Deutsche Bank
Markets Research

Rating
Hold

Asia
Hong Kong

Property

Company
SHK Properties Ltd

Reuters	Bloomberg	Exchange	Ticker
0016.HK	16 HK	HSI	0016

ADR Ticker	ISIN
SUHJY	US86676H3021

Date
27 February 2018

Results

Price at 27 Feb 2018 (HKD)	129.80
Price target - 12mth (HKD)	135.90
52-week range (HKD)	138.30 - 112.00
HANG SENG INDEX	31,499

1H18 results a strong beat driven by front-loaded property sales bookings

Maintain Hold on valuation; revising up NAV to HK$203/sh and TP to HK$135.9

Following a strong beat in 1H18, we revise our earnings forecast by 7%-9% for FY18-20E by adopting higher development margin assumptions overall. Correspondingly, we revise our DPS by 3.5-4.8% in FY18-20E (merely reflecting higher earnings but payout remains flat) and target price by 4% to HK$135.9 (HK$130.7). Nevertheless, in light of macro headwinds (upcoming rate hike and supply increase) and management guidance of little scope for imminent share buyback/ flat dividend payout, we see few near-term catalysts. As the current valuation is close to our assessed fair value, we maintain our Hold.

1H18 underlying earnings +37% YoY to HK$19,973mn, a strong beat

SHKP reported 1H18 underlying profit of HK$19,973mn, implying a 37% YoY surge from HK$14,608mn in 1H17, markedly beating our expectation. The strong beat was predominantly driven by property bookings being skewed in 1H (90:10 split between 1H:2H) as well as higher development margins. An interim dividend of HK$1.2/share was declared in 1H18, implying 9% YoY growth, reversing a moderating trend in dividend hikes in since 1H16.

Rental growth in overall portfolio accelerated in 1H18; driven by new projects

In 1H18, gross rental income (inclusive of associates/JV) rose by 6.5% YoY to HK$11,506mn, comprising of HK$9,011mn from HK (+4%), HK$2,140mn from China (+16% in HK$, +13% in Rmb) and HK$355mn from Singapore (+10%). Strong growth in the China portfolio was particularly attributable to new project completion on top of positive rental reversion. Overall growth momentum accelerated (1H18: 6.5%; FY17: 4%; FY16: 7%), with HK registering a slight acceleration to 4.3% in 1H18, vs. 2H17 at 3.2%/1H17 at 4.4%.

Development margins markedly improved by 7.7 percentage points to 40.1%

In addition to the front-loaded booking schedule in 1H18, another key reason for the strong 1H18 was the higher-than-expected development margins. In particular, operating profit margin for the Hong Kong portfolio saw a 5 percentage point expansion to 39.9% and that for the China portfolio saw an expansion by 19 percentage points to 43%.

HK landbank +6% to 55mn sf/China landbank -3% to 65mn sf in past 6 months

As of end-17, SHKP has total HK landbank of 55.1mn sf, of which 21.4mn sf was under development (up from 19.6mn in mid-17), implying 6% growth in the past six months, following three projects totaling 5.2mn sf being added. In particular, land-use conversion of Shap Sz Heung was completed with 4.8mn sf GFA. In China, total landbank fell by 3% to 65mn sf, of which 51mn sf was under development (down from 52.6mn in mid-17).

Target price of HK$135.9 is based on a sum-of-the-parts approach

Our target price is based on a sum-of-the-parts approach and implies a 2018E PE of 14x. We believe applying a 5-7x PE to HK property development and a 34% target discount to our estimated value of the respective investment property portfolio is appropriate in an ex-growth market. Risks: fluctuation in HK/China economies, adverse or favorable changes to interest rate trends and government policies. See page 4.

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Key changes

TP	130.70 to 135.90	↑	4.0%
Sales (FYE)	94,026 to 94,357	↑	0.4%
Op prof margin (FYE)	31.7 to 34.4	↑	8.6%
Net profit (FYE)	25,945.8 to 28,188.8	↑	8.6%

Source: Deutsche Bank

Price/price relative

Performance (%)	1m	3m	12m
Absolute	-6.1	0.2	13.2
HANG SENG INDEX	-5.0	6.1	31.7

Source: Deutsche Bank

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Distributed on: 27/02/2018 17:09:31 GMT

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Figure 1: Summary of 2017/18 interim results

