Company report

FIG
Real Estate
Equity – China

HSBC Global Research

Longfor Properties (960 HK)

Overweight

Target price	(HKD)	14.20
Share price	(HKD)	9.81
Forecast dividend yield (%)		4.3
Potential return (%)		49

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Dec	2014 a	2015 e	2016 e
HSBC EPS	1.21	1.35	1.53
HSBC PE	6.5	5.8	5.1

Performance	1M	3M	12M
Absolute (%)	-4.6	4.4	6.6
Relative^ (%)	-3.9	-1.4	-21.6

Note: (V) = volatile (please see disclosure appendix)

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Issuer of report: The Hongkong and Shanghai Banking Corporation Limited

OW: Stability and sustainability to long for

- **Solid FY14 highlights low but quality growth**
- **Strong balance sheet management shining through**
- **Reiterate OW with revised PT of HKD14.20 (from HKD14.10)**

Seeing the fruits of the focus on sustainable growth. Longfor reported a solid set of results which is largely in line with our forecast. Revenue was up 23% y-o-y while gross profit was up 17% y-o-y. Gross profit margin of 26.5% was down 1.3ppt from last year, but the compression trend is likely to be industry wide, while more importantly we believe it should have found the bottom. To offset the dilution from the share issuance for restructuring, the company has increased to dividend payout ratio from 20% to 25%, declaring a DPS of Rmb0.284.

Strong balance sheet management a real highlight. The company has reversed the leverage increase during the interim period, and reported largely flat net gearing level of 57%. The effective interest cost has come down to 6.4% (from 6.58%) and with average maturity of 4.5 years. These improved metrics is the result of proactive management which saw them take on a significant amount of low cost syndicated financing in HK and the issuance of a dim sum bond, which swapped out a higher cost debt instrument. With the market increasingly focused on potential impact of Rmb depreciation, we believe the company is in a very defensive position with only 30% offshore balance sheet exposure of which it is partially hedged.

Contracted sales target growth of 10% for FY15. This is in line with our expectation and industry average. Based on sellable resources of Rmb98bn, the company will need to increase its sell through rate to 55% (from ~50%). In the past Longfor's contracted sales growth has been seen as slow vs. the industry, but when taking into account that cash collection is at 90% (vs. average of <80%), it portrays quite a different story. Inventory control was encouraging in FY14, with a slight decline in total value which is against industry trend.

Maintain OW with a revised TP of HKD14.20. Our revised target price is based on unchanged 40% discount to forward NAV. The slight upward revision in TP reflects the minor adjustment in NAV to HKD23.70 (from HKD23.50). As equity investors' appetite for high growth subsides, and move towards a more balance evaluation of growth sustainability and balance sheet management, we expect Longfor will shine. This is one of our preferred plays in our coverage universe.

Index^	HSCEI
Index level	11,982
RIC	0960.HK
Bloomberg	960 HK

Source: HSBC

Enterprise value (CNYm)	72,477
Free float (%)	24
Market cap (USDm)	7,332
Market cap (HKDm)	56,931

Source: HSBC

Financials & valuation Longfor Properties Overweight

Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
Profit & loss summary (RMBm)				
Property sales revenue	49,289	57,587	63,147	66,554
Property investment & other revenue	1,702	2,434	2,904	3,277
Cost of sales	(37,475)	(43,796)	(47,895)	(49,913)
Gross profit	13,516	16,224	18,157	19,917
Selling & Admin expenses	(2,363)	(2,458)	(3,063)	(3,225)
Other gains	(653)	0	0	0
Operating profit/EBIT	10,499	13,766	15,094	16,692
Net interest	123	48	28	(740)
Share of profit from asso.	276	277	335	1,140
PBT	13,627	14,273	15,648	17,293
Taxation	(4,876)	(6,293)	(6,675)	(7,404)
Minority interests	(397)	(110)	(38)	(457)
Net profit	8,354	7,871	8,935	9,432
Core Profit	6,438	7,871	8,935	9,432
Cash flow summary (RMBm)				
Cash flow from operations	1,097	(429)	(726)	1,666
Capex	(2,773)	(3,524)	(3,990)	(3,459)
Changes in investments	(2,756)	0	0	0
New shares issued	29	0	0	0
Dividends paid	(1,240)	(1,557)	(1,968)	(2,234)
Net change in cash	4,395	(1,365)	470	298
Cash at beginning	14,399	18,794	17,430	17,900
Cash at end	18,794	17,430	17,900	18,198
Balance sheet summary (RMBm)				
Shareholders' funds	47,764	53,985	60,952	68,150
Long-term liabilities	39,769	32,041	36,365	35,823
Minority interests	2,508	2,618	2,656	3,113
Deferred items	3,753	3,753	3,753	3,753
Total capital employed	93,794	92,397	103,726	110,839
Fixed assets	33,552	40,858	44,848	48,307
Other assets	24,668	24,970	25,331	26,497
Current assets	109,937	110,134	110,184	109,630
Total assets	168,156	175,961	180,362	184,433

