

Guangzhou R&F Properties

2777 HK

Target (HKD): 12.90 → 12.90

Upside: 60.0%

17 Mar price (HKD): 8.06

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

Can the company re-invent itself?

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- Weak 2014 results likely to hit near-term sentiment
- 2015 earnings should rebound on booking of high-margin projects pre-sold
- Much depends on progress in strengthening balance sheet; reiterate Buy on valuation

What's new

Guangzhou R&F's 2014 reported underlying net profit fell by 9% YoY to HKD5,280m, which would be a 32% YoY decline to HKD3,949m if payments to holders of its perpetual capital instruments are deducted. The lack of a dividend in 2014 was a surprise and may hit sentiment toward the stock in the near term.

What's the impact

2014 earnings decline was due more to product mix than margin squeeze. R&F's GFA recognition in 2014 was unusual in that only 6% of GFA came from its high-margin commercial projects, which accounted for 23% of its recognised GFA in 2013. We think this product mix change (which led to an 18.7% YoY fall in its ASP) was one main reason for the earnings decline in 2014. Note that the gross profit margin in 2014 was still 37.1%, which is high by industry standards.

2015 earnings should rebound on high-margin projects it has pre-

sold. At end-2014, R&F had unbooked property sales revenue of CNY40bn, which means it has already locked in a significant portion of its 2015 recognised sales revenue. Meanwhile, among its pre-sold projects were some high-margin commercial property projects which should help underpin a rebound in earnings in 2015. Nevertheless, we cut our 2015-16E EPS by 9.1-9.3% because it may have to accept a lower ASP for inventories to enhance cash flow.

Balance sheet challenges to address. We continue to see R&F as an experienced player in the China property market and believe its main challenge is that it looks under-capitalised relative to its ambitions. Its ambitious expansion since 2013 has stretched its balance sheet and we believe its prospects hinge critically on the progress it can achieve in settling on a scale and pace of expansion that can be well-supported by its capital base.

Various potential initiatives are planned for the next 6-12 months, including the issuance of corporate bonds, divesting of some projects, or even listing of A shares. We see its move to stop paying a dividend in 2014 as an indication of management's determination to address the company's balance sheet challenges and believe progress along these lines would be regarded as positive by the market.

What we recommend

We continue to view R&F as a high beta stock in China property, and believe the current valuation has discounted many of the risks and challenges it is facing; and any progress the company can make in addressing its balance sheet challenges would help improve its

valuation. At the current PER of 3.1x for 2015E, we reiterate our Buy (1) rating and TP of HKD12.90, now on a 12-month horizon versus 6-month previously, and based on an unchanged 50% discount applied to our end-2015E NAV of HKD25.80. The key risk to our call would be the group's failure to address the balance sheet issues it faces.

How we differ

Unlike some, we think a lot of value can be unlocked if R&F can carve out a business strategy and scale commensurate with its capital base.

Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	(0.6)	(3.8)	n.a.
Net profit change	(9.3)	(9.1)	n.a.
Core EPS (FD) change	(9.3)	(9.1)	n.a.

Source: Daiwa forecasts

Share price performance



12-month range	7.80-11.66
Market cap (USDbn)	3.35
3m avg daily turnover (USDm)	9.86
Shares outstanding (m)	3,222
Major shareholder	Li Sze Lim (33.1%)

Financial summary (CNY)

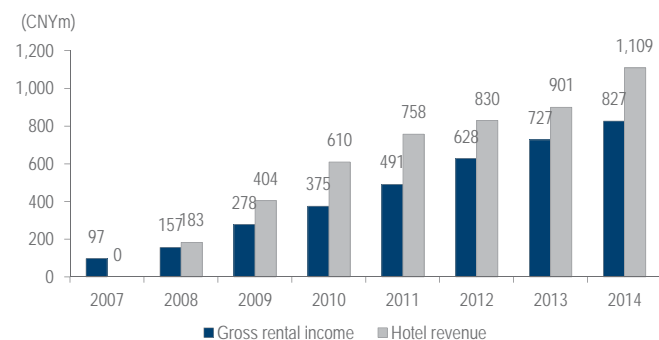
Year to 31 Dec	15E	16E	17E
Revenue (m)	53,728	60,747	67,910
Operating profit (m)	15,739	17,857	19,464
Net profit (m)	6,766	7,860	8,920
Core EPS (fully-diluted)	2,100	2,439	2,769
EPS change (%)	71.3	16.2	13.5
Daiwa vs Cons. EPS (%)	13.4	16.3	n.a.
PER (x)	3.1	2.7	2.3
Dividend yield (%)	3.9	4.6	5.4
DPS	0.250	0.300	0.350
PBR (x)	0.5	0.5	0.4
EV/EBITDA (x)	3.8	3.2	2.7
ROE (%)	17.6	18.1	18.2

