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13 December 2018

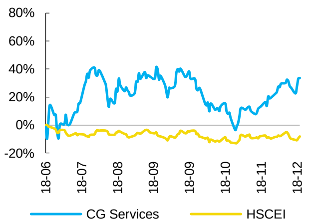
增持

首次覆盖

Market Data: 13, Dec

Closing Price (HK$)	13.36
Price Target (HK$)	14.90
HSCEI	10,557
HSCCI	4,380
52-week High/Low (HK$)	14.48/8.80
Market Cap (USD Mn)	4,278
Market Cap (HK$ Mn)	33,400
Shares Outstanding (Mn)	2,500
Exchange Rate (RMB-HK$)	1.14

Price Performance Chart:



Source: Bloomberg

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规模利润并重，巩固龙头优势

碧桂园服务 (06098: HK)

Financial summary and valuation

	2016	2017	2018E	2019E	2020E
Revenue (Rmbm)	2,358	3,122	4,992	7,152	9,693
YoY (%)	41%	32%	60%	43%	36%
Net income (Rmbm)	324	402	885	1,159	1,506
YoY (%)	47%	24%	120%	31%	30%
EPS (Rmb)	0.13	0.16	0.35	0.46	0.60
ROE (%)	42%	34%	49%	45%	41%
Net Gearing (%)	0%	0%	0%	0%	0%
Dividend Yield (%)			0.8%	1.0%	1.3%
P/E (x)	87	70	32	24	19
P/B (x)	26	18	12	9	6

Core EPS is calculated as if all non-recurring items are excluded. P/E is calculated as closing price divided by each year’s core EPS.

碧桂园服务是中国最大物业开发商碧桂园控股旗下的物业管理服务板块，于 6 月 19 日在香港联交所主板独立挂牌上市，并一举成为行业龙头。我们看好公司未来业绩快速增长可见度高，且在低阶城市市场具备领先的管理实力。我们预计公司 2018-2020 年每股净利分别为 0.35 元（同比增长 120%）、0.46 元（同比增长 31%）和 0.60 元（同比增长 30%）。我们给予公司 27 倍 19 年 PE，对应目标价 14.9 港币，较现价有 12%上升空间，首次覆盖碧桂园服务并给予增持评级。

截止 2018 年 6 月末，碧桂园服务总合约管理面积同比增长 56%至 3.68 亿平米（对应 2015-2017 年复合增长率为 43%），仅次于上市同业彩生活服务的 4.84 亿平米。同期公司总收费管理面积同比增长 27%至 1.37 亿平米（对应 2015-2017 年复合增长率为 33%），其中近 90%来自于碧桂园控股开发的物业项目，而与此同时，我们注意到碧桂园服务持续优化管理组合，丰富管理业态，承接非住宅项目如商业或市政设施等，将其收费管理面积的贡献占比从 2015 年的 0.1%，2016 年的 0.2%提升至 2017 年的 4.6%。我们预计公司 2018-2020 年总收费管理面积分别为 1.91 亿平米（同比增长 55%）、2.68 亿平米（同比增长 41%）和 3.64 亿平米（同比增长 36%），对应三年复合增长率达 44%。

我们注意到板块平均毛利率从 2015 年的 27%稳步改善至 2017 年的 30%，同期平均净利率从 10%提升至 12%。其中基础物管服务板块的毛利率存在明显分化，主要原因在于，一是毛利率为 100%的酬金制占比不同，二是代表公司经营效率和成本管控能力的包干制毛利率有所不同。若剔除酬金制影响，板块平均包干制毛利率从 2015 年的 18%提升至 2017 年的 21%，其中碧桂园服务以 29%位居首位。伴随收入结构的变动，我们预计公司 2018-2020 年综合毛利率分别为 34.3%，33.9%和 33.4%（相比 2017 年为 33.2%），同期净利率分别为 17.7%，16.2%和 15.5%（相比 2017 年为 12.9%），因公司于 2018 年 5 月获得“高新技术企业”证书并由此在 2017-2019 三年期间享有优惠所得税率 15%。

港股物业管理板块自十月下旬开始有所企稳，因市场预期明年 1 月起实施社保征缴新规时将有望结合下调社保费率，且房地产行业新房销售增速放缓的预期已部分反应，作为行业龙头的碧桂园服务显著跑赢同业。目前板块平均估值为 18 倍 19 年 PE，其中业绩增长可见度高且深耕低阶城市的碧桂园服务估值为 24 倍 19 年 PE，具备高端品牌和充足储备面积但短期利润率承压的绿城服务估值为 23 倍 19 年 PE，更为依赖集团开发商且有望扩张提速的中海物业估值为 15 倍 19 年 PE，母公司开发能力偏弱而积极发展增值服务的彩生活估值仅为 7 倍 19 年 PE。我们注意到公司在稳健增长的同时，也积极开拓第三方项目并把握合适收并购机会，以降低在地产下行周期中对集团开发商的单一依赖。我们给予公司 27 倍 19 年 PE，对应目标价 14.9 港币，较现价有 12%上升空间，首次覆盖碧桂园服务并给予增持评级。

Country Garden Services (CG Services) is a property management services provider, which listed in June 2018 following its spin-off from Country Garden Holdings (02007:HK – Outperform), China's largest developer in terms of sales. We are positive on the company given the high visibility of its rapid earnings growth on the back of aggressive expansion and market-leading management capabilities in lower-tier cities. We forecast EPS of Rmb0.35 in 2018E (+120% YoY), Rmb0.46 in 2019E (+31% YoY) and Rmb0.60 in 2020E (+30% YoY). Our HK$14.9 target price (27x 19E PE) represents 12% upside and we initiate coverage with an Outperform recommendation.

Aggressive expansion. As of mid-2018, CG Services recorded a total contracted gross floor area (GFA) of 368msqm (+56% YoY) which rose at a two-year Cagr of 43% in 2016-17, second to market leader Colour Life Services (01778: HK – Outperform) at 484msqm. During the same period, revenue-generating GFA reached 137msqm (+27% YoY), expanding at a 33% Cagr, of which c.90% was contributed by Country Garden Holdings. Meanwhile, we note that CG Services continues to diversify its property management portfolio by expanding coverage to non-residential properties, such as commercial properties and public facilities, with the contribution rising from 0.1% of revenue-generating GFA in 2015 to 0.2% in 2016 and 4.6% in 2017. We forecast total revenue-generating GFA to reach 191msqm in 2018E (+55% YoY), 268msqm in 2019E (+41% YoY) and 364msqm in 2020E (+36% YoY), translating into a three-year Cagr of 44% in 2018-20E.

Margin outlook. We note that the industry's average gross margin steadily improved from 27% in 2015 to 30% in 2017, while average net margin rose from 10% to 12% during the same period. The variance in the property management service segment primarily stems from the contribution of properties booked on a commission basis with a gross margin of 100% and the actual gross margin of properties booked on a lump-sum basis, which is impacted by management efficiency and cost controls. By excluding the contribution of commission-based properties, the average gross margin of lump-sum based properties improved from 18% in 2015 to 21% in 2017, with CG Services ranking first at 29% in 2017. We expect the firm's blended gross margin to reach 34.3%, 33.9% and 33.4% in 2018-20E, vs 33.2% in 2017, given the rising proportion of lower margin business with third parties. Net margin is expected to improve from 12.9% in 2017 to 17.7%, 16.2% and 15.5% in 2018-20E as we employ a 15% tax rate, versus the historical average of 26% in 2015-17. We note that the company received a "High and New Technology Enterprise" certificate in May-2018, under which it is entitled to an income tax rate of 15% for three years from January 2017 to December 2019.

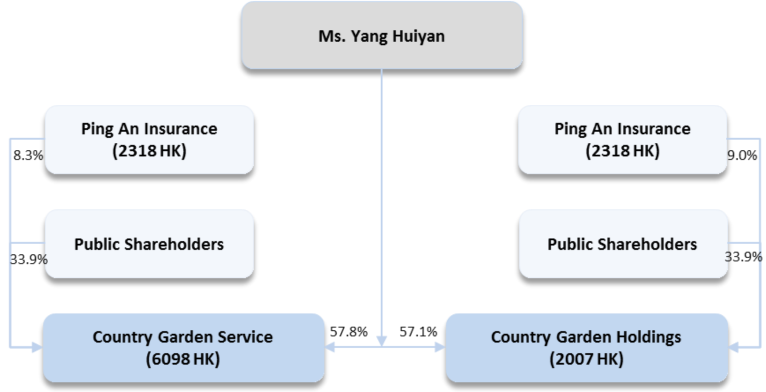
Initiate with an Outperform. The Hong Kong-listed property management industry began to rebound from late October, with CG Services significantly outperforming its peers. The sector now trades at 18x 19E PE, with CG Services at 24x 19E PE, versus Greentown Service (02869:HK – Outperform) at 23x, China Overseas Property Holdings (02669:HK – BUY) at 15x and Colour Life Services at 7x. We note its encouraging progress in decreasing reliance on developer support amid weakening market and remain positive on its rapid earnings growth and leading management capabilities in lower-tier cities. We forecast EPS of Rmb0.35 in 2018E (+120% YoY), Rmb0.46 in 2019E (+31% YoY) and Rmb0.60 in 2020E (+30% YoY). Given our target PE of 27x 19E PE, we arrive at a target price of HK$14.9. With 12% upside, we initiate coverage with an Outperform rating.

Company at a glance

CG Services is a property management services provider, which listed in June 2018 following its spin-off from Country Garden Holdings, China's largest developer in terms of sales.

A total of 2.5bn CG Services shares were distributed on 29 May 2018 to all registered shareholders of Country Garden, representing one CG Services share for every 8.7 Country Garden shares. The founder Ms. Yang Huiyan remain the largest shareholder of CG Services with a 57.8% stake, followed by Ping An Insurance (8.3% stake).

Fig 1: Shareholding structure of Country Garden Service

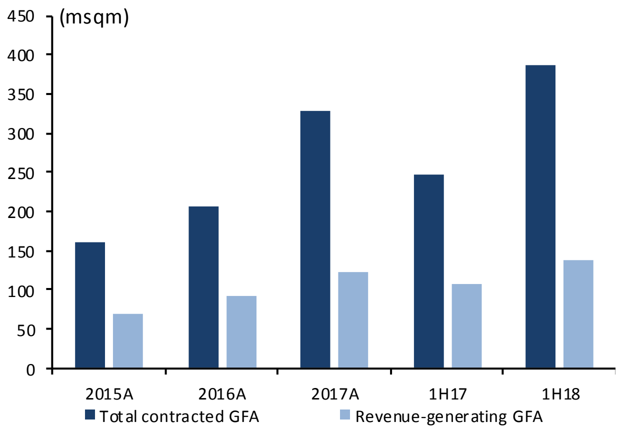


Source: Company data, SWS Research

As of mid-2018, CG Services recorded a total contracted gross floor area (GFA) of 368msqm (+56% YoY) which rose at a two-year Cagr of 43% in 2016-17, second to market leader Colour Life Services at 484msqm. During the same period, revenue-generating GFA reached 137msqm (+27% YoY), expanding at a 33% Cagr, of which c.90% was contributed by Country Garden Holdings.

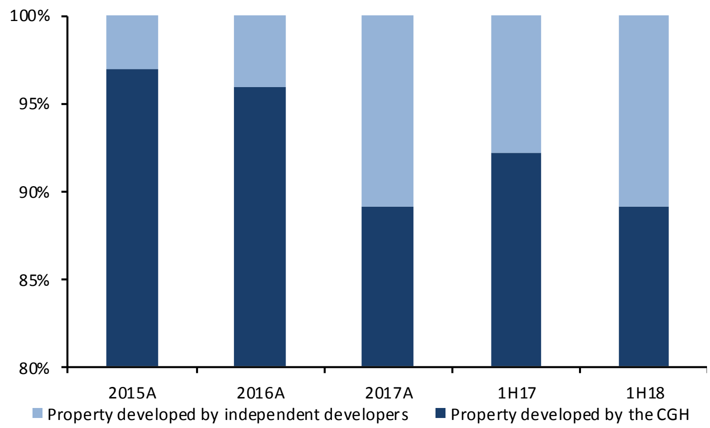
However, we note that the percentage of properties developed by third-party developers rose from 3% in 2015 to 11% in 1H18.

Fig 2: Total contracted GFA and revenue-generating GFA



Source: Company data, SWS Research

Fig 3: Breakdown of revenue-generating GFA by source

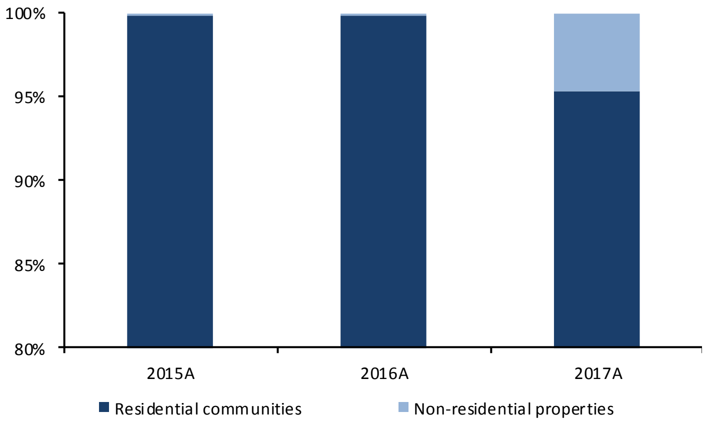


Source: Company data, SWS Research

As Country Garden Holdings is China's largest developer that focuses on lower-tier cities, residential properties accounted for 95% of revenue-generating GFA for CG Services or 99% of property management revenue in 2017. The company's average monthly property management fees are currently Rmb1.8/sqm, versus the industry average of Rmb2.3/sqm.

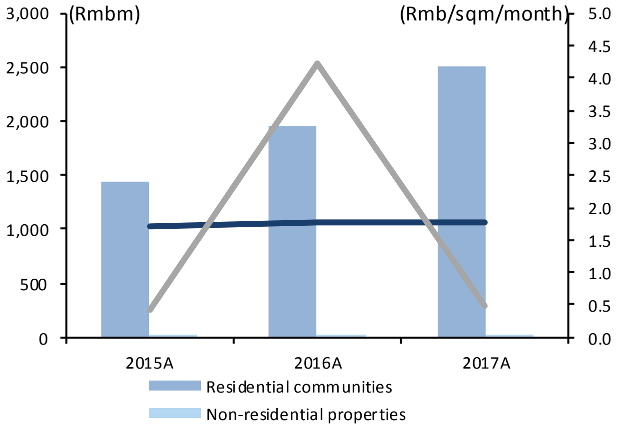
CG Services continues to diversify its property management portfolio by expanding coverage to non-residential properties, such as commercial properties, (office buildings and complexes) and public facilities, with the contribution rising from 0.1% of revenue-generating GFA in 2015 to 0.2% in 2016 and 4.6% in 2017.

