Poly Development - A (600048 CH)

West Point in China

SUMMARY. Being the fifth largest property developer in China, Poly Development takes the advantage of being central SOE. Currently, the Company has land bank of 230mn sq m in more than 100 cities in China. We estimate net profit to be RMB24.7bn in 2019. Our target price is RMB16.64, representing 8.0x 2019E P/E. We initiate Poly Development with BUY recommendation.

- **Over RMB400bn contracted sales in 2018.** Contracted sales increased by 30.9% to RMB404.8bn in 2018. In 2019, China property market is facing many uncertainties. But the Company experienced a 21.8% contracted sales growth to RMB189bn in 5M19. Given RMB650bn saleable resources, we expect Poly Development 2019 full year contracted sales to be RMB480bn, up 18.6% YoY.
- **230mn sq m land bank in more than 100 cities.** Poly Development owns a 230mn sq m land bank as at Mar 2019. Headquartered in Guangzhou, more than one-third of GFA under development is located at the PRD. The Company penetrates more than 100 cities in China. Its major products are targeted to first time home buyers or first time upgraders who have great demand for housing in China.
- **High efficiency management team.** Due to the military culture, the Company was built into a highly efficient management structure. It has a high execution power through clear defined responsibility, scientific decision-making mechanism, fair job duty appraisal, precise internal audit and organization monitoring. Meanwhile, it implements an attractive incentive scheme to retain talent.
- **Forecast net profit to grow at a 23.1% CAGR from 2018 to 2021.** Thanks for the increasing recognized GFA and recognized ASP, we forecast total revenue to grow from RMB194.6bn in 2018 to RMB364.9bn in 2021. Gross margin is expected to stay around 31.8-32.3% next three years. Therefore, we project net profit to be RMB24.7bn, RMB30.9bn and RMB35.4bn in 2019-21, respectively.
- **Healthy balance sheet and central SOE advantage.** Net gearing ratio was 80.6% by FY18. The Company has slowed down its land acquisition plan because of the cautious view on land market. Thus, we forecast net gearing ratio to trend down to 71.9% by FY19. The Company has already accumulated ample land bank that is sufficient to its next 3-4 years development. Furthermore, cost of debt was 5.03% in 2018 because of the central SOE status.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	146,659	194,555	252,043	316,015	364,871
YoY growth (%)	-5.2	32.7	29.5	25.4	15.5
Net income (RMB mn)	15,634	18,904	24,706	30,867	35,391
EPS (RMB)	1.32	1.59	2.08	2.59	2.98
YoY growth (%)	20	20.5	30.6	24.9	14.7
P/E (x)	9.7	8.1	6.2	4.9	4.3
P/B (x)	1.5	1.3	1.2	1.0	0.9
Yield (%)	3.1	3.9	4.9	6.1	7.0
ROE (%)	15.3	16.4	18.6	20.0	19.8
Net gearing (%)	86.4	80.6	71.2	64.4	56.3

Source: Company data, CMBIS estimates

BUY (Initiation)

Target Price	RMB16.64
Up/downside	+29.8%
Current Price	RMB12.82

China Property Sector

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Stock Data

Mkt Cap (RMB mn)	152,494
Avg 3 mths t/o (RMB mn)	1,093
52w High/Low (RMB)	15.08/ 10.23
Total Issued Shares (mn)	11,895.0

Source: Bloomberg

Shareholding Structure

China Poly Group	40.7%
Free float	59.3%

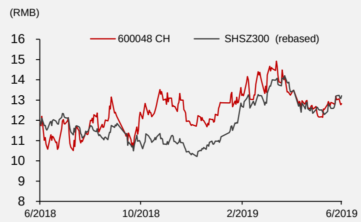
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	2.5%	-3.1%
3-mth	-4.3%	-5.8%
6-mth	8.0%	-14.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: BDO

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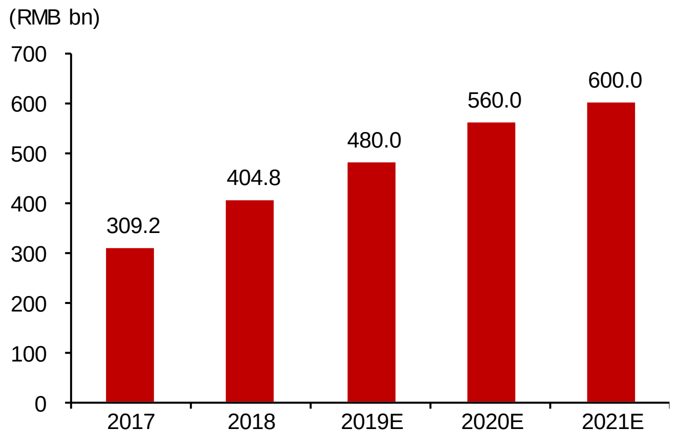
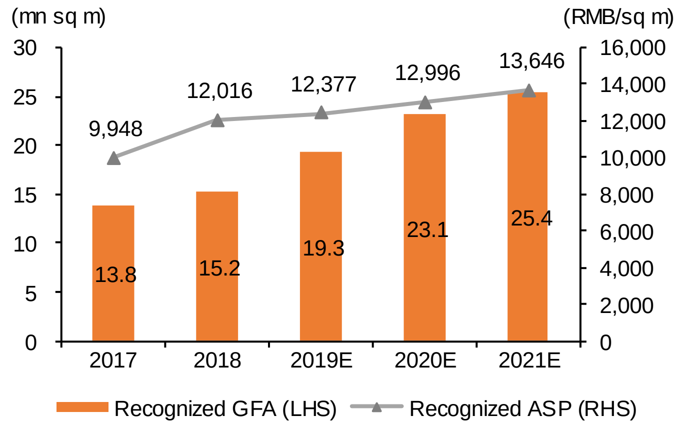
Focus charts

