

FIG
Real Estate
Equity – China

Buy

Target price (HKD)	6.70
Share price (HKD)	4.80
Upside/Downside (%)	39.6

Performance	1M	3M	12M
Absolute (%)	-3.2	-4.4	15.4
Relative ^A (%)	-4.1	-8.1	-10.5

Index ^A	HSCEI
RIC	1813.HK
Bloomberg	1813 HK
Market cap (USDm)	1,822
Market cap (HKDm)	14,142
Enterprise value (CNYm)	8364
Free float (%)	39

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KWG (1813 HK)

Buy: 8.6% dividend yield shines above all else

- ▶ **Lived up to the expectation of a generous dividend payout**
- ▶ **Absolute level of earnings is below consensus as market overestimated on sales revenue; margins remain solid**
- ▶ **We establish a Buy rating on KWG with a fair value target price of HKD6.70**

Core earnings per se not exciting as it misses consensus and HSBC forecast. Depending on whether we exclude the early redemption penalty of two senior notes, core earnings is in the range of Rmb2,268m (-3% y-o-y) to Rmb2,581m (+10% y-o-y) based on our estimate. The key difference with consensus really stems from the lower property sales revenue reported at Rmb9.8bn vs. over Rmb12bn, and that could be a misinterpretation of GFA delivery of 1.2m sqm, which is actually spread between the subsidiary and JCE levels.

Margins are rock solid. KWG remains as one of the most profitable Chinese developers at 35.5% GPM and over 20% core net margin. GPM level is consistent with the interim period and actually held quite steady in the past few years. Core net profit margin is down 3ppt to 21.7% but that's the result of the early redemption penalty of the senior notes of over Rmb300m. Otherwise, core net profit margin would have been flat at close to 25%.

Delivered a consistent and generous dividend, at a yield of 8.6%. KWG increased its DPS by 10% y-o-y to Rmb0.33, which equates to 8.6% yield. This represents a payout ratio of close to 30% to reported net profit and over 40% on the conservative end of our core earnings estimate. This is the most positive point of the FY14 results and shines above the lower than expected earnings, and dividend disappointment of some of its peers. The increased dividend payout reflects management's confidence amid a challenging industry environment. Net gearing receded slightly from the interim period to 67%, but is 10ppt higher than FY13.

We establish a Buy rating on KWG (vs OW under our previous rating system). We see fair value at HKD6.70 based on an unchanged target discount of 65% (historical mean) to our forward NAV estimate of HKD19.10 per share. This is one of our preferred plays of the sector. We believe KWG is one of the most profitable listed Chinese developers that have continued to demonstrate stable improvement in execution and still in a position to deliver above sector average sales growth. Key risks include delay in the launch of new projects, lower-than-expected ASP as price competition intensifies, overspending on new acquisition which could lead to a further increase in the net gearing level, and uncertainties related to macroeconomic and property-specific policies in China.