Fig 4: Breakdown of revenue-bearing GFA by property type



Source: Company data, SWS Research

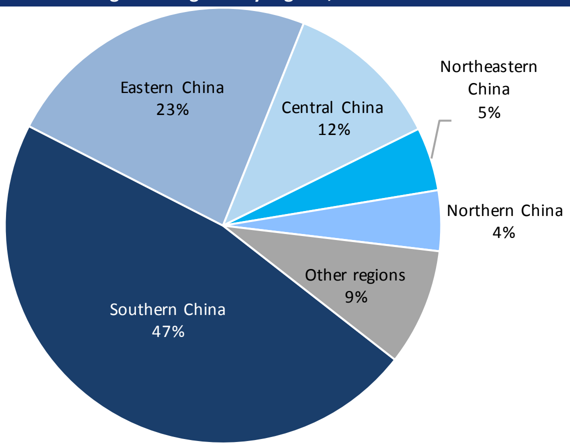
Fig 5: Breakdown of property management revenue by property type with fee



Source: Company data, SWS Research

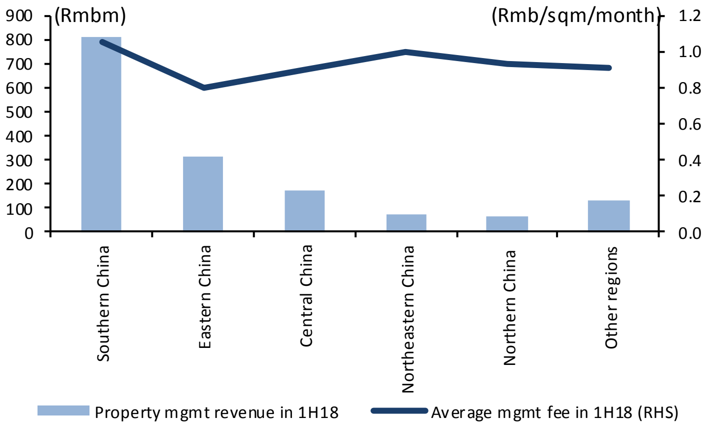
By region, southern China accounted for 47% of revenue-generating GFA in mid-2018, followed by eastern China (23%) and central China (12%), with other regions accounting for the remaining 18%. These three regions remain the largest revenue contributors, accounting for 52%, 20% and 11% of property management revenue in 1H18, translating into a monthly property management fee of c.Rmb1.0/sqm in 1H18, vs. Rmb0.9/sqm in 1H17.

Fig 6: Breakdown of revenue-generating GFA by regions, Jun-2018



Source: Company data, SWS Research

Fig 7: Breakdown of property management revenue by regions with fee, 1H18



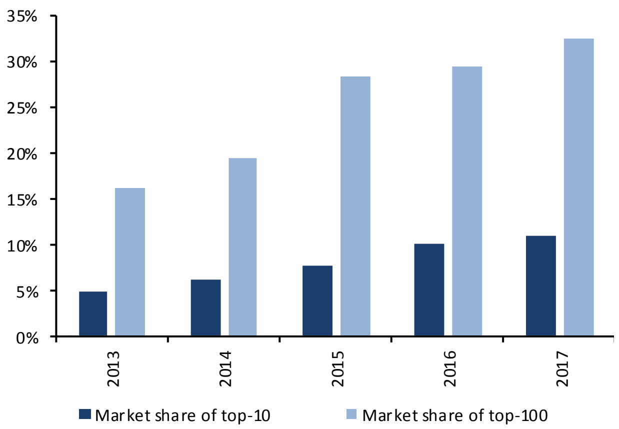
Source: Company data, SWS Research

Market consolidation

According to the China Index Academy, although the property management sector was a highly fragmented industry, it has consolidated over the years, with the market share of the top-10 companies increasing from 5% in 2013 to 11% in 2017, and that of the top-100 firms rising from 16% in 2013 to 32% in 2017.

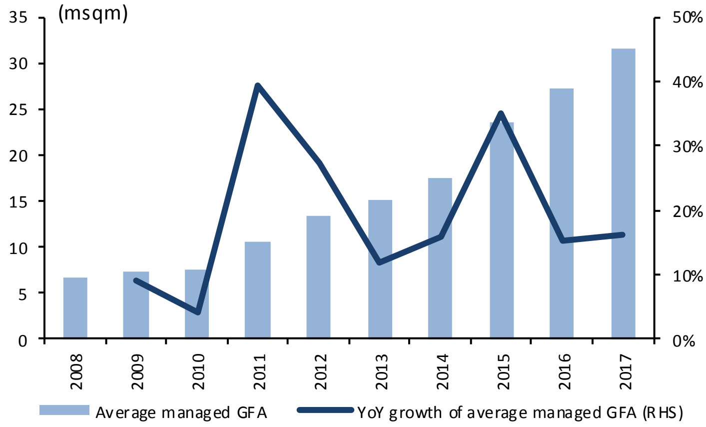
More specifically, the top-10 companies recorded an average managed GFA of 216msqm in 2017 (+8% YoY), seven times the average managed GFA of 32msqm for the top-100 firms (+16% YoY). We expect market leaders to continue benefiting from industry concentration on the back of their strong execution capabilities and effective cost control measures.

Fig 8: Market share of top-10 and top-100 companies



Source: China Index Academy, SWS Research

Fig 9: Average managed GFA of top-100 companies



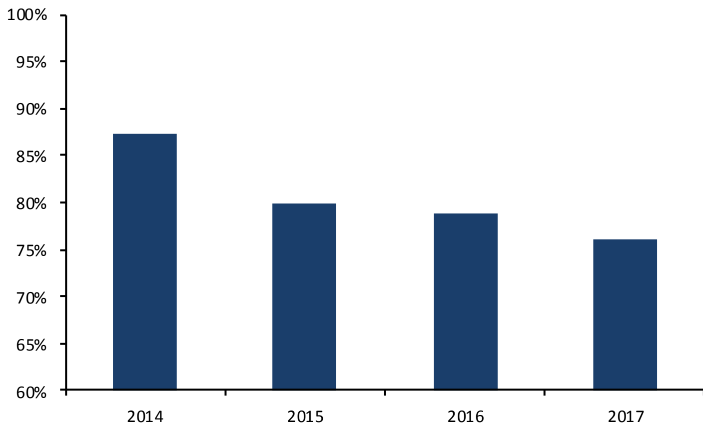
Source: China Index Academy, SWS Research

Policy overhang

Although the property management industry is traditionally a labour intensive industry, the average operating expense ratio of the top-100 companies declined from 87% in 2014 to 76% in 2017, with the adoption of standardised management systems, and the development and application of intelligent equipment.

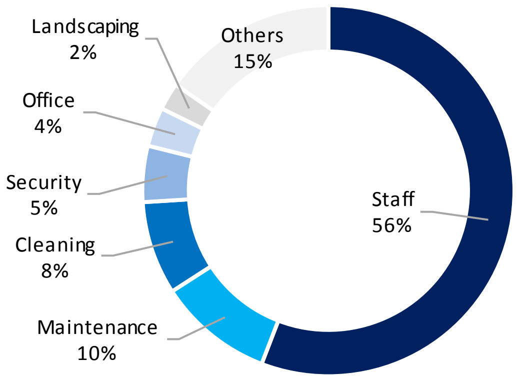
Staff costs accounted for 56% of top-100 firms' average operating expenses in 2017, while cleaning, security and landscaping costs together contributed for 15%, which are normally outsourced to deal with rising labour costs while ensuring service quality and efficiency.

Fig 10: Operating expenses ratio of top-100 companies, 2014-17



Source: China Index Academy, SWS Research

Fig 11: Breakdown of operating expenses, 2017



Source: China Index Academy, SWS Research

In late August, rising expectations of increasing labour costs under a new social insurance collection policy became a concern for the industry. However, according to the latest policy tone, corporate tax burdens are unlikely to be increased, while potential tax cuts are under consideration. We believe that favourable policy announcements on corporate tax should help alleviate negative sentiment and rebuild confidence in the near term.

On 20 July, Xinhua News Agency reported that the General Office of the CPC Central Committee and the General Office of the State Council issued the "Regulations on the Reform of the Taxation and Collection System of National Taxes and Local Taxes". More specifically, national and local taxation agencies will be merged and social insurance will be collected by tax authorities, starting from 1 January 2019, to enhance policy transparency and uniformity of law enforcement, as well as standardise collection management services. We expect the new collection policy to reduce tax evasion and lead to rising labour costs for companies as the latter will be required to pay social insurance in full based on employees' actual incomes.

Later in September, Prime Minister Li Keqiang hosted the State Council's executive meeting and stressed that accumulated pensions are sufficient to ensure full payment on time, while existing collection policies should remain unchanged before the reform of social insurance collection agencies takes place. Moreover, local authorities are required to reduce the social insurance rate according to their specific situation, such as local fiscal revenue, employment rate, social insurance collection, etc., to avoid increasing the overall tax burden on companies.

Social insurance reforms first gained the market's attention when Greentown Service Group guided during its analyst meeting on 27 August an estimated increase in labour costs of Rmb70m for in-house staff, or Rmb130m when taking sub-contracting costs into consideration. Given the difficulties in comparing the potential impact across peers, we carried out an analysis on extra labour costs under the new collection policy, mainly focusing on in-house staff, as sub-contracting costs may vary across cities and largely rely on property managers' bargaining power, while it takes time to shift costs.

We estimate that extra labour costs for in-house staff will reach c.Rmb55m on average, with CG Services ranking first at Rmb78m, followed by Greentown Service (Rmb72m), China Overseas Property (Rmb52m), A-Living Services (03319:HK – Not rated; Rmb39m), and Colour Life Services (Rmb31m).

Fig 12: Estimated increase in labour cost for in-house staff under the new social insurance collection policy

Rmb/month	Colour Life Services	China Overseas Property	Greentown Service	A-Living Services	Country Garden Services
Total labour cost for in-house staff (Rmbn)	549	1,448	1,670	784	1,760
Number of in-house staff	13,000	30,014	20,639	12,192	23,961
Average income of in-house staff	3,518	4,022	6,743	5,360	6,120
Major area	Southern China	Southern China	Eastern China	Southern China	Southern China
Key city	Shenzhen	Shenzhen	Hangzhou	Guangzhou	Guangzhou
Minimum wage in 2017	2,130	2,130	1,860	1,895	1,895
Social insurance base in 2017	7,480	7,480	4,699	6,071	6,071
Lower limit (=60%*social insurance base)	4,488	4,488	2,819	3,642	3,642
Upper limit (=300%*social insurance base)	22,439	22,439	14,096	18,212	18,212
Old social insurance base	2,200	3,050	4,800	3,600	4,300
Social insurance paid (=30%* old social insurance base)	660	915	1,440	1,080	1,290
New social insurance base under new rule (= average income)	3,518	4,022	6,743	5,360	6,120
Social insurance paid (=30%* new social insurance base)	1,055	1,206	2,023	1,608	1,836
Newly-added social insurance paid	395	291	583	528	546
Newly-added social insurance paid for in-house staff costs (Rmbm)					
If 100% of staff were paid at new social insurance base, 0% paid at old social insurance	62	105	144	77	157
If 70% of staff were paid at new social insurance base, 30% paid at old social insurance	43	73	101	54	110
If 50% of staff were paid at new social insurance base, 50% paid at old social insurance	31	52	72	39	78
If 30% of staff were paid at new social insurance base, 70% paid at old social insurance	18	31	43	23	47
If 0% of staff were paid at new social insurance base, 100% paid at old social insurance	-	-	-	-	-
Average	31	52	72	39	78

Source: Company data, SWS Research

As for sub-contracting costs, in order to remain consistent with the industry average, we assume total labour costs account for 70% of total operating costs, thus translating into differentiated sub-contracting ratios among listed peers, with Greentown Service ranking first at 48%, followed by Colour Life Services at 35%, A-Living Services at 18%, China Overseas Property at 17%, and CG Services at 2%.

We calculate extra labour costs for sub-contracted staff to reach an industry average of c.Rmb21m. Greentown Service tops the list at Rmb68m, versus Rmb16m for Colour Life Services, Rmb11m for China Overseas Property, Rmb9m for A-Living Services, and Rmb1m for CG Services.

Total extra labour costs under the new social insurance collection policy amount to Rmb76m on average, with Greentown Service suffering highest burden of Rmb140m, in line with company guidance, followed by CG Services (Rmb80m), China Overseas Property (Rmb63m), Colour Life Services (Rmb47m) and A-Living Services (Rmb47m).

Fig 13: Estimated increase in labour cost for sub-contracting staff under new social insurance collection policy

(Rmbm)	Colour Life Service	China Overseas Property	Greentown Service	A-Living Services	Country Garden Services
Total operating costs	1,201	2,499	4,632	1,373	2,555
Total labour costs = in-house staff costs + sub-contracting costs, and assume total labour costs / total operating costs = 70%					
In-house staff costs / total operating costs	46%	58%	36%	57%	69%
Sub-contracting costs / total operating costs	24%	12%	34%	13%	1%
Total	**70%**	**70%**	**70%**	**70%**	**70%**
In-house staff costs / total labour costs	65%	83%	52%	82%	98%
Sub-contracting costs / total labour costs	35%	17%	48%	18%	2%
Total	**100%**	**100%**	**100%**	**100%**	**100%**
Newly-added social insurance paid for sub-contracting costs (Rmbm)					
If 100% of staff were paid at new social insurance base, 0% paid at old social insurance	33	22	136	17	3
If 70% of staff were paid at new social insurance base, 30% paid at old social insurance	23	15	95	12	2
If 50% of staff were paid at new social insurance base, 50% paid at old social insurance	16	11	68	9	1
If 30% of staff were paid at new social insurance base, 70% paid at old social insurance	10	7	41	5	1
If 0% of staff were paid at new social insurance base, 100% paid at old social insurance	-	-	-	-	-
Average	**16**	**11**	**68**	**9**	**1**
Newly-added social insurance paid for total labour costs (Rmbm)					
If 100% of staff were paid at new social insurance base, 0% paid at old social insurance	94	127	280	95	160
If 70% of staff were paid at new social insurance base, 30% paid at old social insurance	66	89	196	66	112
If 50% of staff were paid at new social insurance base, 50% paid at old social insurance	47	63	140	47	80
If 30% of staff were paid at new social insurance base, 70% paid at old social insurance	28	38	84	28	48
If 0% of staff were paid at new social insurance base, 100% paid at old social insurance	-	-	-	-	-
Average	**47**	**63**	**140**	**47**	**80**

Source: Company data, SWS Research

Based on our estimation, we calculate the operating profits of five key listed companies to decline by an average of 12% after payment for extra social insurance for in-house staff, and to drop by 16% when taking extra social insurance of sub-contracted staff into account.

By paying extra social insurance for both in-house and sub-contracted staffs, Greentown Service would see the largest decline in operating profit in 2017 of 29%, versus China Overseas Property (-17%), CG Services (-14%), A-Living Services (-12%) and Colour Life Services (-9%).