Figure 1: Contracted sales



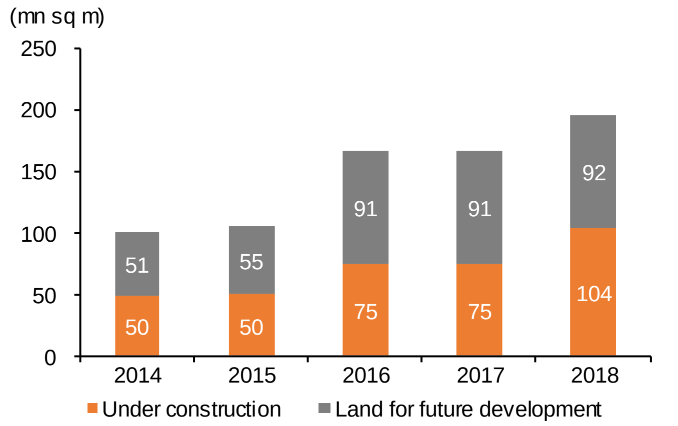
Source: Company data, CMBIS estimates

Figure 2: Recognized GFA and ASP



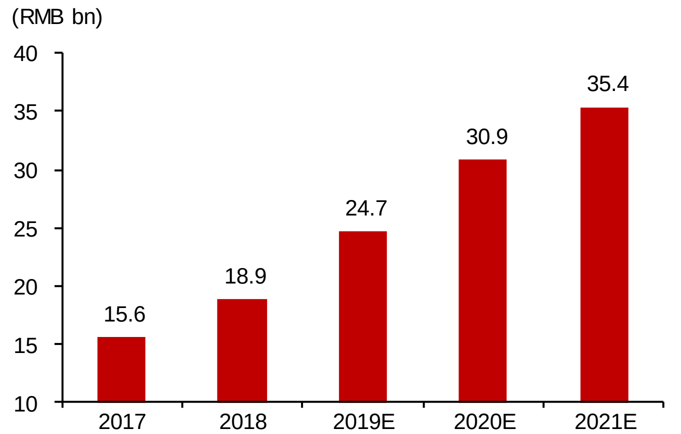
Source: Company data, CMBIS estimates

Figure 3: Land bank



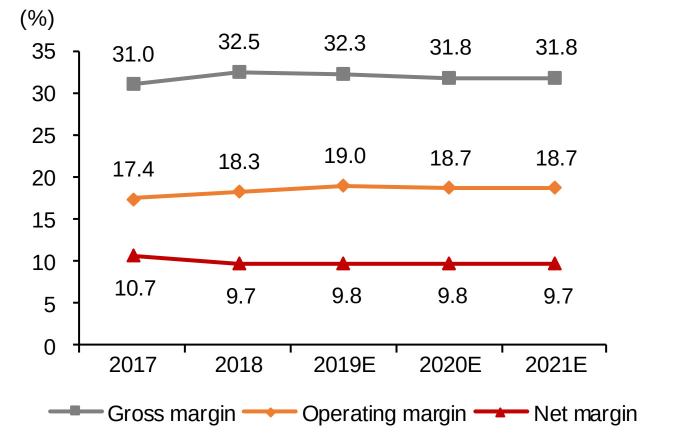
Source: Company data, CMBIS estimates

Figure 4: Net profit to shareholders



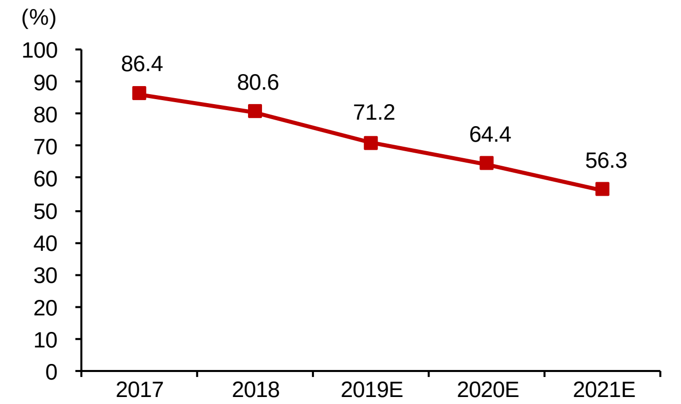
Source: Company data, CMBIS estimates

Figure 5: Profit margin



Source: Company data, CMBIS estimates

Figure 6: Net gearing ratio



Source: Company data, CMBIS estimates

Company background

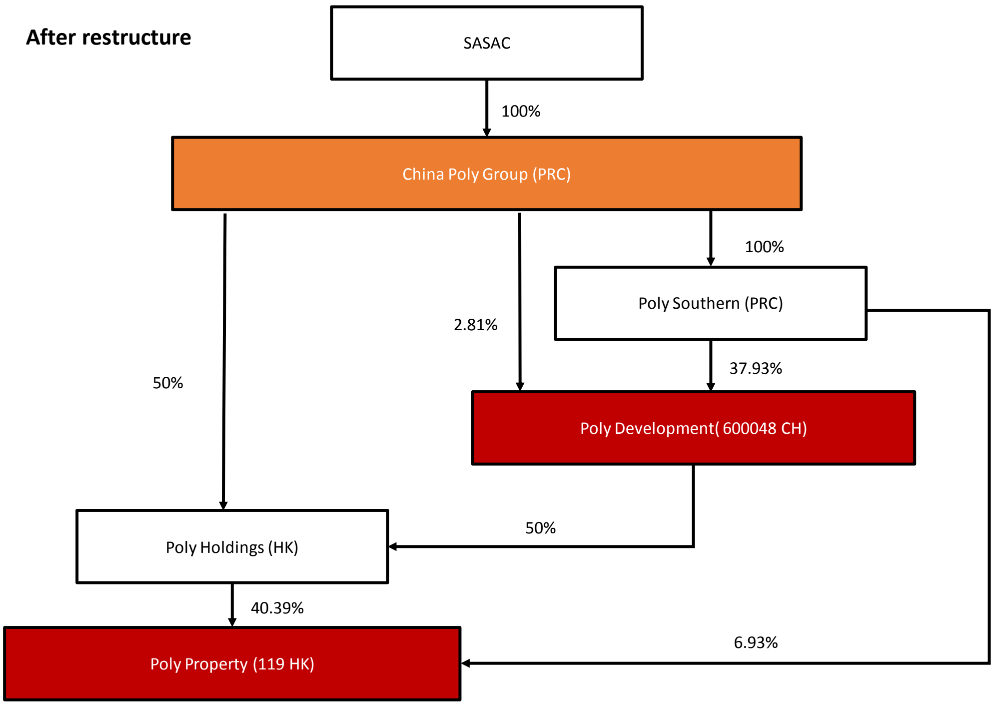
A large scale central SOE

Poly Development is owned by China Poly Group, which is a large scale central state-owned enterprise (SOE) under the direct supervision and administration of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC). Founded in Feb 1992, China Poly Group obtained the approval from the State Council and the Central Military Commission to build a multi-businesses conglomerate. Except for the property business, China Poly Group is engaged in military and civilian trade and business, investment and exploitation in mineral resource field, culture and arts business and the manufacture of civilian explosive equipment and blasting service. Now, China Poly Group is the parent of five listed companies, namely Poly Development (600048 CH), Poly Property (119 HK), Poly Culture (3636 HK), China Haisum Engineering (002116 CH) and Guizhou Industrial Explosive Materials Development (002037 CH).

Poly Development was established in 1992 and was listed on Shanghai Stock Exchange in 2006. It is engaged in the property development business. In 2018, its contracted sales amounted to RMB404.8bn, up 30.9% YoY. As a result, the Company was ranked as the fifth largest property company in China, in terms of contracted sales amount, based on CRIC report. As at Mar 2019, Poly Development was investing in 598 property projects with total GFA of 230mn sq m.