For period ended Dec 31 (HK$mn)	1H17A	1H18A	YoY	Remarks
Property sales	24,132	33,432	39%	- Reported higher development margin at 40% (vs. 35% in 1H17); HK contracted sales of HK$26.5bn; with over HK$17.5bn sales yet to be recognized in HK
Property rental	8,865	9,416	6%	- Positive overall rental reversions in HK and mainland China
Hotel operation	2,171	2,293	6%	
Telecommunications	5,372	4,108	(24%)	- Lower revenue recognition from SmarTone
Transport infrastructure and logistics	1,930	1,981	3%	
Other businesses	3,873	3,936	2%	
Revenue	**46,343**	**55,166**	**19%**	
Cost of sales	(26,246)	(28,479)	9%	
Gross Profit	**20,097**	**26,687**	**33%**	
Finance cost	(1,055)	(910)	(14%)	- Driven by lower debt balances
Finance income	131	188	44%	
Selling and marketing costs	(2,418)	(2,858)	18%	
Administrative expenses	(1,149)	(1,240)	8%	
Others	679	523	(23%)	
Revaluation gains	5,079	9,716	91%	
Profit from operations	**21,364**	**32,106**	**50%**	
Share of results of associates/JVs	3,748	6,467	73%	- Boosted by HK$4.5bn IP revaluation gain (vs. HK$2.1bn in 1H17)
Pre-tax profit	**25,112**	**38,573**	**54%**	
Taxation	(4,038)	(5,094)	26%	
Post-tax profit before MI	**21,074**	**33,479**	**59%**	
Perpetual capital securities holders	0	(87)	nm	
Minority interests	(415)	(361)	(13%)	
Net attributable profit	**20,659**	**33,031**	**60%**	
Adjustment for non-recurring items	(6,051)	(13,058)	nm	
Core net profit	**14,608**	**19,973**	**37%**	- Higher than our estimate on higher development margins and front-loaded property bookings
Core EPS – diluted (HK$)	**5.05**	**6.90**	**37%**	
Interim DPS (HK$)	**1.10**	**1.20**	**9%**	- Interim dividend raised by 9% yoy

Source: Deutsche Bank, company data

Figure 2: Balance sheet (HK$mn)

As of	30-Jun-17	31-Dec-17
Non-current assets	**375,462**	**397,861**
Investment properties	337,980	354,667
Land use rights		
Property and equipment	26,977	32,958
Other assets	10,505	10,236
Share of net assets	**63,841**	**68,328**
Other investments	**3,375**	**3,206**
Current assets	**196,738**	**210,359**
Properties for sale	146,409	151,578
Inventories	444	552
Debtors & deposits/receivables/others	18,611	26,552
Bank balances & cash	31,274	31,677
Current liabilities	**(50,972)**	**(56,011)**
Bank loans and overdrafts	5,390	9,361
Forward sales deposits received	10,458	6,716
Creditors, deposits & accruals/others	26,908	30,624
Taxation	8,216	9,310
Proposed dividend		
Total assets less current liabilities	**588,444**	**623,743**
Non-current liabilities	**62,151**	**67,163**
Long term bank loans	61,936	66,975
Others	215	188
Deferred income tax	**18,930**	**20,745**
Issued share capital	70,516	70,582
Reserves	427,699	455,965
Shareholders' funds	**498,215**	**526,547**
Perpetual capital securities	**3,910**	**3,910**
Minority interests	**5,238**	**5,378**
Total capital employed	**588,444**	**623,743**

Source: Deutsche Bank, company data

Figure 3: Summary of earnings revision

(HK$mn)	2018E			2019E			2020E		
	New	Old	%	New	Old	%	New	Old	%
Revenue	94,357	94,026	0.4%	99,787	99,436	0.4%	100,125	97,967	2.2%
Gross Profit	39,020	36,343	7.4%	38,583	36,463	5.8%	40,181	37,658	6.7%
Profit before tax	34,646	31,917	8.5%	33,823	31,669	6.8%	34,991	32,481	7.7%
Core profit	28,189	25,946	8.6%	27,490	25,707	6.9%	27,343	25,275	8.2%
EPS	9.73	8.96	8.6%	9.49	8.87	6.9%	9.44	8.72	8.2%
DPS	4.30	4.15	3.6%	4.35	4.15	4.8%	4.40	4.25	3.5%
NAV	203.00	200.55	1.2%						

Source: Deutsche Bank estimates

Valuation and risks

Our target price is based on the sum-of-the-part approach (previously target discount on overall NAV), which imply a 2018 PE of 14x. We believe applying a 5-7x PE to HK property development and a 34% target discount to our estimated value on the respective investment property portfolio is appropriate in an ex-growth market. For China property development, we believe applying 8x PE (on par to industry leaders with strong financial positions such as COLI and CR Land) is appropriate by considering the financial strength and profitability profile of Hong Kong developers. Such methodology is now our new valuation metric adopted across HK developers under our coverage.