Fig 14: Estimated decline in operating profit under new social insurance collection policy

(Rmbm)	Colour Life Services	China Overseas Property	Greentown Service	A-Living Services	Country Garden Services
Actual operating profit in 2017	542	368	485	398	581
Estimated operating profit after newly-added social insurance paid for in-house staff costs					
If 100% of staff were paid at new social insurance base, 0% paid at old social insurance	481	263	340	321	424
If 70% of staff were paid at new social insurance base, 30% paid at old social insurance	499	294	383	344	471
If 50% of staff were paid at new social insurance base, 50% paid at old social insurance	511	315	412	360	503
If 30% of staff were paid at new social insurance base, 70% paid at old social insurance	524	336	441	375	534
If 0% of staff were paid at new social insurance base, 100% paid at old social insurance	542	368	485	398	581
Average	511	315	412	360	503
Estimated % change in operating profit					
If 100% of staff were paid at new social insurance base, 0% paid at old social insurance	-11%	-29%	-30%	-19%	-27%
If 70% of staff were paid at new social insurance base, 30% paid at old social insurance	-8%	-20%	-21%	-14%	-19%
If 50% of staff were paid at new social insurance base, 50% paid at old social insurance	-6%	-14%	-15%	-10%	-14%
If 30% of staff were paid at new social insurance base, 70% paid at old social insurance	-3%	-9%	-9%	-6%	-8%
If 0% of staff were paid at new social insurance base, 100% paid at old social insurance	0%	0%	0%	0%	0%
Average	-6%	-14%	-15%	-10%	-14%
Estimated operating profit after newly-added social insurance paid for total labour costs					
If 100% of staff were paid at new social insurance base, 0% paid at old social insurance	448	241	204	304	422
If 70% of staff were paid at new social insurance base, 30% paid at old social insurance	476	279	288	332	469
If 50% of staff were paid at new social insurance base, 50% paid at old social insurance	495	304	344	351	501

If 30% of staff were paid at new social insurance base, 70% paid at old social insurance	514	329	400	370	533
If 0% of staff were paid at new social insurance base, 100% paid at old social insurance	542	368	485	398	581
Average	495	304	344	351	501
Estimated % change in operating profit					
If 100% of staff were paid at new social insurance base, 0% paid at old social insurance	-17%	-34%	-58%	-24%	-27%
If 70% of staff were paid at new social insurance base, 30% paid at old social insurance	-12%	-24%	-40%	-17%	-19%
If 50% of staff were paid at new social insurance base, 50% paid at old social insurance	-9%	-17%	-29%	-12%	-14%
If 30% of staff were paid at new social insurance base, 70% paid at old social insurance	-5%	-10%	-17%	-7%	-8%
If 0% of staff were paid at new social insurance base, 100% paid at old social insurance	0%	0%	0%	0%	0%
Average	-9%	-17%	-29%	-12%	-14%

Source: Company data, SWS Research

We note that a few Chinese cities have already implemented social insurance rate cuts, ranging from 1-5%. We thus conducted a scenario analysis by assuming potential social insurance rate cuts of 0%, 2.5%, 5.0%, 7.5%, and 10%, and assume 50% of employees are affected by the new social insurance collection rule (our base-case scenario).

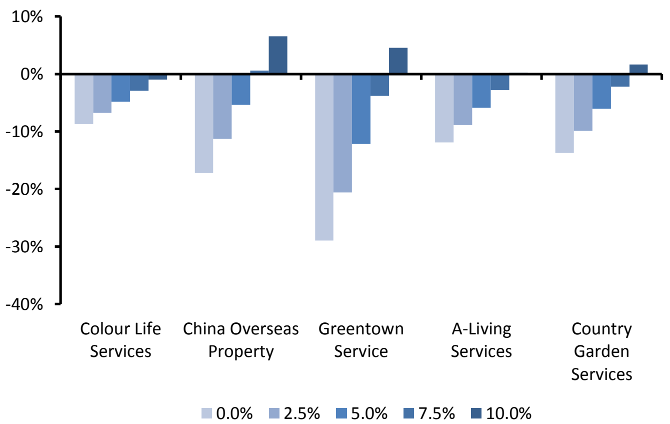
According to our analysis, Greentown Service is the most sensitive player, with 2017 operating profit falling c.30% if no rate cut takes place, but rising 4.5% under a 10% rate cut, while China Overseas Property would be the primary beneficiary of sizeable rate cuts, with its 2017 operating profit turning positive with a 7.5% rate cut, and increasing 6.5% with a 10% rate cut.

Fig 15: Proposed social insurance rate cuts in multiple cities across the nation

City	Shanghai	Changzhou	Jiangsu	Sichuan	Shanxi	Guangxi	Anhui	Inner Mongolia	Fujian	Guangzhou	Jining	Henan	Deyang	Nanning	Guizhou
Date	2018/	2018/	2018/	2018/	2018/	2018/	2018/	2018/	2018/	2018/	2018/	2018/	2018/	2018/	2018/
	May-18	May-18	Jun-18	Jun-18	Jun-18	Jun-18	Jul-18	Jul-18	Aug-18	Aug-18	Sep-18	Sep-18	Sep-18	Sep-18	Oct-18
Pension insurance rate		19%	19%			Cut from 20% to 19%	19%	Cut From 20% to 19%				19%	Cut from 20% to 19%	Cut from 20% to 19%	19%
Health insurance rate														Cut From 8% to 6%	
Unemployment insurance rate	1%	1%	1%		1%	Cut from 1.5% to 0.5%	1%	1%	1%,			1%	Cut from 2% to 1%	Cut from 1.5% to 0.5%	1%
Work injury insurance rate	50% off (0.2%-1.9%)	50% off (0.4%-2.2%).	20-50% off (0.96%)	20-50% off (0.2%-1.9%)		Cut from 1% to 0.75%	Cut to 0.2%-1.9%.	20-50% Off (0.2%-1.9%)	Cut from 0.75% to 0.59%	20-30% off (0.15%-1.0%）	50% off (0.2%-1.9%）	20-50% off (0.2%-1.9%)	20% off (0.16%-1.52%)	Cut from 1% to 0.55%	20% off (0.2%-1.9%)
Maternity insurance rate										Cut to 0.5%-0.45%				Lifted from 0.8% to 1.3%	

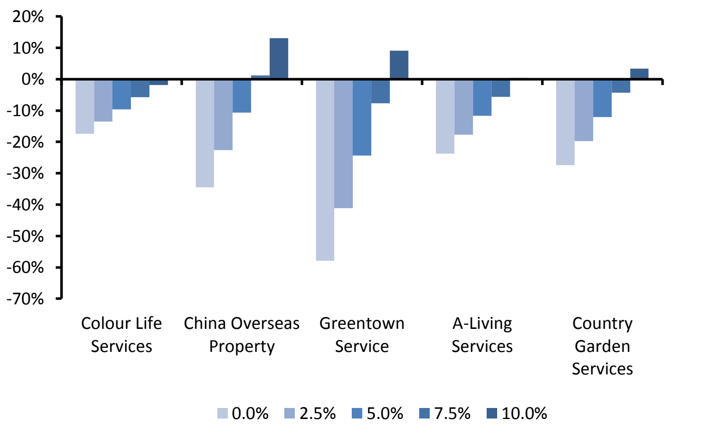
Source: Media reports, SWS Research

Fig 16: Estimated change in 17A operating profit with different potential social insurance rate cuts when 50% of staff are under the new social insurance policy



Source: Company data, SWS Research

Fig 17: Estimated % change in 17A operating profit with different potential social insurance rate cuts when 100% of staff are under new social insurance policy



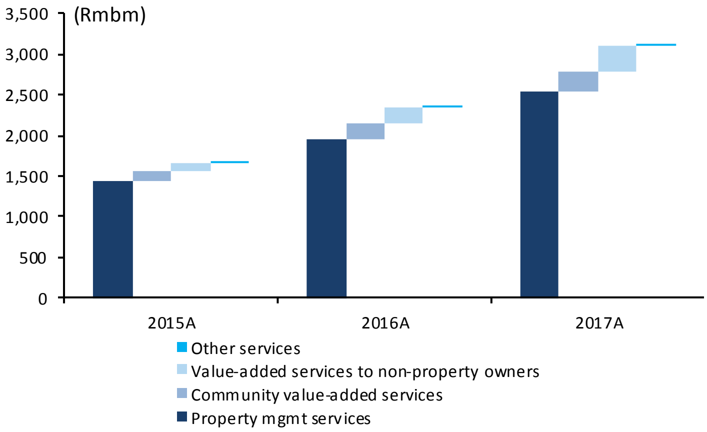
Source: Company data, SWS Research

Financial summary

CG Service recorded total revenue of Rmb3.1bn in 2017, rising at a two-year Cagr of 37% in 2016-17, of which property management services remains the largest contributor at Rmb2.5bn (82% of total revenue), rising at a two-year Cagr of 33%, while value-added services (VAS) to non-property owners contributed Rmb328m (11% of total, two-year Cagr of 73%), and community VAS recorded revenue of Rmb242m (8% of total, two-year Cagr of 41%), vs. 0.2% from other services.

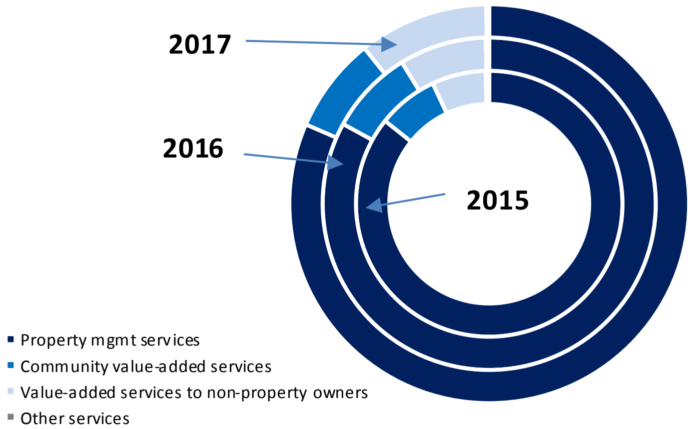
While the property management services segment guaranteed steady revenue growth on the back of the gradual delivery of newly-built properties, we highlight that the revenue contribution from VAS rose from 14% in 2015 to 18% in 2017, which help to expand the revenue stream and smooth cyclical fluctuations.

Fig 18: Revenue breakdown by segment



Source: Company data, SWS Research

Fig 19: Revenue breakdown by segment

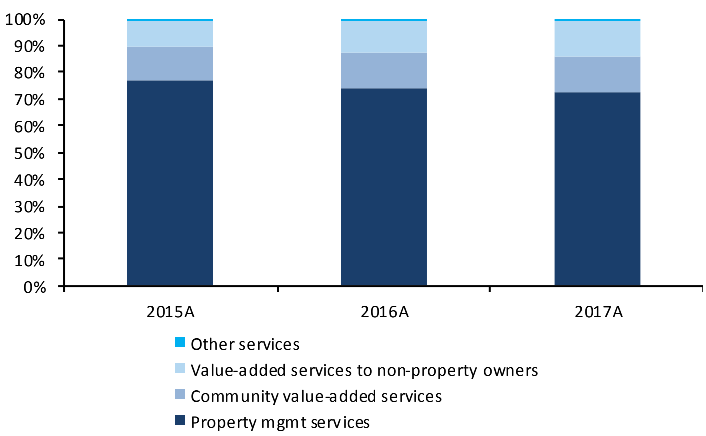


Source: Company data, SWS Research

In terms of segment gross profit, while the contribution of property management services (gross margin of c.30%) declined from 77% in 2015 to 72% in 2017, we note that VAS to non-property owners (gross margin of 44%) rose from 9% in 2015 to 14% in 2017, vs. stable gross profit contribution of 13% from community VAS (gross margin of 56%) and the remaining 1% from other services (gross margin of 82%). Therefore, given the gradual improvement of the segment structure, the company's blended gross margin improved from 30.6% in 2015 to 33.2% in 2017.

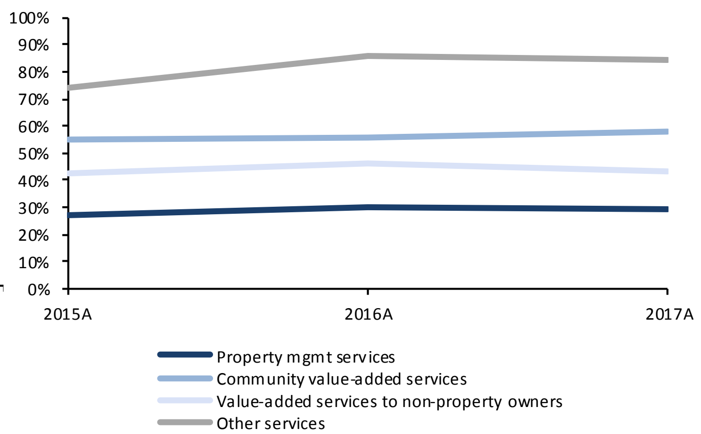
CG Service's net profit amounted to Rmb4.0bn in 2017 (+24% YoY) with a two-year Cagr of 35%, while net margin slightly declined from 13.2% in 2015 to 12.9% in 2017 due to rising costs.

Fig 20: Gross profit breakdown by segment



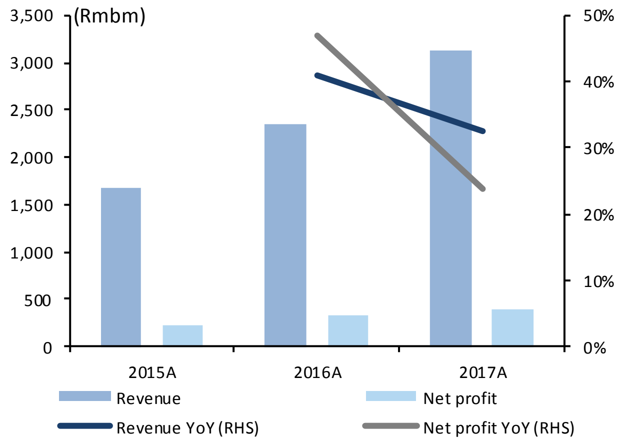
Source: Company data, SWS Research

Fig 21: Gross profit margin by segment



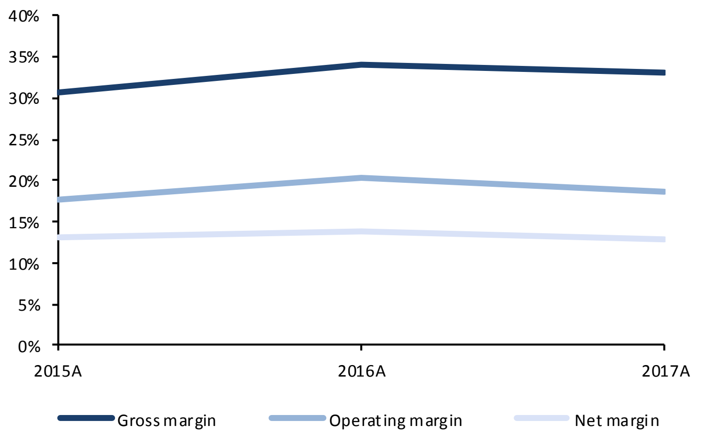
Source: Company data, SWS Research

Fig 22: Revenue and net profit



Source: Company data, SWS Research

Fig 23: Gross margin, operating margin and net margin

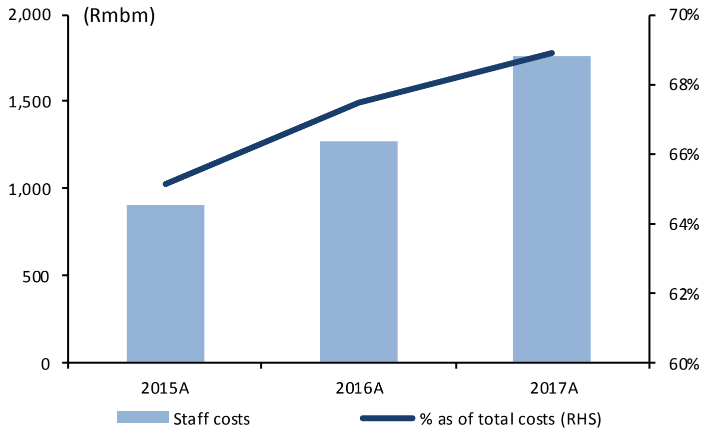


Source: Company data, SWS Research

The company's total staff costs reached Rmb1.76bn in 2017, rising at a two-year Cagr of 40% in 2016-17, in line with the managed area expansion, while its percentage of total costs rose from 65% in 2015 to 69% in 2017, in line with the industry average of c.70%.

