.43	0.61	0.72					
BVPS	7.93	8.91	10.13	11.89	13.95					
Key Ratios, RMB mn	2016	2017	2018e	2019e	2020e					
GPM	34.6%	34.8%	34.9%	34.5%	34.4%					
NPM	39.1%	31.4%	23.1%	24.4%	21.6%					
Core NPM	37.6%	23.4%	23.0%	24.3%	21.5%					
ROA	3.1%	2.7%	2.2%	2.6%	2.4%					
ROCE	5.9%	4.7%	4.0%	5.0%	5.0%					
ROE	14.4%	10.5%	12.8%	15.9%	15.9%					
Total Debt / EBITDA	8.9x	10.1x	11.3x	9.6x	10.0x					
Total Debt / Equity	178.9%	211.2%	215.7%	211.2%	212.6%					
Total Debt / Capitalization	64.1%	67.9%	68.3%	67.9%	68.0%					
Net Debt / EBITDA	3.3x	3.3x	3.5x	2.8x	1.8x					
Net Debt / Equity	66.8%	67.9%	66.0%	60.7%	39.1%					
Net Debt / Capitalization	24.0%	21.8%	20.9%	19.5%	12.5%					
Current Ratio	158.4%	165.4%	150.7%	145.6%	149.2%					
Cash / Total Assets	24.3%	30.0%	28.0%	26.9%	28.4%					
Inventory / Total Assets	41.0%	27.8%	38.8%	45.9%	50.3%					
Net debt / Net Inventory	35.4%	51.2%	31.8%	23.6%	12.7%					
Quick Ratio	101.6%	83.5%	89.6%	93.1%	96.3%					
Cash Ratio	56.9%	81.9%	61.1%	52.5%	52.9%					
Interest Coverage	1.7x	1.9x	1.7x	2.0x	1.9x					

Source: Company data, AMTD Equity Research

Figure 3: Balance sheet forecast & Cash flow forecast

Balance Sheet, RMB mn	2016	2,017	2018e	2019e	2020e
Non-current assets	35,795	53,207	53,207	53,207	53,207
Current assets	74,947	81,738	118,194	156,310	214,211
Properties under development	38,503	30,908	59,591	89,280	127,540
Completed properties held for sale	6,866	6,540	6,866	6,866	6,866
Restricted bank deposits	1,131	1,268	1,268	1,268	1,268
Bank balances and cash	25,771	39,199	46,647	55,073	74,714
Others	2,676	3,822	3,822	3,822	3,822
Current liabilities	47,309	49,407	78,410	107,333	143,602
Advanced proceeds received from customers	4,186	0	23,287	45,953	83,452
Borrowings	4,754	3,741	9,456	15,714	14,483
Others	38,369	45,667	45,667	45,667	45,667
Non-current liabilities	39,424	57,292	60,977	64,746	80,014
Borrowings	38,196	55,905	59,589	63,358	78,627
Others	1,228	1,387	1,387	1,387	1,387
Capital and reserves	24,009	28,246	32,015	37,438	43,801
Equity attributable to owners of the Company	23,950	27,607	31,391	36,830	43,208
Non-controlling interests	58	638	623	608	593
Cash Flow Statement, RMB mn	2016	2017	2018e	2019e	2020e
Profit before income tax	4,527	5,555	5,736	7,768	8,838
Operating cash flows before movements in working capital	2,270	3,325	2,832	3,886	4,955
Cash (used in) from operations	524	12,147	(2,889)	(3,137)	4,195
Interest received	170	330	381	437	514
Interest paid	(2,231)	(3,099)	(3,587)	(4,108)	(4,837)
PRC Income tax paid	(324)	(1,107)	(1,096)	(1,165)	(1,326)
Land appreciation tax paid	(229)	(843)	(871)	(1,179)	(1,149)
Net cash (used in) from operating activities	(2,091)	7,428	(8,062)	(9,152)	(2,602)
Net cash used in investing activities	3,318	4,999	6,109	7,552	8,206
Financing activities					
Proceeds from borrowings	9,068	9,230	13,141	19,483	29,751
Repayments of borrowings	(11,148)	(4,754)	(3,741)	(9,456)	(15,714)
Net cash from (used in) financing activities	13,580	1,002	9,400	10,027	14,037
Net increase in cash and cash equivalents	14,807	13,428	7,448	8,427	19,641
Effect of foreign exchange rate changes	17	0	0	0	0
Cash and cash equivalents at beginning of the year	10,946	25,771	39,199	46,647	55,073
Cash and cash equivalents at end of the year	25,771	39,199	46,647	55,073	74,714

