



Rating
Buy

Asia
China

Property
Property

Company
China Vanke

Reuters 000002.SZ	Bloomberg 000002 CH	Exchange SHZ	Ticker 000002
ADR Ticker CVKEY	ISIN US16948J1097		

Date
26 October 2017

Forecast Change

Price at 26 Oct 2017 (CNY)	27.53
Price target - 12mth (CNY)	31.21
52-week range (CNY)	29.30 - 18.47
HANG SENG INDEX	28,303

Improving sales visibility and 30% earnings CAGR

Buy for high earnings visibility and undemanding valuation

We upgrade Vanke A to Buy from Hold and raise our TP by 22% to RMB31.21 after factoring its strong 3Q17 results and latest land acquisitions. We believe Vanke can sustain its double-digit sales growth given its proactive landbanking and the potential JV with SZ Metro on the two Shenzhen projects. We forecast Vanke to report 30% earnings CAGR with post-tax gross margin expanding to 24-25% in FY17-19F. Also, we expect the privatization of GLP to be completed by April 2018, which should be a positive share price catalyst. The stock now trades at 8.4x FY18F P/E and 21% discount to NAV, which is undemanding versus peers given its high earnings visibility.

Proactive landbanking and JV with SZ Metro to sustain double-digit growth

Vanke has acquired 19.0mn sqm in 3Q17 (including the asset package from GD International Trust), which is 22% more than its landbanking in 1H17. We estimate these projects could add ~RMB380bn of saleable resource with ~25% pre-tax gross margin on average (assuming no ASP increase). Also, Vanke is bidding for the two Shenzhen projects (1.8mn sqm GFA) auctioned by SZ Metro (Vanke's largest shareholder). We believe Vanke will likely win the auction and the gross margin would be >50%, if the auction price is similar to the offer price that SZ Metro planned for exchange of Vanke's shares before. Together with the other 40 above-metro JV projects with SZ Metro under good discussion, we believe Vanke can sustain double-digit sales growth in 2018F.

Strong full-year results and GLP deal as positive catalysts

We expect Vanke to report 30% earnings growth this year with post-tax gross margin expanding to ~24% (vs. 20.3% in FY16), given there are RMB432bn unbooked sales by September. Also, the privatization of GLP is expected to be completed before April 2018, which should provide synergy to Vanke's existing logistics property business as its long-term earnings driver. We believe these two should be positive near-term catalysts for the share price.

Strong 9M17 results with margin expansion

Vanke reported strong 9M17 results with: 1) revenue staying flat at RMB117bn; 2) post-tax gross margin expanding to 23.7% (vs. 20.3% in FY16); 3) core profits increasing 31% to RMB10.6bn; and 4) net gearing ratio increasing to 38% (vs. 26% in FY16 and 20% in 1H17).

Valuation and risks

Our TP is based on a 10% discount to end-2018F NAV of RMB34.68. The stock now trades at 8.4x FY18F P/E and at a 21% NAV discount. Key risks: 1) Baoneng selling its shares in the secondary market, 2) slower property sales, and 3) failure to acquire quality sites.

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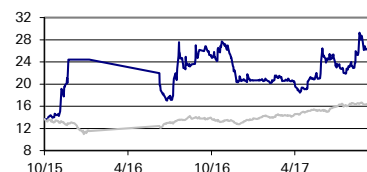
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Key changes

TP	25.51 to 31.21	↑	22.3%
Rating	Hold to Buy	↑	
Sales (FYE)	282,105 to 283,818	↑	0.6%
Op prof margin(FYE)	-	↑	0.1%
Net profit(FYE)	27,299.1 to 27,361.6	↑	0.2%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	2.9	17.5	9.4
HANG SENG INDEX	2.9	5.1	21.3

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	195,549.1	240,477.2	283,817.9	346,258.7	414,208.6
DB EPS growth (%)	12.8	18.8	30.5	32.8	30.6
PER (x)	9.1	12.4	11.1	8.4	6.4
DPS (net) (CNY)	0.72	0.79	0.99	1.31	1.72
Yield (net) (%)	4.9	3.4	3.6	4.8	6.2

Source: Deutsche Bank estimates, company data

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Investment Thesis

Outlook

We upgrade Vanke A to Buy from Hold. We believe Vanke can sustain its double-digit sales growth given its proactive landbanking and the potential JV with SZ Metro on the two Shenzhen projects. We forecast Vanke to report 30% earnings CAGR with post-tax gross margin expanding to 24-25% in FY17-19F. Also, we expect the privatization of Global Logistic Properties (GLP) to be completed by April 2018, which should be a positive share price catalyst.

