

JPM-pp1

Asia Pacific Equity Research

17 March 2015

Guangzhou R&F Properties (2777 HK)

Overweight

Price: HK\$8.72

16 Mar 2015

Price Target: HK\$11.50

PT End Date: 31 Dec 2015

More overhangs; too early to re-enter

R&F's 2014 results were disappointing. Core net profit was 12% below our estimates on the back of less-than-expected delivery. Margins held up but overhead costs increased heavily. Despite the sales growth, R&F has seen further inventory built-up (from Rmb13 bn to Rmb17 bn), which resulted in an adjusted net gearing of 177% by end-2014 (vs 189% in mid-2014). As a result, the company declared **NO FINAL DIVIDEND**. With only 10% sales growth, we think the balance sheet burden will drag on R&F's development in the near term, and the stock might see weaknesses for some time. We are disappointed with R&F's result, and given the increased overheads and financing pressure, we believe there could be downward pressure on consensus earnings forecasts. We believe the market will start thinking which developers will cut dividend next, and among all, **Evergrande** and **Agile** carry the highest risk.

Foci of the analyst briefing:

- (1) sales plan in 2015 and plans to lower inventory (price cut, margin guidance);
- (2) plans to de-gear and refinance (landbanking, new start plan, trust, on-shore);
- (3) cost control plan (increasing SG&A and financing cost);
- (4) delivery guidance;
- (5) margin guidance (where will margin stabilize, delivery of high margin commercial projects).

Result review:

- Delivery was 16% lower than expected at only Rmb31.6 bn, at only 75% of 2013 contracted sales. Although margins held up at 34% post-LAT level, SG&A is higher than expected and hence core net profit is 13% lower than expected.
- The company has made several land purchases. Five sites in Australia, and one hotel site in Huizhou from the Chairman. These are all not favorable assets.
- Inventory level increased by 30% H/H and 70% Y/Y to about 2.7 mn sqm by our estimates. This is equivalent to about 8 months of sales, worse than 5 months by mid-2014. This should induce a price cut like what Agile did in 2014 and could cause margin pressure.
- Net gearing remained high at 177% by end-2014, versus mid-2014 189%. Although cash recovery was average at 80%, the company did not slow down construction, hence resulted in an increase in inventory, and this has resulted in a weak balance sheet. Current liabilities now account for 33% of total loan book, versus 26% in mid-2014.
- More details after the analyst briefing (**2:30 pm at Conrad Hong Kong**).

Summary of R&F interim result

	2H2013	1H2014	2H2014	% H/H	% Y/Y	2014	JPM 2014E	% Y/Y	vs JPM
Property development	24,635.3	8,368.9	23,282.0	178%	-5%	31,651.0	37,838.1	-6%	-16%
Property investment	388.7	413.3	413.9	0%	6%	827.3	860.5	14%	-4%
Hotel operation	488.7	513.8	594.8	16%	22%	1,108.6	990.7	23%	12%
Construction services and others	568.0	526.3	592.2	13%	4%	1,118.5	1,091.4	13%	2%
Gross Revenue	26,080.6	9,822.4	24,883.0	153%	-5%	34,705.4	40,780.7	-4%	-15%
Selling and marketing expenses	(387.1)	(344.6)	(551.5)	60%	42%	(896.1)	(622.4)	43%	44%
Administrative expenses	(1,078.1)	(1,058.2)	(1,162.3)	10%	8%	(2,220.5)	(1,969.1)	21%	13%
Property development	9,157.1	2,224.8	7,063.4	217%	-23%	9,288.2	10,958.7	-22%	-15%
Property investment	292.7	46.2	982.1	2025%	236%	1,028.3	657.8	86%	56%
Hotel	(41.4)	(34.7)	79.8	-330%	-293%	45.0	(73.4)	-167%	-161%
Constructions services and others	(150.8)	(109.7)	(252.7)	130%	68%	(362.4)	(276.0)	31%	31%
EBIT	9,257.6	2,126.6	7,872.5	270%	-15%	9,999.1	11,267.1	-17%	-11%
Interest expenses	(1,093.9)	(672.8)	(241.6)	-64%	-78%	(914.4)	(1,256.5)	-55%	-27%