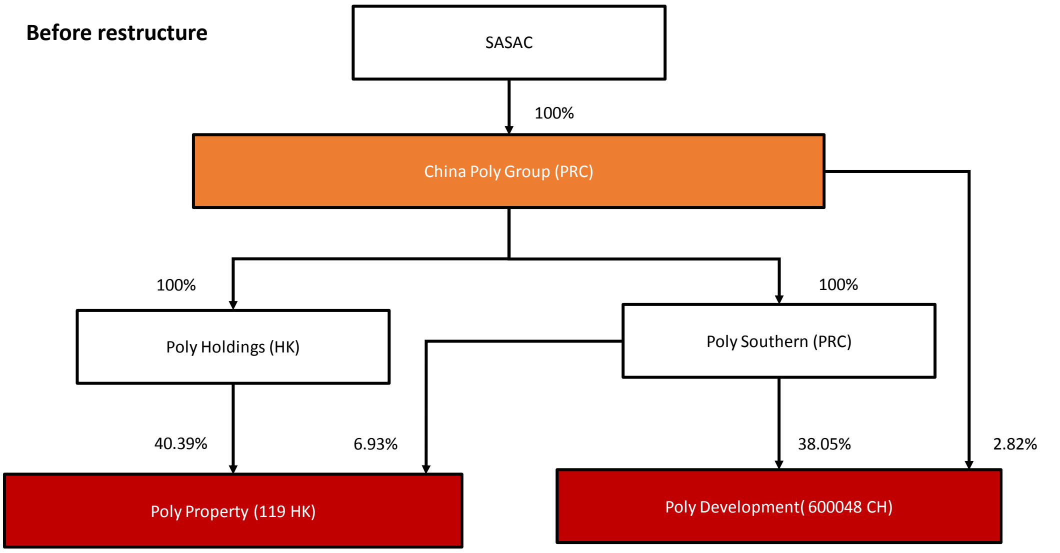
In Nov 2017, Poly Development entered a sale and purchase agreement with its parent, China Poly Group Corporation, to acquire 50% stake of Poly Holdings, which owns 40.39% of Poly Property (119 HK). This transaction was completed in Jun 2018. Furthermore, China Poly Group Corporation owns 6.93% of Poly Property directly through Poly Southern Group Limited. So China Poly Group Corporation owns 47.32% of Poly Property directly and indirectly. Lastly, according to HKEx announcement, Poly Development will lead all new property development projects in China (excluding Hong Kong and Macau).

Figure 7: Current organization structure of Poly Development and Poly Property



Source: Company data, CMBIS

Figure 8: Previous organization structure of Poly Development and Poly Property



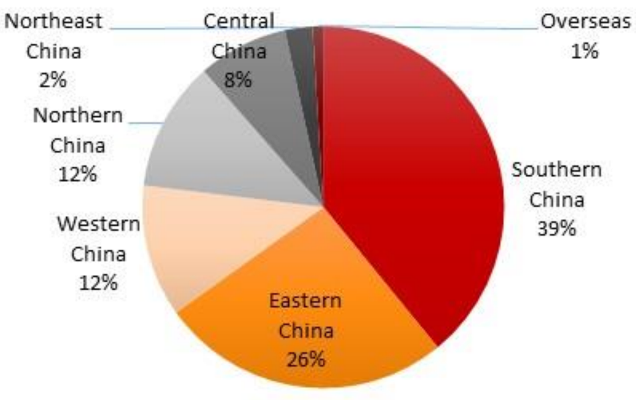
Source: Company data, CMBIS

National footprint

Being the fifth largest property developer in China and having 230mn sq m land bank as at Mar 2019, Poly Development invests nationally. Headquartered in Guangzhou, Southern China is the major battle field for Poly Development. Revenue from Southern China accounted for 39.1% of total revenue in 2018, being the largest geographical contributor. Eastern China was the second largest contributor, which accounted for 26.0% of total revenue in 2018. The Company penetrates more than 100 cities in China. Furthermore, Poly Development had entered the oversea property market, such as in Melbourne, Sydney, London and Los Angeles.

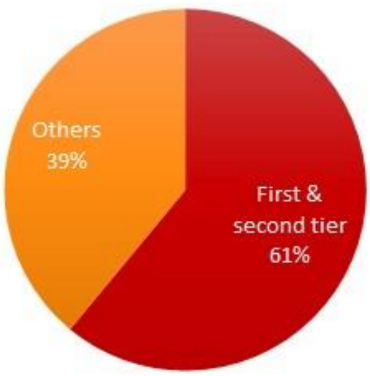
In 2018, Poly Development newly acquired 132 projects with total GFA of 31.16mn sq m. Total considerations was RMB192.7bn, that translated to average land cost of RMB6,186 per sq m. New projects in the first and second tier cities accounted for 74% and 61% in terms of acquisition cost and GFA, respectively. Lastly, new start and completion were 43.96mn sq m and 22.17mn sq m in 2018, respectively.

Figure 9: Geographical breakdown of revenue in 2018



Source: Company data

Figure 10: New land bank in GFA by tiers of cities

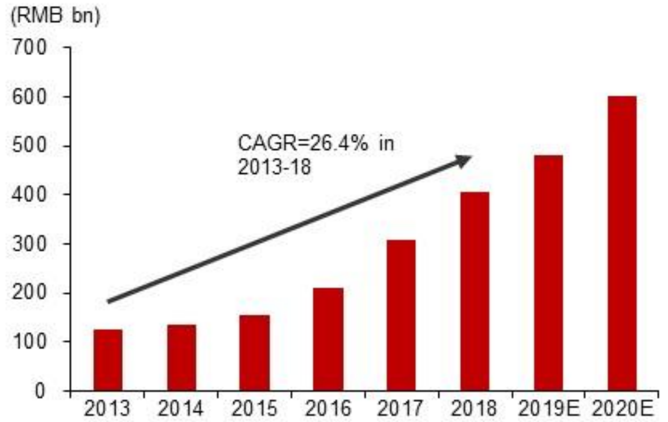


Source: Company data

Robust sales growth

Poly Development experienced a steady contracted sales growth from RMB125.3bn in 2013 to RMB404.8bn in 2018, representing a 26.4% CAGR in the corresponding period. In 2018, contracted sales increased by 30.9% to RMB404.8bn, ranking fifth nationally and first among SOE. In 2019, China property market is facing many uncertainties. But Poly Development experienced a 21.8% of contracted sales growth to RMB189.0bn in 5M19. Given RMB650bn saleable resources in 2019, we expect its 2019 full year contracted sales to be RMB480bn, up 18.6% YoY, or representing a 73.8% sales through rate.

Figure 11: Contracted sales amount



Source: Company data, CMBIS estimate

Business diversification

Revenue from property sales amounted to RMB182.5bn in 2018, representing 93.8% of total revenue. The Company will leverage its brand name and marketing position to penetrate general property service business and real estate fund.

In Jun 2019, the Company announced its plan of spinning off property management business and listing on Stock Exchange of Hong Kong. Poly Property Management is serving properties projects in 131 mainland cities. According to the information from NEEQ, revenue and net profit of Poly Property Management increased by 30.3% to RMB1,853mn and 64.4% to RMB185mn in 1H18. Since the delisting in Mar 2019, we estimate its 2018 full year revenue and net profit to be RMB4bn and RMB400mn, respectively.

AUM of Poly Real Estate Fund was RMB100bn. It had invested in more than 150 properties projects. Real Estate Fund not only improves the balance sheet, but also enhances return by receiving management fee and performance fee.

Competitive advantage

High efficiency management team

Referring to the military culture, Poly Development was built into a highly efficient management structure. The Company has a high execution power through the clear defined responsibility, scientific decision-making mechanism, fair job duty appraisal, precise internal audit and organization monitoring. Furthermore, Poly Development implements an attractive incentive scheme with share option and project investment plans in order to stimulate staff performance. In addition, the Company pays attention to human resource training to secure a professional and sustainable management team.

