

## KWG

### Seeking balance between scale and profitability

**Downgrade to 'HOLD' and revise down TP to HK\$12.50: 2017 result missed our estimation; core net profit dropped by 19% YoY, expansion execution takes times to testify.**

Revenue increased by 30% from RMB 8.87 bn in 2016 to RMB 11.54 bn in 2017. GPM slightly improved by 0.2ppt to 35%. SG&A to contracted sales further compressed to only 3.6%, down from 5.8% in 2016. However, finance cost doubled in 2017 and income tax expense increased by 83% YoY to RMB 20 bn. These led core net profit to decline 19% to 2.71bn in 2017, which is 22% below our estimation. Key takeaways from result meeting: 1) 30-40% growth of revenue will be delivered from 2018; 2) GPM will stay above 30% in next 3 years; 3) land acquisition in last 2 years will bear fruit in next 3 years. The company has acquired land plots with relatively low cost in 2017. Low cost land acquisition is the first step for developer, and the key step is to sell products as schedule. KWG's execution in new cities takes time to testify. We downgrade its rating to 'HOLD' and revise down TP to HK\$12.50.

#### 70% YoY growth target of contracted sales

The company has announced its sales target of RMB 65 bn in 2018, which implies 70% YoY increase. Comparing with peers, the company's growth target is very aggressive. The management explained that the company had prepared for years and over RMB 110 bn of saleable resource would be launched. In addition, the company has entered 21 new cities in 2017. We are cautious on its execution with rapid expansion.

#### More redevelopment projects ahead & incentive scheme

The company is looking for redevelopment projects in Guangzhou, thanks to Guangzhou's accelerated redevelopment pace in 2018. The company has entered 8 villages in Guangzhou and one redevelopment in Guangzhou will be acquired by KWG in 2018. The company will look for more redevelopment projects in order to maintain its profitability. Regarding to incentive scheme, the scheme has reduced pre-launch time from 12 months to 10 months and delivery time from 20 months to 15 months, which is still slow comparing with large-scale developers. We believe the company will further accelerate its turnover to boost its sales. KWG was a profit-oriented developer in the past, rather than a scale-oriented. We believe the company is looking for a balance between rapid expansion and profitability. However, the strategy change will be much easier for scale-oriented developer to slow down, much harder for profit-oriented developer to speed up.

#### We expect GPM to be above 30%

We believe the company will deliver over 30% GPM in next 3 years, as en-bloc sales and high profitable commercial projects will be gradually delivered in next 3 years. Additionally, contracted sales with low land cost in 1<sup>st</sup> and 2<sup>nd</sup> tier cities will contribute high GPM in future. We expect GPM will be 35%/35%/34% in 2018/2019/2020, respectively.

#### Revise down price target to HK\$12.50, 13% upside, 'Hold'

We are disappointed at 2017 result. And we believe the company will take time to find a sweet spot between profitability and sales scale. Expanding to 34 cities also takes times to testify its execution. Therefore, we revised down its price target to HK\$12.50. Our price target implies 40% discount to Dec-18 NAV, 9.2x 2018e core PE and 6.4x 2019e core PE. The stock is trading at 49% discount to Dec-18 NAV, 8.1x 2018e core PE and 1.0x 2018e PB.

Stock code: 1813.HK

Rating: **HOLD**

Price target (HK\$)	12.50
Previous target(HK\$):	15.79
Current price (HK\$, 26 Mar 2018)	11.08
Upside/downside %	13%
Market cap (HK\$ m)	34,959
Market cap (US\$ m)	4,455
Avg daily turnover (HK\$ m)	139.6

Source: Bloomberg, AMTD Equity Research

#### Key forecasts

(RMB m)	2017	2018e	2019e	2020e
Revenue	11,543	16,408	22,320	29,535
yoy %	30%	42%	36%	32%
Attr NP	3,620	3,784	5,438	6,379
yoy %	4%	5%	44%	17%
Core Attr NP	2,716	3,784	5,438	6,379
yoy %	-19%	39%	44%	17%
Gross margin	34.8%	34.9%	34.5%	34.4%
Net gearing	67.9%	92.2%	83.6%	59.2%
EPS	0.88	1.22	1.76	2.06
DPS	0.41	0.43	0.61	0.72
BPS	8.91	10.13	11.89	13.95