Source: Company data, AMTD Equity Research

IMPORTANT DISCLOSURES

AMTD Investment Ratings

Stock Rating

Buy	Stock with potential return of over 20% over the next 12 months
Hold	Stock with potential return of -20% to +20% over the next 12 months
Sell	Stock with potential loss of over 20% over the next 12 months

Analyst Certification

We, Donald Yu, Max Liang and Michelle Li, hereby certify that (i) all of the views expressed in this research report reflect accurately our personal views about the subject company and its securities; and (ii) no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed by us in this research report, nor is it tied to any specific investment banking transactions performed by AMTD Global Market Limited.

AMTD Global Markets Limited

Address: 23/F & 25/F, Nexus Building, No. 41 Connaught Road Central, Central, Hong Kong

Tel: (852) 3163-3288 **Fax:** (852) 3163-3289

GENERAL DISCLOSURES

The research report is prepared by AMTD Global Markets Limited ("AMTD") and is distributed to its selected clients.

This research report provides general information only and is not to be construed as an offer to sell or a solicitation of an offer to buy any security in any jurisdiction where such offer or solicitation would be illegal. It does not (i) constitute a personal advice or recommendation, including but not limited to accounting, legal or tax advice, or investment recommendations; or (ii) take into account any specific clients' particular needs, investment objectives and financial situation. AMTD does not act as an adviser and it accepts no fiduciary responsibility or liability for any financial or other consequences. This research report should not be taken in substitution for judgment to be exercised by clients. Clients should consider if any information, advice or recommendation in this research report is suitable for their particular circumstances and seek legal or professional advice, if appropriate.

This research report is based on information from sources that we considered reliable. We do not warrant its completeness or accuracy except with respect to any disclosures relative to AMTD and/or its affiliates. The value or price of investments referred to in this research report and the return from them may fluctuate. Past performance is not reliable indicator to future performance. Future returns are not guaranteed and a loss of original capital may occur.

The facts, estimates, opinions, forecasts and any other information contained in the research report are as of the date hereof and are subject to change without prior notification. AMTD, its group companies, or any of its or their directors or employees ("AMTD Group") do not represent or warrant, expressly or impliedly, that the information contained in the research report is correct, accurate or complete and it should not be relied upon. AMTD Group will accept no responsibilities or liabilities whatsoever for any use of or reliance upon the research report and its contents.

This research report may contain information from third parties, such as credit ratings from credit ratings agencies. The reproduction and redistribution of the third party content in any form by any means is forbidden except with prior written consent from the relevant third party. Third party content providers do not guarantee the timeliness, completeness, accuracy or availability of any information. They are not responsible for any errors or omissions, regardless of the cause, or for the results obtained from the use of such content. Third party content providers give no express or implied warranties, including, but not limited to, any warranties of merchantability of fitness for a particular purpose or use. Third party content providers shall not be liable for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including lost income or profits and opportunity costs) in connection with any use of their content. Credit ratings are statements of opinions and are not statements of fact or recommendations to purchase, hold or sell securities. They do not address the suitability of securities for investment purposes, and should not be relied on as investment advice.

To the extent allowed by relevant and applicable law and/or regulation: (i) AMTD, and/or its directors and employees may deal as principal or agent, or buy or sell, or have long or short positions in, the securities or other instruments based thereon, of issuers or securities mentioned herein; (ii) AMTD may take part or make investment in financing transactions with, or provide other services to or solicit business from issuer(s) of the securities mentioned in the research report; (iii) AMTD may make a market in the securities in respect of the issuer mentioned in the research report; (iv) AMTD may have served as manager or co-manager of a public offering of securities for, or currently may make a primary market in issues of, any or all of the entities mentioned in this research report or may be providing, or have provided within the previous 12 months, other investment banking services, or investment services in relation to the investment concerned or a related investment.

AMTD controls information flow and manages conflicts of interest through its compliance policies and procedures (such as, Chinese Wall maintenance and staff dealing monitoring).

The research report is strictly confidential to the recipient. No part of this research report may be reproduced or redistributed in any form by any means to any other person without the prior written consent of AMTD Global Markets Limited.