

SHK Properties

16 HK

Target (HKD): 138.00 → 138.00

Upside: 14.0%

2 Mar price (HKD): 121.10

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

In its last year of transition

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- Interim dividend unchanged despite earnings decline
- Earnings prospects to pick up from 2H FY15 onward
- Reaffirming Buy (1) rating

■ What's new

SHK Properties' (SHKP) underlying net profit for 1H FY15 was HKD8,463m, down 20.5% YoY (interim dividend maintained at HKD0.95/share). However, the results also highlight that SHKP's net gearing is declining (down 1.9pp to 13.8%) and its completion pipeline should be much stronger from 2016 onward, which we expect to underpin earnings prospects. Buy (1) call reiterated.

■ What's the impact

Facing transitional gap. A decline in SHKP's property sales profit (down 45% YoY in Hong Kong and 77% YoY in China) was the main reason for the decline in its interim earnings for 2015, as the group did not have major projects upon which to recognise profits in 1H FY15, whereas 1H FY14 featured exceptionally high-margin projects such as Cullinan and Shanghai Arch (over 60% for the Cullinan).

Earnings prospects should improve notably from 2H FY15, as the group has confirmed plans to sell the last batch of units at the Cullinan. SHKP should also have some high-margin projects (such as W50 and some

houses at Twelve Peak) for recognition in 2H15 and may dispose of some non-core properties.

Sales of Homantin luxury project and Acapella in Yuen Long may be delayed until 2H15. SHKP stated in the analyst meeting that selling Acapella after it has been completed would help its pricing, and we think it may also be prepared to wait for the best time to sell its Homantin project. We now assume profit recognition for these 2 projects in FY16 rather than FY15, which will lower property sales profits, one wild card of which now becomes how many Cullinan units and non-core properties it decides to sell.

Property sales profit outlook should improve from 2016 onward, as the group's residential GFA completion in 2016 is set to rise appreciably. SHKP is scheduled to complete some 1.28m sq ft in GFA in 2015 (including Acapella and the Homantin project), rising to 3.15m sq ft in 2016 and 3.38m sq ft in 2017. More importantly, many of its 2016 projects have been pre-sold already (securing over HKD20bn in sales proceeds). While we lower FY15-17 core EPS by 6-12% to factor in the likely deferral in profit recognition, we note that SHKP should have a strong development pipeline to underpin sustained earnings growth in 2016-17 and beyond.

■ What we recommend

We continue to see SHKP as a company that owns quality property assets yet trades at a low valuation – 0.79x PBR based on its latest (end-1H FY15) BVPS of HKD153.40, well below the stock's past-24-year average PBR of 1.21x. We have a Buy (1) rating and target price of HKD138/share (now 12-month

basis, formerly 6-month), based on a 35% discount applied to our end-2015E NAV of HKD212.30/share. The key risk to our call: a major deterioration in the Hong Kong economy.

■ How we differ

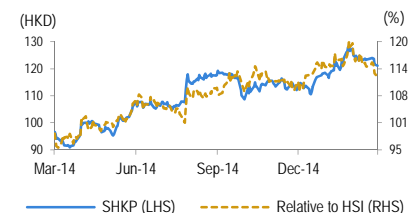
We believe that the latest property-cooling measures by the HKMA will mainly result in reduced transaction volumes in the secondary market. Within the industry as whole, the developers and primary market as a whole may be better placed than the market appreciates.

Forecast revisions (%)

Year to 30 Jun	15E	16E	17E
Revenue change	(24.6)	-	-
Net profit change	(10.8)	(11.8)	(5.8)
Core EPS (FD) change	(10.8)	(11.8)	(5.8)

Source: Daiwa forecasts

Share price performance



12-month range	90.90-128.20
Market cap (USDbn)	44.08
3m avg daily turnover (USDm)	62.28
Shares outstanding (m)	2,823
Major shareholder	Kwok family (47.0%)

Financial summary (HKD)