Financials & Valuation: KWG Property

Buy

Financial statements

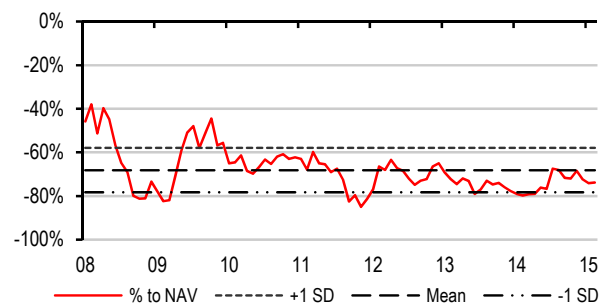
Year to	12/2013a	12/2014e	12/2015e	12/2016e
Profit & loss summary (RMBm)				
Property sales revenue	8,977	12,280	14,935	17,505
Property investment & other revenue	491	565	616	675
Cost of sales	(6,036)	(8,129)	(9,981)	(11,696)
Gross profit	3,432	4,716	5,570	6,484
Selling & admin. expenses	(1,015)	(1,269)	(1,505)	(1,737)
Other income and gains	75	98	106	104
Operating profit/EBIT	2,492	3,545	4,171	4,851
Net interest expense	(214)	(220)	(227)	(229)
Share of profit from asso.	884	1,507	1,770	2,331
PBT	3,704	4,833	5,715	6,953
Taxation	(955)	(1,911)	(2,384)	(2,782)
Minority interests	1	(37)	(27)	(305)
Net profit	2,750	2,884	3,304	3,866
Core profit	2,343	2,884	3,304	3,866
Cash flow summary (RMBm)				
Cash flow from operations	7,611	2,771	3,591	2,414
Capex	(307)	(461)	(214)	(128)
Other investing activities	(4,016)	(1,581)	(1,272)	(338)
Cash flow from invt. activities	(4,323)	(2,042)	(1,486)	(466)
Bank financing	4,715	2,935	3,000	748
Dividends paid	(434)	(839)	(865)	(991)
Net cash used in fin. activities	3,543	2,685	2,135	(243)
Net change in cash	4,484	307	837	(1,920)
Cash at the beginning	4,927	9,412	9,718	10,555
Cash at the end	9,412	9,718	10,555	8,635
Balance sheet summary (RMBm)				
Shareholders' funds	17,818	19,863	22,302	25,177
Minority interests	25	62	89	393
Long-term liabilities	17,840	21,840	22,588	22,816
Deferred taxation & others	921	921	921	921
Total capital employed	36,603	42,685	45,899	49,307
Fixed assets	9,311	9,177	9,389	9,317
Other assets	15,829	18,917	21,959	24,828
Current assets	36,451	42,786	50,020	56,879
Total assets	61,590	70,881	81,369	91,023
Ratio, growth and per share analysis				
Year to	12/2013a	12/2014e	12/2015e	12/2016e
y-o-y % change				
Revenue	-2%	36%	21%	17%
Operating profit	-8%	42%	18%	16%
PBT	-2%	30%	18%	22%
Reported EPS	14%	5%	15%	17%
HSBC EPS	20%	23%	15%	17%
Ratios (%)				
ROIC ex-exceptional	8%	8%	9%	9%
ROAE ex-exceptional	14%	15%	16%	16%
ROAA ex-exceptional	4%	4%	4%	4%
Operating margin	26%	28%	27%	27%
Core profit margin	25%	22%	21%	21%
Interest cover ex-exceptional (x)	1.3	1.6	1.8	2.1
Net debt/equity (incl-restricted cash)	56%	62%	63%	65%
Per share data (RMB)				
Reported EPS (fully diluted)	0.95	1.00	1.14	1.34
HSBC EPS (fully diluted)	0.81	1.00	1.14	1.34
DPS	0.29	0.30	0.34	0.40

KWG: NAV breakdown

	(RMBm)	(HKD/sh)	% of GAV
Development properties			
Office/retail	17,976	7.8	27.4%
Residential	32,134	13.9	48.9%
Investment properties			
Office/retail	8,513	3.7	13.0%
Residential	921	0.4	1.4%
Hotel Properties under development	6,121	2.6	9.3%
Net debt	(14,087)	(6.1)	
Outstanding LAT	(900)	(0.4)	
Outstanding land premium	(6,544)	(2.8)	
12M fwd. NAV	44,135	19.1	100.0%