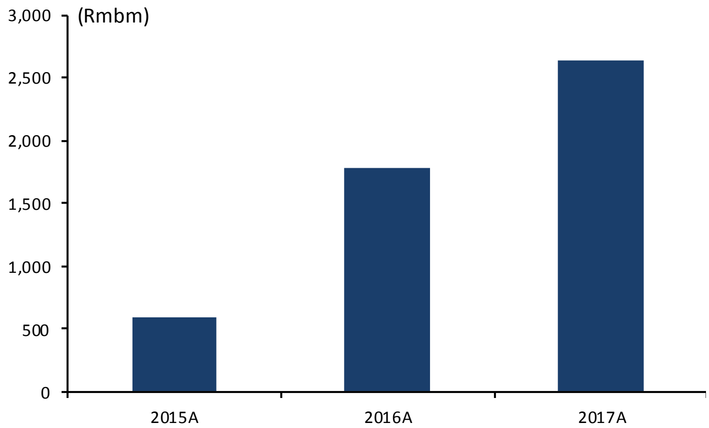
CG Service maintain a net cash position with cash on hand ring from Rmb0.6bn in 2015 to Rmb2.6bn in 2017, while debt remain at nil, thus providing sufficient support for potential acquisitions or new investments in the future. Furthermore, the impact from tightening liquidity will be limited.

Fig 24: Staff costs continue to rise



Source: Company data, SWS Research

Fig 25: The company remains in a net cash position



Source: Company data, SWS Research

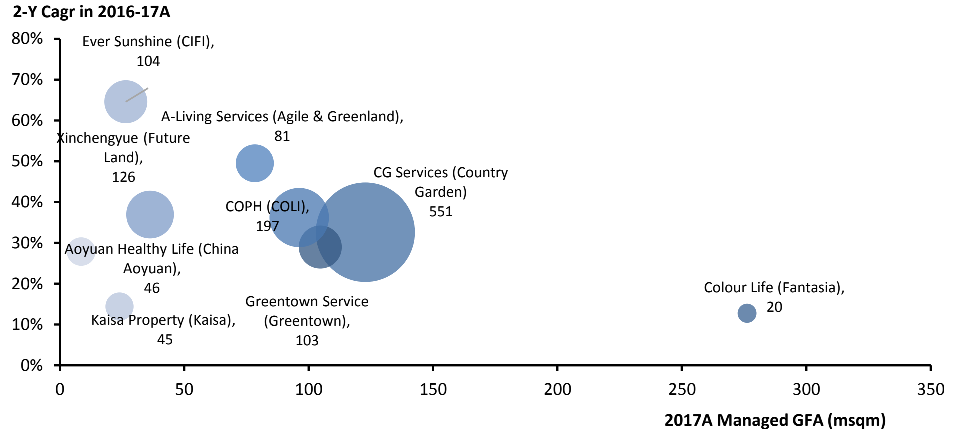
Ambitious expansion

As affiliated departments of developers originally, all property management companies under our coverage have developer backgrounds, however, we note the developer contribution varies across the sector. For small-sized companies, strong developers with robust sales growth can support rapid expansion in managed GFA on the basis of new property deliveries, while for medium-to large-sized peers, third-party properties and potential mergers & acquisitions become important means to expand revenue.

Among peers, Colour Life remains the largest service provider with managed GFA reaching 276msqm at end-2017 (two-year Cagr of 13% in 2016-17) with just 1% contributed by its shareholder, Shenzhen-based developer Fantasia (01777: HK – Not rated). CG Services ranks second largest with managed GFA of 123msqm (two-year Cagr of 33%) with c.90% contributed by private Guangzhou-based developer Country Garden Holdings, and the remaining 10% derived from third-party properties.

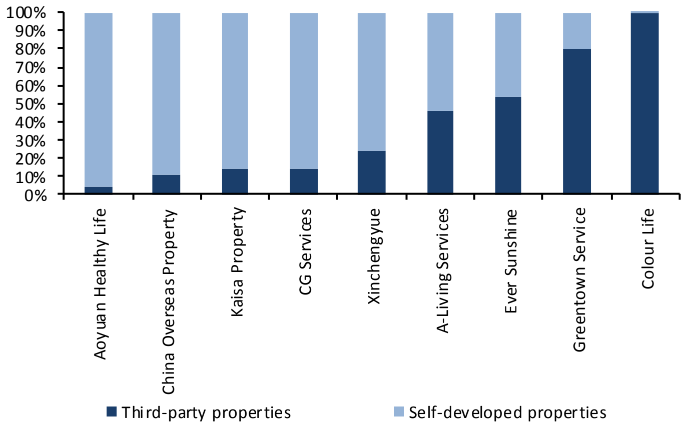
Greentown Service ranks the third largest, with managed GFA of 105msqm at end-2017 (two-year Cagr of 29% in 2016-2017), of which 20% were self-developed properties, followed by 96msqm from China Overseas Property (two year Cagr of 36%, developer contribution of 89% from China Overseas Land & Investment) and 78msqm from A-Living Services (two-year Cagr of 50%, developer support of 54% from Agile and Greenland).

Fig 26: Comparable peers: Managed GFA with two-year Cagr and developers' contracted sales (2017A)



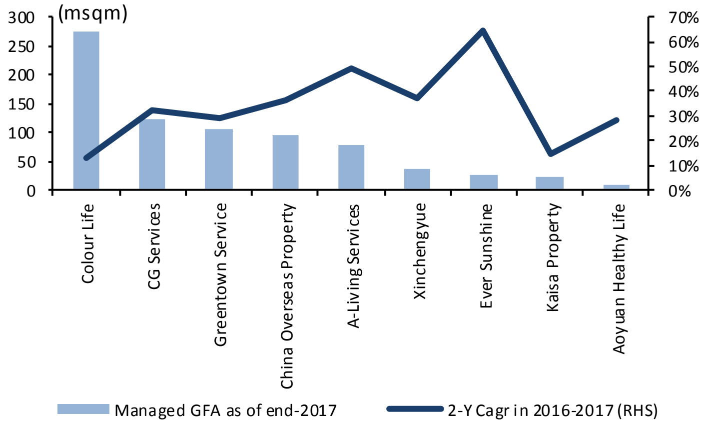
Note: The bubble size represents developer's 2017A contracted sales (Rmbbn).
Source: Company data, SWS Research

Fig 27: Contracted GFA breakdown by property source



Source: Company data, SWS Research

Fig 28: Managed GFA with two-year Cagr in 2016-17 (17A)

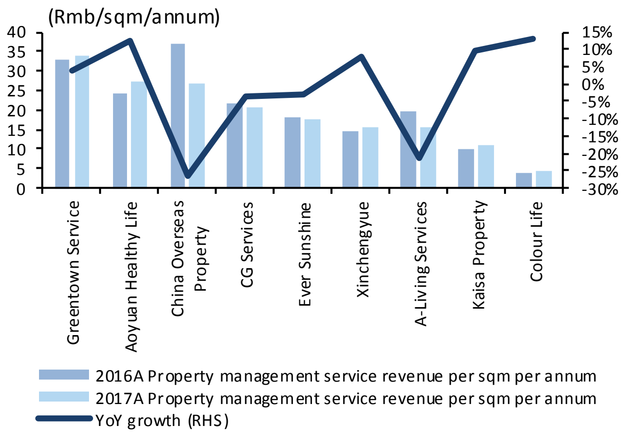


Source: Company data, SWS Research

In terms of revenue generation, according to our calculations, Greentown Service ranks first among peers with property management revenue of Rmb34.0/sqm/annum in 2017 (versus Aoyuan Healthy Life at Rmb27.4 and China Overseas Property at Rmb27.0), mainly due to its higher exposure to the economically developed areas of the Yangtze River Delta (c.70% of its managed GFA in 2017) and its positioning in the high-end market.

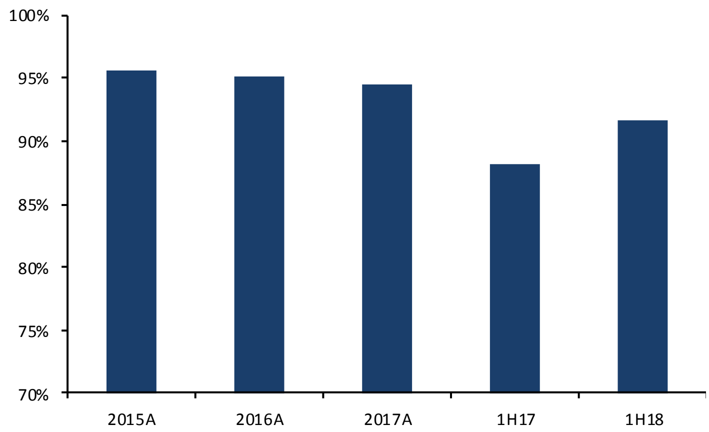
Meanwhile, CG Services recorded property management revenue of Rmb20.7/sqm/annum in 2017 (versus the sector average of Rmb19.3), as Country Garden mainly focuses on lower-tier cities with relatively lower disposal incomes. In addition, we highlight that CG Services' collection ratio remained high at 95% on average in 2015-2017, signifying high customer satisfaction for its service quality.

Fig 29: Property management revenue per sqm per annum, 2016-17



Source: Company data, SWS Research

Fig 30: Collection ratio of CG Services, 2015-1H18

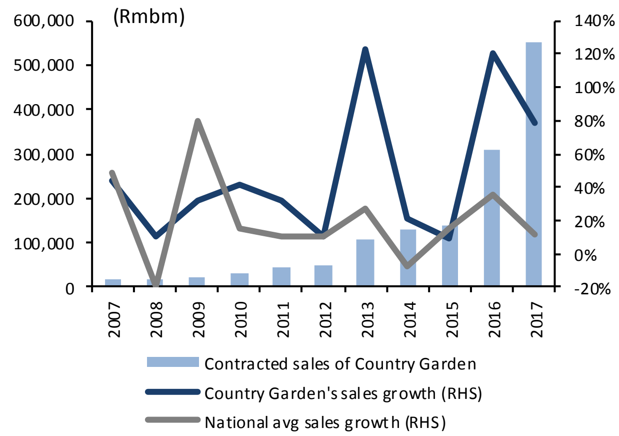


Source: Company data, SWS Research

In 2017, Country Garden became the largest developer in China, recording a five-year contract sales Cagr of 63%, of which sales attributable to the company rose at a 54% Cagr (versus the sector average at 30%). However, the company's shares fell sharply from July 2018, mainly due to a series of accidents, while led to rising market concerns about the sustainability of its high turnover model, as well as an ambiguous sales outlook in lower-tier cities amid the weakening property market.

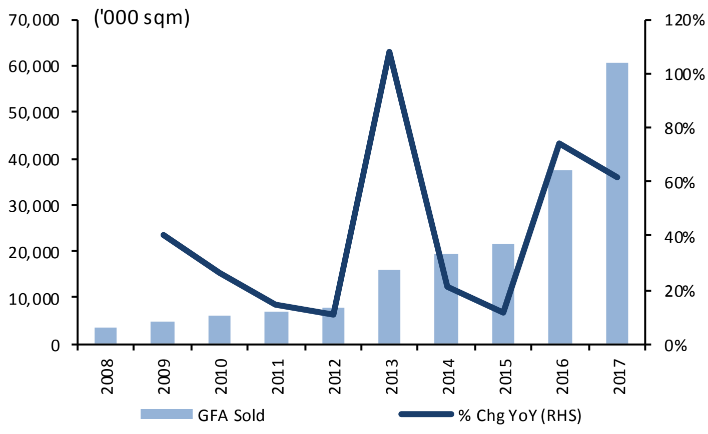
Moreover, starting from July 2018, Country Garden only disclosed attributable sales figures, which amounted to Rmb456bn in 10M18 (+35% YoY), completing 91% of its 2018 full-year target of Rmb500bn. In addition, we highlight that 77% of its land reserves are located in lower-tier cities, which expect to face higher risks than higher-tier cities given weakening home purchase demand and potential inventory rebuilding.

Fig 31: Country Garden's contracted sales vs. national sales growth



Source: NBS, Company data, SWS Research

Fig 32: Country Garden's GFA sold



Source: Company data, SWS Research

Fig 33: Key listed developer 2018 sales guidance

	Contracted Sales in Jan-Oct 18						Target of Nov-Dec 18						
Company	GFA sold ('000 sqm)	% Chg YoY	ASP achieved (Rmb/sqm)	% Chg YoY	Sales value (Rmbbn)	% Chg YoY	2018 (Target) (Rmbbn)	% Chg YoY	% achieved by Oct	Nov-Dec 18 (Target) (Rmbn)	% Chg YoY	Monthly Sales of Jan-Aug 18A (Rmbbn)	Monthly Sales of Sep-Dec 18 (Target) (Rmbbn)
BCL	1.9	1%	24,927	26%	48.1	27%	75	34%	64%	27	49%	4.8	13.5
Yuzhou	2.6	38%	15,382	-10%	40.2	24%	60	50%	67%	20	161%	4	9.9
Greentown	3	-18%	24,527	8%	72.6	-11%	103	0%	70%	30	44%	7.3	15.2
Agile	6.1	14%	12,968	8%	78.5	23%	110	36%	71%	31	82%	7.9	15.7
R&F	7.3	43%	13,048	1%	95.7	45%	130	60%	74%	34	127%	9.6	17.2
Country Garden	63.3	26%	9,561	7%	605.1	35%	800	45%	76%	195	89%	60.5	97.4
SCE	3.1	125%	12,641	-32%	39.2	54%	50	50%	78%	11	37%	3.9	5.4
Yuexiu	2.1	12%	21,219	22%	43.9	37%	55	35%	80%	11	26%	4.4	5.6
Vanke	32.4	11%	14,972	1%	485.6	12%	600	13%	81%	114	17%	48.6	57.2