Year to 30 Jun	15E	16E	17E
Revenue (m)	60,825	89,765	98,658
Operating profit (m)	29,038	33,850	39,623
Net profit (m)	21,920	25,810	30,620
Core EPS (fully-diluted)	8.207	8.915	10.577
EPS change (%)	2.4	8.6	18.6
Daiwa vs Cons. EPS (%)	5.5	5.5	17.8
PER (x)	14.8	13.6	11.4
Dividend yield (%)	2.8	3.1	3.3
DPS	3.350	3.700	4.000
PBR (x)	0.7	0.8	0.7
EV/EBITDA (x)	11.2	9.6	8.1
ROE (%)	5.1	5.7	6.5

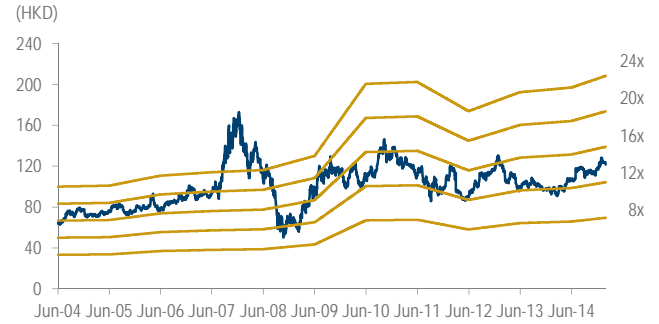
Source: FactSet, Daiwa forecasts

■ **SHKP: 1H FY15 results highlights**

(HKDm)	1H FY14	1H FY15	YoY chg
Property-sales profit	5,626	2,285	-59.4%
- Hong Kong	3,071	1,694	-44.8%
- China	2,559	594	-76.8%
- Singapore	(4)	(3)	-25.0%
Property rental EBIT	6,879	7,438	8.1%
- Hong Kong	5,541	5,955	7.5%
- China	1,073	1,218	13.5%
- Singapore	265	265	0.0%
Hotel operation	642	720	12.1%
Telecom	431	628	45.7%
Other businesses	1,375	1,509	9.7%
Other revenue	445	236	-47.0%
Unallocated admin expenses	(608)	(608)	0.0%
EBIT	14,790	12,208	-17.5%
Net interest expenses	(1,102)	(1,295)	17.5%
Investment gain / exceptional items	535	-	nm
Profit before tax	14,223	10,913	-23.3%
Tax and others	(3,202)	(1,676)	-47.7%
Minority interest	(377)	(774)	105.3%
Underlying net profit	10,644	8,463	-20.5%
EPS (underlying, HKD)	3.98	3.08	-22.6%
DPS (HKD)	0.95	0.95	0.0%