Niche strategic position

Founded in 1992, Poly Development surged with the sustainable economic growth and urbanization. It receives ample harvest and enjoys steady growth by focusing business development in property market. In the past, contribution from property development always accounted for more than 90%. Now, the Company further expands business to general property service and real estate fund. On the one hand, there is synergy as these new business lines are related to property development business. On the other hand, it can cultivate new earnings growth drivers.

Focus on major city clusters

Poly Development focuses on the property market in the first and second tier cities as well as major city clusters, such as those in Pearl River Delta (PRD), Yangtze River Delta, Beijing-Tianjin-Hebei, Central China, Western China and West Strait Region. For optimization, Poly Development would strengthen the business development in the robust cities. For example, about 60% of GFA under development is located in the first and second tier cities. Another 30% is situated in the third and fourth tier cities where are adjacent to the major city clusters. Especially, more than one-third of GFA under development is located at the PRD. In terms of product design, more than 85% of properties for sales are residential units, or majority of residential units are having average GFA of less than 144 sq m that satisfied the demand for first time home buyers or first time upgraders.

Integrated development of property related business

After many years of development, Poly Development established multi channels for land acquisitions, including tendering, auction, listing, M&A, co-operation, urban renewal development etc. It had accomplished many urban renewal development projects, theme parks, landmark buildings, signature towns and industrial parks. All of these projects enjoyed cost advantages.

Thanks to the strong base in property development business, Poly Development is participating in upper and lower streams of property industry. For example, the Company is engaged in the general property servicing and real estate financing industries. It has strategic development in property management, agent, construction and real estate funds.

Low funding cost

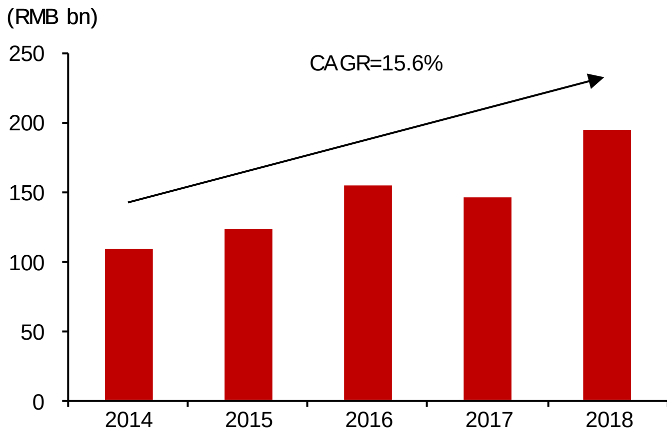
Poly Development strengthened cash management. Cash collection ratio was maintained at more than 85% in recent years. Taking advantage of central SOE, the Company has multi financing channels, such as bank borrowing, equity financing, direct debt financing, asset back securities, etc. As at end of 2018, net gearing ratio was 80.6%. At the same period of time, cash on hand and short term borrowing were RMB113.4bn and RMB48.8bn, respectively. It is sufficient to fulfill any short-term financial obligation. Lastly, average annual funding cost was 5.03% in 2018, which was lower than other major competitors.

Financial analysis

Revenue to grow at 23.3% CAGR from 2018 to 2021

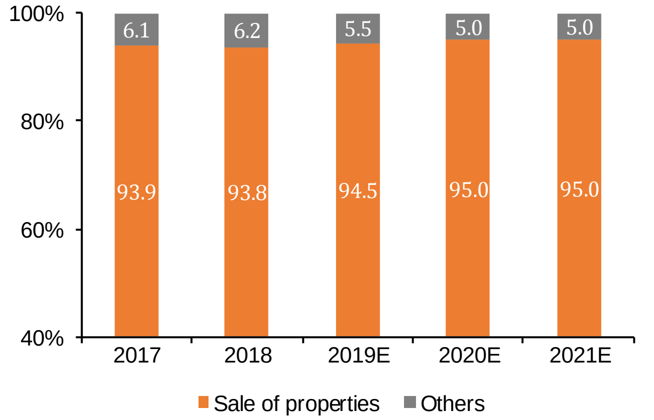
Sales of property accounted for 95%/94%/94% of total revenue in FY16/17/18. The rest of the revenue includes property related business (construction, decoration, property management, sales agency, exhibition, hotel etc.) and interest income from financial business. Driven by property development business, or in specific, increased GFA recognized and recognized ASP, total revenue grew at 15.6% CAGR from 2014 to 2018.

Figure 12: Historical revenue



Source: Company data

Figure 13: Revenue breakdown by segments

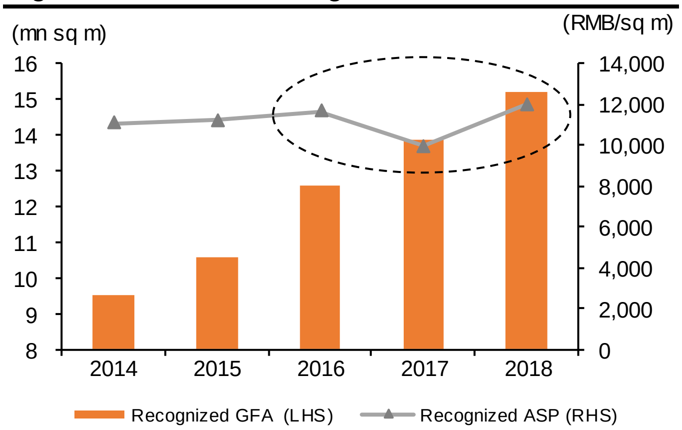


Source: Company data

Geographically, Poly Development operates its business in 7 regions, including *Southern China*, *Eastern China*, *Central China*, *Western China*, *Northern China*, *Northeast China* and *overseas regions*. Southern China and Eastern China are the two most important targeted markets, together accounting for 65% of total revenue in FY18.

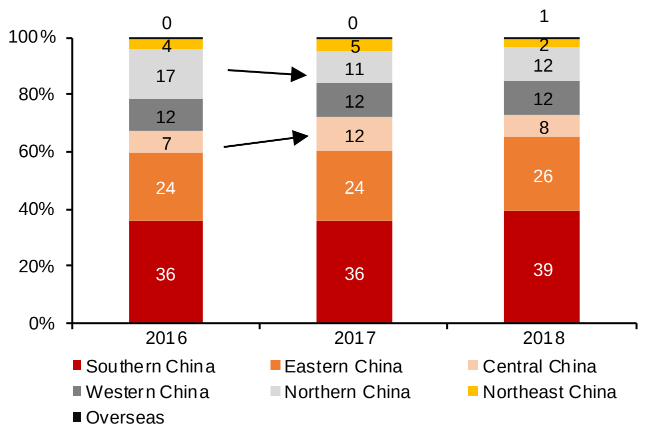
Revenue recorded a 5.4% decline in FY17. This was mainly due to 40% decline of revenue from Northern China in FY17. However, revenue from Central China increased 60% during the period, which largely compensated the decline of Northern China. But ASP in Central China was lower than that in Southern China. Thus, although overall recognized GFA still grew in FY17 because of increased GFA recognized from Central China, overall recognized ASP still dropped from RMB11,652/sq m in FY16 to RMB9,948/sq m in FY17.