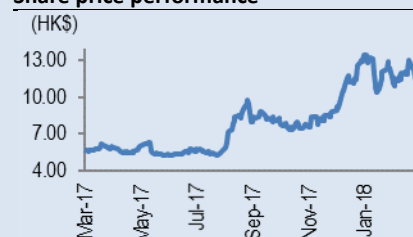
Source: Company data, AMTD Equity Research

#### Valuation

	2017	2018e	2019e	2020e
P/E	11.4	8.2	5.7	4.8
P/BV	1.1	1.0	0.8	0.7
Div. yield	4.2%	4.3%	6.2%	7.2%
ROE	10.5%	12.8%	15.9%	15.9%
ROA	2.7%	2.2%	2.6%	2.4%

Source: Bloomberg, AMTD Equity Research

#### Share price performance



Source: Bloomberg

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Figure 1: Previous forecast vs actual result

PnL, RMB '000	2016	2017	AMTD 2017E	YoY	Actual vs Est
Revenue	8,865,329	11,543,072	12,115,408	30.2%	-4.7%
Sales of properties	7,922,956	10,432,094	11,078,798	31.7%	-5.8%
Cost of sales	(5,794,980)	(7,523,140)	(7,922,168)	29.8%	-5.0%
<b>GPM</b>	35%	35%	35%	0.2 pts	0.2 pts
Gross profit	3,070,349	4,019,932	4,193,240	30.9%	-4.1%
Other income	731,732	632,914	731,732	-13.5%	-13.5%
Fair value gains on investment properties	165,900	1,204,881	-	626.3%	n.a.
Selling expenses	(322,768)	(432,506)	(468,954)	34.0%	-7.8%
Administrative expenses	(969,196)	(936,814)	(1,085,400)	-3.3%	-13.7%
Finance costs	(159,875)	(329,505)	(176,543)	106.1%	86.6%
Profit before tax	4,527,499	5,555,028	4,689,937	22.7%	18.4%
Income tax expense	(1,065,893)	(1,950,015)	(1,219,384)	82.9%	59.9%
Profit for the year	3,461,606	3,605,013	3,470,554	4.1%	3.9%
Adjusted profit for the year	3,337,181	2,701,352	3,470,554	-19.1%	-22.2%
<b>Profit for the year attributable to:</b>					
<b>Owners of the Company</b>	3,464,714	3,620,071	3,473,662	4.5%	4.2%
<b>Non-controlling interests</b>	(3,108)	(15,058)	(3,108)	384.5%	384.5%
<b>Core net profit</b>	3,337,181	2,701,352	3,470,554	-19.1%	-22.2%
Net Debt / Equity	67%	68%	59%	-8.0 pts	0.2 pts
Current Ratio	158%	165%	184%	25.6 pts	-0.1 pts
Interest Coverage	1.7x	1.9x	1.6x	-0.1x	0.2x
ROA	3.13%	2.68%	2.87%	-0.3 pts	-0.1 pts
ROCE	5.91%	4.68%	4.90%	-1.0 pts	0.0 pts
ROE	14.42%	10.48%	13.51%	-0.9 pts	-0.2 pts
GPM	34.63%	34.83%	34.61%	0.0 pts	0.0 pts
NPM	39.08%	31.36%	28.67%	-10.4 pts	0.1 pts
Core NPM	37.64%	23.40%	28.65%	-9.0 pts	-0.2 pts
Total Debt	42,949,970	59,645,171	47,426,204	10.4%	25.8%
Cash	26,901,572	40,467,321	31,258,380	16.2%	29.5%
Net Debt	16,048,398	19,177,850	16,167,824	0.7%	18.6%
ST Debt	4,753,515	3,740,551	1,481,182	-68.8%	152.5%
Properties held under development	38,503,341	30,908,445	44,298,522	15.1%	-30.2%
Advanced proceeds received from customers	4,185,791	6,800,000	6,390,993	52.7%	6.4%