Ratio, growth and per share analysis

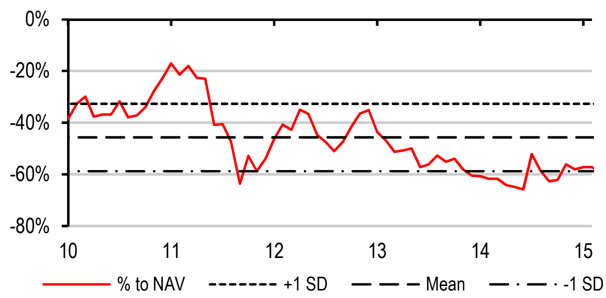
Year to	12/2014a	12/2015e	12/2016e	12/2017e
y-o-y % change				
Revenue	23%	18%	10%	6%
Operating profit	5%	30%	9%	10%
PBT	3%	5%	10%	11%
Reported EPS	3%	-11%	14%	6%
HSBC EPS	6%	12%	14%	6%
Ratios (%)				
ROIC ex-exceptional	9%	9%	9%	8%
ROAE ex-exceptional	16%	15%	16%	15%
ROAA ex-exceptionals	4%	5%	5%	5%
Gross profit margin	27%	27%	28%	29%
Core profit margin	13%	13%	14%	14%
Interest cover ex-exceptional (x)	4.9	4.0	3.9	4.2
Net debt/equity (incl. restricted cash)	60%	63%	67%	66%
ROIC ex-exceptional	9%	9%	9%	8%
Per share data (RMB)				
Reported EPS (fully diluted)	1.52	1.35	1.53	1.62
HSBC EPS (fully diluted)	1.21	1.35	1.53	1.62
DPS	0.28	0.34	0.38	0.40
BV	8.19	9.26	10.45	11.68

Longfor: NAV breakdown

	(RMBm)	(HKD/sh)	% of GAV
Development properties			
Office/retail	18,043	3.9	11%
Residential	131,737	28.2	81%
Investment properties			
Office/retail	12,905	2.8	8%
Net debt	(34,196)	(7.3)	
Outstanding LAT	(7,060)	(1.5)	
Outstanding Land premium	(11,000)	(2.4)	
12-month NAV	**110,429**	**23.7**	**100%**

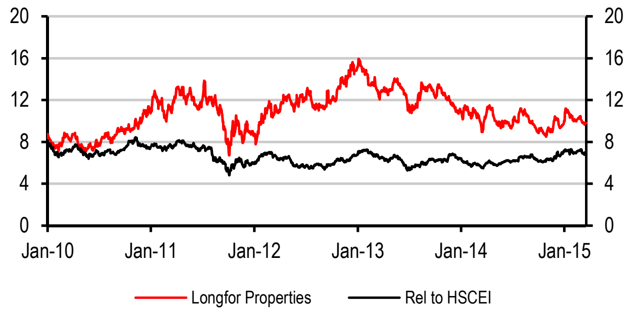
Source: HSBC estimates

NAV discount chart



Source: HSBC estimates

Price relative



Source: Thomson Reuters Datastream, HSBC estimates

Note: Price at close of 18 March 2015

Stable and sustainable

- Earnings largely in line but other metrics were solid, which highlights the company's ability to weather market volatility
- Strong balance sheet management with healthy net gearing and lower finance cost
- Increased dividend payout from 20% to 25%, offsetting dilution from the corporate restructuring