Figure 14: Historical recognized ASP and GFA



Source: Company data

Figure 15: Revenue breakdown by regions

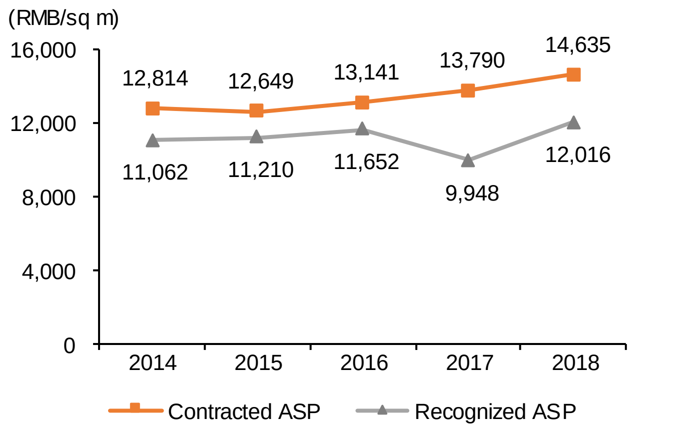


Source: Company data

In FY18, contribution from Southern China and Eastern China increased 5ppt to 65% and revenue from Northern regained a 43% growth, so recognized ASP rapidly recovered to RMB12,016/ sq m in FY18.

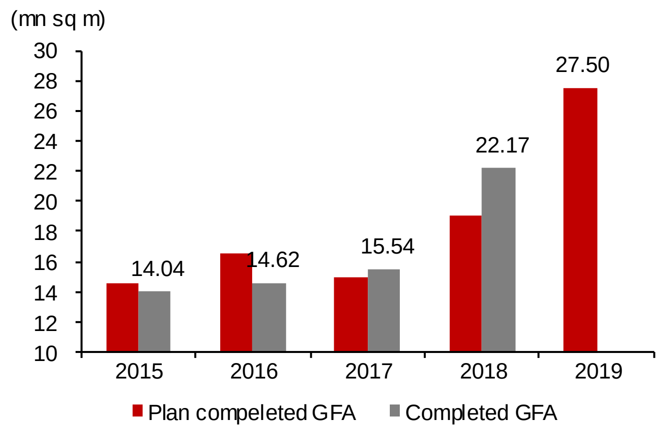
Looking forward, we expect recognized ASP will be sustainable and follow its growth track of its leading indicator, contracted ASP. Furthermore, the Company has disclosed its planned GFA completion in FY19, which increases to 27.50 mn sq m, 24% increase from 22.17mn sq m actual completion in FY18.

Figure 16: Contracted ASP vs. recognized ASP



Source: Company data

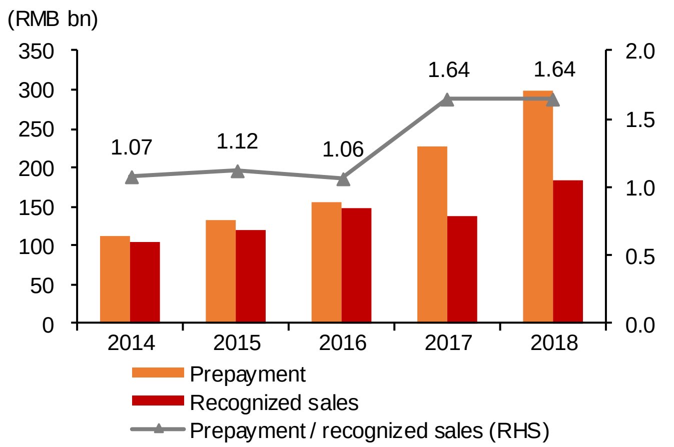
Figure 17: Planned completed GFA vs. actual completed GFA



Source: Company data

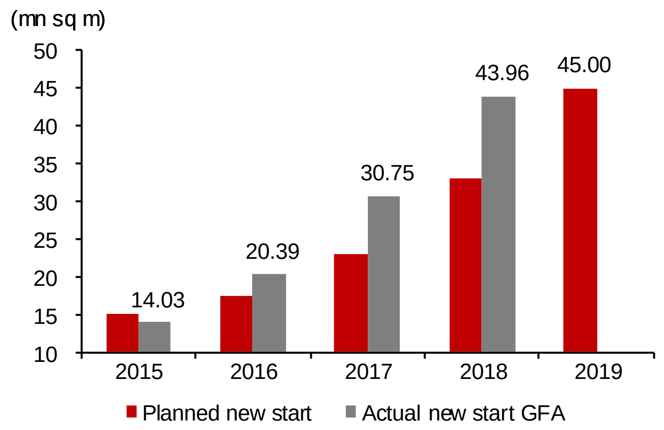
Ratio of prepayment/recognized is a good revenue indicator. Normally, large ratio indicates more revenue has been locked. For Poly Development, the ratio jumped from 1.06 in FY16 to 1.64 in FY17 and stayed flat in FY18, which indicates strong revenue visibility in the near term. The Company completed more than 33% its original new start GFA plan to 43.96mn sq m in FY18 and plans to new start 45.00mn sq m in FY19. We believe these new starts will provide ample saleable resources for FY19/20 and support the growth of revenue.

Figure 18: Prepayment to recognized sales



Source: Company data

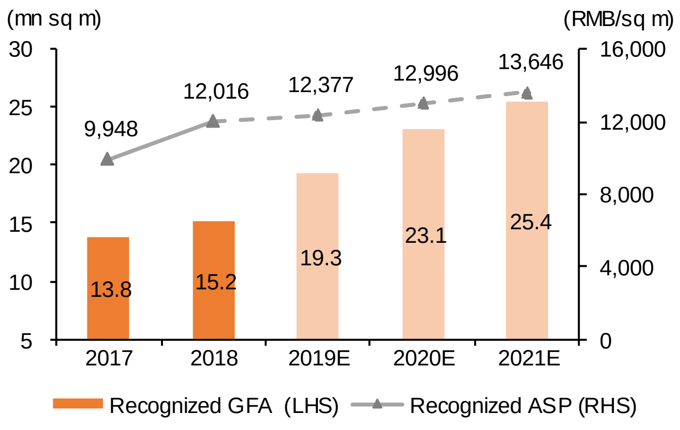
Figure 19: Planned new start vs. actual new start GFA



Source: Company data

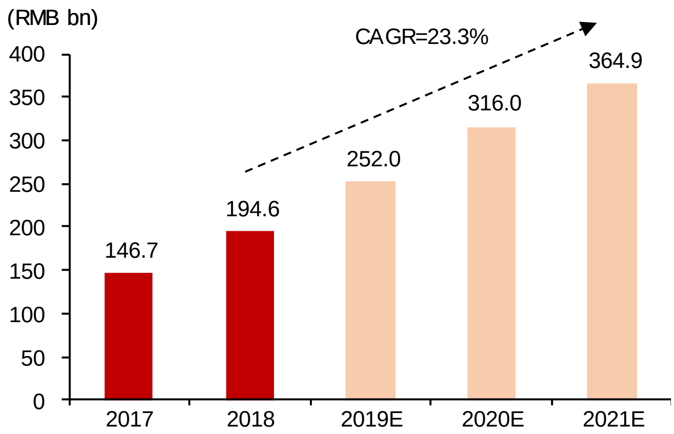
Accordingly, we forecast recognized GFA and recognized ASP to be 19.25mn/23.10mn/25.41mn sq m and RMB12,377/12,996/13,646 per sq m in FY19E/20E/21E. We also forecast other revenue to grow at around 15% annually. Thus, total revenue is expected to be RMB 252.0bn/316.0bn/364.9bn in FY19E/20E/21E, representing a 23.3% CAGR from 2018 to 2021.