KWG	3.1	54%	17,161	8%	53.1	67%	65	70%	82%	12	84%	5.3	5.9
Longfor	10.2	11%	16,136	5%	164.1	17%	200	30%	82%	36	167%	16.4	17.9
Sino-ocean Land	3.8	33%	21,485	14%	82.3	51%	100	40%	82%	18	5%	8.2	8.9
Sunac	24.2	69%	15,317	-12%	371.3	49%	450	25%	83%	79	-29%	37.1	39.3
Evergrande	47.6	12%	10,524	6%	501.1	19%	600	20%	84%	99	27%	50.1	49.4
A-share Poly	22.4	31%	14,974	7%	334.8	41%	400	27%	84%	65	-15%	33.5	32.6
Poly HK	1.9	-20%	17,772	28%	33.5	2%	40	0%	84%	7	-10%	3.4	3.3
CIFI	7.4	64%	15,886	-9%	117.9	49%	140	35%	84%	22	-11%	11.8	11.1
Gemdale	6.4	5%	18,714	2%	119.3	7%	141	0%	85%	22	-26%	11.9	10.9
China Jinmao	3.6	103%	28,723	21%	102.7	146%	120	75%	86%	17	-36%	10.3	8.7
COLI	13.6	10%	15,294	14%	210.3	25%	245	25%	86%	35	25%	21	17.4
Times	2.9	39%	16,632	8%	47.7	51%	55	30%	87%	7	-31%	4.8	3.7
Merchant Shekou	6.3	38%	21,126	9%	132.9	50%	150	33%	89%	17	-29%	13.3	8.5
Future Land	14.5	123%	12,539	-9%	181.3	103%	200	60%	91%	19	-48%	18.1	9.3
Logan	3.3	68%	17,912	2%	59.9	72%	66	52%	91%	6	-28%	6	3.1
Central China	5.6	63%	7,328	10%	41	79%	45	48%	91%	4	-47%	4.1	2
China Aoyuan	n.a.	n.a.	n.a.	n.a.	67.5	125%	73	60%	93%	5	-65%	6.8	2.7
Powerlong	2.2	79%	15,118	15%	33.2	107%	35	68%	95%	2	-62%	3.3	0.9
CR Land	9.7	33%	18,169	19%	177	57%	183	20%	97%	6	-85%	17.7	3
Shimao	8.3	77%	16,431	-2%	136	73%	140	40%	97%	4	-81%	13.6	2
Average		41%		6%		50%		40%	83%		23%		

Source: Company data, SWS Research

Fig 34: Key listed developers' land reserves

	Land Reserves							
	GFA (msqm)	Pipeline (Rmbbn)	Average selling price (Rmb/sqm)	Average floor cost (Rmb/sqm)	AFC as % of ASP	Attr GFA (msqm)	No. of cities	% lower-tier
Country Garden	267	2,509	9,398	2,560	27%	201	261	77%
Future Land	86	1,063	12,303	2,800	23%	46	101	72%
R&F	63	809	12,840	2,300	18%	55	89	69%
Shimao	52	880	17,048	5,325	31%	37	84	45%
KWG	32	550	17,089	4,800	28%	20	39	34%
Yuzhou	17	236	13,691	4,995	36%	12	25	32%
Vanke	143	2,140	14,967	5,055	34%	89	80	30%
Longfor	64	982	15,435	5,142	33%	46	37	28%
Sunac	156	2,280	14,615	4,470	31%	109	83	25%
CIFI	40	650	16,089	6,500	40%	22	53	24%
CR Land	43	713	16,505	6,051	37%	34	62	24%
Sino-ocean	39	766	19,549	7,000	36%	21	37	21%
COLI	69	1,026	14,786	5,246	35%	58	39	13%

Source: Company data, SWS Research

We also note that the yields on Country Garden's newly issued senior notes rose sharply on the offshore market in November 2018. We expect financing activities to remain challenging in the near term. Further deceleration of home sales and deteriorating cash flows are likely to surface as key obstacles for developers in 4Q18-1Q19.

Fig 35: Senior notes issued by Country Garden offshore

Issue Date	Tenor	Yield	Currency	Amount (m)
Nov-18	5.0	4.50%	HK$	7,830
Sep-18	3.3	7.13%	US$	425
Sep-18	5.3	8.00%	US$	550
Mar-18	3.0	5.80%	RMB	950
Jan-18	5.0	4.75%	US$	625
Jan-18	7.0	5.13%	US$	750
Jan-18	1.0	0.75%	HK$	15,200
Nov-18	1.0	3.88%	US$	500
Jul-18	5.0	4.75%	US$	700
Dec-18	10.0	5.63%	US$	350
Sep-18	7.0	4.75%	US$	650
Mar-18	5.0	7.50%	US$	900
Jun-18	5.0	7.50%	US$	250
May-18	5.0	7.88%	US$	550
Oct-18	8.0	7.25%	US$	750
Jan-18	10.0	7.50%	US$	750

Feb-18	7.0	11.13%	US$	900
Aug-18	5.0	10.50%	US$	400
Apr-18	7.0	11.25%	US$	550
Sep-18	5.0	11.75%	US$	375

Source: Company data, SWS Research

Fig 36: Overview of the balance sheet for key listed developers as of mid-2018

Ticker	Company	Cash (Rmb/HK$m)		Debt (Rmb/HK$m)		Equity (Rmb/HK$m)		Net gearing ratio		Average interest rates		Perpetual debt (Rmb/HK$m)		Foreign debt (Rmb/HK$m)	
		End-17	Mid-18	End-17	Mid-18	End-17	Mid-18	End-17	Mid-18	End-17	Mid-18	End-17	Mid-18	Mid-18	(% of total))
1918 HK	Sunac	96,718	87,416	228,558	217,359	51,350	55,947	257%	232%	6.2%	6.4%	9,288	7,592	21,953	10%
337 HK	Greenland HK	7,856	7,053	18,377	20,650	10,797	11,490	97%	118%	4.4%	4.7%	788	788	6,210	30%
3383 HK	Agile	30,120	29,508	67,204	83,584	38,647	43,969	96%	123%	6.0%	6.3%	5,529	8,276	36,890	44%
1638 HK	Kaisa	21,169	25,886	111,173	109,622	29,998	32,272	300%	259%	7.8%	8.4%	-	-	38,103	35%
3333 HK	Evergrande	286,722	257,944	732,625	671,129	242,208	324,526	184%	127%	7.5%	7.9%	-	-	114,763	17%
813 HK	Shimao	33,007	36,036	91,704	102,486	92,547	99,611	63%	67%	5.3%	5.6%	4,200	4,000	50,000	49%
817 HK	Jinmao	22,641	31,619	85,031	93,756	52,744	54,895	118%	113%	4.8%	5.0%	13,700	13,700	32,559	35%
6158 HK	Zhengrong	19,665	20,837	42,063	49,323	12,224	16,581	183%	172%	7.0%	7.4%	-	-	2,642	5%
1813 HK	KWG	40,467	41,571	59,644	64,895	28,246	30,156	68%	77%	5.5%	5.8%	-	-	18,944	29%
3900 HK	Greentown	35,977	44,418	66,310	81,821	38,190	43,639	79%	86%	5.0%	5.3%	8,604	8,604	11,100	14%
1030 HK	Future Land	24,648	26,496	49,381	68,193	24,632	28,252	100%	148%	5.3%	5.8%	-	-	15,412	23%
1628 HK	Yuzhou	17,498	25,087	29,478	38,460	15,531	16,290	77%	82%	6.0%	6.5%	1,912	1,912	13,635	35%
2868 HK	BCL	21,038	21,782	72,345	90,501	26,041	23,962	197%	287%	5.1%	5.2%	5,890	10,033	12,765	14%
2777 HK	R&F	32,215	35,861	142,243	159,137	62,489	65,757	176%	187%	5.1%	5.6%	2,404	-	35,177	22%
1966 HK	SCE	9,641	17,071	22,223	30,869	15,858	18,235	79%	76%	5.8%	6.4%	700	700	13,258	43%
688 HK	COLI	104,050	127,931	178,237	205,447	273,543	286,647	27%	27%	4.3%	4.3%	-	-	88,342	43%
119 HK	Poly Property	21,251	20,998	46,825	47,636	30,817	31,370	83%	85%	4.9%	5.0%	-	-	12,500	26%
832 HK	Central China	13,409	14,957	15,583	19,662	8,473	9,949	26%	47%	9.8%	10.4%	-	-	11,090	56%
3377 HK	Sino-ocean	24,766	25,813	64,932	77,029	54,828	58,218	73%	88%	5.1%	5.3%	3,900	3,900	27,730	36%
3301 HK	Ronshine	20,517	20,308	72,196	68,372	28,019	31,340	184%	153%	6.9%	7.1%	2,742	1,745	6,598	10%
1777 HK	Fantasia	16,441	22,609	29,667	36,996	17,698	17,721	75%	81%	8.5%	9.0%	-	-	16,560	45%
1238 HK	Powerlong	9,962	13,821	37,258	45,401	27,752	29,467	98%	107%	5.8%	6.0%	1,722	1,004	12,576	28%
960 HK	Longfor	26,761	42,128	77,403	107,931	106,179	120,425	48%	55%	4.5%	4.5%	-	-	23,745	22%
1109 HK	CR Land	53,774	60,872	105,557	140,902	144,240	153,898	36%	52%	4.2%	4.4%	-	5,000	40,862	29%
2007 HK	Country Garden	148,402	209,914	214,764	293,921	116,612	142,447	57%	59%	5.2%	5.8%	-	-	76,419	26%
2222 HK	Vanke	174,121	159,552	190,624	226,899	186,674	205,784	9%	33%	5.2%	5.7%	-	-	72,608	32%
884 HK	CIFI	29,787	39,097	51,087	74,456	30,422	39,824	70%	89%	5.2%	5.3%	3,848	3,899	32,760	44%
1233 HK	Times	17,207	20,656	33,289	40,578	27,945	29,658	58%	67%	7.3%	7.8%	-	-	10,300	25%
123 HK	Yuexiu	20,794	25,831	47,708	52,766	36,989	41,888	73%	64%	4.3%	4.8%	-	-	21,106	40%
3380 HK	Logan	22,408	27,598	43,204	50,461	24,800	28,573	84%	80%	5.7%	6.0%	2,363	2,363	17,000	34%
3883 HK	Aoyuan	26,539	25,823	42,494	46,515	27,126	28,426	59%	73%	7.0%	7.3%	-	-	16,280	35%
Total/Average		**1,429,570**	**1,566,493**	**3,069,187**	**3,416,756**	**1,883,618**	**2,121,217**	**101%**	**107%**	**5.8%**	**6.2%**	**67,590**	**73,516**	**909,888**	**30%**

Source: Company data, SWS Research

To offset the potential slowdown in sales, CG Services has focused on diversifying its portfolio. It has signed cooperation agreements with more than one hundred small- to medium-sized developers, which should provide a steady pipeline of newly-built properties.

The company has also explored municipal services, and established a joint venture with Strait Energy (Beijing) intercontinental Investment Company in July 2018 by contributing Rmb400m for an 80% equity interest (its JV partner contributed Rmb100m for the remaining stake), for the purpose of undertaking property management and value-added services for cooperative PRC Central enterprises in relation to the reform of "Three Supplies and Property Management". The potential managed area amounts to 138msqm, of which the first project with a GFA of 27msqm will be delivered by end-2018, with the remaining properties to be delivered by end-2019. As it takes time to reorganise management teams and improve operating efficiency, we expect this project to gradually contribute profit in the coming three to five years. We note that the company has also signed agreements with c.15 cities to take over the property management of several municipal facilities.

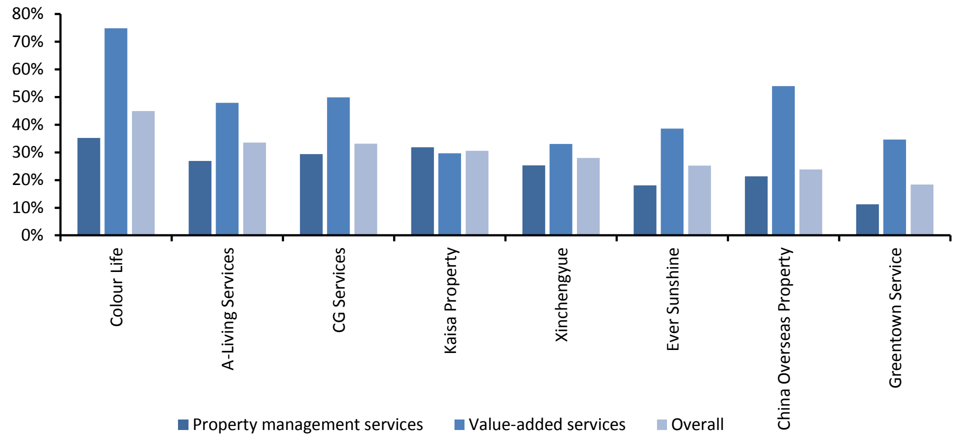
CG Services has also made headway in mergers & acquisitions. The company announced that it will acquire equity interests in five third-party property management companies in November 2018 for a total consideration of Rmb683m. These companies are located in Beijing (1 acquisition), Shanghai (1), Chengdu (2) and Nanchang (1), with total managed area reached 24msqm. Management expects their net contribution to reach Rmb68m in 2018. We believe this acquisition will help the CG Services expand its geographical footprint, and decrease its reliance on developer support.

Margin expansion

We noted above that the average gross margin of key Hong Kong-listed property management companies steadily improved from 27% in 2015 to 30% in 2017, while the average net margin rose from 10% to 12% during the same period.

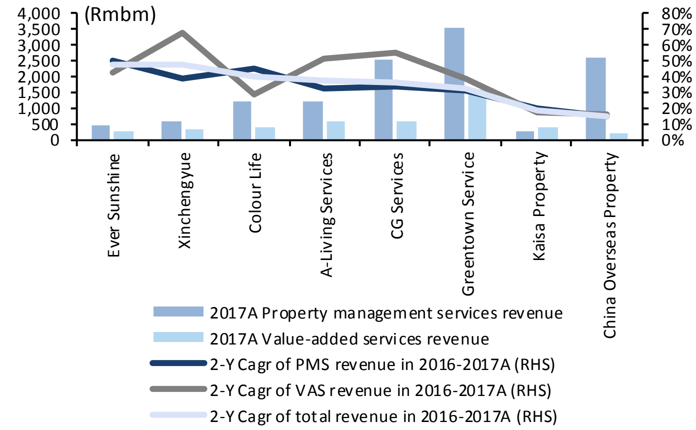
More specifically, we calculated the average gross margin of property management services reached 25% in 2017, while that of VAS hit 45% in 2017. As property management services accounted for 70% of total revenue (versus VAS at 30%), its contribution to total gross profit reached c.60%, with VAS accounting for the remaining 40%.

Fig 37: 2017 Gross margin breakdown by service segment



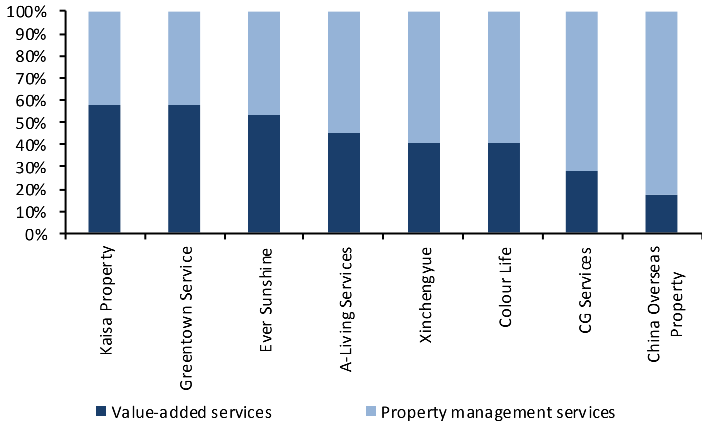
Source: Company data, SWS Research

Fig 38: 2017 Revenue breakdown by services segment



Source: Company data, SWS Research

Fig 39: 2017 Gross profit breakdown by service segment



Source: Company data, SWS Research

The gross margins of property management services vary across the sector mainly due to the contribution of properties managed under a commission basis with gross margin of 100% and the actual gross margin of properties managed under the lump-sum basis, which signifies management efficiency and cost controls.