Source: FactSet, Daiwa forecasts

Guangzhou R&F: 2014 results highlights

(CNYm)	2013	2014	YoY chg
Recognised GFA (sq m)	2,732,900	3,161,900	15.6%
Property-sales revenue	33,651	31,651	-5.9%
Gross profit from property sales	13,696	11,743	-14.3%
Gross-profit margin from property sales (%)	40.7%	37.1%	-3.6pp
ASP (CNY/sq m)	12,313	10,010	-18.7%
Revenue	36,271	34,705	-4.3%
Gross profit	14,235	12,314	-13.5%
Gross-profit margin (%)	39.2%	35.5%	-3.8pp
Reported underlying net profit	5,803	5,280	-9.0%
Reported net profit margin (%)	16.0%	15.2%	-0.8pp
Exceptional item	0	(1,331)	nm
Adjusted underlying net profit	5,803	3,949	-32.0%
Adjusted net profit margin (%)	16.0%	11.4%	-4.6pp
Gross rental income	727	827	13.8%

Source: Company

Guangzhou R&F: recurrent income base


Source: Company

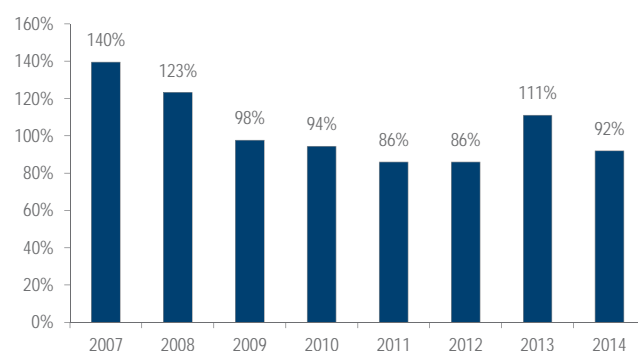
Guangzhou R&F: PER trend


Source: Bloomberg, Daiwa forecasts

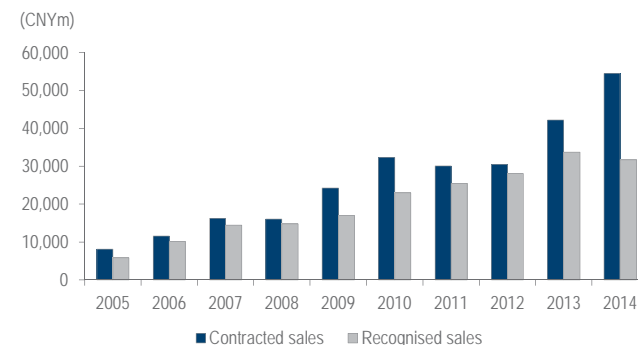
Guangzhou R&F: HoH breakdown of financial performance

(CNYm)	1H10	2H10	1H11	2H11	1H12	2H12	1H13	2H13	1H14	2H14
Recognised GFA (m sq m)	0.70	1.56	0.72	1.48	0.53	1.62	0.97	1.76	0.81	2.35
Property sales revenue	6,221	16,752	10,067	15,323	7,367	20,691	9,016	24,635	8,369	23,282
Gross profit from property sales	1,997	6,703	4,943	5,860	3,256	8,584	3,444	10,252	2,971	8,772
Gross-profit margin from property sales	32.1%	40.0%	49.1%	38.2%	44.2%	41.5%	38.2%	41.6%	35.5%	37.7%
Revenue	6,960	17,682	10,982	16,292	8,440	21,925	10,191	26,081	9,822	24,883
Gross profit	2,261	7,032	5,259	6,157	3,552	8,826	3,691	10,544	3,332	8,982
Gross-profit margin	32.5%	39.8%	47.9%	37.8%	42.1%	40.3%	36.2%	40.4%	33.9%	36.1%
Underlying net profit	559	3,212	2,006	2,502	869	4,287	1,140	4,680	705	4,575
Net-profit margin	8.0%	18.2%	18.3%	15.4%	10.3%	19.6%	11.2%	17.9%	7.2%	18.4%
Gross rental income	145	230	182	309	292	336	339	388	413	414

