

## Hongkong Land (HKL SP) : BUY

**Mkt. Cap:** US\$15,987m | **3m Avg. Daily Val:** US\$10.9m

**Last Traded Price ( 24 May 2019):** US\$6.85

**Price Target 12-mth:** US\$8.02 (17.1% upside)

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### Company Guide



Summary of our point of view, and highlights the relevant data points, which are actively tracked

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## Takeaways from China Management Presentation and Site Visit in Chongqing

- **Decent profit contributions from development projects which carry respectable margins**
- **Contract sales to pick up in 2H19 from more new project launches**
- **Property development in China should enhance earnings profile but may not necessarily re-rate the stock due to the inherent risk perceived by the market on this sector**
- **Valuation is undemanding; Maintain BUY with US\$8.02 TP**

### Forecasts and Valuation

FY Dec (US\$ m)	2017A	2018A	2019F	2020F
Turnover	1,616	2,665	2,260	1,840
EBITDA	879	1,094	1,013	1,068
Pre-tax Profit	1,100	1,240	1,230	1,241
Underlying Profit	947	1,036	1,039	1,040
EPS (US\$)	0.41	0.44	0.45	0.45
EPS Gth (%)	12.6	9.0	0.6	0.1
PE (X)	16.9	15.5	15.4	15.4
P/Cash Flow (X)	17.1	10.1	12.7	21.5
EV/EBITDA (X)	22.0	17.7	19.1	18.1
DPS (US\$)	0.20	0.22	0.22	0.23
Div Yield (%)	2.9	3.2	3.2	3.4
Net Gearing (%)	7	9	11	12
ROE (%)	2.8	2.8	2.7	2.6
Est. NAV (US\$):			13.0	13.4
Disc. to NAV (%)			(47)	(49)
Earnings Rev (%):			Nil	Nil
Consensus EPS (US\$):			0.46	0.46
Other Broker Recs:		B: 9	S: 3	H: 2

Source: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

### What's New

I attended Hongkong Land's China Management Presentation in Chongqing last week. Hongkong Land entered into the China property market with the development of Maple Place in Beijing in 1997. The company then made its first foray into Chongqing in 2005 with the acquisition of Bamboo Grove site, a joint venture with Longfor Properties. After gradually accumulating development expertise, Hongkong Land started to develop its first wholly owned project, Yorkville South, in Chongqing in 2010. In the same year, the company acquired two sites in Beijing for commercial development and expanded to the Chengdu market. In 2015, Hongkong Land entered Shanghai with the development of Parkville. In 2017, the company established its property footprint in Wuhan, Nanjing and Hangzhou markets.

The company has expedited its expansion in China with the carrying value of its China properties growing at CAGR of 10% between 2014 and 2018. Currently, Hongkong Land has 22 projects in seven cities in China which account for 10% of total employed capital of US\$41.9bn.

Hongkong Land boasts of a development land bank of 6.15m sm in terms of GFA in China. About 75% is earmarked for residential development with 14% and 8% designated for retail and office purpose respectively. These commercial properties will be classified as assets held for medium-term lease when completed. Meanwhile, they will



Live more, Bank less

## Flash Note

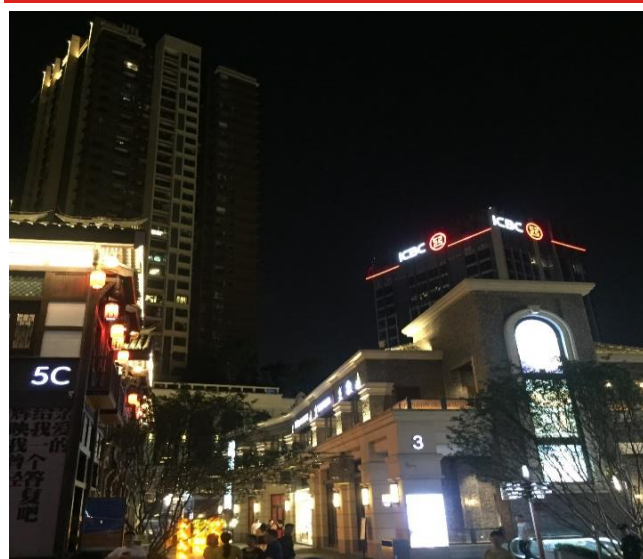
be retained for rental initially and profit contribution is expected to be immaterial. Once the rental performance stabilises after one or two leasing cycles, the company plans to unlock the value of these commercial assets. Currently, Hongkong Land has three completed retail assets which fall into this category and include Landmark Riverside Park & Danzishi Old Street in Chongqing and LCM in Shanghai. Hongkong Land is developing a mall at Yorkville North which is scheduled to be completed in 2020 with NFA of 80,000sm. Unlike WF Central in Beijing and its Hong Kong retail portfolio, the abovementioned projects are mass market retail properties with different management skill sets required, which may pose challenges to the company.