Valuation

Our end-FY18F NAV estimate comprises of RMB21.14/share of development properties, RMB2.31/share of investment properties and RMB11.23/share of net cash. Our NAV estimate values existing landbank and properties based on a sum-of-the-parts methodology: 1) we use DCF to value the company's development properties, with a WACC of 9.1% (we apply a risk-free rate of 3.0%, beta of 1.5, risk premium of 6.0% and cost of debt at 5.7%); and 2) we use a cap-rate approach (cap rate between 5% and 9%) to value investment properties. In our model, we assume full prepayment of the land appreciation tax. In terms of property price assumptions, we assume prices will grow 5% in T1/T2/T3 cities in 2018F and remain flat thereafter.

Our 12-month target price is based on a discount to our NAV estimate. The rationale for such a target discount is based on eight key measures of the companies we cover (product quality, landbank quality, scale, leverage, growth prospect, profitability, financing advantage, and execution). Comparing China Vanke to peers in terms of operating and financial performance, we apply a 10% discount to our NAV estimate. The benchmark index for the stock is MSCI China.

Risks

Macro risks: The government's property tightening measures might be stricter than expected, which could result in volatile moves in housing transaction volumes, housing prices, land prices, and financing available to developers and homebuyers. The unexpected economic fluctuations in the Chinese economy also add risks to the sector. In addition, potential RMB depreciation may result in FX losses for developers with offshore financing.

Company-specific risks: 1) Baoneng to sell its shares in the secondary market; 2) property sales slow down significantly in the second half of 2017; and 3) failure to acquire quality sites, and therefore, inability to sustain its growth.



Figure 1: Summary of NAV breakdown

NAV breakdown (share price currency)	2018E
Development properties	233,317
Residential	233,618
Retail	(301)
Office	-
Hotel	-
Investment properties	25,544
Residential	1,681
Retail	23,863
Office	-
Hotel	-
GAV	258,861
Net debt	123,965
Adjustment for perpetuals	-
NAV	382,827
Number of shares - basic (mn)	11,039
NAV per share	34.68
Discount to NAV	10%
Target price	31.21