Source: Company data, AMTD Equity Research

Figure 2: P&amp;L forecast and key ratios

PnL, RMB mn	2016	2017	2018e	2019e	2020e	2016	2017	2018e	2019e	2020e
<b>Revenue</b>	<b>8,865</b>	<b>11,543</b>	<b>16,408</b>	<b>22,320</b>	<b>29,535</b>	<b>6.3%</b>	<b>30.2%</b>	<b>42.1%</b>	<b>36.0%</b>	<b>32.3%</b>
Sale of properties	7,923	10,432	15,297	21,209	28,313	4.8%	31.7%	46.6%	38.6%	33.5%
Cost of sales	(5,795)	(7,523)	(10,674)	(14,629)	(19,383)					
<b>Gross profit</b>	<b>3,070</b>	<b>4,020</b>	<b>5,734</b>	<b>7,691</b>	<b>10,153</b>	<b>2.0%</b>	<b>30.9%</b>	<b>42.6%</b>	<b>34.1%</b>	<b>32.0%</b>
Selling expenses	(323)	(433)	(740)	(1,110)	(1,665)	16.7%	34.0%	71.1%	50.0%	50.0%
Administrative expenses	(969)	(937)	(1,528)	(1,950)	(2,633)	25.1%	-3.3%	63.1%	27.7%	35.0%
Share of post-tax loss of an associate	0	(3)	(3)	(3)	(3)					
Share of post-tax (losses)/profits of joint ventures	2,130	1,900	2,522	3,444	3,369					
<b>Finance costs</b>	<b>(160)</b>	<b>(330)</b>	<b>(381)</b>	<b>(437)</b>	<b>(514)</b>	<b>1429.8%</b>	<b>106.1%</b>	<b>15.8%</b>	<b>14.5%</b>	<b>17.8%</b>
<b>Profit before tax</b>	<b>4,527</b>	<b>5,555</b>	<b>5,736</b>	<b>7,768</b>	<b>8,838</b>	<b>-2.9%</b>	<b>22.7%</b>	<b>3.3%</b>	<b>35.4%</b>	<b>13.8%</b>
Income tax expense	(1,066)	(1,950)	(1,967)	(2,344)	(2,475)					
<b>Profit for the year</b>	<b>3,462</b>	<b>3,605</b>	<b>3,769</b>	<b>5,423</b>	<b>6,364</b>	<b>1.4%</b>	<b>4.1%</b>	<b>4.5%</b>	<b>43.9%</b>	<b>17.3%</b>
Profit for the year attributable to:										
<b>Net profit</b>	<b>3,465</b>	<b>3,620</b>	<b>3,784</b>	<b>5,438</b>	<b>6,379</b>	<b>1.4%</b>	<b>4.5%</b>	<b>4.5%</b>	<b>43.7%</b>	<b>17.3%</b>
<b>Core net profit</b>	<b>3,340</b>	<b>2,716</b>	<b>3,784</b>	<b>5,438</b>	<b>6,379</b>	<b>15.8%</b>	<b>-18.7%</b>	<b>39.3%</b>	<b>43.7%</b>	<b>17.3%</b>
Non-controlling interests	(3)	(15)	(15)	(15)	(15)					
Dividends	1,222	1,283	1,324	1,903	2,233					
<b>EPS - basic</b>	<b>1.15</b>	<b>1.17</b>	<b>1.22</b>	<b>1.76</b>	<b>2.06</b>					
<b>EPS-underlying</b>	<b>1.11</b>	<b>0.88</b>	<b>1.22</b>	<b>1.76</b>	<b>2.06</b>					
<b>DPS - basic</b>	<b>0.40</b>	<b>0.41</b>	<b>0.43</b>	<b>0.61</b>	<b>0.72</b>					
<b>BVPS</b>	<b>7.93</b>	<b>8.91</b>	<b>10.13</b>	<b>11.89</b>	<b>13.95</b>					
<b>Key Ratios, RMB mn</b>	<b>2016</b>	<b>2017</b>	<b>2018e</b>	<b>2019e</b>	<b>2020e</b>					
GPM	34.6%	34.8%	34.9%	34.5%	34.4%					
NPM	39.1%	31.4%	23.1%	24.4%	21.6%					
Core NPM	37.6%	23.4%	23.0%	24.3%	21.5%					
ROA	3.1%	2.7%	2.2%	2.6%	2.4%					
ROCE	5.9%	4.7%	4.0%	5.0%	5.0%					
ROE	14.4%	10.5%	12.8%	15.9%	15.9%					
Total Debt / EBITDA	8.9x	10.1x	11.3x	9.6x	10.0x					
Total Debt / Equity	178.9%	211.2%	215.7%	211.2%	212.6%					
Total Debt / Capitalization	64.1%	67.9%	68.3%	67.9%	68.0%					
Net Debt / EBITDA	3.3x	3.3x	3.5x	2.8x	1.8x					
Net Debt / Equity	66.8%	67.9%	66.0%	60.7%	39.1%					
Net Debt / Capitalization	24.0%	21.8%	20.9%	19.5%	12.5%					
Current Ratio	158.4%	165.4%	150.7%	145.6%	149.2%					
Cash / Total Assets	24.3%	30.0%	28.0%	26.9%	28.4%					
Inventory / Total Assets	41.0%	27.8%	38.8%	45.9%	50.3%					
Net debt / Net Inventory	35.4%	51.2%	31.8%	23.6%	12.7%					
Quick Ratio	101.6%	83.5%	89.6%	93.1%	96.3%					
Cash Ratio	56.9%	81.9%	61.1%	52.5%	52.9%					
Interest Coverage	1.7x	1.9x	1.7x	2.0x	1.9x					