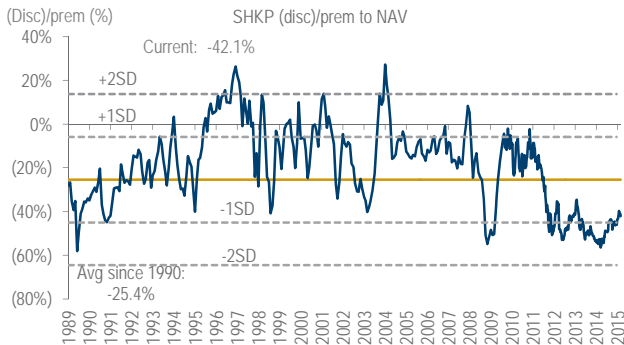
Source: Company, Daiwa

■ **SHKP: PER**



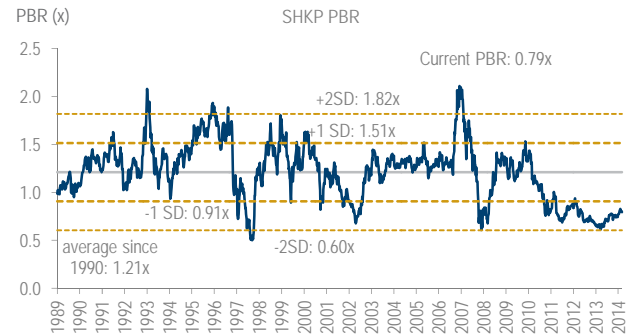
Source: Bloomberg, Daiwa

■ **SHKP: price/NAV trend**



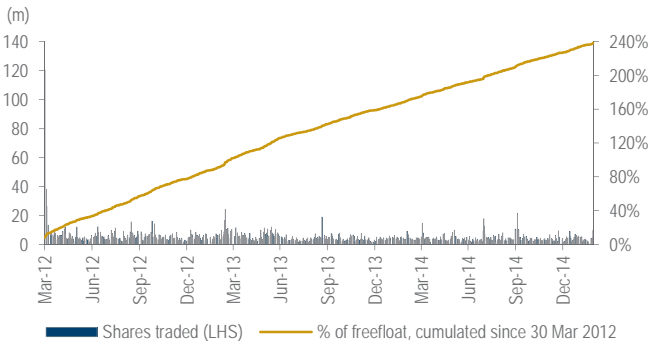
Source: Datastream, Daiwa

■ **SHKP: PBR trend**



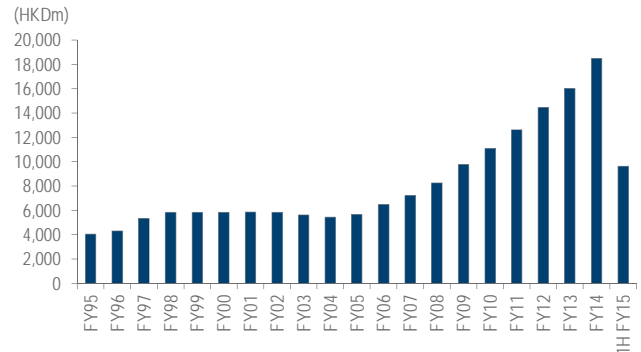
Source: Datastream, Daiwa

■ **SHKP: shares traded since the Kwok brothers' arrest on 29 March 2012**



Source: Bloomberg, Daiwa

■ **SHKP: gross rental income**



Source: Company, Daiwa

Financial summary

■ Key assumptions

Year to 30 Jun	2010	2011	2012	2013	2014	2015E	2016E	2017E
Rental EBIT (HKDm)	8,314	9,511	11,069	12,236	14,272	15,158	16,219	17,522
Property sales profit (HKDm)	6,616	16,647	13,074	7,190	10,511	8,060	10,617	13,650
Size of completed investment properties in HK (m sq ft)	27.6	27.7	28.3	28.6	28.7	28.8	29.4	29.4
Size of completed investment properties in China (m sq ft)	5.5	7.5	9.4	9.5	9.5	12.2	13.1	14.0

■ Profit and loss (HKDm)

Year to 30 Jun	2010	2011	2012	2013	2014	2015E	2016E	2017E
Property sales	15,027	36,230	37,032	20,060	36,330	19,650	34,753	37,917
Rental income	11,082	12,609	14,444	16,019	18,489	19,634	21,009	23,050
Other Revenue	7,102	13,714	24,585	17,714	20,281	21,541	34,003	37,691
Total Revenue	33,211	62,553	76,061	53,793	75,100	60,825	89,765	98,658
Other income	663	574	532	985	1,009	1,045	1,080	1,120
COGS	(14,328)	(31,367)	(43,894)	(27,013)	(43,565)	(29,362)	(53,409)	(56,458)
SG&A	(905)	(1,284)	(1,361)	(1,132)	(1,200)	(1,272)	(1,348)	(1,390)
Other op.expenses	(1,595)	(1,657)	(1,718)	(2,036)	(2,150)	(2,198)	(2,238)	(2,307)
Operating profit	17,046	28,819	29,620	24,597	29,194	29,038	33,850	39,623
Net-interest inc./(exp.)	(860)	(1,199)	(1,532)	(2,176)	(2,339)	(2,465)	(2,420)	(2,380)
Assoc./forex/extraord./others	0	0	0	0	0	0	0	0
Pre-tax profit	16,186	27,620	28,088	22,421	26,855	26,573	31,430	37,243
Tax	(2,005)	(5,831)	(5,896)	(3,454)	(4,773)	(4,241)	(5,185)	(6,143)
Min. int./pref. div./others	(300)	(310)	(514)	(348)	(667)	(412)	(435)	(480)
Net profit (reported)	13,881	21,479	21,678	18,619	21,415	21,920	25,810	30,620
Net profit (adjusted)	13,881	21,479	21,678	18,619	21,415	21,920	25,810	30,620
EPS (reported)(HKD)	5.414	8.358	8.435	7.245	8.018	8.207	8.915	10.577
EPS (adjusted)(HKD)	5.414	8.358	8.435	7.245	8.018	8.207	8.915	10.577
EPS (adjusted fully-diluted)(HKD)	5.414	8.358	8.435	7.245	8.018	8.207	8.915	10.577
DPS (HKD)	2.700	3.350	3.350	3.350	3.350	3.350	3.700	4.000
EBIT	17,046	28,819	29,620	24,597	29,194	29,038	33,850	39,623
EBITDA	18,367	30,189	31,041	26,321	31,024	30,906	35,753	41,578