Fluctuations in the Hong Kong economy may lead to higher/lower housing demand; An interest rate hike and continuous liquidity outflow may severely harm sentiment and demand in the property market. On the other hand, the property market may further strengthen if the low interest rate environment persists; Unexpected fluctuations in the Chinese economy could affect our forecasts; The Chinese government's measures may be stricter/looser than expected.

Model updated:27 February 2018

Running the numbers

Asia

Hong Kong

Property

SHK Properties Ltd

Reuters: 0016.HK Bloomberg: 16 HK

Hold

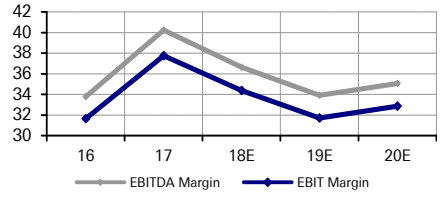
Price (27 Feb 18)	HKD 129.80
Target Price	HKD 135.90
52 Week range	HKD 112.00 - 138.30
Market Cap (m)	HKDm 375,924
	USDm 48,051

Company Profile

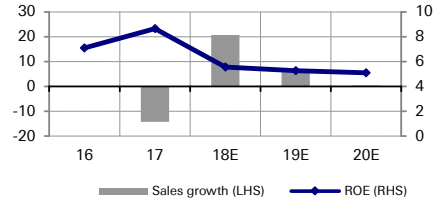
Sun Hung Kai Properties Limited, through its subsidiaries, develops and invests in properties. The Company also operates hotels, manages properties, car parking and transportation infrastructure. In addition, Sun Hung Kai operates logistics business, construction, financial services, internet infrastructure and enabling services.

Price Performance

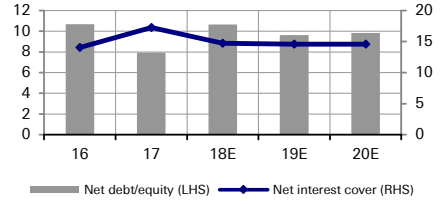
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 30-Jun	2016	2017	2018E	2019E	2020E
Financial Summary					
DB EPS (HKD)	8.36	8.97	9.73	9.49	9.44
Reported EPS (HKD)	11.30	14.43	9.73	9.49	9.44
DPS (HKD)	3.85	4.10	4.30	4.35	4.40
BVPS (HKD)	161.9	172.0	177.5	182.6	187.6
Weighted average shares (m)	2,887	2,895	2,896	2,896	2,896
Average market cap (HKDm)	282,158	321,356	375,924	375,924	375,924
Enterprise value (HKDm)	277,865	302,715	369,379	362,184	361,543
Valuation Metrics					
P/E (DB) (x)	11.7	12.4	13.3	13.7	13.8
P/E (Reported) (x)	8.6	7.7	13.3	13.7	13.8
P/BV (x)	0.57	0.67	0.73	0.71	0.69
FCF Yield (%)	2.2	7.5	nm	4.8	3.2
Dividend Yield (%)	3.9	3.7	3.3	3.4	3.4
EV/Sales (x)	3.0	3.9	3.9	3.6	3.6
EV/EBITDA (x)	9.0	9.6	10.7	10.7	10.3
EV/EBIT (x)	9.6	10.3	11.4	11.4	11.0
Income Statement (HKDm)					
Sales revenue	91,184	78,207	94,357	99,787	100,125
Gross profit	36,689	37,713	41,160	40,754	42,362
EBITDA	30,806	31,465	34,567	33,834	35,099
Depreciation	1,950	1,939	2,141	2,171	2,181
Amortisation	0	0	0	0	0
EBIT	28,856	29,526	32,426	31,663	32,918
Net interest income(expense)	-2,055	-1,709	-2,203	-2,175	-2,255
Associates/affiliates	4,216	7,598	4,422	4,335	4,329
Exceptionals/extraordinaries	8,769	13,810	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0
Profit before tax	39,786	49,225	34,646	33,823	34,991
Income tax expense	6,390	6,750	5,409	5,350	6,532
Minorities	730	693	1,048	983	1,116
Other post-tax income/(expense)	0	0	0	0	0
Net profit	32,666	41,782	28,189	27,490	27,343
DB adjustments (including dilution)	-8,496	-15,817	0	0	0
DB Net profit	24,170	25,965	28,189	27,490	27,343
Cash Flow (HKDm)					
Cash flow from operations	12,722	32,596	7,335	25,717	19,789
Net Capex	-6,480	-8,607	-8,648	-7,539	-7,883
Free cash flow	6,242	23,989	-1,313	18,178	11,906
Equity raised/(bought back)	2,046	112	0	0	0
Dividends paid	-10,517	-11,964	-12,454	-12,598	-12,743
Net inc/(dec) in borrowings	-1,147	-13,249	9,662	-858	2,490
Other investing/financing cash flows	863	2,338	-1,703	-1,738	-1,734
Net cash flow	-2,513	1,226	-5,808	2,984	-82
Change in working capital	*-9,803*	*7,876*	*-18,115*	*-158*	*-6,075*
Balance Sheet (HKDm)					
Cash and other liquid assets	30,048	31,274	25,466	28,450	28,368
Tangible fixed assets	25,446	26,977	27,389	27,530	27,530
Goodwill/intangible assets	0	0	0	0	0
Associates/investments	60,807	63,841	68,263	72,599	76,928
Other assets	498,214	517,324	545,172	556,427	572,258
Total assets	614,515	639,416	666,290	685,005	705,084
Interest bearing debt	80,761	71,236	80,898	80,040	82,530
Other liabilities	59,246	64,727	65,156	68,854	70,728
Total liabilities	140,007	135,963	146,054	148,894	153,258
Shareholders' equity	468,707	498,215	513,950	528,842	543,442
Minorities	5,801	5,238	6,286	7,269	8,385
Total shareholders' equity	474,508	503,453	520,236	536,111	551,826
Net debt	*50,713*	*39,962*	*55,432*	*51,590*	*54,161*
Key Company Metrics					
Sales growth (%)	nm	-14.2	20.7	5.8	0.3
DB EPS growth (%)	na	7.2	8.5	-2.5	-0.5
EBITDA Margin (%)	33.8	40.2	36.6	33.9	35.1
EBIT Margin (%)	31.6	37.8	34.4	31.7	32.9
Payout ratio (%)	34.0	28.4	44.2	45.8	46.6
ROE (%)	7.1	8.6	5.6	5.3	5.1
Capex/sales (%)	7.3	11.8	9.2	7.6	7.9
Capex/depreciation (x)	3.4	4.7	4.0	3.5	3.6
Net debt/equity (%)	10.7	7.9	10.7	9.6	9.8
Net interest cover (x)	14.0	17.3	14.7	14.6	14.6