Source: Company data, AMTD Equity Research

Figure 3: Balance sheet forecast &amp; Cash flow forecast

Balance Sheet, RMB mn	2016	2,017	2018e	2019e	2020e
<b>Non-current assets</b>	35,795	53,207	53,207	53,207	53,207
<b>Current assets</b>	74,947	81,738	118,194	156,310	214,211
Properties under development	38,503	30,908	59,591	89,280	127,540
Completed properties held for sale	6,866	6,540	6,866	6,866	6,866
Restricted bank deposits	1,131	1,268	1,268	1,268	1,268
Bank balances and cash	25,771	39,199	46,647	55,073	74,714
Others	2,676	3,822	3,822	3,822	3,822
<b>Current liabilities</b>	47,309	49,407	78,410	107,333	143,602
Advanced proceeds received from customers	4,186	0	23,287	45,953	83,452
Borrowings	4,754	3,741	9,456	15,714	14,483
Others	38,369	45,667	45,667	45,667	45,667
<b>Non-current liabilities</b>	39,424	57,292	60,977	64,746	80,014
Borrowings	38,196	55,905	59,589	63,358	78,627
Others	1,228	1,387	1,387	1,387	1,387
<b>Capital and reserves</b>	24,009	28,246	32,015	37,438	43,801
Equity attributable to owners of the Company	23,950	27,607	31,391	36,830	43,208
Non-controlling interests	58	638	623	608	593
Cash Flow Statement, RMB mn	2016	2017	2018e	2019e	2020e
<b>Profit before income tax</b>	<b>4,527</b>	<b>5,555</b>	<b>5,736</b>	<b>7,768</b>	<b>8,838</b>
Operating cash flows before movements in working capital	2,270	3,325	2,832	3,886	4,955
Cash (used in) from operations	524	12,147	(2,889)	(3,137)	4,195
Interest received	170	330	381	437	514
Interest paid	(2,231)	(3,099)	(3,587)	(4,108)	(4,837)
PRC Income tax paid	(324)	(1,107)	(1,096)	(1,165)	(1,326)
Land appreciation tax paid	(229)	(843)	(871)	(1,179)	(1,149)
<b>Net cash (used in) from operating activities</b>	<b>(2,091)</b>	<b>7,428</b>	<b>(8,062)</b>	<b>(9,152)</b>	<b>(2,602)</b>
<b>Net cash used in investing activities</b>	<b>3,318</b>	<b>4,999</b>	<b>6,109</b>	<b>7,552</b>	<b>8,206</b>
Financing activities					
<b>Proceeds from borrowings</b>	<b>9,068</b>	<b>9,230</b>	<b>13,141</b>	<b>19,483</b>	<b>29,751</b>
<b>Repayments of borrowings</b>	<b>(11,148)</b>	<b>(4,754)</b>	<b>(3,741)</b>	<b>(9,456)</b>	<b>(15,714)</b>
<b>Net cash from (used in) financing activities</b>	<b>13,580</b>	<b>1,002</b>	<b>9,400</b>	<b>10,027</b>	<b>14,037</b>
<b>Net increase in cash and cash equivalents</b>	<b>14,807</b>	<b>13,428</b>	<b>7,448</b>	<b>8,427</b>	<b>19,641</b>
Effect of foreign exchange rate changes	17	0	0	0	0
Cash and cash equivalents at beginning of the year	10,946	25,771	39,199	46,647	55,073
<b>Cash and cash equivalents at end of the year</b>	<b>25,771</b>	<b>39,199</b>	<b>46,647</b>	<b>55,073</b>	<b>74,714</b>

Source: Company data, AMTD Equity Research

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<b>Buy</b>	Stock with potential return of over 20% over the next 12 months
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