We believe Longfor's FY14 results displayed their efforts in the past years to achieve sustainable growth even amid a turbulent market. In our view, this is a solid set of results, and when dwell into the details, provides an insight to the competitive strength of the company particularly amid an environment of slower growth. No doubt GPM remains weak, but that should be discounted by the market for some time, and FY14 may have marked the bottom. We are seeing the fruits of proactive balance sheet management, with net gearing healthily contained despite continual investment in new landbank. Debt maturity has been extended and effective interest rate continued to head lower. The company has also been successful in its efforts to manage inventory, as there was a slight decline in properties held for sale. These are all key metrics which we believe investors are looking for in a developer under the present industry environment, in which the focus of high growth will gradually shift to balanced strength of execution and sustainability of growth. Longfor remains as one of our preferred plays in our coverage universe.

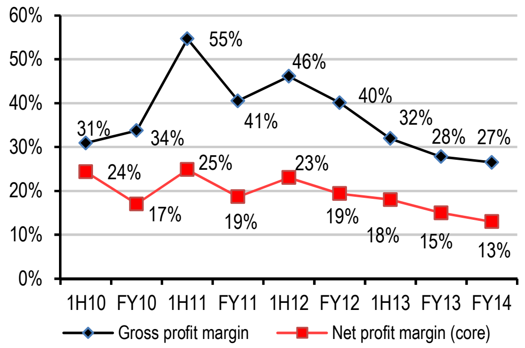
Steady FY14 highlights ability to weather difficult conditions

Longfor reported FY14 core earnings of Rmb6.61bn, representing a growth of 6.5% y-o-y, and broadly in line with our estimate of Rmb6.73bn. Revenue came in slightly higher than our forecast but GPM at 26.5% is around 2% lower than our expectation. We believe this probably reflects the difficult market conditions and the company's effort to clean out some of the more aged inventory. SG&A has increased by 20% y-o-y but at 4.8% of contracted sales remain very competitive within the industry. The core net profit margin of 13% is just less than 1ppt below our forecast, but we don't see this as a serious issue as more importantly we feel that FY14 should have marked a bottom of the company's margins. From FY15e onwards, we are forecasting a minor improvement in margin trend.

The company has made a strong commitment to build a sizeable investment property portfolio in order to enhance the earnings and cashflow structure over the longer term. In FY14, gross rental income grew 38% y-o-y, and it's almost double the rental income level from FY12. Two major new openings are expected in 4Q15, Hangzhou Jinsha Paradise Walk and Chengdu Jinnan Paradise Walk, and alongside the rental reversion of the existing portfolio (especially new assets in FY14) should see the rental income to grow at a phenomenal pace. Having said that, the gross margin on rental income is likely to come down closer to the 70% level (from 74% in FY14 and 80% in FY13), given the opening cost and timing of rental inflow. The gradual increase in rental income contribution will help in the rebuilding of overall margin of the company.

In FY14, the major shareholders have streamlined the corporate structure by selling the 8.7% stake in Chongqing Longhu Development into the company which resulted in the issuance of new shares. The company has offset the dilution impact on dividends by stepping up the payout ratio from 20% to 25%. A full year (final) DPS of Rmb0.284 was announced.