■ Cash flow (HKDm)

Year to 30 Jun	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	16,186	27,620	28,088	22,421	26,855	26,573	31,430	37,243
Depreciation and amortisation	1,321	1,370	1,421	1,724	1,830	1,868	1,903	1,955
Tax paid	(1,203)	(3,498)	(2,606)	(3,496)	(4,020)	(4,160)	(4,430)	(4,790)
Change in working capital	(2,949)	(2,797)	3,406	1,655	1,320	1,410	1,560	1,680
Other operational CF items	1,259	1,589	1,889	2,392	2,679	2,905	2,960	3,008
Cash flow from operations	14,614	24,284	32,198	24,696	28,664	28,596	33,423	39,096
Capex	(9,733)	(30,949)	(26,206)	(9,673)	(33,630)	(16,431)	(28,745)	(23,250)
Net (acquisitions)/disposals	0	0	0	0	0	0	0	0
Other investing CF items	(392)	(414)	(425)	(430)	(450)	(460)	(470)	(490)
Cash flow from investing	(10,125)	(31,363)	(26,631)	(10,103)	(34,080)	(16,891)	(29,215)	(23,740)
Change in debt	0	0	0	0	0	0	0	0
Net share issues/(repurchases)	0	0	0	0	0	11,185	10,000	0
Dividends paid	(6,538)	(6,935)	(8,610)	(3,353)	(8,948)	(9,850)	(10,860)	(11,925)
Other financing CF items	(1,252)	(1,339)	(1,349)	(2,471)	(2,680)	(2,780)	(2,565)	(2,370)
Cash flow from financing	(7,790)	(8,274)	(9,959)	(5,824)	(11,628)	(1,445)	(3,425)	(14,295)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(3,302)	(15,353)	(4,391)	8,769	(17,044)	10,260	783	1,061
Free cash flow	4,881	(6,665)	5,992	15,023	(4,966)	12,165	4,678	15,846

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (HKDm)