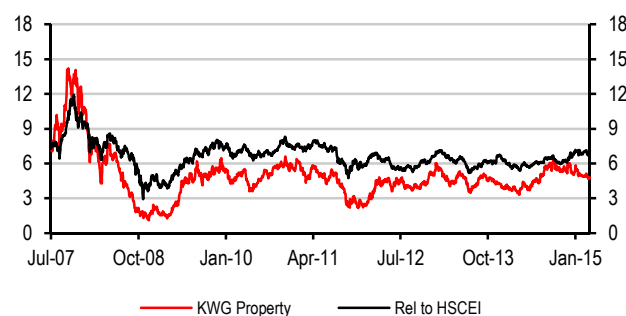
Source: HSBC estimates

NAV discount chart



Source: Thomson Reuters Datastream, Company data, HSBC estimates

Price relative



Source: Thomson Reuters Datastream, HSBC estimates

Note: Price at close of 23 March 2015

FY14 results review

(RMB mn)	2013	2014	2014e	y-o-y%	2014 Actual vs HSBC estimates
Turnover					
Sales of properties	8,977	9,770	12,280	9%	-20%
Gross rental income	145	147	153	2%	-4%
Hotel operation income	203	332	240	64%	38%
Property management fees	143	216	172	51%	26%
Total Turnover	9,468	10,466	12,846	11%	-19%
Cost of sales	(6,036)	(6,748)	(8,129)	12%	-17%
Gross Profit	3,432	3,718	4,716	8%	-21%
Other income and gains	75	98	98	31%	1%
Selling and marketing costs	(261)	(298)	(364)	14%	-18%
Administrative expenses	(753)	(794)	(904)	5%	-12%
Other operating expenses, net	(1)	(313)	(1)	N/A	N/A
Fair value gains on investment properties	541	699	-	29%	N/A
Finance costs	(214)	(6)	(220)	-97%	-97%
Share of results of associates & jointly controlled entities	884	1,542	1,507	74%	2%
Profit before taxation	3,704	4,646	4,833	25%	-4%
Income tax (ex LAT)	(585)	(692)	(974)	18%	-29%
LAT	(369)	(686)	(937)	86%	-27%
Profit for the year	2,749	3,268	2,922	19%	12%
Less: Minority Interests	1	4	(37)	691%	-111%
Net Profit	2,750	3,272	2,884	19%	13%
Revaluation gain on IP, net of tax&others	-433	-1,004	-	132%	N/A
Core Profit	2,343	2,268	2,884	-3%	-21%
Reported EPS (RMB)	0.95	1.12	1.00	0.18	13%
Core EPS (RMB)	0.81	0.78	1.00	(0.04)	-22%
DPS (RMB)	0.29	0.33	0.30	0.14	10%
Payout ratio	36%	42%	-	6.6	-
Weighted number of shares	2,894	2,916	-	1%	-
Contract sales (RMBm)	16,300	20,524	20,524	26%	-
Margins					
SG&A to contract sales ratio	6.2%	5.3%	6.2%	-0.9	-
SG&A to turnover ratio	10.7%	10.4%	9.9%	-0.3	-
Gross margin	36.2%	35.5%	36.7%	-0.7	-
Reported NP margin	29.0%	31.3%	22.5%	2.2	-
Core profit margin	24.7%	21.7%	22.5%	-3.1	-
LAT to property sales revenue	4.1%	7.0%	7.6%	2.9	-
Effective tax rate (Tax expenses / PBT)	25.8%	29.7%	-	-	-
Liquidity					
	FY13	FY14		% change	
Long-term borrowings	17,840	21,048		18%	
Short-term borrowings	3,065	3,465		13%	
Cash (ex- restricted cash)	9,414	10,094		7%	
Cash (Inc- restricted cash)	10,859	10,871		0%	
Net Debt (ex- restricted cash)	11,491	14,419		25%	
Net Debt (Inc- restricted cash)	10,047	13,642		36%	
Shareholder's equity	17,818	20,416		15%	
Net gearing (ex- restricted cash)	64.5%	70.6%		6.1	
Net gearing (Inc- restricted cash)	56.4%	66.8%		10.4	
Reported gearing	56.3%	66.8%		10.5	
Effective interest expenses	1,894	2,297		21%	
Interest capitalised	1,679	2,291		36%	
Interest cap rate	89%	100%		11.1	
Effective interest cost	10.2%	10.1%		0.0	

Source: Company data, HSBC estimates

Disclosure appendix

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The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

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Upside/Downside is the percentage difference between the target price and the share price.

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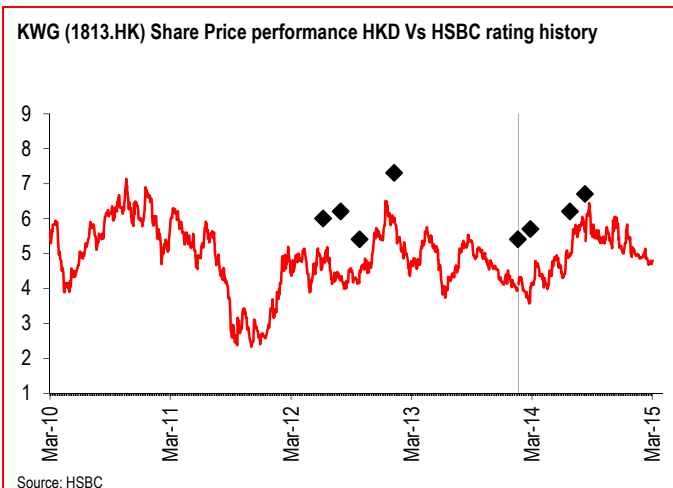
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Share price and rating changes for long-term investment opportunities



Recommendation & price target history

From	To	Date
Overweight (V)	Overweight	09 February 2014
Target Price	Value	Date
Price 1	6.00	28 June 2012
Price 2	6.20	20 August 2012
Price 3	5.40	17 October 2012
Price 4	7.30	30 January 2013
Price 5	5.40	09 February 2014
Price 6	5.70	18 March 2014
Price 7	6.20	16 July 2014
Price 8	6.70	31 August 2014

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
KWG	1813.HK	4.80	23-Mar-2015	1, 5, 6, 7

Source: HSBC

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