


Rating
Hold
Asia
Hong Kong
Property
Company
SHK Properties Ltd

Reuters 0016.HK	Bloomberg 16 HK	Exchange HSI	Ticker 0016
ADR Ticker SUHJY	ISIN US86676H3021		

Date
14 September 2018
Results

Price at 13 Sep 2018 (HKD)	114.70
Price target - 12mth (HKD)	135.10
52-week range (HKD)	138.30 - 111.30
HANG SENG INDEX	26,345

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Key changes			
TP	139.40 to 135.10	↓	-3.1%
Sales (FYE)	96,725 to 96,042	↓	-0.7%
Op prof margin (FYE)	36.0 to 36.1	↑	0.2%
Net profit (FYE)	29,035.4 to 28,696.6	↓	-1.2%

Source: Deutsche Bank

Price/price relative


Performance (%)	1m	3m	12m
Absolute	-4.6	-8.2	-16.2
HANG SENG INDEX	-5.7	-14.3	-5.6

Source: Deutsche Bank

FY18 results strong, but macro headwinds override in near term; Hold

Maintain Hold – current dividend yield should provide good near-term support

SHKP reported strong FY18 results (stronger-than-expected margins and rental growth momentum picking up), with dividend growth beating expectations, continuing to reflect a quality management team. Yet, we expect macro headwinds (an imminent rate hike and uncertainties in relation to the trade war) to override in the near term. Meanwhile, the primary sales market is increasingly competitive, as reflected in a 21% YoY increase in the vendor financing balance, although HK contracted sales actually declined 8% YoY. FY18 dividend yield surpassing 4% should provide medium-term support; Hold.

FY18 underlying earnings +17% YoY to HK\$30,398m, beating our expectations

SHKP reported FY18 underlying profit of HK\$30,398m, implying a 17% YoY surge from HK\$25,965m in FY17 and beating our expectations. The beat was predominantly driven by higher-than-expected development margins in HK and higher sales bookings in China. Final dividend of HK\$3.45/shr was declared (+15% YoY), bringing full-year dividend to HK\$4.65/shr (+13% YoY), representing a marked accelerating pace compared to FY17 at 6.5%.

Rental revenue +8.2% YoY, driven by strong operations/AEI/new projects

In FY18, gross rental income (including associates/JVs) rose by 8.2% YoY to HK\$23,682m, with HK\$18,506m from HK (+6%), HK\$4,457m from China (+18% in HK\$, +11% in Rmb) and HK\$719m from Singapore (+7%). Strong growth in the China portfolio was particularly driven by new project completion and positive rental reversion. Overall growth momentum accelerated (FY18: 8.2%; FY17: 4%; FY16: 7%), with HK registering acceleration to 7.9% in 2H18 vs. 4.3% in 1H18 (2H17 at 3.2%/1H17 at 4.4%).

Development margins markedly improve in HK and China in FY18

A key reason behind the earnings beat in FY18 was higher-than-expected sales development margins. In particular, operating profit margins for the HK portfolio saw a 6.2 percentage point expansion to 39%. Those for the China portfolio saw an even stronger expansion by 14 percentage points to 37%.

HK landbank +9% YoY to 56.5m sf/China landbank -3% YoY to 64.5m sf

As of mid-2018, SHKP had a total HK landbank of 56.5m sf (+9% YoY), of which 22.7m sf was under development, implying 16% growth YoY following five projects that total 6.76m sf being added. In particular, the Shap Sz Heung project (farm-land conversion) boosted 4.8m sf GFA, and the Kai Tak project has total GFA of 1.3m sf. In China, total landbank fell by 3% to 64.5m sf, of which 50.7m sf was under development (down from 52.6m sf one year ago).

New target price of HK\$135.1 is based upon a sum-of-the-parts approach; risks

Our target price is based on a sum-of-the-parts approach, and implies a 2019E P/E of 14x. We believe that applying a 5-7x P/E 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.

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Figure 1: Summary of FY18 results