Gross and core net profit margins

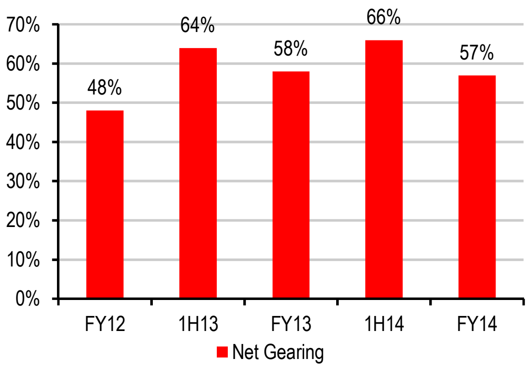


Source: Company data

Balance sheet management should win over more investors

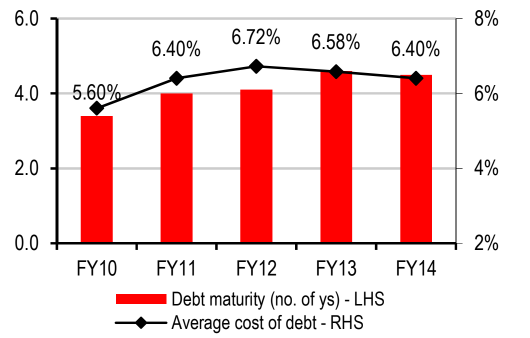
Longfor has reversed the increase in net gearing in the interim period to report stable net gearing of 57%, which we believe is no easy feat given that contracted sales in FY14 was lower than initial anticipation while they have continued to replenish their landbank despite the more sluggish physical market. The fact that their cash collection ratio from sales is at the forefront of the industry at 90% certainly helped, but also the enlarged share capital base after share issuance to the major shareholders (to buy 8.7% of Chongqing Longhu to streamline the corporate structure). Effective interest cost has trended lower still from the interim period, and stood at 6.4% in FY14, among the lowest for non SOE developers. The company has been able to stretch its maturity to 4.5 years which will put it past of the peak of offshore debt maturity in the sector. The incremental new offshore financing in FY14 comprises of a HKD3.4bn syndicated loan (HIBOR+3.1%) and a Rmb2bn dim sum bond, while having called back the USD750bn senior note at 9.5% coupon.

Net gearing reported



Source: Company data

Debt maturity and average cost of debt



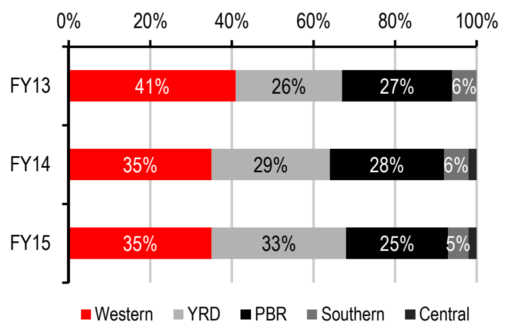
Source: Company data

With the market increasingly focused on the potential impact of Rmb depreciation on the offshore portion of the balance sheet, we believe Longfor is in a superior position given that its USD linked component of the balance sheet is only 31% (FY14) vs. the sector average of over 40% and it is the only company that partially hedges their foreign exchange exposure. We believe the major funding options that the company may explore in FY15 are onshore corporate debt instruments (it recently attained AAA rating from Dagong Global Credit Rating) and HK syndicated financing (given its relative low cost).

Contract sales target set to grow 10%

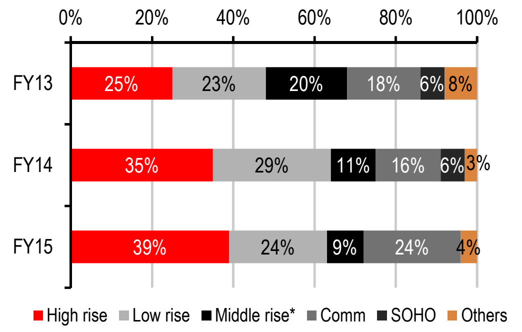
Longfor has missed its contracted sales target in FY14 by quite some margin (Rmb49.1bn vs. original target of Rmb57bn) and was only slightly ahead of what was achieved in FY13. The company is adhering to its principle of only executing ‘quality’ sales that will bring in cashflow, and true to that insistence the cash collection ratio remained well ahead of its peers at 90%. Management is guiding for a 10% growth in contracted sales in FY14 to Rmb54bn. Sellable resources for the year (based on current landbank) is earmarked at Rmb98bn, a similar level to last year. This comprises of 66 key projects of which 13 will be brand new and 21 projects will launch new phases with new product offer. The required sell through rate is therefore 55% which means the company will have to step up from the ~50% level of FY14. Contracted sales for the first two months of the year was Rmb4.26bn, down 16% y-o-y, which means the required monthly sales for the remainder of the year needs to average almost Rmb5bn. This compares to the average monthly sales level of Rmb4.09bn achieved in FY14.