Source: Deutsche Bank estimates

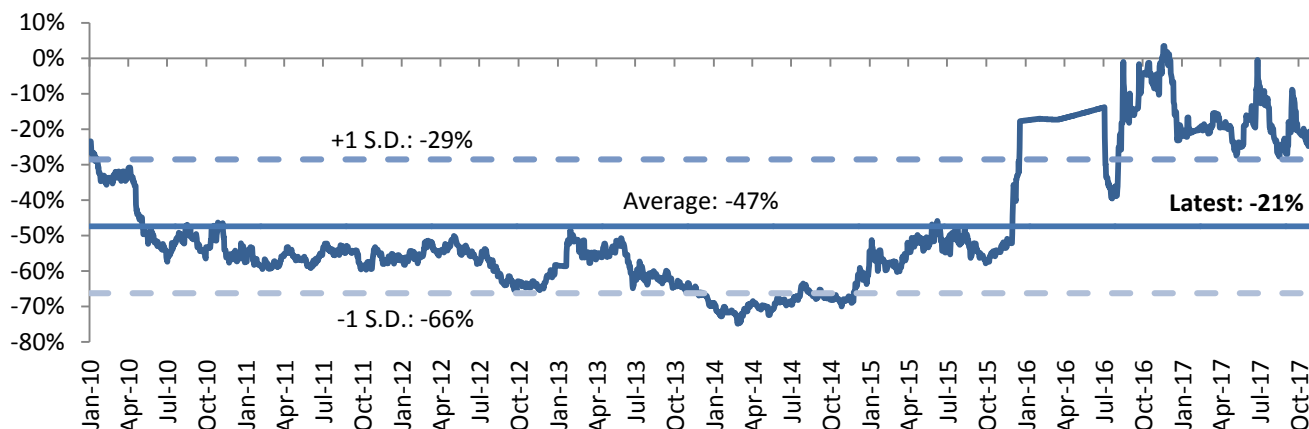
Figure 2: Summary of 9M17 results

(RMB mn)	9M17	9M16	y-y %
Revenue	117,101	117,055	0%
Cost of sales	(89,387)	(96,084)	-7%
Gross profit	27,713	20,971	32%
SG&A	(8,989)	(6,499)	38%
Other operating income/expenses	1,086	100	991%
Operating profit	19,811	14,571	36%
Net finance income	(1,326)	(657)	102%
Share of results of associates and JCE	2,417	2,047	18%
Profit before tax	20,902	15,961	31%
Income tax	(6,085)	(4,671)	30%
Profit before minority interests	14,817	11,290	31%
Minority interests	3,726	3,028	23%
Reported net profit	11,091	8,262	34%
Core profits	10,595	8,093	31%
Post-tax gross margin	23.7%	17.9%	5.8%
Core profits margin	9.0%	6.9%	2.1%
Net gearing *	38%	26%	12%

Note: Net gearing for 9M16 is as of end-2016.
 Source: Company data

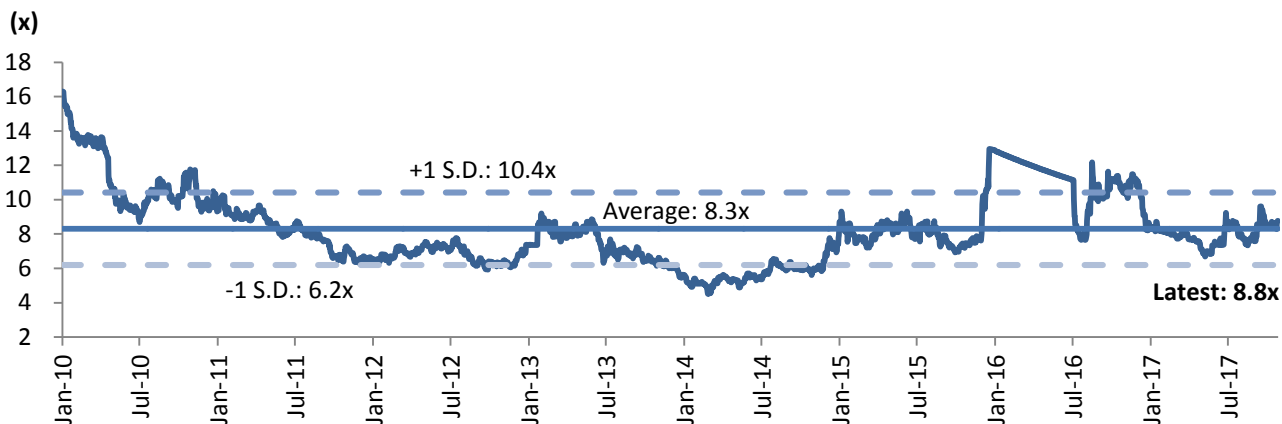


Figure 3: Vanke-A: NAV discount chart



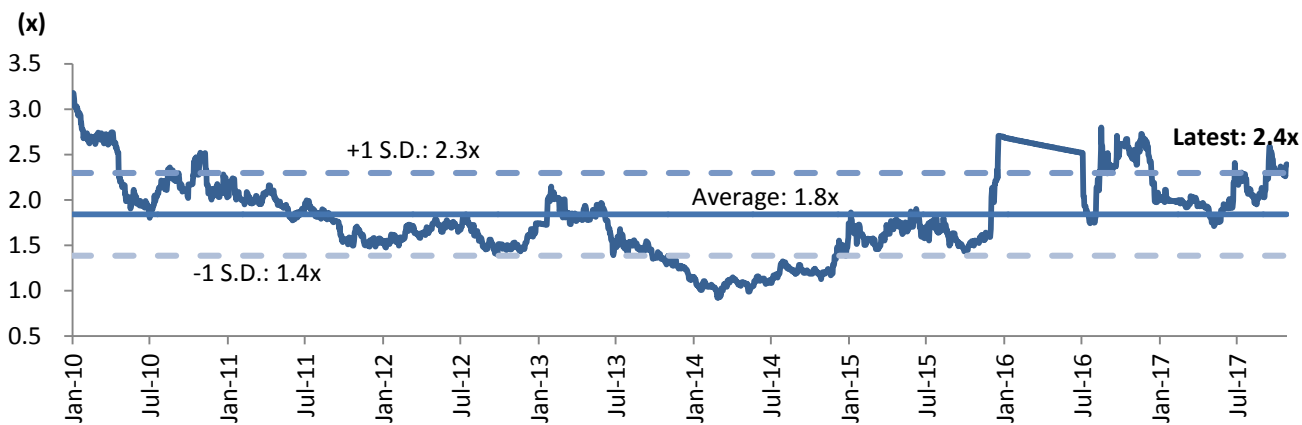
Source: Bloomberg Finance LP, Company data, Deutsche Bank