(HK\$m)	2018A	2017A	YoY	Remarks
Property sales	39,795	35,962	11%	- HK DP reported higher development margins at 39.0% (vs. 32.8% in FY17); HK contracted sales of HK\$41bn (HK\$44.7bn in FY17), exceeding the annual target of HK\$36bn; over HK\$29bn sales are yet to be recognized in HK. - China DP reported higher development margins at 34.9% (vs. 20.5% in FY17); HK\$4.7bn in sales are yet to be recognized in mainland China.
Property rental	19,411	17,970	8%	- Boosted by positive rental reversions and contributions from new rental properties.
Hotel operation	4,438	4,166	7%	
Telecommunications	9,988	8,715	15%	- Partly boosted by 16% YoY growth in customer base of SmarTone.
Transport infrastructure and logistics	4,009	3,860	4%	
Other businesses	8,003	7,534	6%	- Three new stores were opened for YATA during FY18.
Revenue	85,644	78,207	10%	
Cost of sales	(43,752)	(42,433)	3%	
Gross Profit	41,892	35,774	17%	
Finance cost	(1,985)	(1,987)	(0%)	
Finance income	368	278	32%	
Selling and marketing costs	(4,937)	(4,708)	5%	
Administrative expenses	(2,658)	(2,467)	8%	
Other net income	1,156	927	25%	
Revaluation gains	15,772	13,810	14%	
Profit from operations	49,608	41,627	19%	
Share of results of associates/JVs	9,748	7,598	28%	- Boosted by HK\$6.3bn in IP revaluation gains (HK\$4.4bn in FY17).
Pre-tax profit	59,356	49,225	21%	
Taxation	(8,402)	(6,750)	24%	
Post-tax profit before MI	50,954	42,475	20%	
Minority interests	(1,003)	(693)	45%	
Net attributable profit	49,951	41,782	20%	
Adjustment for non-recurring items	(19,553)	(15,817)	24%	
Core net profit	30,398	25,965	17%	- Mainly driven by higher-than-expected development margins in HK and higher sales bookings in China.
Reported EPS (HK\$)	17.24	14.43	19%	
Core EPS (HK\$)	10.49	8.97	17%	
DPS (HK\$)	4.65	4.10	13%	
Final	3.45	3.00	15%	- Equivalent to payout ratio of 44% on core EPS.
Interim	1.20	1.10	9%	

Source: Company data, Deutsche Bank

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Figure 2: Balance sheet

(HK\$m)	30-Jun-2017	30-Jun-2018
Non-current assets	375,462	415,053
Investment properties	337,980	369,477
Property and equipment	26,977	34,587
Other assets	10,505	10,989
Associates	63,841	71,767
Other investments	3,375	3,384
 Current assets	 196,738	 225,282
Properties for sale	146,409	177,367
Inventories	444	440
Debtors & deposits/receivables/others	18,611	21,380
Bank balances & cash	31,274	26,095
 Current liabilities	 (50,972)	 (66,435)
Bank loans and overdrafts	5,390	12,646
Forward sales deposits received	10,458	12,230
Creditors, deposits & accruals/others	26,908	31,008
Taxation	8,216	10,551
 Total assets less current liabilities	 588,444	 649,051
 Non-current liabilities	 62,151	 78,959
Long term bank loans	61,936	78,788
Others	215	171
Deferred income tax	18,930	21,660
 Issued share capital	 70,516	 70,612
Retained profits	425,407	466,194
Revaluation surplus	961	961
Capital & other reserves	1,331	1,331
Shareholders' funds	498,215	539,098
Perpetual capital securities	3,910	3,887
Minority interests	5,238	5,447
 Total capital employed	 588,444	 649,051

Source: Company data, Deutsche Bank

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Investment thesis

Outlook

SHKP reported strong FY18 results (stronger-than expected margins and rental growth momentum picking up), with dividend growth beating expectations, continuing to reflect a quality management team. Yet, we expect macro headwinds (an imminent rate hike and uncertainties in relation to the trade war) to override in the near term. Meanwhile, the primary sales market is increasingly competitive, as reflected in a 21% YoY increase in the vendor financing balance, although HK contracted sales actually declined 8% YoY. FY18 dividend yield surpassing 4% should provide medium-term support; Hold.

Valuation

Our target price is based on a sum-of-the-part approach (previously, a target discount on overall NAV), which implies a 2019 P/E of 14x. We believe that applying a 5-7x P/E 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 that applying an 8x P/E (on par with industry leaders with strong financial positions, such as COLI and CR Land) is appropriate, considering the financial strength and profitability profile of HK developers. We adopt this methodology as our new valuation metric across HK developers under our coverage.

Risks

- Fluctuations in the HK economy could lead to higher/lower housing demand;
- An interest rate hike and continuous liquidity outflows could 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 could be stricter/looser than expected.

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Model updated: 13 September 2018

Running the numbers

Asia

Hong Kong

Property

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Reuters: 0016.HK

Bloomberg: 16 HK

Hold

Price (13 Sep 18) HKD 114.70

Target Price HKD 135.10

52 Week range HKD 111.30 - 138.30

Market Cap (m) HKDm 332,287

USDm 42,336

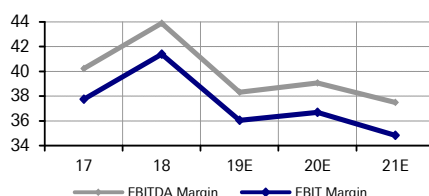
Company Profile

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.