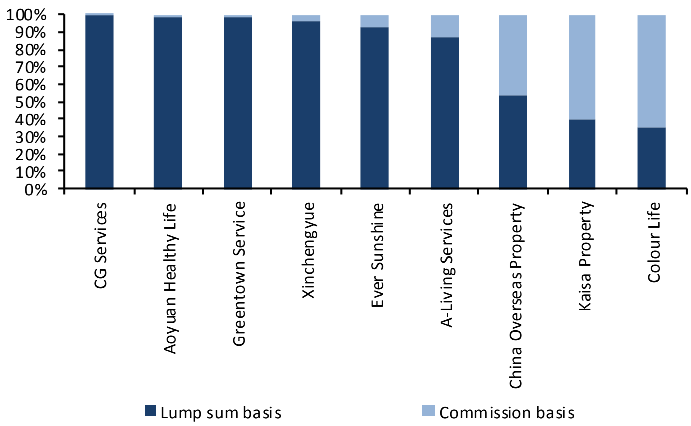
In terms of charging methods, properties under lump-sum basis contributed 96% of booked revenue in 2017 (vs. 4% from commission basis), or 78% of actual revenue in 2017 (when we apply a 10x multiple to revenue for properties managed under the commission basis) versus 22% from commissions. Note that when booking revenue under a commission basis, property management companies only book 10% of total revenue with gross margin of 100%. Colour

Life employed commissions for 64% of revenue in 2017, followed by 60% from Kaisa Property and 46% from China Overseas Property, while the remaining peers preferred to use a lump sum basis, with 99.8% for CG Services, 98% for Aoyuan Healthy Life and Greentown Service, 96% for Xinchengyue, 92% from Ever Sunshine and 86% for A-Living Service.

By excluding the effect of properties managed under the commission basis with a gross margin of 100%, we note that the average gross margin of properties managed under the lump-sum basis improved from 18% in 2015 by 3ppts to 21% in 2017, with CG Services ranking the first at 29%, followed by A-Living Services at 26% and Xinchengyue at 25%, while Greentown Service recorded the lowest gross margin of 11%. We attribute the significant differences between business strategies, geographical footprint and labour costs.

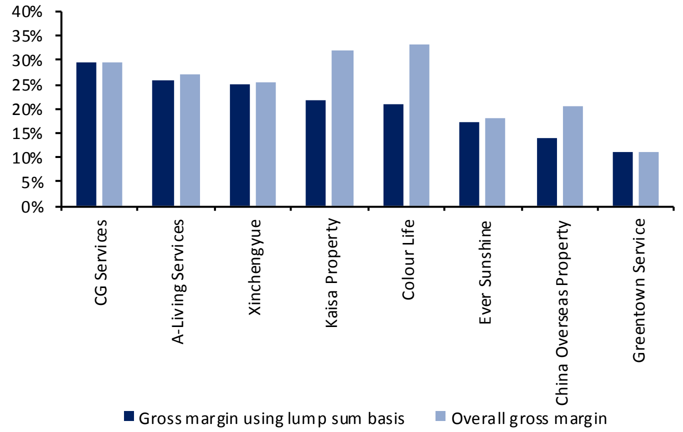
For instance, CG Services enjoyed the highest gross margin of properties managed under the lump-sum basis, as the company aimed to achieve a balance between margin and service quality, and also enjoyed lower operating costs in lower-tier cities given its market-leading position in large-scale property management. At the other end of the spectrum, Greentown Service is well known for its high quality service and may suffer more risks from rising labour costs, as it mainly focuses on high-end markets in core tier-1 and tier-2 cities.

Fig 40: Property management services revenue breakdown by method (2017)



Source: Company data, SWS Research

Fig 41: Property management services gross margin by method (2017)



Source: Company data, SWS Research

Fig 42: Factors impacting margins

City		Tier-1&2	Tier-3&4
Target market		High-end residential	Mid-end residential
Property GFA	(sqm)	200,000	400,000
No. of residents		6,000	12,000
Managed fee	(Rmb/sqm/month)	3.1	2.0
Total revenue	(Rmb/year)	7,440,000	9,600,000
Gross margin		12%	30%
Cost of Services		6,547,200	6,720,000
Labor costs	(70% of CoS)	4,583,040	4,704,000
Annual salary per staff	(Rmb/annum)	100,000	62,000
No. of staff		46	76
- Manager		4	8
- Butler		10	16
- Security		12	22
- Maintenance		8	12
- Cleaning		12	20
Managed GFA per staff	(sqm)	4,364	5,272

Source: Company data, SWS Research

Earnings forecast

The company's revenue-generating GFA reached 123msqm in 2017 (a two-year Cagr of 33% in 2016-17), of which properties developed by Country Garden Holdings contributed 109msqm with a two-year Cagr of 27% during the same period, while third-party properties recorded 13msqm with a rapid two-year Cagr of 149%.

We expect the contribution from Country Garden Holdings to reach 150msqm in 18E (+37% YoY), 201msqm in 19E (+34% YoY) and 263msqm in 20E (+31% YoY) with a three-year Cagr of 34% in 2018-20E on the basis of a steady pipeline of new properties, while that of third-party properties amounts to 41msqm in 18E (+205% YoY), 67msqm in 19E (+65% YoY) and 101msqm in 20E (+50% YoY) with a three-year Cagr of 96% during the same period.

We estimate total revenue-generating GFA to reach 191msqm in 18E (+55% YoY), 268msqm in 19E (+41% YoY) and 364msqm in 20E (+36% YoY), translating into a three-year Cagr of 44% in 2018-20E. More specifically, area managed under the lump sum basis remains the largest contributor at c.99% of revenue-generating GFA, with the remainder derived from area managed under the commission basis with a gross margin of 100%.

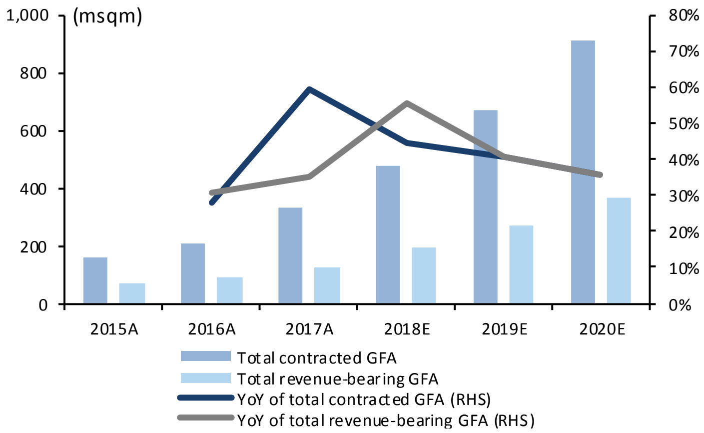
We calculated the company's three-year average monthly management fee at Rmb1.74/sqm in 2015-2017, and expect it to mildly increase to Rmb1.76/sqm in 18E, Rmb1.79/sqm in 19E and Rmb1.83/sqm in 20E, factoring in a rising contributing from new properties with higher fees, as well as the company's strong motivation to lift fees when facing rising labour costs.

Fig 43: Contracted GFA, revenue-generating GFA and management fee

(msqm)	2015A	2016A	2017A	2018E	2019E	2020E
Total revenue-generating GFA	70	91	123	191	268	364
Newly-added GFA		21	32	68	77	96
% YoY growth		30%	35%	55%	41%	36%
Under lump sum basis	70	91	122	190	267	362
Newly-added GFA		21	31	67	77	95
% YoY growth		30%	34%	55%	41%	36%
% of total revenue-generating GFA	100.00%	99.96%	99.69%	99.50%	99.50%	99.50%
Under commission basis	0	0.04	0.39	0.95	1.34	1.82
Newly-added GFA		0	0.3	0.6	0.4	0.5
% YoY growth			941%	147%	41%	36%
% of total revenue-generating GFA	0.00%	0.04%	0.31%	0.50%	0.50%	0.50%
Number of managed properties	194	284	440	638	893	1,233
% YoY growth		46%	55%	45%	40%	38%
Avg revenue-generating GFA per property	0.36	0.32	0.28	0.3	0.3	0.3
Revenue-generating GFA breakdown		23%	20%	29%	26%	23%
Properties developed by CGH	68	87	109	150	201	263
% YoY growth		29%	25%	37%	34%	31%
Newly-added GFA		20	22	40	51	62
% YoY growth			12%	83%	26%	22%
% of total revenue-generating GFA	97%	96%	89%	79%	75%	72%
Properties developed by independent developers	2	4	13	41	67	101
% YoY growth		73%	258%	205%	65%	50%
Newly-added GFA		2	10	27	26	34
% YoY growth			511%	184%	-3%	27%
% of total revenue-generating GFA	3%	4%	11%	21%	25%	28%
Property management fee (Rmb/sqm/month)						
Average	1.71	1.79	1.73	1.76	1.79	1.83
% YoY growth		5%	-4%	2%	2%	2%
Under lump sum basis	1.71	1.79	1.73	1.77	1.8	1.84
% YoY growth		5%	-3%	2%	2%	2%
Under commission basis		10.95	1.1	1.12	1.14	1.16
% YoY growth			-90%	2%	2%	2%

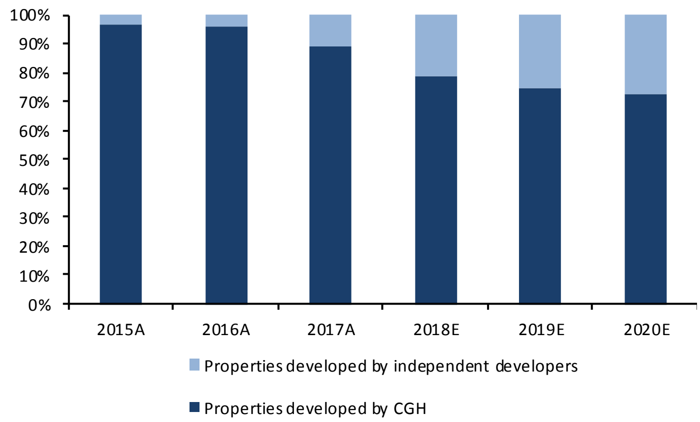
Source: Company data, SWS Research

Fig 44: Actual and estimated total contracted GFA and managed GFA



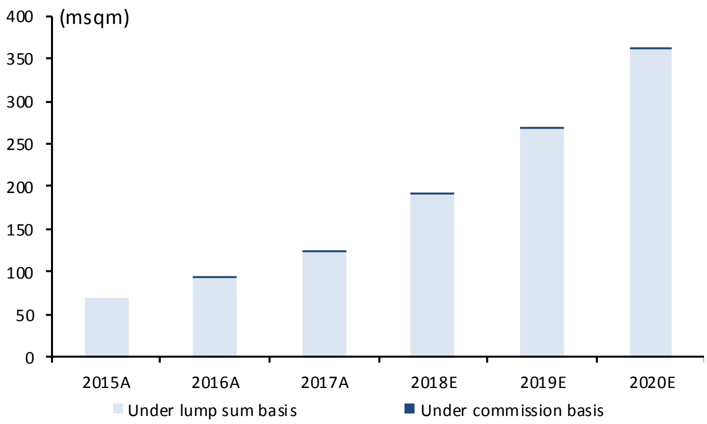
Source: Company data, SWS Research

Fig 45: Actual and estimated managed GFA breakdown by property sources



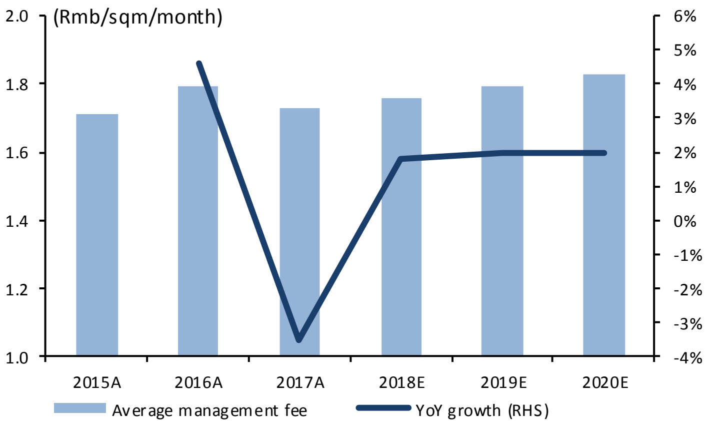
Source: Company data, SWS Research

Fig 46: Actual and estimated total managed GFA breakdown by methods



Source: Company data, SWS Research

Fig 47: Actual and estimated monthly management fee



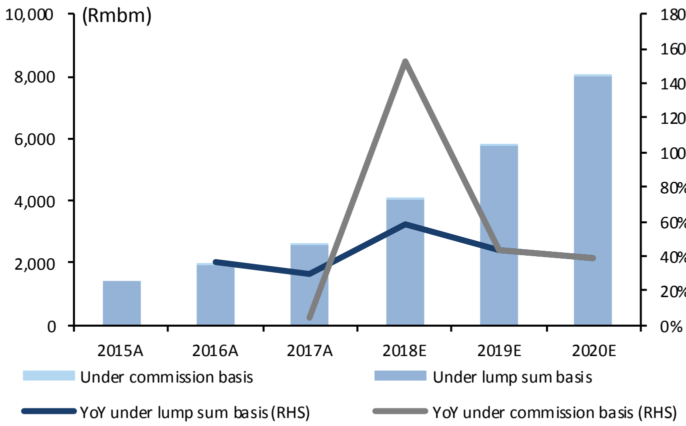
Source: Company data, SWS Research

Based on our revenue-generating GFA and management fees forecasts, we expect booked property management services revenue to reach Rmb4.0bn in 18E (+58% YoY), Rmb5.8bn in 19E (+43% YoY) and Rmb8.0bn in 20E (+38% YoY), with the contribution from property management services under the lump sum basis remaining high at almost 100%. In addition, we expect the gross margin of properties under the lump sum basis to slightly decline from 34.3% in 1H18 to 30.1% in 2018-20E on average, given rising the contribution of third-party properties for total revenue-generating GFA from 11% in 1H18 to 28% in 20E.

While property management services revenue remains the largest contributor at c.80%, VAS to non-property owners and community VAS each accounted for 11% and 8% of total revenue in 2017 with a two-year Cagr of 73% and 41% respectively, versus 0.2% of total revenue from other services with a two-year Cagr of 2%.