Source: Company

Guangzhou R&F: net gearing ratio


Source: Company

Guangzhou R&F: contracted and recognised sales


Source: Company

Financial summary

■ Key assumptions

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Recognized ASP (CNY/sq m)	10,165	11,494	13,038	12,313	10,010	12,603	12,700	12,800
Recognized sales vol. ('000 sq m GFA)	2,260	2,209	2,152	2,733	3,162	4,000	4,500	5,000
Contracted ASP (CNY/sq m)	12,800	13,024	12,373	12,020	13,400	12,300	12,500	12,700
Contracted sales vol. ('000 sq m GFA)	2,426	2,253	2,478	2,726	4,060	4,878	5,280	5,748

■ Profit and loss (CNYm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Property Development Revenues	22,972	25,390	28,057	33,651	31,651	50,410	57,150	64,000
Investment Property Revenues	375	491	628	727	827	902	1,010	1,130
Other Revenue	1,294	1,489	1,679	1,893	2,227	2,416	2,587	2,780
Total Revenue	24,642	27,370	30,365	36,271	34,705	53,728	60,747	67,910
Other income	0	0	0	0	0	0	0	0
COGS	(15,349)	(15,954)	(17,987)	(22,037)	(22,391)	(34,192)	(39,460)	(44,708)
SG&A	(1,547)	(1,924)	(1,976)	(2,143)	(2,780)	(3,840)	(3,471)	(3,787)
Other op. expenses	18	(9)	0	(113)	56	43	42	49
Operating profit	7,764	9,482	10,402	11,978	9,590	15,739	17,857	19,464
Net-interest inc./(exp.)	(863)	(1,010)	(1,353)	(1,934)	(1,216)	(2,219)	(2,192)	(1,919)
Assoc./forex/extraord./others	1,170	696	993	306	145	152	154	156
Pre-tax profit	8,070	9,168	10,042	10,350	8,519	13,672	15,819	17,701
Tax	(3,614)	(4,333)	(4,382)	(4,535)	(3,193)	(5,462)	(6,390)	(7,165)
Min. int./pref. div./others	(106)	7	(157)	(12)	(1,377)	(1,444)	(1,569)	(1,616)
Net profit (reported)	4,351	4,842	5,502	5,803	3,949	6,766	7,860	8,920
Net profit (adjusted)	3,772	4,508	5,156	5,803	3,949	6,766	7,860	8,920
EPS (reported)(CNY)	1.350	1.506	1.722	1.801	1.226	2.100	2.439	2.769
EPS (adjusted)(CNY)	1.171	1.402	1.614	1.801	1.226	2.100	2.439	2.769
EPS (adjusted fully-diluted)(CNY)	1.171	1.402	1.614	1.801	1.226	2.100	2.439	2.769
DPS (CNY)	0.500	0.600	0.600	0.620	0.000	0.250	0.300	0.350
EBIT	7,764	9,482	10,402	11,978	9,590	15,739	17,857	19,464
EBITDA	8,024	9,765	10,710	12,299	9,926	16,090	18,213	19,820

■ Cash flow (CNYm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	8,070	9,168	10,042	10,350	8,519	13,672	15,819	17,701
Depreciation and amortisation	260	283	308	322	336	351	356	356
Tax paid	(2,677)	(1,914)	(3,387)	(3,628)	(2,554)	(4,369)	(5,112)	(5,732)
Change in working capital	(2,020)	(4,644)	(6,540)	2,661	14,485	13,412	11,523	11,210
Other operational CF items	(302)	475	1,038	1,627	1,071	2,067	2,038	1,763
Cash flow from operations	3,331	3,369	1,461	11,332	21,857	25,133	24,625	25,298
Capex	(1,109)	(1,331)	(1,464)	(20,120)	(24,000)	(14,630)	(14,110)	(13,080)
Net (acquisitions)/disposals	(2,499)	0	0	0	0	0	0	0
Other investing CF items	(94)	0	0	0	0	0	0	0
Cash flow from investing	(3,702)	(1,331)	(1,464)	(20,120)	(24,000)	(14,630)	(14,110)	(13,080)
Change in debt	3,464	525	7,254	0	0	0	0	0
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(1,482)	(1,920)	(1,917)	(2,417)	(1,611)	0	(1,611)	(1,933)
Other financing CF items	(1,278)	(1,781)	(2,624)	(3,129)	(6,970)	(7,200)	(6,240)	(5,920)
Cash flow from financing	704	(3,176)	2,713	(5,546)	(8,581)	(7,200)	(7,851)	(7,853)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	334	(1,138)	2,710	(14,334)	(10,724)	3,303	2,664	4,365
Free cash flow	2,222	2,038	(3)	(8,788)	(2,143)	10,503	10,515	12,218

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (CNYm)