Figure 20: Forecasted recognized ASP and GFA



Source: Company data, CMBIS estimates

Figure 21: Forecasted revenue

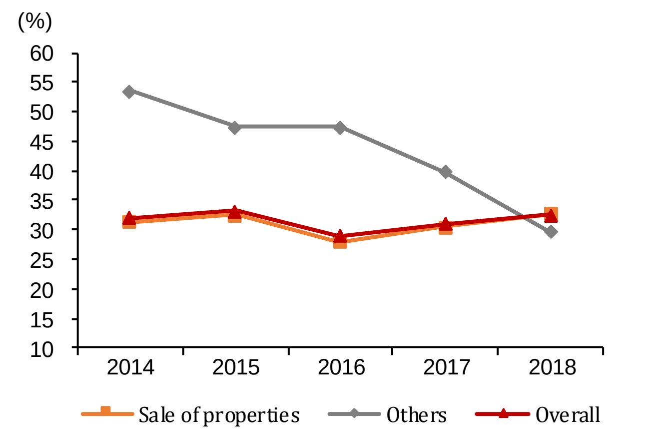


Source: Company data, CMBIS estimates

Gross margin sustains at 30% level

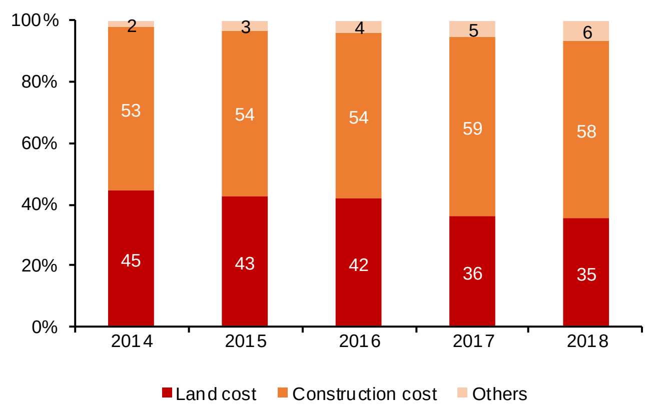
As 95% of revenue comes from sale of properties, overall gross margin is largely affected by property development business. Overall gross margin was 29.0%/31.0%/32.5% in FY16/17/18. And gross margin of sales of properties was 28.0%/30.5%/32.7% in FY16/17/18. Cost of goods sold mainly includes land cost, construction cost and others. Land cost and construction together accounts for about 95% of cost of goods sold.

Figure 22: Historical gross margin



Source: Company data

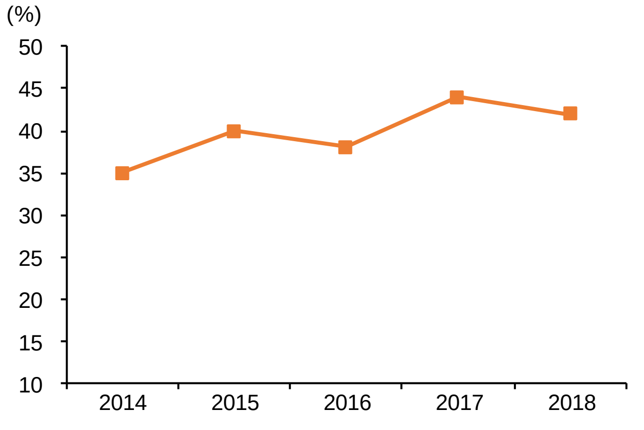
Figure 23: Breakdown of cost of goods sold



Source: Company data

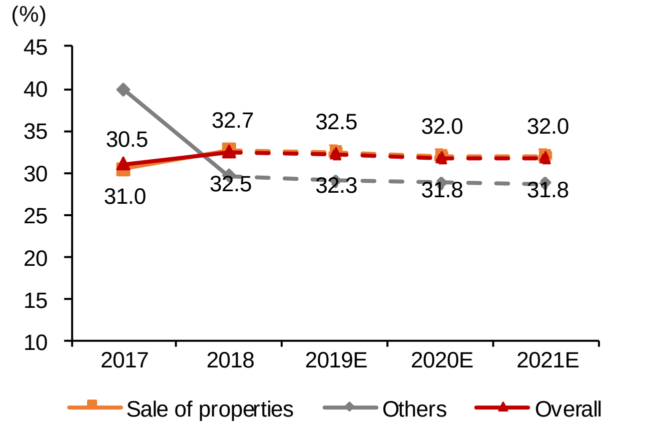
Ratio of land cost to contracted ASP of new acquired land are stable at 40% level. We believe gross margin of sale of properties will sustain at 30% level in the future. However, due to price restriction, we do not expect gross margin to significantly improve. Thus, we forecast gross margin of sale of properties to be 32.5%/32.0%/32.0% in FY19E/20E/21E, and overall gross margin to be 32.3%/31.8%/31.8% in FY19E/20E/21E.

Figure 24: Contracted ASP to new acquired land cost



Source: Company data

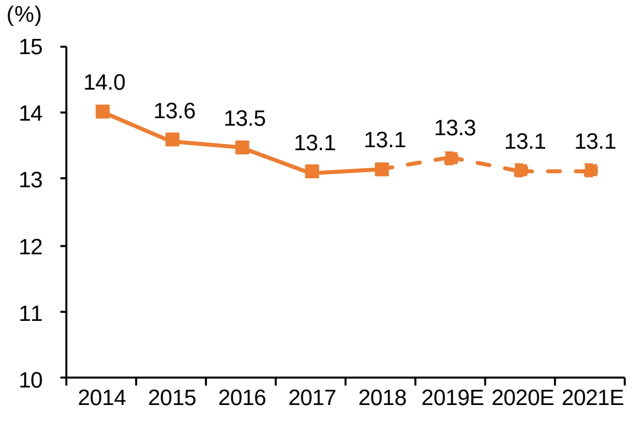
Figure 25: Forecasted gross margin



Source: Company data, CMBIS estimates

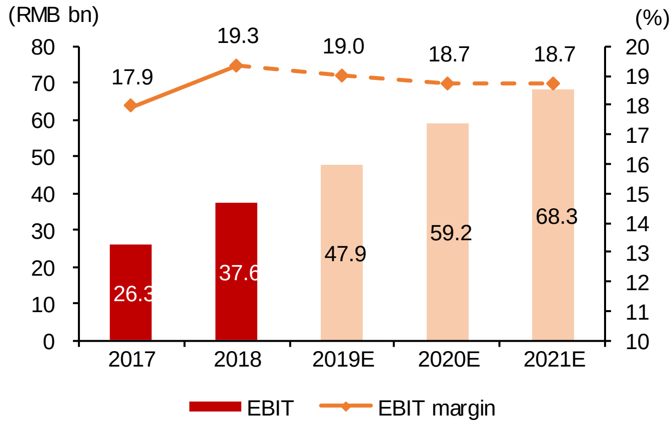
Taxes & surcharges, sell expenses, admin expenses, and R&D expenses together accounted for 13.5%/13.1%/13.1% of total revenue in FY16/17/18. We forecast these expenses to be stable during forecast period, which is 13.3%/13.1%/13.1% in FY19E/20E/21E. Therefore, EBIT is estimated to be RMB47.9bn/59.2bn/68.3bn in FY19E/20E/21E, representing 22.0% from FY18 to FY21.