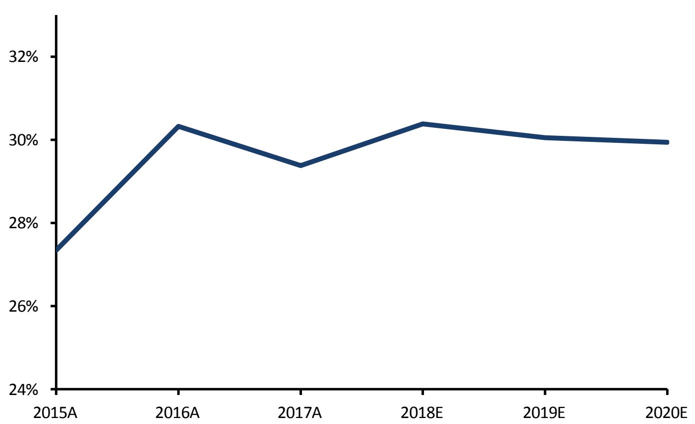
Based on historical growth rates, we forecast three-year Cagrs of 53%, 30% and 3% for revenue of VAS to non-property owners, community VAS and other services respectively, and arrive at total revenue forecast of Rmb5.0bn in 18E (+60% YoY), Rmb7.2bn in 19E (+43% YoY) and Rmb9.7bn in 20E (+36% YoY), implying a three-year of 46% in 2018-20E.

Fig 48: Actual and estimated property management services revenue



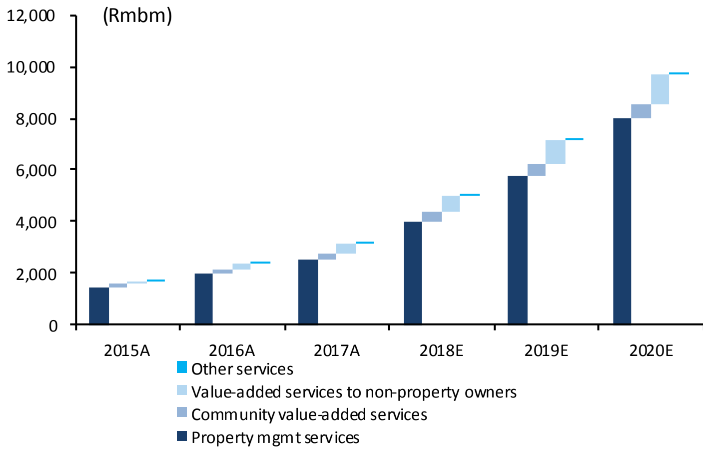
Source: Company data, SWS Research

Fig 49: Actual and estimated gross profit margin under lump sum basis



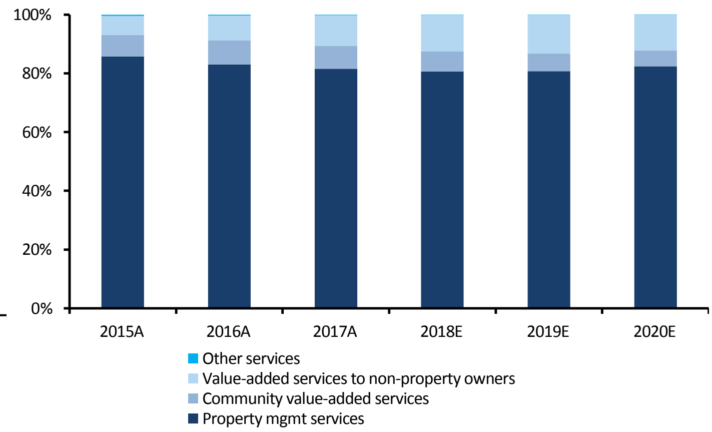
Source: Company data, SWS Research

Fig 50: Actual and estimated total revenue breakdown by value



Source: Company data, SWS Research

Fig 51: Actual and estimated total revenue by percentage



Source: Company data, SWS Research

The company's overall gross profit margin improved from 30.6% in 2015 to 33.9% in 2016, and declined to 33.2% in 2017, with property management services recording the lowest gross margin of 29.4%, versus 43.2% from VAS to non-property owners, 57.7% from community VAS and 84.4% from other services. Looking forward, we expect the blended gross margin to improve to 34.3% in 18E and slightly decline to 33.9% in 19E and 33.4% in 20E. More specifically, as for property management services which account for 70%-plus of total gross profit, we expect gross margin to rise from 29.4% in 2017 to 30.4% in 2018, and gradually retreat to 30.1% in 19E and 30.0% in 20E, as the contribution from lower margin third-party properties of managed GFA increase from 11% in 2017 to 21% in 18E, 25% in 19E and 28% in 20E (self-developed properties enjoy a 30%-plus margin). Meanwhile, we forecast gross margins for the remaining three segments to remain stable, with VAS to non-property owners (17% of total gross profit) at c.45%, community VAS (11% of total) at 60% and other services (1% of total) at 80%-plus on average in 2018-20E.

The company maintains a net cash position with the cash on hand rising from Rmb592m in 2015 to Rmb2.6bn in 2017, while the debt remained at nil during the same period. We expect the company to remain in a net cash position in the coming years.

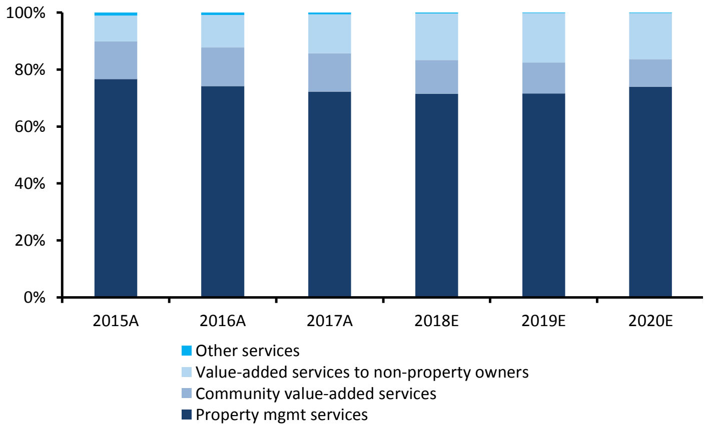
We note that the company received a "High and New Technology Enterprise" certificate in May-2018, under which it is entitled to an income tax rate of 15% for three years from January 2017 to December 2019, versus the average effective income tax rate of c.26% in 2015-17.

By employing the preferential tax rate, we expect the net margin to improve from 12.9% in 2017 to 17.7% in 18E, 16.2% in 19E and 15.5% in 20E. Meanwhile, we forecast the net profit to reach Rmb885m in 18E (+120% YoY), Rmb1.2bn in 19E (+31% YoY) and Rmb1.5bn in 20E (+30%

YoY), translating into EPS of Rmb0.35 in 18E (+120% YoY), Rmb0.46 in 19E (+31% YoY) and Rmb0.60 in 20E (+30% YoY).

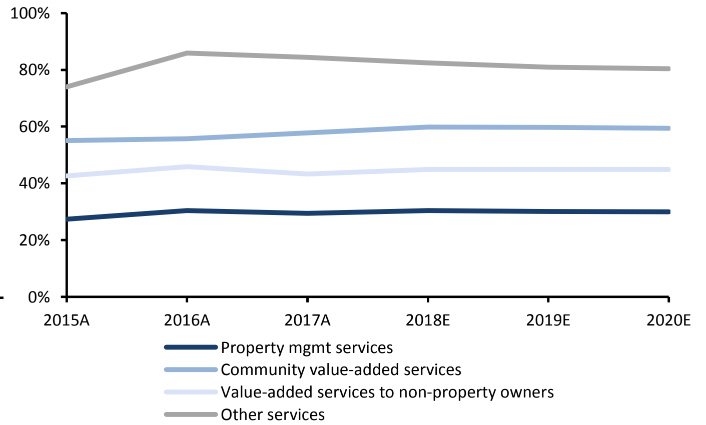
We also note that in its prospectus, the company guided a dividend pay-out ratio of 25% from year 2018 onwards, which is consistent with the sector average.

Fig 52: Actual and estimated total gross profit breakdown by value



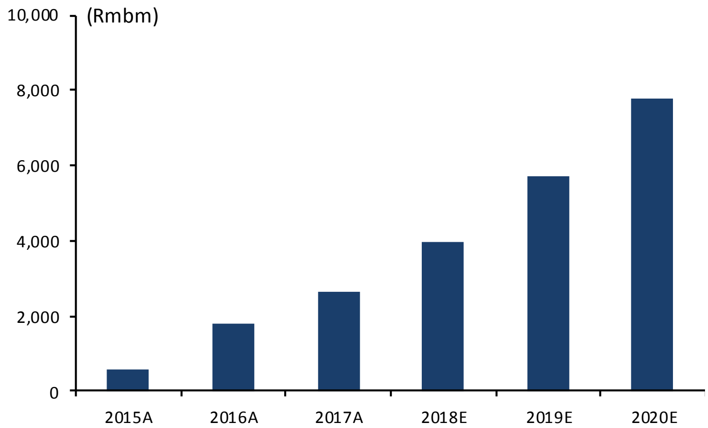
Source: Company data, SWS Research

Fig 53: Actual and estimated gross profit margins by segment



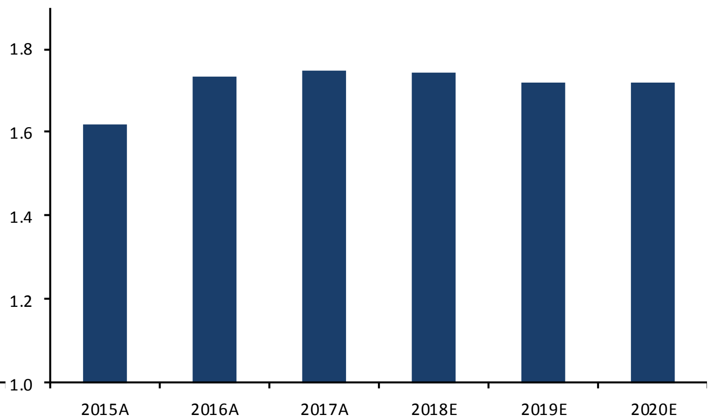
Source: Company data, SWS Research

Fig 54: Actual and estimated cash



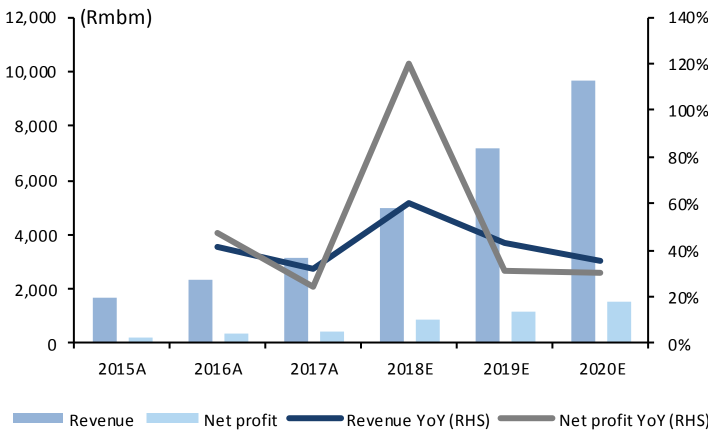
Source: Company data, SWS Research

Fig 55: Actual and estimated current ratio



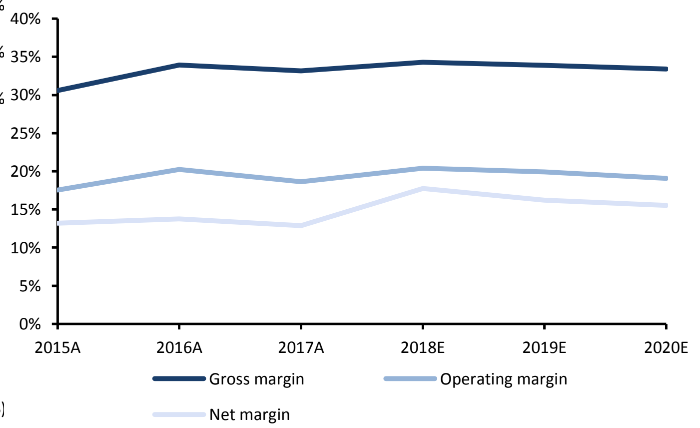
Source: Company data, SWS Research

Fig 56: Actual and estimated revenue and net profit



Source: Company data, SWS Research

Fig 57: Actual and estimated gross, operating and net margins



Source: Company data, SWS Research

Valuation

The Hong Kong-listed property management industry began to rebound from late October, with CG Services significantly outperforming its peers. The sector now trades at 18x 19E PE, with CG Services at 24x 19E PE, versus Greentown Service (02869:HK – Outperform) at 23x, China Overseas Property Holdings (02669:HK – BUY) at 15x and Colour Life Services at 7x.

We are positive on CG Services given it high earnings visibility and growth on the back of aggressive expansion and market-leading management capabilities in lower-tier cities. We evaluate key listed companies using six categories:

1) Developer support (20% weighting): Among its peers, CG Services ranks first as its partner developer Country Garden recorded the highest contract sales, which have expanded rapidly. It is followed by China Overseas Property and Greentown Service, while Colour Life positions itself as independent service provider.

2) Managed area growth visibility (20% weighting): CG Services tops the list with the highest reserve to managed area ratio at 168%, followed by Greentown Service (109%), Colour Life (58%) and China Overseas Property (33%).

3) Property management capability and service quality (20% weighting): CG Services recorded the highest gross margin of property management services booked under the lump sum basis at 29% in 2017, signalling strong management capabilities and effective cost controls, while achieving a collection ratio at c.95%, implying high resident satisfaction. Meanwhile, although Greentown Service reported gross margin at 11%, its high-quality service is also well recognised by the market.

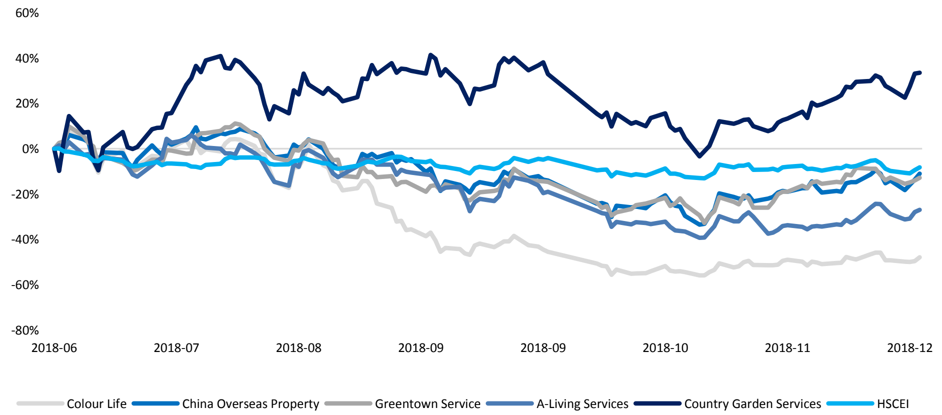
4) Profitability and growth (20% weighting): CG Services recorded a net margin of 13% in 2017, only second to Colour Life at 20%. However, we expect the company's earnings growth to outpace peers with a two-year Cagr of 70% in 2018-19E, versus 43% for Colour Life, 29% for Greentown Service and 27% for China Overseas property.

5) VAS potential (10% weighting): CG Service reported VAS gross profit contribution at 28% in 2017, with a gross margin of 50%, only higher than China Overseas Property at 18% (gross margin of 54%). VAS gross profit contribution stood at 41% for Colour Life (gross margin of 75%) and at 58% for Greentown Service (gross margin of 35%).

