

JPM-pp1

Asia Pacific Equity Research

07 September 2016

Longfor Properties Co. Ltd. (960 HK)

Overweight

Price: HK\$12.90

07 Sep 2016

Price Target: HK\$16.00

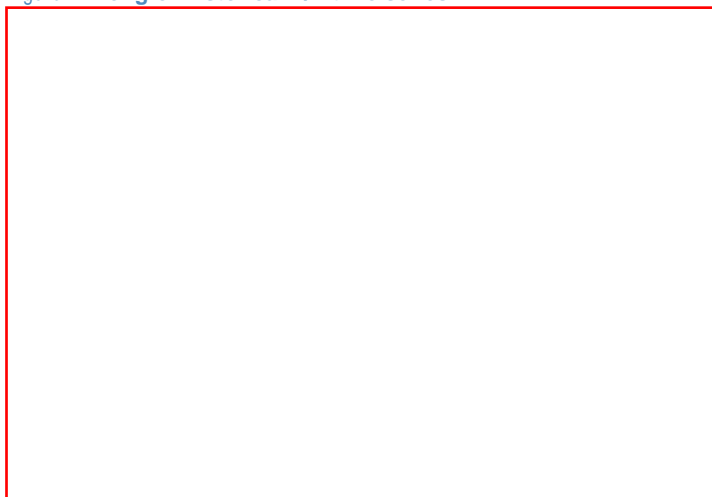
PT End Date: 30 Jun 2017

Still a preferred name

Longfor has outperformed country index by 8% since Aug 1, and we still like the name given its strong fundamentals. Our **Jun-2017 price target is HK\$16.0**, mainly assuming Longfor to revert back to its historical mid-cycle P/E. Given the rapid increase in share price, the risk of secondary share placement from Cai Kui (ex-husband of Chairlady) exists, but even if that happens, we think the negative impact could be short-term and the stock can still see outperformance over the next 6-12 months when market prices in its strong fundamental numbers. At HK\$12.9, Longfor is trading at 7.4x 2016E P/E and 6.1x 2017E P/E, which is low compared to its history. The mid-cycle 12m rolling forward P/E was 8.75x, implying **30% potential upside if such P/E is achieved**, not accounting for potential earning upgrades on better market performance.

- **Strong earnings momentum:** We expect Longfor to see an 18% earnings CAGR for 2015-2018E, this is mainly driven by margin expansion in 2016 and 2017 due to market improvement in 2015 and landbank restructuring, and expansion in delivery in 2018. Of this, 80% of delivery in 2016E and 60% of delivery in 2017E are being locked-in. Moreover, Company is also proactive in managing the payout ratio, and Longfor could be paying out 35% of its profit in 2016, implying 4.7% yield in 2016E and 5.7% yield in 2017E, at HK\$12 per share.

Figure 1: Longfor historical P/E time series

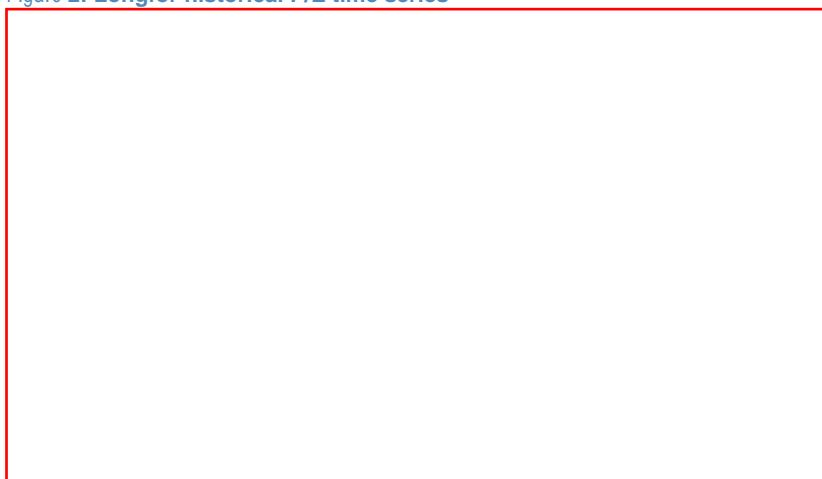


Source: Bloomberg, Company data, J.P. Morgan estimates

- **The next growth driver about to come:** Longfor's 8M2016 sales were Rmb56 bn, up 86% Y/Y and among the strongest growth of all major developers. At current run-rate of ~Rmb7-8 bn sales a month, Longfor will be tracking Rmb85-90 bn sales for 2016E, up >80% Y/Y, and this will be the key driver of earnings growth in 2018 and 2019E. More importantly, after doing well in cities like Beijing, Shanghai, Nanjing, Suzhou and Xiamen, which are where they expanded in 2H2014-2015, they have chosen to expand in Jinan, Qingdao, Chengdu and Chongqing which could be the next driver due to inventory improvement in these places. We are hence positive on Longfor's sales outlook, and expect 2016 attributable sales to be at Rmb65 bn, up 42% Y/Y, with risk on the upside.
- **Longfor could see rerating due to improved fundamentals:** The P/E derate of Longfor since end-2012 was driven mainly by margin disappointment and the lack of growth, and we expect the most recent set of results and guidance, together with continuous strong sales growth, to rectify this and cause a rerate similar to mid-2011 to mid-2012. Back in 2H2011 post credit easing, Longfor saw the biggest rerate since IPO when market appreciated their defensiveness and had a decent expectation on earnings growth (~20% earnings CAGR for 11-14E back then). These are all happening similarly this time, but we think **the fundamentals of**

Longfor have improved multiple times with much better quality landbank and financial situation.