Figure 4: Vanke-A: 12-month forward P/E chart



Source: Bloomberg Finance LP, Company data, Deutsche Bank

Figure 5: Vanke-A: Price-to-book value chart



Source: Bloomberg Finance LP, Company data, Deutsche Bank



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
China Vanke	000002.SZ	27.53 (CNY) 26 Oct 17	1,7

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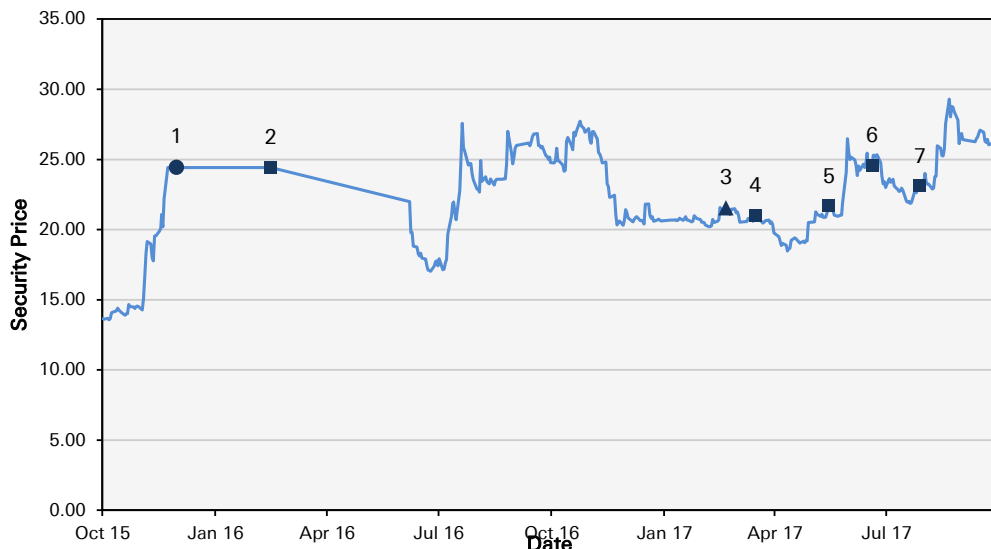
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Historical recommendations and target price: China Vanke (000002.SZ)
 (as of 10/26/2017)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

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1. 28/12/2015:	Downgrade to Sell, Target Price Change CNY16.30	5. 12/06/2017:	Hold, Target Price Change CNY22.72 Jeffrey Gao
Jason Ching			
2. 14/03/2016:	Sell, Target Price Change CNY17.10 Jason Ching	6. 17/07/2017:	Hold, Target Price Change CNY25.42 Jeffrey Gao
3. 20/03/2017:	Upgrade to Hold, Target Price Change CNY21.65 Jeffrey Gao	7. 25/08/2017:	Hold, Target Price Change CNY25.51 Jeffrey Gao
4. 13/04/2017:	Hold, Target Price Change CNY20.49 Jeffrey Gao		

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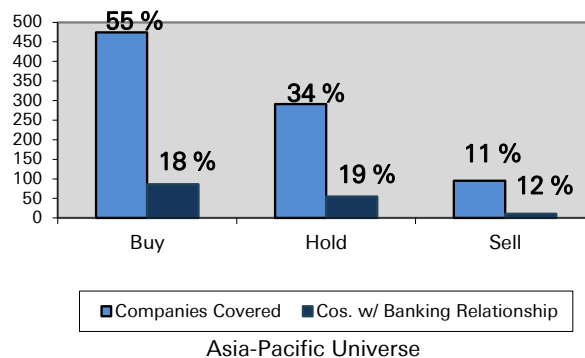
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

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