

JPM-pp1

Asia Pacific Equity Research

24 March 2015

KWG Property Holding Ltd.

(1813 HK)

Overweight

Price: HK\$4.80

23 Mar 2015

Price Target: HK\$7.00

PT End Date: 31 Dec 2015

2014 result: A positive mix - high dividend; lower gearing and strong earnings growth

With a high dividend yield (8.6%), improvement in net gearing (70.5% to 66.8%) and strong earnings growth (+17% Y/Y), we think the result is a very good mix and is positive to KWG. The consolidated margin has deteriorated, but this is becoming more irrelevant as more than half of the earnings are coming from Associate / JCE level, of which margin is still good. The company has increased the payout ratio from 28% to 35% with a script dividend option, which is positive as on one hand we expect the Chairman to continue to increase his stake via taking some script dividend, and on the other hand it is a vote of confidence in the company's balance sheet in our view. We have an **Overweight** rating on KWG.

Focus of the analyst briefing was on:

- (1) Off-balance sheet debt;
- (2) Contracted sales target in 2015;
- (3) Margin trend;
- (4) Landbanking strategy and launch plan;
- (5) Chairman's response to the reports on KWG's relationship with former Guangzhou mayor.
 - KWG 2014 result was better than our estimates. Core net profit was Rmb2.7 bn, 5% higher than our estimates and growth rate of 17% Y/Y. The company has delivered 1.19 mn sqm in 2014, in line with the company target.
 - Final dividend was Rmb0.33 per share, representing an 8.6% dividend yield and a 35.4% payout ratio.
 - Consolidated margin has deteriorated, but is getting more irrelevant as more than half of the profit now comes from Associate/JCE level. Among the Rmb2.75 bn core net profit, Rmb1.54 bn (56%) is from Associate / JCE. This is generated from an asset of Rmb17.4 bn, or a ROA of 8.8% from its investment in the Associates / JCE which is very good in our view.
 - Due to less land capex, net gearing improved from 70.5% in June 2014 to 66.8% in December 2014. Net debt has just marginally increased by Rmb793 mn in 2H2014 despite weaker sales momentum. However, similar to other developers, KWG also has seen a pretty big increase in completed unsold inventory, of about 0.7 mn sqm by end-2014, about 5-6 months of inventory.
 - More details after analyst briefing (**March 24 / 10:30 am at 5/F, Island Shangri-La**).

KWG 2013 result summary

	2H13	1H14	2H14	% H/H	% Y/Y	2014	JPM 2014E	% Y/Y	vs JPM
Property Development	4,542.8	5,105.0	4,665.4	-9%	3%	9,770.4	10,515.7	9%	-7%
Property Investment	71.2	73.3	73.6	0%	3%	147.0	174.8	2%	-16%
Hotel	137.3	149.8	182.4	22%	33%	332.2	121.2	64%	174%
Property Management	72.0	106.1	110.1	4%	53%	216.2	164.7	51%	31%
Net revenue	4,823.2	5,434.2	5,031.6	-7%	4%	10,465.8	10,976.4	11%	-5%
Sales and marketing expenses	(131.2)	(146.8)	(151.7)	3%	16%	(298.5)	(302.7)	14%	-1%
Administrative expenses	(383.5)	(402.3)	(391.9)	-3%	2%	(794.2)	(524.6)	5%	51%