### Yorkville North Shopping Mall (Under construction)



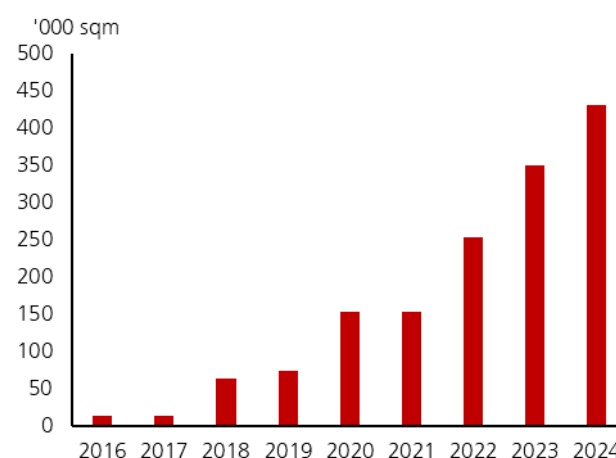
Source: DBS HK

### Danzishi Old Street



Source: DBS HK

### Development Properties – Asset held for Medium-Term Lease



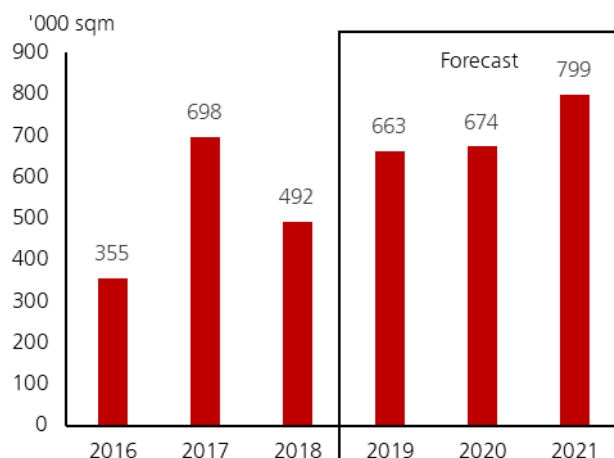
Source: DBS HK

**Decent profit from property development which carries respectable margins.** Hongkong Land's development income from China doubled to US\$1.2-1.3bn in FY17-18 from FY14-16. Additionally, gross margins also improved to 40-41% in FY17-18, compared to an average of 36% during FY14-18. As a combined result, operating profit from China more than doubled to US\$430-470m in FY17-18 from FY14's US\$166m and accounted for >25% of the company's total operating profits. With the average effective tax rate of 45%, net margins stood at 15-20% in FY14-18.

**Increasing project completion.** In FY19, FY20, and FY21, Hongkong is scheduled to complete development properties of 0.66m sm, 0.67m sm and 0.8m sm respectively, up from FY18's 0.49m sm. While the bulk of projects scheduled for completion are from Chongqing, projects in new markets including Wuhan, Nanjing and Hangzhou should come onstream from FY20 onwards.