Saleable resources by regions



Source: Company data

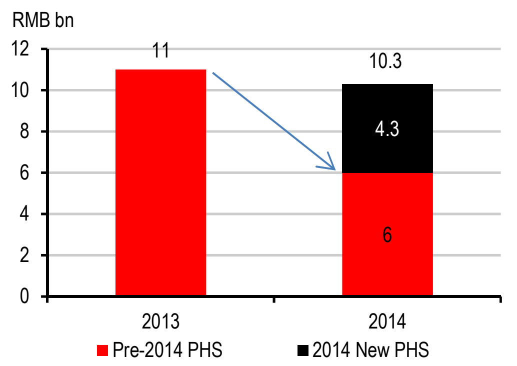
Saleable resources by product types (in terms of sales value)



Source: Company data

One of the focuses in FY14 was inventory clearance and we believe the company has done a decent job. The completed properties held for sale was down 6% y-o-y in value to Rmb10.3bn, which is counter industry trend from what we deduced from the developers that have reported earnings thus far. We believe this should be as a positive in the eyes of the investors.

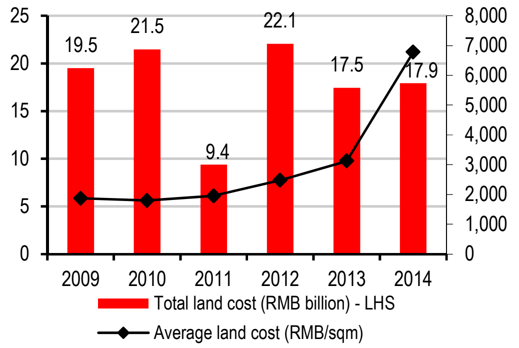
Properties held for sales (PHS) 2013-2014



Source: Company data

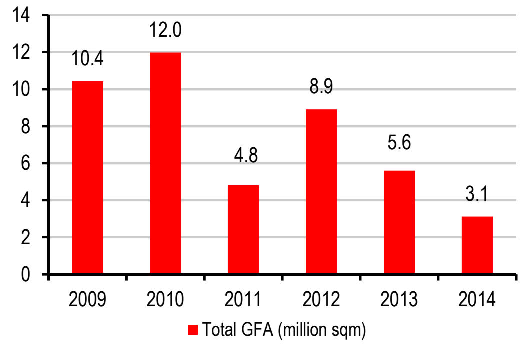
Longfor has continued to remodel its landbank, based on the principles of more controllable project size (new acquisitions in FY14 had average GFA of 195,000sqm) and moving more towards city core. In FY14, the company has added 16 new projects with a total GFA of 3.1mn sqm vs. contracted sales GFA of 4.5mn sqm. The average cost per sqm was Rmb6,875/sqm vs. the average unit land cost of the whole landbank of Rmb2,363/sqm. The company often likes to enter the land market when it is less competitive, and the higher average land cost certainly highlights the focus of adding in tier-1/2 cities with prime location. Longfor is now in 17 out of the 24 target cities, with the new additions in FY14 being Nanjing and Guangzhou.

Total land cost and average land cost



Source: Company data

Land acquisition (GFA)



Source: Company data

What's changed?

We have revised up EPS estimate by 4.3% and 4.0% for FY15 and FY16, respectively, mainly to reflect the new landbank acquisitions and fine tuning of the development schedule with a lower margin assumption. In particular, we have revised down the gross margin estimate by 3ppt and 2.5ppt to 27.0% and 27.5% in FY15/16, taking into account the latest margin trend in FY14 results. We introduce the FY17 EPS estimate of RMB1.62.

We have increased our 12-month forward NAV by 1% to HKD23.7 (from HKD23.5).