Figure 26: Forecasted SG&A to revenue



Source: Company data, CMBIS estimates

Figure 27: Forecasted EBIT and EBIT margin

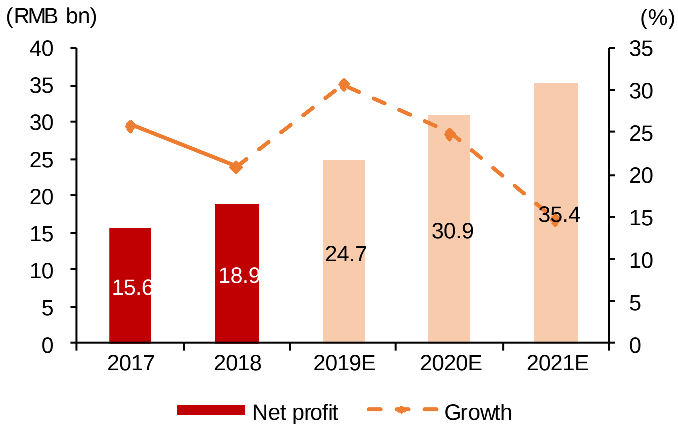


Source: Company data, CMBIS estimates

Forecasted net profit attributable to shareholders to grow by a CAGR of 23.1% next three years

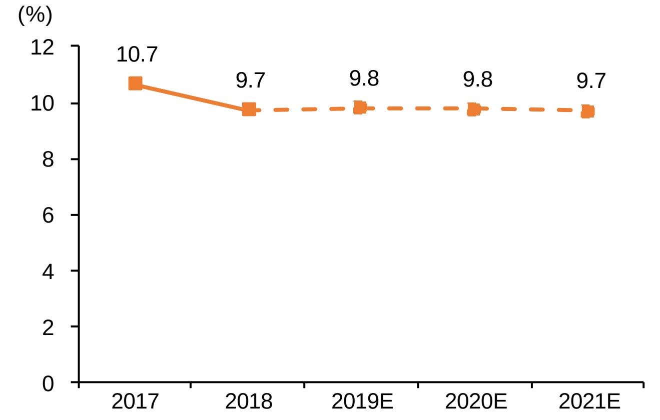
Net profit attributable to shareholders was RMB12.4bn/15.6bn/18.9bn in FY16/17/18, respectively, representing net margin of 8.0%/10.7%/9.7%. We forecast net profit attributable to shareholders to be RMB26.0bn/30.8bn/35.3bn in FY19E/20E/21E, respectively, representing a CAGR of 23.1% next three years. Net margin, accordingly, is expected to be 10.2%/9.7%/9.7% in FY19E/20E/21E.

Figure 28: Forecasted net profit to shareholders



Source: Company data, CMBIS estimates

Figure 29: Forecasted net margin

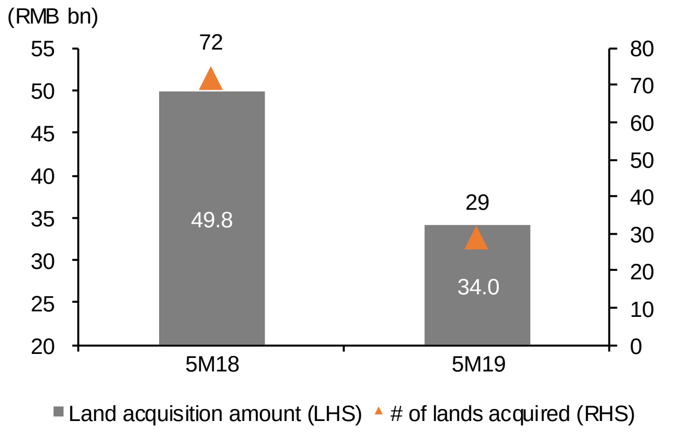


Source: Company data, CMBIS estimates

Net gearing is expected to decrease in FY19 due to cautious move in land acquisition

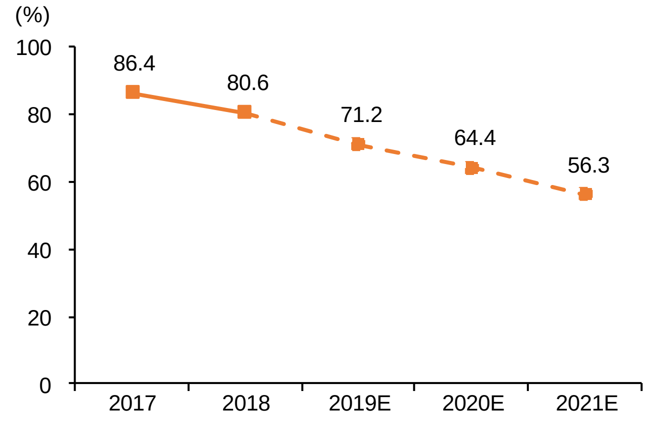
Total borrowing was RMB204.7bn by FY18, of which 48.7bn was short term debt. Cash on hand was RMB113.4bn, which is sufficient to cover the short term debt. Net gearing was 55.2%/86.4%/80.6% by FY16/17/18. In 5M19, Poly Development achieved contracted sales of RMB189.0bn, up 22% YoY. However, Poly Development has slowed down its investment in land acquisition. We believe this was mainly because of the Company's cautious view on current land market, as land premium is rising rapidly in 5M19.Thus, we expect net gearing ratio to decrease in FY19, as the Company holds a stronger cash position due to less investment.