## Flash Note

### Development Properties – Attributable Saleable GFA completions



Source: DBS HK

**More new project launches in the pipeline.** Hongkong Land's contracted sales in China tumbled 36% to US\$193m in 1Q19 due to the timing of new project launches. With growing number of new projects expected to be offered for pre-sale in 2H19, the company is set to see stronger contracted sales. In 3Q19, Hongkong Land is scheduled to offer Yue City and River and City, both in Nanjing, for pre-sale. In 4Q19, River One, Harbour Tale, Hillview and Yuelai project in Chongqing, Caohejing project in Shanghai and Yixinhu project in Chengdu are expected to be released into the market.

**Where to invest** In searching for cities for investment, there are four major criteria. The market has to be large with annual residential transaction value of >Rmb100bn. Cities with sizeable population base or strong population inflow are preferred. Supply outlook is crucial with preference towards those cities with a low inventory level. Last but not least, it would be better if Hongkong Land has existing resources or market relationships in the cities. In future, it is more likely that Hongkong Land will deepen its presence in the current seven cities when pursuing new investments instead of branching out to new cities.

**Benefitting from forming joint ventures.** In its property development strategy in China, Hongkong Land is relatively more flexible in forming joint ventures with local developers including Country Garden, Longfor and CIFI, compared to other Hong Kong-based real estate companies. We believe these joint venture arrangements play a key crucial to speed up expansion in China as it allows the company to benefit from the local expertise of its partners. This also reduces exposure to any individual project, resulting in a more balanced risk profile. Local partners could also provide referrals to more potential projects, thus strengthening its capability in sourcing new projects.

**Commercial investment properties in Beijing.** Currently, Hongkong Land has two investment properties within its portfolio. Completed in 2017, WF Central in Beijing has total NFA of 43,000sm. This premium lifestyle mall is currently 88% let with occupancy expected to exceed 90% by end-19. Fashion and accessories tenants, and F&B operators altogether account for >70% of floor area.

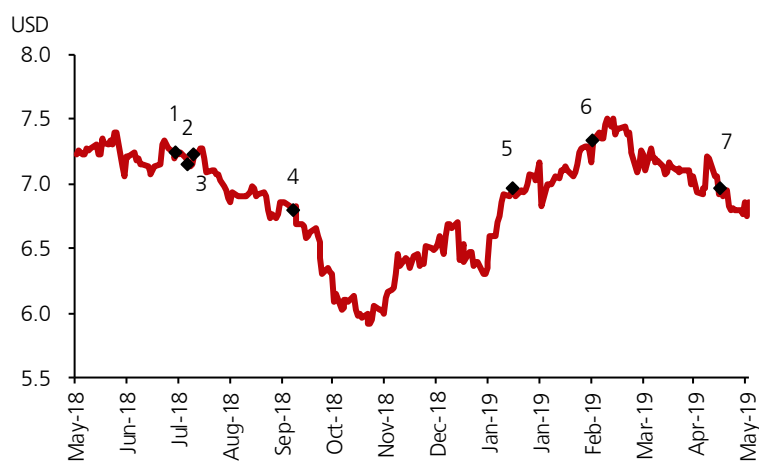
The land title of the Chaoyang commercial site in Beijing was obtained in late 2018 with construction work expected to commence in 2020. Upon scheduled completion in 4Q23, this commercial project will provide 111,000sm of office space and 16,000sm of retail space. Its project partner, CICC, will be an anchor tenant taking up 20% of office space when completed

Overall, led by a well-structured China property team with growing local talent, the China property business should continue to provide reasonably good returns to Hongkong Land. This would not only add momentum to the company's earnings growth but also diversify its earning base. Having said that, due to the risks inherently perceived by the market on the China property development sector, the good progress made in this sector by Hongkong Land may not necessarily translate into higher valuation for the stock over the short-to-medium term.

YTD, share price of Hongkong Land has risen 9%, underperforming the other Hong Kong landlords. Meanwhile, the stock is trading at 47% discount to our appraised current NAV. Even allowing for subdued office leasing demand in Central, the current valuation remains undemanding. Therefore, we maintain our BUY rating on the stock. Our TP of US\$8.02 is premised on 40% discount to our Dec-19 NAV estimate

## Flash Note

### Target Price & Ratings History



Source: DBS HK

Analyst: Jeff YAU CFA,  
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**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

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**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

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*\*Share price appreciation + dividends*

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