Valuation and risks

We revise up our 12-month forward NAV by 1% to HKD23.7 (from HKD23.5), mainly reflecting the new acquisitions to date and the updates on net debt. Accordingly, we raise our target price by 1% to HKD14.20 (from HKD14.10), maintaining our target discount at 40% (0.5 standard deviation above mean). Under our research model, for stocks without a volatility indicator, the Neutral band is 5 percentage points above and below the hurdle rate for China stocks of 9.0%. Our target price of HKD14.20 implies a potential return of 49% (including a forecast dividend yield of 4.3%), above the Neutral band of our model; therefore, we are reiterating our OW rating on Longfor stock. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Key downside risks include failure to replicate success it has had when entering new markets, inability to demonstrate meaningful sales growth in 2015, and lower-than-expected ASP which would negatively impact profit margins.

FY14 results review

Longfor reported core net profit of RMB6.61bn, up 6.5% y-o-y. Final DPS of RMB0.284 was declared with a payout ratio of 25% (vs. 20% in 2013). Gross profit was up 17% y-o-y to 13.5bn while core profit margin decreased from 15% in FY13 to 13% in FY14. Gross margin is largely in line at 26.5% and well within the management's guided range.

Revenue growth driven by higher GFA delivered. Property development revenue grew 23% y-o-y driven by 9% increase in GFA delivered and 12% increase in recognised ASP. The recognised average selling price was RMB10,925/sqm (RMB9,738/sqm in FY13). Project bookings were concentrated in Beijing (25%), Chongqing (15%), Hangzhou (10%), Yantai (8%) and Chengdu (8%) which contributed to about 66% of overall development revenue in aggregate. Gross margins from property sales decreased by 1.3ppt to 25.7%.

Strong investment property rental income growth: FY14 rental income was up 38% y-o-y. The rental income is contributed by Paradise Walk (83%), Starry Street (13%) and MOCO (4%) which see substantial rental growth of 42%, 21% and 21% y-o-y.

Lower finance cost with slightly higher capitalisation rate. Total finance cost decreased by 43% to RMB23m with slightly higher interest capitalisation rate of 99% (FY13:98%). However, gross interest cost increased by 6% y-o-y to RMB2,796m in FY14.

SG&A expenses: The general and administrative expenses as a percentage of total contracted sales increased marginally by 0.4ppt to 2.8% in FY14 while selling expenses edged down to 2.2% from 1.8% last year.

Dividend payout ratio increased by 5ppt at 25.0% (based on core EPS calculated with total number of shares as of end-14). A final and full year DPS of RMB0.284 represents a payout ratio of 25% on core EPS, vs. 20% in FY13.

Gearing level still comfortable: Net gearing (reported incl. minority and restricted cash) edged down to 57% in FY14, from 58% in FY13 and lower than 66% in 1H14. The company has early redeemed the USD750mn 9.5% senior notes during the year and issued a 4-year Renminbi bond of RMB2bn at 6.75%, The effective interest cost decreased to 6.4% in FY14 from 6.58% last year.