6) Cash on hand and gearing ratio (10% weighting): Other than Colour Life, the remaining three companies are net cash, with cash on hand of Rmb2.6bn for CG Services, Rmb2.3bn for China Overseas Property and Rmb2.0bn for Greentown Service.

According to our scores based on our methodology above, we note CG Services outperforms its peers, with a score of 8.6/10, versus 7.0/10 for Greentown Service, 6.4/10 for China Overseas Property and 5.2/10 for Colour Life Services, thus we expect CG Services to trade at a premium to Greentown Services (historical average: 24x PE), and arrive at a target PE multiple of 27x PE, translating into a target price of HK$14.9. With 12% upside, we initiate coverage of CG Services with an Outperform rating.

Fig 58: CG Services has significantly outperformed its peers since listing in June 2018



Source: Wind, SWS Research

Fig 59: Score card of key listed property management companies under our coverage

		Colour Life Services	China Overseas Property	Greentown Service	Country Garden Services
	Total score	**5.2**	**6.4**	**7.0**	**8.6**
Developer support (20%)	Developer	Fantasia (1777: HK)	COLI (688: HK)	Greentown China (3900: HK)	Country Garden (2007: HK)
	2017 contracted sales (Rmbbn)	20	197	103	551
	% Chg YoY	65%	10%	8%	78%
	2017 GFA sold (msqm)	2	14	5	61
	% Chg YoY	44%	11%	-5%	62%
	Score	**2**	**8**	**6**	**9**
Growth visibility (20%)	2017 managed area (mqm)	276	96	105	123
	% of group-developed projects	1%	89%	20%	86%
	% of third-party projects	99%	11%	80%	14%
	2017 reserve area / managed area	58%	33%	109%	168%
	Score	**6**	**4**	**8**	**9**
Property management (20%)	2017 property management revenue (Rmb/sqm/month)	0.8	3.6	2.9	1.7
	2017 gross margin of lump sum basis	21%	14%	11%	29%
	2017 gross margin of commission basis	100%	100%	100%	100%
	2017 gross margin of property management services	33%	21%	11%	29%
	Fee collection ratio	92%	93%	97%	95%
	Score	**4**	**5**	**6**	**7**
Profitability & growth (20%)	2017 net margin	20%	9%	8%	13%
	2017 net profit (Rmbm)	321	258	387	402
	2018E net profit (Rmbm)	521	347	505	885
	2019E net profit (Rmbm)	656	415	645	1,159
	2-Y Cagr in 2018-19E net profit	43%	27%	29%	70%
	Score	**8**	**6**	**7**	**9**
VAS potential (10%)	2017 VAS gross profit contribution	41%	18%	58%	28%
	2017 gross margin of VAS segment	75%	54%	35%	50%
	Score	**7**	**8**	**6**	**8**
Cash & gearing (10%)	2017 cash on hand (Rmbbn)	1.4	2.3	2.0	2.6
	2017 debt (Rmbbn)	1.5	0.2	0.0	0.0
	2017 net debt to equity ratio	4%	-284%	-100%	-171%
	Score	**5**	**10**	**10**	**10**

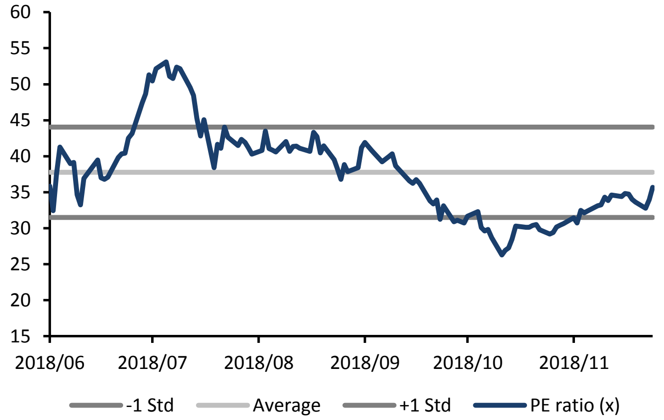
Note: Score valutaion for each category ranges from 1-10.
Source: Company data, SWS Research

Fig 60: Target prices and valuations

Company	Code	Market Cap (HK$bn)	Rating	Target price (HK$)	PE (x) 17A	PE (x) 18E	PE (x) 19E	Dividend yield	Share price performance 2017	Share price performance YTD
Country Garden Services	6098 HK	33.4	Outperform	14.9	70	32	24	0.8%	--	34%
Greentown Service	2869 HK	17.8	Outperform	7.5	39	30	23	1.2%	133%	5%
China Overseas Property	2669 HK	7.7	Buy	3.3	25	19	15	1.7%	59%	10%
Colour Life Services	1778 HK	5.7	Outperform	8.3	11	9	7	3.3%	-10%	-17%
Average					36	22	18	2%	61%	8%

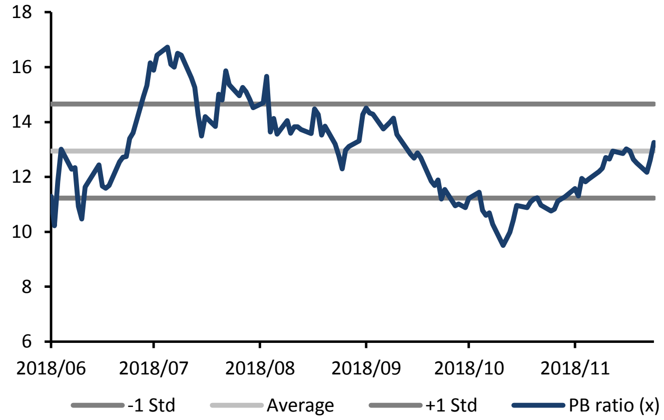
Source: Bloomberg, Company data, SWS Research

Fig 61: Forward PE band chart



Source: Bloomberg, SWS Research

Fig 62: Forward PB chart



Source: Bloomberg, SWS Research

Risks

Expansion outlook. As newly-built properties from its developer partner Country Garden Holdings remains the largest contributor for area expansion of CG Services in the coming few years, the potential slowdown of new home sales in lower-tier cities amid weakening property market may lead to concerns over the pace of future deliveries. The company may also face fiercer competition over third-party contracts as an increasing number of peers aim to expand their managed area. Moreover, merger and acquisition opportunities must be carefully analysed and management improvements may take time to generate profit.

Margin pressure. The company outperformed its peers in terms of properties managed under a lump sum basis at c.30% versus the sector average of 21% in 2017. However, margins may erode given the rising contribution from third-party properties with lower-than-expected margins. Meanwhile, the gross margins of VAS segments may fluctuate amid business unit adjustments, aiming to create stable profit models.

Social insurance policy overhang. As a labour-intensive company, profitability is sensitive to labour costs. If the new social insurance policy is strictly enforced starting from January 2019 without any extra rate cut, we expect to see labour costs rise significantly, which would cast a shadow over for the whole sector, with profits deteriorating.

Preferential tax rate renewal. The company is entitled to an income tax rate of 15% for three years from January 2017 to December 2019, versus the historical average of 26% in 2015-17, as it received a “High and New Technology Enterprise” certificate in May-2018. However, this preferential tax rate is subject to renewal every three years, and can be revoked by the relevant local authorities upon a review process. The company plans to apply for renewal in late-2019.

Appendix 1

Fig 1: Management team

Name	Age	Position	Principle responsibilities	Summary
Yang Huiyan	36	Chairman of the board and non-executive director	Formulation and provision of guidance and development strategies	Yang joined CGH in March 2005 as a general manager of the procurement department, has been an executive director and the vice chairman of CGH since December 2006 and March 2012. Yang is also a director of several subsidiaries of the CGH Group.
Yang Zhicheng	44	Non-executive director	Provision of guidance for the firm's overall development	Yang has served as a project general manager at the CGH Group since 1997, and has been an executive director, the head of Jiangzhong region and the vice president of CGH since December 2006, January 2010 and November 2017.
Wu Bijun	44	Non-executive director	Provision of guidance for the firm's overall development	Ms. Wu joined the CGH Group in November 2005, and has been serving as the general manager of the finance centre, vice president and chief financial officer of CGH, Wu is mainly responsible for the company's financial management.
Li Changjiang	52	Executive director and general manager	Overall strategic decisions, business planning, and major operational decisions	Li has served in positions including administrative director at several property management companies for 14 years prior to join CGH, then he served as general manager after joining CGH in December 2011.
Xiao Hua	40	Executive director and deputy general manager	Overall management of value-added services to non-property owners	From 2004 to 2009, Xiao worked at CGH as an assistant manager, a deputy manager and a manager where he was mainly responsible for security management and providing assistance to day-to-day operations of the branch office. Then Xiao was promoted to regional director and now executive director as well as deputy general manager.
Guo Zhanjun	38	Executive director and deputy general manager	Overall management of human resources	Guo joined CGH as a deputy general manager of training and development department in July 2013, then left but returned to CGH Group as the assistant general manager of human resources management centre in February 2017.
Mei Wenjue	48	Independent non-executive director	Providing independent advice to the board	Mei was served as independent non-executive director of the board at Miko International Holdings from December 2013 to March 2016 and at CGH from May 2013 to March 2018. From September 2008 to October 2014, he served as the chief representative at the Shenzhen Office of China Europe International Business School.
Rui Meng	50	Independent non-executive director	Providing independent advice to the board	Rui currently serves as an independent director of the board and chairman of the audit committee at Midea Group, COSCO Shipping Energy Transportation, Shanghai Winner Information Technology, China Education Group Holdings Limited, an independent director of the board at Shang Gong Group.
Chen Weiru	47	Independent non-executive director	Providing independent advice to the board	Chen currently serves as an independent director of the board at TAL Education Group and Dian Diagnostics. Chen is currently an assistant professor of strategy at China Europe International Business School. He became the chief strategy officer at Zhejiang Cainiao Supply Chain Management Company in August in 2017.

Source: Company data, SWS Research

Appendix 2, Financial statements

Fig 1: Forecast Income Statement

(Rmbm)	2015A	2016A	2017A	2018E	2019E	2020E
Revenue	1,672	2,358	3,122	4,992	7,152	9,693
Cost of services	(1,161)	(1,558)	(2,086)	(3,281)	(4,728)	(6,456)
Gross profit	511	800	1,036	1,711	2,424	3,238
Selling and marketing expenses	0	0	(9)	(15)	(21)	(39)
General and administrative expenses	(226)	(333)	(459)	(701)	(1,012)	(1,396)
Other income	8	8	13	21	29	40
Other gains - net	0	2	1	2	3	4
Operating profit	293	477	581	1,018	1,424	1,847
Finance income - net	2	16	35	39	43	47
Share of results of joint ventures	0	(2)	1	(1)	(1)	(1)
Share of results of associates	(0)	(5)	(9)	(8)	(12)	(16)
Profit before income tax	295	486	608	1,047	1,453	1,877
Income tax expenses	(74)	(134)	(168)	(120)	(247)	(319)
Profit for the year	220	353	440	928	1,206	1,558
Non-controlling interests	0	28	39	43	47	52
Profit attr to shareholders	220	324	402	885	1,159	1,506
Dividends paid				(221)	(290)	(377)
Basic EPS (Rmb)	0.09	0.13	0.16	0.35	0.46	0.60
Diluted EPS (Rmb)	0.09	0.13	0.16	0.35	0.46	0.60
DPS (Rmb)				0.09	0.12	0.15

Source: Company data, SWS Research

Fig 2: Forecast Balance Sheet

(Rmbm)	2015A	2016A	2017A	2018E	2019E	2020E
PP&E	37	43	79	134	204	289
Intangible assets	0	2	21	21	21	21
Investments in joint ventures	0	12	14	14	14	14
Investments in associates	5	7	4	4	4	4
Financial assets at fair value through other comprehensive income	0	0	0	0	0	0
Deferred income tax assets	5	4	4	4	4	4
Prepayments for intangible assets	0	1	0	0	0	0
Non-current assets	47	70	122	177	247	332
Inventories	6	5	6	10	14	19
Trade and other receivables	789	617	712	998	1,430	1,939
Restricted bank deposits	1	1	3	3	3	3
Cash and cash equivalents	591	1,774	2,634	3,983	5,646	7,719
Current assets	1,387	2,398	3,356	4,994	7,093	9,679
Total assets	1,434	2,468	3,477	5,170	7,340	10,012
Combined capital	0	0	0	0	0	0
Other reserves	225	455	500	500	500	500
Retained earnings	352	565	921	1,585	2,454	3,584
Majority interests	577	1,019	1,421	2,085	2,954	4,084
Non-controlling interests	0	64	121	164	210	262
Total equity	577	1,083	1,542	2,248	3,165	4,346
Deferred income tax liabilities	0	0	14	14	14	14
Non-current liabilities	0	0	14	14	14	14
Contract liabilities	202	397	557	890	1,276	1,729
Trade and other payables	626	943	1,315	1,968	2,837	3,873
Current income tax liabilities	29	45	49	49	49	49
Current liabilities	857	1,385	1,921	2,908	4,161	5,651
Total liabilities	857	1,385	1,935	2,922	4,176	5,666
Total equity and liabilities	1,434	2,468	3,477	5,170	7,340	10,012

Source: Company data, SWS Research

Fig 3: Forecast Cash Flow Statement

(Rmbm)	2015A	2016A	2017A	2018E	2019E	2020E
Cash generated from operations	101	1,118	1,036	1,731	2,273	2,877
Income tax paid	(113)	(117)	(151)	(120)	(247)	(319)
Net cash generated from operating activities	(12)	1,001	885	1,611	2,026	2,558
Payments for acquisition of subsidiaries, net of cash acquired	(1)	0	(4)	0	0	0
Payments for investments in joint ventures	0	(14)	(1)	0	0	0
Payments for investments in associates	(43)	(7)	(6)	0	0	0
Purchases of property, plant and equipment	(4)	(21)	(55)	(88)	(127)	(172)
Purchases of intangible assets	0	(3)	(5)	0	0	0
Payments for financial assets at fair value through profit or loss	(520)	(755)	0	0	0	0
Payments for financial assets at fair value through other comprehensive income	0	0	(0)	0	0	0
Proceeds from disposal of investments in associates	0	38	0	0	0	0
Proceeds from disposal of property, plant and equipment	0	1	2	4	7	11
Proceeds from disposal of financial assets at fair value through profit or loss	520	757	0	0	0	0
Repayments by related parties	96	55	0	0	0	0
Interest received	2	16	35	39	43	47
Net cash generated from investing activities	50	67	(32)	(46)	(77)	(114)
Capital injection from non-controlling interests	0	0	10	4	4	5
Repayments of borrowings	0	0	(3)	0	0	0
Interest paid	0	0	(0)	(221)	(290)	(377)
Transaction with non-controlling interests	0	115	0	0	0	0
Net cash generated from financing activities	0	115	7	(217)	(286)	(372)
Net increase in cash and cash equivalents	38	1,183	860	1,348	1,663	2,073
Cash and cash equivalents at beginning of year	554	591	1,775	2,634	3,983	5,646
Cash and cash equivalents at end of year	591	1,775	2,634	3,983	5,646	7,719

Source: Company data, SWS Research

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