As at 30 Jun	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	8,204	7,898	14,338	16,471	18,528	23,300	22,445	24,423
Inventory	9,685	9,935	10,452	10,825	1,046	1,850	2,350	2,650
Accounts receivable	16,060	23,932	24,159	18,191	23,394	24,120	25,380	26,540
Other current assets	76,088	90,052	107,840	123,125	149,409	153,154	152,241	163,394
Total current assets	110,037	131,817	156,789	168,612	192,377	202,424	202,416	217,007
Fixed assets	205,079	235,653	257,324	286,564	307,112	315,605	337,637	340,719
Goodwill & intangibles	42	47	48	51	53	55	58	58
Other non-current assets	36,443	45,680	53,409	57,669	57,506	61,335	63,650	65,700
Total assets	351,601	413,197	467,570	512,896	557,048	579,419	603,761	623,484
Short-term debt	11,262	9,682	9,801	8,060	9,241	8,940	8,620	8,230
Accounts payable	17,667	20,452	22,256	22,753	25,283	26,560	27,320	27,960
Other current liabilities	15,938	8,666	9,870	20,504	12,031	13,250	13,650	13,980
Total current liabilities	44,867	38,800	41,927	51,317	46,555	48,750	49,590	50,170
Long-term debt	34,126	50,753	61,465	56,570	74,490	69,303	67,985	69,292
Other non-current liabilities	22,744	11,449	13,219	14,480	16,314	17,015	17,720	18,450
Total liabilities	101,737	101,002	116,611	122,367	137,359	135,068	135,295	137,912
Share capital	1,285	1,285	1,308	1,335	1,335	1,335	1,446	1,446
Reserves/R.E./others	243,793	305,680	345,251	384,577	413,448	437,846	461,830	478,896
Shareholders' equity	245,078	306,965	346,559	385,912	414,783	439,181	463,276	480,342
Minority interests	4,786	5,230	4,400	4,617	4,906	5,170	5,190	5,230
Total equity & liabilities	351,601	413,197	467,570	512,896	557,048	579,419	603,761	623,484
EV	351,354	357,697	353,678	341,107	358,385	344,858	341,865	338,844
Net debt/(cash)	37,184	52,537	56,928	48,159	65,203	54,943	54,160	53,099
BVPS (HKD)	95.584	119.442	134.848	150.160	155.291	164.425	160.026	165.921

■ Key ratios (%)

Year to 30 Jun	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	(3.0)	88.4	21.6	(29.3)	39.6	(19.0)	47.6	9.9
EBITDA (YoY)	7.3	64.4	2.8	(15.2)	17.9	(0.4)	15.7	16.3
Operating profit (YoY)	7.6	69.1	2.8	(17.0)	18.7	(0.5)	16.6	17.1
Net profit (YoY)	11.8	54.7	0.9	(14.1)	15.0	2.4	17.7	18.6
Core EPS (fully-diluted) (YoY)	11.8	54.4	0.9	(14.1)	10.7	2.4	8.6	18.6
Gross-profit margin	56.9	49.9	42.3	49.8	42.0	51.7	40.5	42.8
EBITDA margin	55.3	48.3	40.8	48.9	41.3	50.8	39.8	42.1
Operating-profit margin	51.3	46.1	38.9	45.7	38.9	47.7	37.7	40.2
Net profit margin	41.8	34.3	28.5	34.6	28.5	36.0	28.8	31.0
ROAE	5.9	7.8	6.6	5.1	5.3	5.1	5.7	6.5
ROAA	4.2	5.6	4.9	3.8	4.0	3.9	4.4	5.0
ROCE	6.0	8.6	7.5	5.6	6.1	5.7	6.3	7.2
ROIC	5.5	7.0	6.1	4.9	5.2	5.0	5.5	6.2
Net debt to equity	15.2	17.1	16.4	12.5	15.7	12.5	11.7	11.1
Effective tax rate	12.4	21.1	21.0	15.4	17.8	16.0	16.5	16.5
Accounts receivable (days)	174.0	116.7	115.4	143.7	101.1	142.6	100.6	96.0
Current ratio (x)	2.5	3.4	3.7	3.3	4.1	4.2	4.1	4.3
Net interest cover (x)	19.8	24.0	19.3	11.3	12.5	11.8	14.0	16.6
Net dividend payout	49.9	40.1	39.7	46.2	41.8	40.8	41.5	37.8
Free cash flow yield	1.4	n.a.	1.8	4.4	n.a.	3.6	1.4	4.6

Source: FactSet, Daiwa forecasts

■ Company profile

SHK Properties is currently one of the two largest property companies in Hong Kong, with substantial investments in the residential, office and retail property sectors of Hong Kong. It also has a total landbank of 46.6m sq ft in the territory. In recent years, it has been expanding into China, with major investments in the commercial property sector in Shanghai and a landbank of about 88.7m sq ft in the country.

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