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	9,168	9,026	12,862	24,344	19,830	20,120	20,450	20,850
Inventory	272	272	306	298	359	358	370	378
Accounts receivable	7,229	7,581	7,609	13,163	10,891	12,567	13,685	14,120
Other current assets	35,383	40,529	48,706	68,760	101,101	97,393	93,284	86,985
Total current assets	52,052	57,408	69,483	106,565	132,181	130,438	127,789	122,333
Fixed assets	4,119	4,125	5,489	6,567	7,496	8,281	9,058	9,850
Goodwill & intangibles	875	848	898	898	978	988	992	998
Other non-current assets	20,371	21,777	22,717	26,317	31,185	31,930	32,448	33,150
Total assets	77,417	84,159	98,587	140,347	171,840	171,637	170,287	166,331
Short-term debt	7,185	10,093	7,212	18,096	22,105	18,250	15,450	11,427
Accounts payable	7,845	10,125	12,679	17,782	19,271	16,400	15,771	12,850
Other current liabilities	19,564	20,559	20,665	23,448	29,315	29,658	26,721	22,712
Total current liabilities	34,594	40,777	40,557	59,326	70,691	64,308	57,942	46,989
Long-term debt	20,669	18,285	28,420	43,353	45,554	46,396	46,862	46,920
Other non-current liabilities	2,155	2,364	2,781	4,186	19,098	19,268	19,433	19,538
Total liabilities	57,418	61,427	71,757	106,865	135,343	129,972	124,237	113,447
Share capital	806	806	806	806	806	806	806	806
Reserves/R.E./others	18,982	21,720	25,660	32,301	35,159	40,314	44,686	51,513
Shareholders' equity	19,788	22,526	26,466	33,107	35,965	41,120	45,492	52,319
Minority interests	212	207	364	375	532	545	558	565
Total equity & liabilities	77,417	84,159	98,587	140,347	171,840	171,637	170,287	166,331
EV	36,422	36,848	40,069	54,007	64,566	60,960	57,971	53,291
Net debt/(cash)	18,686	19,353	22,771	37,105	47,829	44,526	41,862	37,497
BVPS (CNY)	6.141	6.990	8.213	10.274	11.161	12.761	14.119	16.238

■ Key ratios (%)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	35.4	11.1	10.9	19.4	(4.3)	54.8	13.1	11.8
EBITDA (YoY)	78.7	21.7	9.7	14.8	(19.3)	62.1	13.2	8.8
Operating profit (YoY)	85.9	22.1	9.7	15.1	(19.9)	64.1	13.5	9.0
Net profit (YoY)	69.0	19.5	14.4	12.6	(31.9)	71.3	16.2	13.5
Core EPS (fully-diluted) (YoY)	69.0	19.8	15.1	11.6	(31.9)	71.3	16.2	13.5
Gross-profit margin	37.7	41.7	40.8	39.2	35.5	36.4	35.0	34.2
EBITDA margin	32.6	35.7	35.3	33.9	28.6	29.9	30.0	29.2
Operating-profit margin	31.5	34.6	34.3	33.0	27.6	29.3	29.4	28.7
Net profit margin	15.3	16.5	17.0	16.0	11.4	12.6	12.9	13.1
ROAE	20.6	21.3	21.0	19.5	11.4	17.6	18.1	18.2
ROAA	5.2	5.6	5.6	4.9	2.5	3.9	4.6	5.3
ROCE	17.4	19.2	18.3	15.2	9.6	15.0	16.6	17.7
ROIC	11.9	12.4	12.8	11.2	7.7	11.1	12.2	13.0
Net debt to equity	94.4	85.9	86.0	112.1	133.0	108.3	92.0	71.7
Effective tax rate	44.8	47.3	43.6	43.8	37.5	39.9	40.4	40.5
Accounts receivable (days)	87.3	98.8	91.3	104.5	126.5	79.7	78.9	74.7
Current ratio (x)	1.5	1.4	1.7	1.8	1.9	2.0	2.2	2.6
Net interest cover (x)	9.0	9.4	7.7	6.2	7.9	7.1	8.1	10.1
Net dividend payout	37.0	39.8	34.8	34.4	0.0	11.9	12.3	12.6
Free cash flow yield	10.6	9.7	n.a.	n.a.	n.a.	50.2	50.3	58.4

Source: FactSet, Daiwa forecasts

■ Company profile

Guangzhou R&F Properties is principally engaged in the development and sale of residential properties in China. It also develops, sells and leases commercial and office space, and provides property-management and agency services. The company was listed on the Hong Kong Stock Exchange in July 2005.

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