

COGO (81 HK)

Underperform (maintained)

Target price: HK\$3.80

Dennis Yao

SFC CE No. ALK994

dennisyao@gfgroup.com.hk

+852 3719 1065

GF Securities (Hong Kong) Brokerage Limited
 29-30/F, Li Po Chun Chambers
 189 Des Voeux Road Central
 Hong Kong

Focus on third/fourth-tier cities a concern, expensive valuation; maintain Underperform

Nov contract sales revenue up 30% YoY The company's Nov contract sales revenue rose 30% YoY to HK\$2.6bn, and GFA sold increased by 14% YoY to 0.23m sqm. 11M17 contract sales revenue was up 57% YoY to HK\$34bn, and GFA sold increased by 27% YoY to 3.2m sqm.

Focus on third/fourth-tier cities a key concern As of June 30, 2017, the company had a total land bank of around 16.6m sqm, mainly in 20 third and fourth-tier cities in China. Third/fourth-tier cities were the main growth drivers of China's property market during 1H17. Given tightening monetary supply, a relatively high sales base in 2016 and 1H17, and the lack of consistent owner-occupier housing demand, we believe demand in third and fourth-tier cities may not be sustainable.

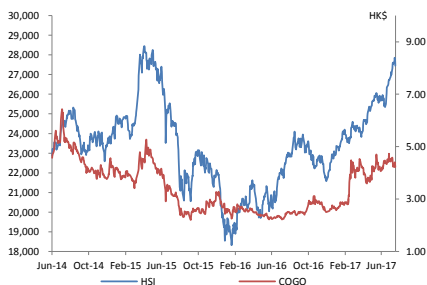
Share price dropped 43% during the 2014 down-cycle In 2014, due to tightening policies, primary residential property sales revenue in China dropped 9% YoY to Rmb10.5trn, while the Hang Seng Index rose 1% to 23,605. The company's contract sales revenue increased by 5% YoY to HK\$18bn during the year, and revenue dropped 12% YoY to HK\$14bn (97% of revenue was from third-tier cities). Gross margin dropped by 900bps YoY to 24%, and net earnings declined by 60% YoY to HK\$1.3bn. Due to its focus on third-tier cities and its poor financial results, its share price dropped from HK\$7.30 (1.4x 2014 NBV) to HK\$4.00 (0.7x2014 NBV) by the end of the year.

Proposed new share issue may dilute 2018 EPS by 50% The company is set to issue 1.14bn new shares to controlling shareholder COLI (688 HK, Buy). According to our calculations, the issuance will dilute total shares and 2018 EPS by 50%. COLI currently has a 38% stake, but the issuance, set to be completed by Jan 2018, will see this rise to 57%.

We forecast EPS will drop by 42% in 2018 As of June 30, 2017, the company had sold but un-booked GFA of 3.0m sqm. We forecast the company will book GFA of 2.2m sqm/2.5m sqm in 2017/18 respectively, at ASPs of HK\$8,400/HK\$8,600. We estimate EPS will rise by 23% YoY in 2017 to HK\$0.49. To factor in the dilution effect from the new share issue, we forecast EPS will drop by 42% YoY to HK\$0.28.

Expensive valuation; maintain Underperform According to our calculations, the stock is trading at 14.4x 2018E P/E, or 1.0x 2018E P/B, after factoring in the dilution effect. Given the uncertainty in China's third/fourth-tier cities and the EPS dilution, we see its current valuation as expensive. We maintain our Underperform rating and our target price of HK\$3.80, equal to 1.0x 2018E P/B, in line with its historical trading range.

Stock performance



Source: Bloomberg

Key data

| | |
|----------------------|--------------|
| Dec 7 close (HK\$) | 4.03 |
| Shares in issue (bn) | 2.3 |
| Major shareholder | COLI (38.0%) |
| Market cap (HK\$ bn) | 9.269 |
| 3M avg vol (m) | 9.7 |
| 52w high/low (HK\$) | 6.16/2.48 |

Source: Bloomberg

Stock valuation

| | Turnover (HK\$ m) | Net profit (HK\$ m) | EPS (HK\$) | EPS YoY (%) | P/E (x) | DPS (HK\$) | Yield (%) | ROE (%) | BPS (HK\$) | P/B (x) |
|-------|----------------------|------------------------|---------------|----------------|------------|---------------|--------------|------------|---------------|------------|
| 2014 | 13,981 | 1,267 | 0.506 | (59) | 8.0 | 0.050 | 1.8 | 10.3 | 5.4 | 0.7 |
| 2015 | 16,614 | 851 | 0.365 | (28) | 11.0 | 0.000 | 0.0 | 7.6 | 4.9 | 0.8 |
| 2016 | 17,093 | 900 | 0.394 | 8 | 10.2 | 0.000 | 0.0 | 8.6 | 4.5 | 0.9 |
| 2017E | 18,733 | 1,116 | 0.485 | 23 | 8.3 | 0.010 | 0.0 | 9.7 | 5.0 | 0.8 |
| 2018E | 21,779 | 1,291 | 0.281 | (42) | 14.4 | 0.000 | 0.0 | 7.4 | 3.8 | 1.1 |

Sources: Company data, GF Securities (Hong Kong)