Operating profit	8,163.6	1,453.8	7,630.9	425%	-7%	9,084.7	10,010.6	-10%	-9%
Share of associates / JCEs	120.1	0.3	144.2	41467%	20%	144.6	1,091.9	-53%	-87%
Profit before tax	8,283.7	1,454.2	7,775.1	435%	-6%	9,229.3	11,102.5	-11%	-17%
LAT	(1,310.8)	(325.3)	(636.6)	96%	-51%	(961.9)	(1,763.7)	-45%	-45%
Income tax	(2,363.2)	(365.3)	(2,015.6)	452%	-15%	(2,380.9)	(2,841.9)	-17%	-16%
Minority Interests	1.1	6.2	39.4	535%	3494%	45.5	33.5	NM	36%
Perpetual Capital Securities	0.0	(522.4)	(809.0)	NM	NM	(1,331.3)	(1,214.0)	NM	10%
Core net profit	4,610.8	247.4	4,353.3	1660%	-6%	4,600.7	5,316.5	-20%	-13%
Revaluation gain / (loss) - after tax	1,504.2	879.6	41.8	-95%	-97%	921.5	0.0	NM	NM
Exceptional items	69.4	(59.0)	(242.6)	311%	NM	(301.5)	0.0	NM	NM
Reported net profit	6,184.4	1,068.0	4,152.6	289%	-33%	5,220.6	5,316.5	-32%	-2%
Total DPS (Rmb)	0.500	0.000	0.000	#DIV/0!	-100%	0.000	0.630	-100%	-100%
Reported EPS (Rmb)	1.936	0.331	1.298	292%	-33%	1.632	1.650	-32%	-1%
Core EPS (Rmb)	1.444	0.077	1.361	1673%	-6%	1.439	1.650	-20%	-13%
Margins									
Pre-LAT development margin	43.0%	35.6%	37.3%	1.7%	-5.7%	36.8%	35.5%	-4.8%	1.4%
Post-LAT development margin	37.7%	31.7%	34.5%	2.9%	-3.2%	33.8%	30.8%	-2.6%	3.0%
EBIT margin	35.5%	21.7%	31.6%	10.0%	-3.9%	28.8%	27.6%	-4.5%	1.2%
Operating margin	31.3%	14.8%	30.7%	15.9%	-0.6%	26.2%	24.5%	-1.6%	1.6%
Net Margin (before MI)	17.2%	2.5%	16.8%	14.3%	-0.5%	12.7%	10.3%	-2.3%	2.4%
SG&A % sales	-5.6%	-14.3%	-6.9%	7.4%	-1.3%	-9.0%	-6.4%	-2.2%	-2.6%
Effective tax rate	-28.9%	-25.1%	-26.4%	-1.3%	2.5%	-26.2%	-28.4%	2.2%	2.2%
LAT % sales	-5.3%	-3.9%	-2.7%	1.2%	2.6%	-3.0%	-4.7%	2.2%	1.6%
Financial									
Net debt / (cash) (incl perp)	39,103.5	75,445.3	79,125.6	4.9%	102.3%	83,307.1	86,650.4	33.4%	-3.9%
Shareholders' equity	32,106.8	31,629.0	35,965.4	13.7%	12.0%	35,965.4	35,818.4	12.0%	0.4%
Net debt to equity	118.7%	189.1%	176.5%	-12.6%	57.8%	0.0%	0.0%	0.0%	0.0%
Development properties									
GFA recognized (sqm) - Subsidiary	1,760,100	814,500	2,345,500	188%	33%	3,160,000	3,161,645	16%	0%
Gross revenue psm (Rmb) - Subsidiary	13,997	10,275	9,926	-3%	-29%	10,016	11,968	-19%	-16%
Contracted sales (Rmb mn) - Incl JCE	23,858	25,769	28,631	11%	20%	54,400	54,400	29%	0%
Contracted sales (sqm)	1,780,700	1,766,200	2,318,000	31%	30%	4,084,200	4,084,200	21%	0%
Average Selling Price (Rmb psm)	13,398	14,590	12,352	-15%	-8%	13,320	13,320	7%	0%

Source: Company data, J.P. Morgan estimates

Valuation

We set our Dec-15 HK\$11.50 price-target at 4.5x 2015E P/E, which is also the lowest among the majors given the high risk profile and low earnings growth. While pessimism on the stock prevails, we think R&F is a good high beta play in the sector on a potential sector rebound, especially when we have started seeing sequential improvement in transaction volume and market sentiment. R&F is also the key beneficiary of potential easing of onshore debt/equity fund raising by CSRC.

Risks to Rating and Price Target

Key risks to our price target are a continued tightening in credit markets, substantial increase in off-shore funding cost and a slowdown in sales in cities where R&F is located.

China Property

AC

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20-Nov-06	OW	14.26	17.00
12-Jan-07	OW	16.40	20.00
22-Apr-07	OW	20.25	25.00
01-Jun-07	OW	20.40	28.00
31-Aug-07	OW	30.75	40.00
26-Nov-07	OW	28.05	47.00
04-Feb-08	OW	24.30	36.00
13-Mar-08	OW	20.50	30.00
28-Jul-08	OW	16.64	22.00
27-Nov-08	OW	4.14	8.50
08-Feb-09	OW	7.54	10.00
25-May-09	OW	14.02	17.00
21-Aug-09	OW	15.14	17.50
25-Mar-10	OW	12.22	18.00
07-Jun-10	OW	9.75	13.80
27-Aug-10	OW	11.50	13.20
11-Nov-10	OW	11.36	16.30
25-Mar-11	OW	10.54	15.60
19-Jul-11	N	10.08	11.30
24-Aug-11	N	9.09	10.80
25-Oct-11	N	6.62	7.20
23-Feb-12	OW	9.50	11.60
21-Mar-12	OW	9.30	12.90
17-Aug-12	OW	9.51	12.20
30-Nov-12	OW	12.30	13.70
17-Jan-13	N	14.76	15.30
21-Mar-13	OW	12.20	15.20
22-Jul-13	OW	10.96	14.00
22-Aug-13	N	12.52	13.20
27-Nov-13	OW	12.34	14.50
21-Mar-14	OW	9.74	13.00
22-Jun-14	OW	9.38	12.60
31-Jul-14	OW	11.14	15.00
27-Aug-14	OW	10.82	12.30
30-Oct-14	OW	8.30	11.50

<http://gps-app.amer.jpmchase.net:6080/server/console/chart/?shareClassId=503807&shareClassServerId=4&chartDesignation=1&actionType=C>

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