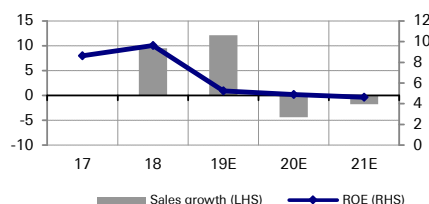
Price Performance



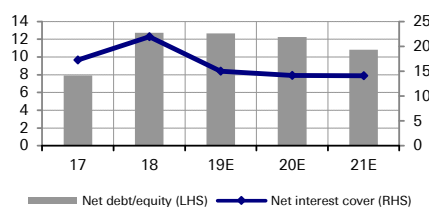
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 30-Jun

Financial Summary

	2017	2018	2019E	2020E	2021E
DB EPS (HKD)	8.97	10.49	9.91	9.50	9.20
Reported EPS (HKD)	14.43	17.24	9.91	9.50	9.20
DPS (HKD)	4.10	4.65	4.65	4.65	4.65
BVPS (HKD)	172.0	186.1	191.3	196.2	200.7
Weighted average shares (m)	2,895	2,897	2,897	2,897	2,897
Average market cap (HKDm)	321,356	367,206	332,287	332,287	332,287
Enterprise value (HKDm)	302,715	370,112	334,746	331,939	322,430

Valuation Metrics

P/E (DB) (x)	12.4	12.1	11.6	12.1	12.5
P/E (Reported) (x)	7.7	7.4	11.6	12.1	12.5
P/BV (x)	0.67	0.64	0.60	0.58	0.57
FCF Yield (%)	7.5	nm	4.0	4.7	6.6
Dividend Yield (%)	3.7	3.7	4.1	4.1	4.1
EV/Sales (x)	3.9	4.3	3.5	3.6	3.6
EV/EBITDA (x)	9.6	9.8	9.1	9.2	9.5
EV/EBIT (x)	10.3	10.4	9.7	9.8	10.3

Income Statement (HKDm)

Sales revenue	78,207	85,644	96,042	91,849	90,251
Gross profit	37,713	44,033	43,295	42,198	40,299
EBITDA	31,465	37,594	36,798	35,894	33,844
Depreciation	1,939	2,141	2,171	2,181	2,400
Amortisation	0	0	0	0	0
EBIT	29,526	35,453	34,627	33,713	31,444
Net interest income/(expense)	-1,709	-1,617	-2,305	-2,379	-2,236
Associates/affiliates	7,598	9,748	3,301	3,395	4,222
Exceptionals/extraordinary	13,810	15,772	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0
Profit before tax	49,225	59,356	35,623	34,729	33,431
Income tax expense	6,750	8,402	5,899	6,026	5,445
Minorities	693	1,003	1,027	1,176	1,339
Other post-tax income/(expense)	0	0	0	0	0
Net profit	41,782	49,951	28,697	27,527	26,647
DB adjustments (including dilution)	-15,817	-19,553	0	0	0
DB Net profit	25,965	30,398	28,697	27,527	26,647

Cash Flow (HKDm)

Cash flow from operations	32,596	3,491	16,537	23,987	29,333
Net Capex	-8,607	-4,278	-3,194	-8,231	-7,296
Free cash flow	23,989	-787	13,343	15,755	22,037
Equity raised/(bought back)	112	0	0	0	0
Dividends paid	-11,964	-13,471	-13,471	-13,471	-13,471
Net inc/(dec) in borrowings	-13,249	24,108	-1,589	2,490	-4,810
Other investing/financing cash flows	2,338	-15,028	-1,699	-1,697	-1,940
Net cash flow	1,226	-5,179	-3,416	3,078	1,815
Change in working capital	7,876	-27,267	-11,585	-3,018	3,629

Balance Sheet (HKDm)

Cash and other liquid assets	31,274	26,095	22,679	25,756	27,572
Tangible fixed assets	26,977	34,587	34,864	35,907	36,580
Goodwill/intangible assets	0	0	0	0	0
Associates/investments	63,841	71,767	75,068	78,463	82,685
Other assets	517,324	583,037	595,052	605,741	610,903
Total assets	639,416	715,486	727,662	745,866	757,739
Interest bearing debt	71,236	95,321	93,732	96,222	91,412
Other liabilities	64,727	75,620	73,132	73,615	75,784
Total liabilities	135,963	170,941	166,865	169,837	167,196
Shareholders' equity	498,215	539,098	554,324	568,380	581,555
Minorities	5,238	5,447	6,474	7,650	8,988
Total shareholders' equity	503,453	544,545	560,798	576,029	590,544
Net debt	39,962	69,226	71,053	70,465	63,840