Figure 1: Financial statements

| Income Statement | | | | | | Balance Sheet | | | | | |
|-------------------------|----------|----------|----------|----------|----------|-------------------------------|--------|--------|--------|--------|--------|
| Year ended Dec (HK\$ m) | 2014 | 2015 | 2016 | 2017E | 2018E | Year ended Dec (HK\$ m) | 2014 | 2015 | 2016 | 2017E | 2018E |
| Revenue | 13,981 | 16,614 | 17,093 | 18,733 | 21,779 | Cash and Cash Equivalents | 8,825 | 9,703 | 15,158 | 17,888 | 25,606 |
| Cost of sales | (10,617) | (14,014) | (14,158) | (15,174) | (17,641) | Inventories of properties | 34,011 | 34,475 | 49,012 | 39,819 | 41,810 |
| Gross profit | 3,364 | 2,600 | 2,935 | 3,559 | 4,138 | Trade and other receivables | 6,143 | 4,404 | 5,453 | 5,824 | 6,698 |
| Operating expenses | (784) | (956) | (983) | (1,077) | (1,252) | Others | 2,911 | 4,054 | 7,196 | 0 | 0 |
| Fair value gains | 30 | 0 | 0 | 0 | 0 | Total Current Assets | 51,890 | 52,637 | 76,819 | 63,390 | 69,595 |
| Financial expenses | (22) | (27) | (18) | (46) | (60) | Fixed assets | 48 | 34 | 928 | 928 | 928 |
| Pre-tax profit | 2,668 | 1,721 | 2,133 | 2,436 | 2,826 | Investment Properties | 3,033 | 2,856 | 2,486 | 4,112 | 4,934 |
| Income taxes | (1,223) | (799) | (1,180) | (1,218) | (1,413) | Interest in JV | 104 | 101 | 377 | 377 | 377 |
| Minority interest | (179) | (71) | (34) | (102) | (122) | Deferred tax | 206 | 147 | 346 | 346 | 346 |
| Net profit | 1,267 | 851 | 900 | 1,116 | 1,291 | Others | 29 | 22 | 399 | 0 | 0 |
| EPS (HK\$) | 0.506 | 0.365 | 0.394 | 0.485 | 0.281 | Total Non Current Assets | 3,419 | 3,160 | 4,535 | 5,762 | 6,585 |
| DPS (HK\$) | 0.050 | 0.000 | 0.010 | 0.000 | 0.000 | Borrowings | 4,132 | 4,919 | 5,289 | 7,575 | 8,332 |
| | | | | | | Trade and other payables | 8,711 | 8,342 | 10,352 | 12,012 | 14,414 |
| | | | | | | Sales deposits | 8,978 | 13,934 | 19,740 | 15,362 | 16,130 |
| | | | | | | Tax liabilities | 1,698 | 946 | 1,506 | 946 | 946 |
| | | | | | | Others | 2,848 | 771 | 11,627 | 0 | 0 |
| | | | | | | Total Current Liabilities | 26,366 | 28,911 | 48,514 | 35,895 | 39,823 |
| | | | | | | Borrowings | 11,465 | 10,634 | 14,685 | 14,036 | 15,440 |
| | | | | | | Notes payable | 3,129 | 3,138 | 3,149 | 3,138 | 3,138 |
| | | | | | | Deferred Tax Liabilities | 1,376 | 1,304 | 3,821 | 3,821 | 3,821 |
| | | | | | | Others | 0 | 0 | 0 | 0 | 0 |
| | | | | | | Total Non Current Liabilities | 15,970 | 15,076 | 21,654 | 20,995 | 22,399 |
| | | | | | | Total Shareholders Equity | 12,301 | 11,173 | 10,422 | 11,538 | 17,489 |
| | | | | | | Minority Interests | 671 | 637 | 763 | 865 | 987 |

| Cash Flow Statement | | | | | |
|-------------------------------------|---------|---------|---------|---------|---------|
| Year ended Dec (HK\$ m) | 2014 | 2015 | 2016 | 2017E | 2018E |
| Cash Flow from Operating Activities | (2,786) | 4,427 | 8,708 | 3,093 | 2,688 |
| Cash Flow from Investing Activities | 142 | 123 | (2,598) | (2,000) | (2,000) |
| Cash Flow from Financing Activities | 4,379 | (3,124) | (382) | 1,637 | 2,161 |
| Net change | 1,701 | 331 | 5,728 | 2,730 | 2,849 |
| CF at end | 8,825 | 9,703 | 15,158 | 17,888 | 25,606 |

| Financial Ratios | | | | | |
|---|------|------|------|-------|-------|
| Year ended Dec | 2014 | 2015 | 2016 | 2017E | 2018E |
| Revenue growth rate (YoY) | -12% | 19% | 3% | 10% | 16% |
| Gross margin | 24% | 16% | 17% | 19% | 19% |
| Net profit margin (incl fair value gains) | 9% | 5% | 5% | 6% | 6% |
| Net gearing | 80% | 80% | 26% | -6% | -40% |
| ROE | 10% | 8% | 9% | 10% | 7% |

Sources: Company data, GF Securities (Hong Kong)

Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

Company ratings

| | |
|---------------------|--|
| Buy | Stock expected to outperform benchmark by more than 15% |
| Accumulate | Stock expected to outperform benchmark by more than 5% but not more than 15% |
| Hold | Expected stock relative performance ranges between -5% and 5% |
| Underperform | Stock expected to underperform benchmark by more than 5% |

Sector ratings

| | |
|-----------------|--|
| Positive | Sector expected to outperform benchmark by more than 10% |
| Neutral | Expected sector relative performance ranges between -10% and 10% |
| Cautious | Sector expected to underperform benchmark by more than 10% |

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29-30/F, Li Po Chun Chambers, 189 Des Voeux Road Central, Hong Kong

Tel: +852 3719 1111 Fax: +852 2907 6176 Website: <http://www.gfgroup.com.hk>