Property Development (Pre-LAT)	1,406.0	1,438.4	1,271.1	-12%	-10%	2,709.5	3,288.1	-3%	-18%
Property Investment	70.4	72.8	73.1	0%	4%	145.9	173.6	1%	-16%
Hotel	70.3	28.2	47.2	67%	-33%	75.3	56.3	-5%	34%
Property Management	3.8	17.1	27.4	NM	NM	44.5	34.3	NM	NM
Unallocated corporate expenses	(301.3)	(165.7)	(497.6)	200%	65%	(663.3)	(524.6)	12%	26%
EBIT	1,249.3	1,390.8	921.1	-34%	-26%	2,311.9	3,027.7	-4%	-24%
Interest expenses	0.0	(6.1)	0.0	NM	#DIV/0!	(6.1)	(92.5)	-97%	-93%
Total interest expenses	(972.7)	(1,095.0)	(1,201.9)	10%	24%	(2,297.0)	(1,849.4)	21%	24%
less: interest capitalized	972.7	1,088.9	1,201.9	10%	24%	2,290.9	1,756.9	36%	30%
Interest income	42.6	44.2	53.0	20%	24%	97.2	95.3	36%	2%
Operating profit	1,291.9	1,429.0	974.1	-32%	-25%	2,403.1	3,030.6	6%	-21%
Other income	0.0	0.0	0.0	NM	NM	0.0	0.0	NM	NM
Associate/JCE	490.0	253.7	1,288.5	408%	163%	1,542.3	903.1	74%	71%
Profit before tax	1,782.0	1,682.7	2,262.6	34%	27%	3,945.3	3,933.7	25%	0%
Income tax	(265.0)	(308.9)	(208.1)	-33%	-21%	(517.1)	(636.4)	15%	-19%
LAT	(179.0)	(230.0)	(455.5)	98%	154%	(685.6)	(693.6)	86%	-1%
Minority interests	0.8	1.6	2.5	55%	NM	4.1	19.1	691%	-79%
Core Net profit	1,338.7	1,145.3	1,601.4	40%	20%	2,746.7	2,622.8	17%	5%
Revaluation gain / (loss) - after tax	50.1	337.3	187.1	-45%	274%	524.4	450.0	29%	NM
Exceptionals	3.7	(137.3)	138.4	-201%	3638%	1.1	(217.3)	-70%	-101%
Reported net profit	1,392.4	1,345.3	1,926.9	43%	38%	3,272.2	2,855.6	19%	15%
DPS (Rmb)	0.290	0.000	0.330	NM	NM	0.330	0.360	14%	-8%
EPS (Rmb)	0.481	0.465	0.666	43%	38%	1.122	0.980	16%	15%
Core EPS (Rmb)	0.463	0.396	0.554	40%	20%	0.942	0.900	14%	5%
Financials									
Net debt / (cash) (Rmb mn)	10,047	12,848	7,976	-38%	-21%	13,642	11,379	36%	20%
Shareholders' equity (Rmb mn)	17,818	18,230	20,416	12%	15%	20,416	20,227	15%	1%
Net gearing	56.4%	70.5%	39.1%	-31.4%	-17.3%	66.8%	56.3%	10.4%	10.6%
Margins									
Gross development margin (Pre-LAT)	31.4%	31.4%	31.7%	0.4%	0.3%	31.5%	31.2%	-0.1%	0.3%
Gross development margin (Post-LAT)	27.7%	27.1%	22.5%	-4.6%	-5.2%	24.9%	25.0%	-2.8%	-0.1%
EBIT margin	24.5%	24.2%	17.3%	-6.9%	-7.2%	20.9%	26.1%	-3.2%	-5.2%
Operating margin	25.3%	24.8%	18.3%	-6.6%	-7.0%	23.0%	27.6%	-1.1%	-4.6%
Net margin (core profit)	16.6%	15.5%	5.9%	-9.6%	-10.8%	11.5%	15.7%	-3.9%	-4.2%
SG&A % revenue	10.7%	10.1%	10.8%	0.7%	0.1%	10.4%	7.5%	-0.3%	2.9%
LAT % sales	3.9%	4.5%	9.8%	5.3%	5.8%	7.0%	6.6%	2.9%	0.4%
Development properties									
Net revenue from development properties	4,542.8	5,105.0	4,665.4	-9%	3%	9,770.4	10,515.7	9%	-7%
Cost of properties	(3,017.1)	(3,391.2)	(3,077.4)	-9%	2%	(6,468.6)	(7,013.6)	9%	-8%
Gross development profit	1,525.7	1,713.8	1,588.1	-7%	4%	3,301.9	3,502.1	9%	-6%
GFA recognized (sqm) - excl JCE	502,269	461,559	726,957	58%	45%	1,188,516	1,340,964	15%	-11%
Gross revenue psm (Rmb psm)	13,663	13,877	12,888	-7%	-6%	12,543	12,410	4%	1%
Contracted sales (Rmb mn)	8,239	9,993	10,507	5%	28%	20,500		26%	NA
Contracted sales (sqm)	556,000	736,500	752,500	2%	35%	1,489,000		26%	NA
Gross ASP (Rmb psm)	14,818	13,568	13,963	3%	-6%	13,768		0%	NA

Sources: Company data, J.P. Morgan estimates.

Investment Thesis

KWG's office sales in 4Q2013 were better than expected, giving it plenty of room to alter the launch schedule and shift some new launches to 2014. The company has a contracted sales target of Rmb25-30B by 2015, equivalent to about 20%-25% Y/Y growth for each of 2014 and 2015. We think such a target is quite achievable.

Valuation

Our Dec-14 price target is based on 5.0x 2014E P/E, which is lower than that for other mid-cap names due to its: (1) more limited access to capital, (2) smaller development scale, and (3) slower growth outlook.

Risks to Rating and Price Target

Key downside risks to our rating and price target are significantly worse-than-expected ASP achieved, lower-than-expected contracted sales, further tightening measures in cities to which KWG has exposure, and slippage of completion schedules.

China / Hong Kong Property

AC

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
04-Feb-08	OW	8.92	-
26-Mar-08	OW	5.34	11.30
28-Jul-08	OW	4.53	7.80
02-Sep-08	OW	3.37	7.30
30-Jan-09	N	1.73	2.10
21-Apr-09	N	2.66	3.50
24-Jun-09	OW	4.67	6.00
12-Nov-09	OW	6.09	6.90
07-Jun-10	OW	4.34	5.50
02-Sep-10	OW	5.46	6.25
21-Sep-10	OW	6.15	7.25
11-Nov-10	OW	6.95	8.25
19-Aug-11	OW	4.70	7.20
25-Oct-11	OW	2.89	4.30
23-Feb-12	OW	4.46	5.70
29-Feb-12	OW	4.72	6.25
21-Aug-12	OW	4.23	5.80
30-Nov-12	OW	5.45	6.20
17-Jan-13	OW	6.14	7.20
27-Mar-13	OW	4.64	6.00
22-Jul-13	OW	4.31	5.00
14-Aug-13	N	4.59	5.60
27-Nov-13	OW	4.57	5.90
20-Mar-14	OW	4.05	6.15
22-Jun-14	OW	4.47	5.90
31-Jul-14	OW	5.58	7.50
04-Sep-14	OW	6.03	7.90
30-Oct-14	OW	5.41	7.00

<http://gfd-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=504965&shareClassServerId=4&chartDesignation=1&actionType=C>

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