Figure 2: Longfor historical P/E time series



Source: Bloomberg, Company data, J.P. Morgan

- At HK\$12.9, Longfor is trading at 7.4x 2016E P/E and 6.1x 2017E P/E, which is low compared to its history. The mid-cycle 12m rolling forward P/E was 8.71x, implying 30% potential upside if such P/E is achieved, not accounting for potential earning upgrades on better market.
- **What if the second largest shareholder places shares?** Cai Kui, the ex-husband of Chairlady, is the second largest shareholder of Longfor. He inherited Longfor's shares after divorcing the Chairlady in November 2012, and he currently holds 29.1% stake in Longfor (1,698 mn shares). There has always been a concern on secondary placement by Cai and we think it is valid. If that happens in small size (say ~2-3% of share outstanding) at small discount, we think impact will be minimal. More importantly, **Cai is not part of the management team of Longfor** and hence, if he sells his shares, we do not think it will symbolize any negative signal to Company's outlook.

Table 1: Longfor (0960.HK) shareholding structure as of Sep 7, 2016

Ultimate Shareholder	No. of Shares (mn)	% Stake
Madam Wu Yajun	2,575	44.1%
Mr. Cai Kui (ex husband of Madam Wu)	1,698	29.1%
Mr. Peter Woo	350	6.0%
General public	1,216	20.8%
Total no. of shares	5,839	100.0%

Source: HKEx, Company data, J.P. Morgan

- **What could be the reason for Cai disposing of his shares?** Cai is one of the founders of Longfor and according to management, the relationship between Cai and the Company is good. Cai via his family fund has spent **>Rmb4 bn in acquiring real estate in China, Germany and UK** (Table 2), and hence apart from pledging shares for loan, we think Cai may possibly sell some of his shares to support these investments, which could be yielding better than Longfor's share considering the leverages.
- **Cai Kui's private investment summary:** According to *Guandian*, he has done several private investments via its family fund Junson Capital (佳辰资本). The latest one being the acquisition of a hotel in London Docklands Riverside, branded under Hilton (Rmb700 mn), in August 2016. Junson Capital is quite active in acquiring properties, apart from London he also bought the Shama Serviced Apartment in Chengdu (JPMe Rmb150-200 mn), and Lanxess Arena in Cologne, Germany (Rmb3.2 bn).

Table 2: Recent private investments by Junson Capita

Date	Location	Project	Property type	Total consideration (Rmb mn)	Partner	Capacity	Property details	Remarks
Aug 31, 2016	London, UK	DoubleTree by Hilton Hotel London - Docklands Riverside	Hotel	700	-	378 rooms	GFA: 13.7k sqm	yield 6%

Jun 29, 2016	Chengdu, China	Shama Xiangnanli Chengdu (成都莎瑪佳辰象南里服務式公寓)	Serviced apartments	Rmb150-200 (JPMe)		252 rooms	Opening in 2017	Onyx is the property manager
Dec 22, 2015	Cologne, Germany	Lanxess Arena	Arena	3,170	Mirae Asset	20,000 people	Opened in 1998, the multi-use arena also includes an adjacent building complex, which comprises training grounds, parking spaces and offices.	Junson to own the training grounds; Mirae to own the parking spaces & offices.

Source: CDnews, Guandian, Pollstar Pro, J.P. Morgan estimates

Investment Thesis

Longfor has strong corporate governance, in our view, and is making smart and sensible capital market decisions to increase its payout, decrease offshore bonds, and maintain a decent ROE. We expect Longfor's margin in 2016-18 to see a multi-year expansion on the back of landbank restructuring since 2014; funding costs could decrease to ~4% p.a. after credit upgrades with more onshore issuance; we estimate an 18% earnings CAGR in 2015-18. Moreover, we expect Longfor to sustain its unique combination of strong growth and defensiveness for another 2-3 years due to its considerable land-sourcing ability. Compared to Longfor, large-caps are too big to restructure, so growth is not likely to be as high, while other mid-caps were mostly late in the cycle to build up their recurring income base to lower funding costs.

Valuation

Our Jun-17 price target of HK\$16.0 is based on a target P/E of 9.0x FY16/17E average earnings, which is the mid-cycle multiple. Given the strong balance sheet, defensive land bank, and good corporate governance, we believe Longfor is the most defensive developer among non-SOEs.

Risks to Rating and Price Target

Key downside risks to our rating and PT include tightening monetary policy, lower-than-expected sales, and policy tightening in cities to which Longfor is exposed.

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
18-Nov-10	OW	9.44	13.50
22-Mar-11	OW	11.60	14.50
16-Aug-11	OW	12.38	15.50
25-Oct-11	OW	8.88	13.00
23-Feb-12	N	11.50	12.20
13-Mar-12	N	10.56	12.00
20-Aug-12	N	11.50	11.50
19-Sep-12	N	11.78	11.70
30-Nov-12	N	14.60	12.10
17-Jan-13	N	15.00	14.40
16-Mar-13	N	12.32	13.00
22-Jul-13	N	11.18	11.00
20-Aug-13	N	13.38	12.50
27-Nov-13	OW	11.72	14.50
23-Mar-14	OW	10.22	13.00
22-Jun-14	OW	9.49	12.00
31-Jul-14	OW	11.02	13.50
05-Aug-14	OW	10.92	13.00
30-Oct-14	OW	8.69	11.00
19-Mar-15	OW	9.81	12.50
25-Apr-15	OW	12.62	15.50
23-Aug-15	OW	9.62	13.30
31-Oct-15	OW	10.36	13.50
30-Mar-16	OW	10.50	14.00
18-Aug-16	OW	11.36	16.00

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