Source: Company data, Deutsche Bank estimates

Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
SHK Properties Ltd	0016.HK	129.80 (HKD) 27 Feb 18	NA

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Historical recommendations and target price: SHK Properties Ltd (0016.HK)
(as of 2/27/2018)

Previous Recommendations

Strong Buy
Buy
Market Perform
Underperform
Not Rated
Suspended Rating

Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

*New Recommendation Structure as of September 9,2002

**Analyst is no longer at Deutsche Bank

1.	13/09/2016:	Downgrade to Hold, Target Price Change HKD113.40 Jason Ching	4.	14/09/2017:	Hold, Target Price Change HKD124.30 Jason Ching
2.	28/02/2017:	Hold, Target Price Change HKD117.00 Jason Ching	5.	19/10/2017:	Hold, Target Price Change HKD122.30 Jason Ching
3.	07/06/2017:	Hold, Target Price Change HKD118.50 Jason Ching	6.	07/02/2018:	Hold, Target Price Change HKD130.70 Jason Ching

Equity rating key

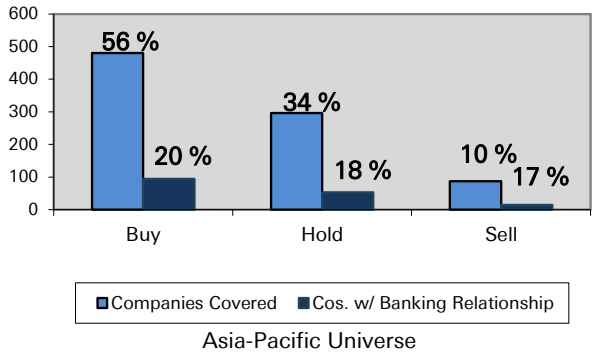
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships



Asia-Pacific Universe

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Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor who is long fixed-rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or liquidation of positions), and settlement issues related to local clearing houses are also important risk factors. The sensitivity of fixed-income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. The index fixings may – by construction – lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. Funding in a currency that differs from the currency in which coupons are denominated carries FX risk. Options on swaps (swaptions) the risks typical to options in addition to the risks related to rates movements.

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