Key Company Metrics

Sales growth (%)	nm	9.5	12.1	-4.4	-1.7
DB EPS growth (%)	na	17.0	-5.6	-4.1	-3.2
EBITDA Margin (%)	40.2	43.9	38.3	39.1	37.5
EBIT Margin (%)	37.8	41.4	36.1	36.7	34.8
Payout ratio (%)	28.4	27.0	46.9	48.9	50.6
ROE (%)	8.6	9.6	5.2	4.9	4.6
Capex/sales (%)	11.8	5.0	3.3	9.0	8.1
Capex/depreciation (x)	4.7	2.0	1.5	3.8	3.0
Net debt/equity (%)	7.9	12.7	12.7	12.2	10.8
Net interest cover (x)	17.3	21.9	15.0	14.2	14.1

Source: Company data, Deutsche Bank estimates

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Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
SHK Properties Ltd	0016.HK	114.70 (HKD) 13 Sep 18	NA

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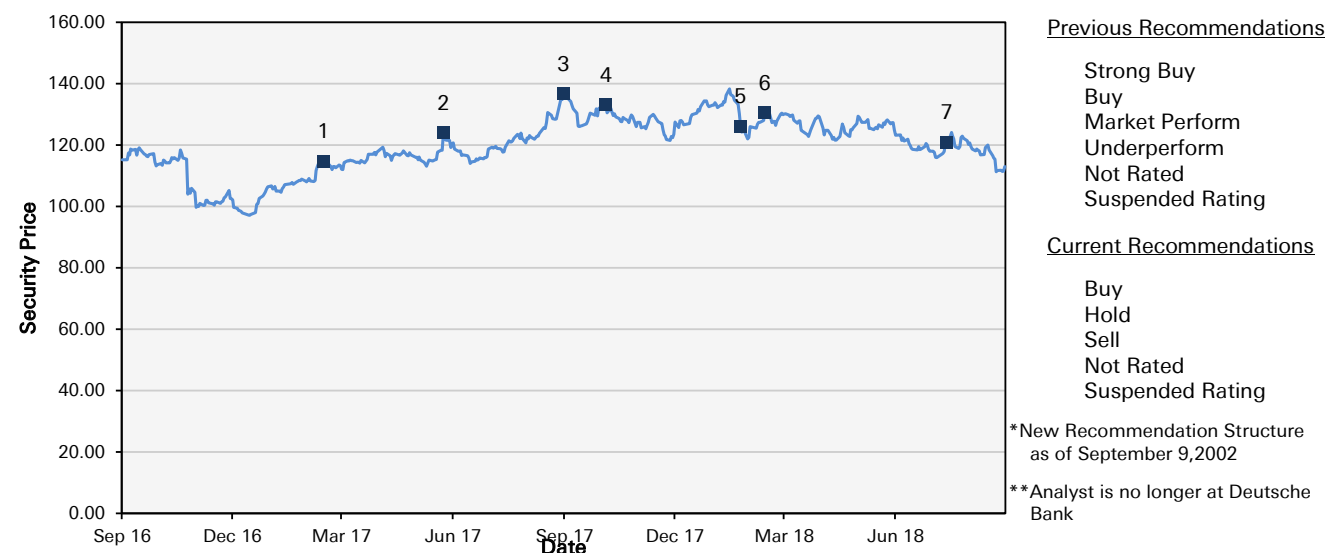
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Historical recommendations and target price: SHK Properties Ltd (0016.HK)

(as of 9/13/2018)



1. 28/02/2017:	Hold, Target Price Change HKD117.00 Jason Ching	5. 07/02/2018:	Hold, Target Price Change HKD130.70 Jason Ching
2. 07/06/2017:	Hold, Target Price Change HKD118.50 Jason Ching	6. 27/02/2018:	Hold, Target Price Change HKD135.90 Jason Ching
3. 14/09/2017:	Hold, Target Price Change HKD124.30 Jason Ching	7. 27/07/2018:	Hold, Target Price Change HKD139.40 Jason Ching
4. 19/10/2017:	Hold, Target Price Change HKD122.30 Jason Ching		

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Equity rating key

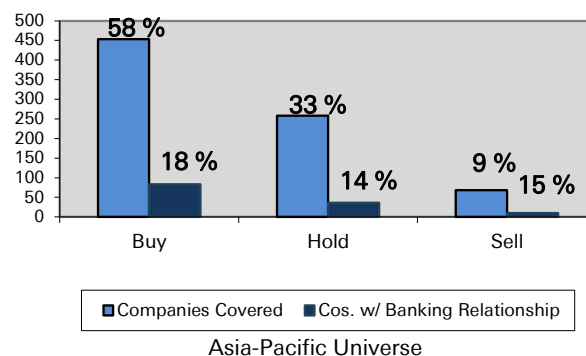
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

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



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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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