FY14 results review

(RMBm)	2013A	2014A	HSBC est.2014E	y-o-y%	2014 actual vs HSBC estimates
Turnover					
Property development	40,224	49,289	46,515	23%	6%
Property investment	635	876	962	38%	-9%
Property management & related services	652	826	912	27%	-9%
Total Turnover	**41,510**	**50,991**	**48,389**	**23%**	**5%**
Cost of sales	(29,972)	(37,475)	(34,402)	25%	9%
Gross Profit	**11,538**	**13,516**	**13,987**	**17%**	**-3%**
Other income and gains	778	(334)	(34)	-143%	881%
Selling and marketing expenses	(887)	(1,065)	(697)	20%	53%
Administrative expenses	(1,084)	(1,298)	(1,395)	20%	-7%
Fair value gains on investment properties	2,592	2,554	-	-1%	N/A
Finance costs	(39)	(23)	(71)	-43%	-68%
Share of results of associates & JCE	321	276	645	-14%	-57%
Profit before taxation	**13,219**	**13,627**	**12,435**	**3%**	**10%**
Income tax (ex LAT)	(2,837)	(3,508)	(2,501)	24%	40%
LAT	(1,746)	(1,368)	(2,432)	-22%	-44%
Profit for the year	**8,636**	**8,750**	**7,502**	**1%**	**17%**
Less: minority interests	(599)	(397)	(771)	-34%	-49%
Net Profit	**8,037**	**8,354**	**6,731**	**4%**	**24%**
Revaluation gain on IP, net of tax	(1,827)	(1,744)	-	-5%	N/A
Core Profit	**6,210**	**6,610**	**6,731**	**6%**	**-2%**
Reported EPS (RMB)	1.48	1.52	1.23	3%	24%
Core EPS (RMB)	**1.14**	**1.21**	**1.23**	**6%**	**-2%**
DPS (RMB)	0.228	0.284	0.247	n.a	n.a
Contract sales (RMBm)	48,120	49,050		2%	
Margins				**y-o-y ppt**	
Selling exp to contracted sales ratio	1.8%	2.2%	1.4%	0.3	0.8
Admin exp to contracted sales ratio	2.3%	2.6%	2.8%	0.4	(0.2)
SG&A to contract sales ratio	4.1%	4.8%	4.3%	0.7	0.6
Gross margin	27.8%	26.5%	28.9%	(1.3)	(2.4)
Reported NP margin	19.4%	16.4%	13.9%	(3.0)	2.5
Core profit margin	15.0%	13.0%	13.9%	(2.0)	(0.9)
LAT to property sales revenue	4.3%	2.8%	5.2%	(1.6)	(2.5)
Payout ratio	20.0%	25.0%	20.0%	5.0	N/A
Liquidity	**FY13**	**FY14**		**y-o-y %**	
Long-term borrowings	28,636	39,769		39%	
Short-term borrowings	9,067	7,973		-12%	
Cash (incl restricted cash)	14,676	19,037		30%	
Net Debt (excl restricted cash)	23,304	28,947		24%	
Net Debt (incl restricted cash)	23,027	28,705		25%	
Shareholders equity (ex minorities)	36,984	47,764		29%	
Net gearing (ex restr cash and minorities)	63%	61%		(2.4)	
Net gearing (incl restr cash, inc minorities)	58%	57%			
Reported net gearing	**58%**	**57%**		**(0.8)**	

Source: Company data, HSBC estimates

Disclosure appendix

Analyst Certification

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Important disclosures

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Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock’s domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

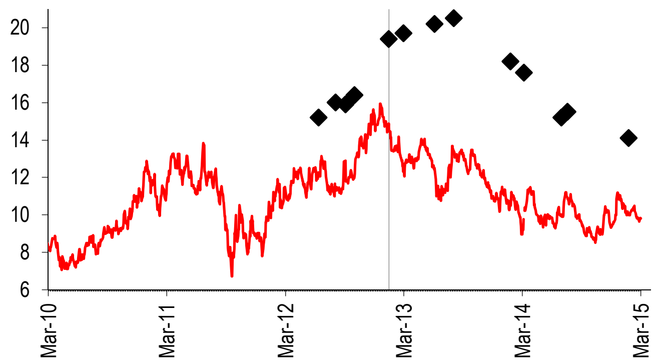
Rating distribution for long-term investment opportunities

As of 18 March 2015, the distribution of all ratings published is as follows:

Overweight (Buy)	41%	(30% of these provided with Investment Banking Services)
Neutral (Hold)	39%	(28% of these provided with Investment Banking Services)
Underweight (Sell)	20%	(20% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Longfor Properties Co Ltd (0960.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	Overweight	30 January 2013
Target Price	**Value**	**Date**
Price 1	15.20	28 June 2012
Price 2	16.00	19 August 2012
Price 3	15.90	19 September 2012
Price 4	16.40	17 October 2012
Price 5	19.40	30 January 2013
Price 6	19.70	17 March 2013
Price 7	20.20	20 June 2013
Price 8	20.50	19 August 2013
Price 9	18.20	09 February 2014
Price 10	17.60	23 March 2014
Price 11	15.20	16 July 2014
Price 12	15.50	04 August 2014
Price 13	14.10	09 February 2015

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
LONGFOR PROPERTIES CO LTD	0960.HK	9.81	18-Mar-2015	1, 4, 5, 6

Source: HSBC

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