Figure 30: Land acquisition in 5M19 and 5M18



Source: Wind

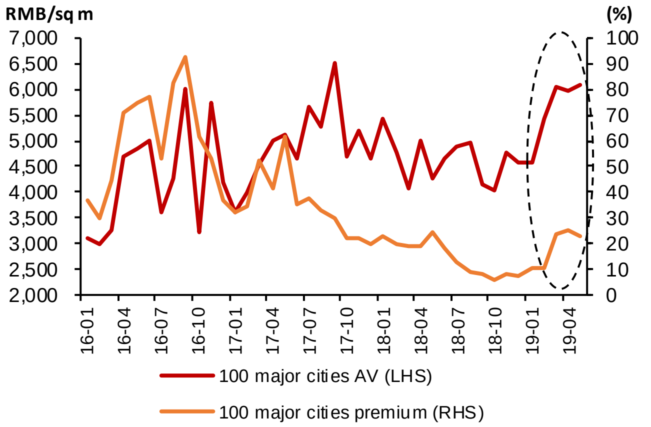
Figure 31: Forecasted net gearing



Source: Company data, CMBIS estimates

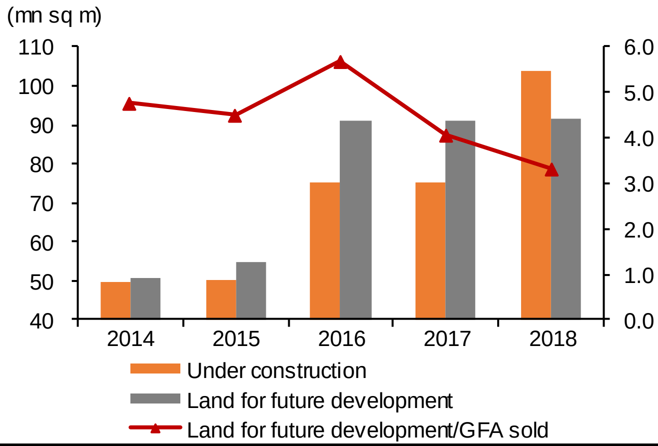
Although Poly Development slows down its land acquisition, the Company has already accumulated ample land bank to sustain the growth. Land bank, including GFA under construction and for future development, reached 195.44mn sq m by end-FY18, 17.8% or 29.51mn sq m increase from end-FY17. With significant growth of new start area in FY19, we believe current land bank is sufficient for the next 3-4 years.

Figure 32: Land acquisition value in 100 major cities



Source: Wind

Figure 33: Land bank vs. GFA sold



Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	**146,659**	**194,555**	**252,043**	**316,015**	**364,871**
Sale of properties	137,778	182,498	238,255	300,201	346,732
Other property related business	8,694	11,251	12,939	14,879	17,111
Others	151	765	803	884	972
Other financial business	36	42	46	50	55
Cost of sales	(101,133)	(131,339)	(170,606)	(215,385)	(248,709)
Gross profit	**45,526**	**63,217**	**81,436**	**100,630**	**116,162**
Taxes and surcharges	(12,473)	(16,122)	(21,424)	(26,861)	(31,014)
Selling expenses	(3,883)	(5,912)	(7,561)	(8,848)	(10,216)
Administrative expenses	(2,823)	(3,495)	(4,537)	(5,688)	(6,568)
R&D expenses	(35)	(41)	(53)	(67)	(77)
EBIT	**26,313**	**37,646**	**47,862**	**59,165**	**68,288**
Finance costs	(2,390)	(2,585)	(3,278)	(3,101)	(3,883)
Asset impairments	(61)	(2,351)	-	-	-
Gain on fair value change	(1)	190	-	-	-
Investment gain, net	1,680	2,690	2,421	2,663	2,929
Other gain	3	2	-	-	-
Operating profit	**25,545**	**35,593**	**47,005**	**58,728**	**67,334**
Other operating income, net	171	188	-	-	-
Profit for year	**25,716**	**35,780**	**47,005**	**58,728**	**67,334**
Income tax	(6,022)	(9,631)	(12,691)	(15,856)	(18,180)
Minority interests	(4,060)	(7,245)	(9,608)	(12,004)	(13,763)
Net profit to shareholders	**15,634**	**18,904**	**24,706**	**30,867**	**35,391**

Balance sheet

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Current assets	**647,337**	**766,481**	**934,059**	**1,106,481**	**1,260,259**
Cash on hand	68,051	113,431	153,124	177,320	210,618
Note & account receivable	1,873	2,044	2,648	3,320	3,833
Prepayment	54,243	26,045	34,121	43,077	49,742
Inventory	439,669	474,505	593,710	732,308	845,609
Others	83,501	150,456	150,456	150,456	150,456
Non-current assets	**50,297**	**80,012**	**80,556**	**81,405**	**82,567**
Investment properties	16,525	19,890	20,176	20,714	21,492
Fixed assets	4,104	4,594	4,674	4,788	4,946
Intangible assets	41	119	136	163	210
Deferred expense	209	356	516	686	866
Others	29,419	55,053	55,053	55,053	55,053
Total assets	**697,635**	**846,494**	**1,014,615**	**1,187,885**	**1,342,826**
Current liabilities	**364,159**	**444,897**	**561,104**	**676,754**	**765,950**
Short-term loans	3,067	3,011	5,041	6,320	7,297
Note & account payable	46,839	50,686	59,712	68,923	74,613
Advances from customers	226,189	299,795	390,666	489,823	565,550
Current portion of non-current liabilities	26,428	45,707	59,988	65,990	72,792
Others	61,636	45,698	45,698	45,698	45,698
Non-current liabilities	**175,312**	**215,103**	**240,115**	**264,125**	**291,332**
Long-term loans	175,156	214,939	239,951	263,961	291,169
Others	156	164	164	164	164
Total liabilities	**539,471**	**660,000**	**801,219**	**940,878**	**1,057,282**
Equity to shareholders	**101,923**	**115,423**	**132,716**	**154,324**	**179,097**
Perpetual bonds	5,000	6,500	6,500	6,500	6,500
Minority interest	51,240	64,572	74,180	86,184	99,947
Total equity	**158,163**	**186,494**	**213,396**	**247,007**	**285,544**

Cash flow summary

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Profit after tax	**19,694**	**26,149**	**34,313**	**42,871**	**49,154**
Depreciation, amortization, impairment	854	3,366	1,187	1,231	1,288
Change in working capital	(50,160)	(19,231)	(27,988)	(39,858)	(39,062)
Others	352	1,610	3,278	3,101	3,883
Net cash from operating	**(29,261)**	**11,893**	**10,789**	**7,345**	**15,262**
Fixed asset Capex & Investment	(7,892)	(13,819)	(1,730)	(2,080)	(2,450)
Associated companies	(10,614)	401	-	-	-
Others	1,556	(41)	-	-	-
Net cash from investing	**(16,951)**	**(13,459)**	**(1,730)**	**(2,080)**	**(2,450)**
Capital injected	15,869	12,783	-	-	-
Change of Debts	66,862	57,086	41,323	31,292	34,987
Dividend and interest paid	(15,291)	(21,401)	(10,689)	(12,361)	(14,500)
Others	(58)	(1,971)	-	-	-
Net cash from financing	**67,382**	**46,498**	**30,633**	**18,931**	**20,487**
Net change in cash	21,169	44,932	39,693	24,196	33,298
Cash at the beginning	46,952	67,983	113,076	152,768	176,964
Exchange difference	(138)	161	-	-	-
Cash at the end of the year	**67,983**	**113,076**	**152,768**	**176,964**	**210,262**

Key ratios

YE Dec 31 (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Sale of properties	93.9	93.8	94.5	95.0	95.0
Other property related business	5.9	5.8	5.1	4.7	4.7
Others	0.1	0.4	0.3	0.3	0.3
Other financial business	0.0	0.0	0.0	0.0	0.0
Total	**100**	**100**	**100**	**100**	**100**
Profit & loss ratios (%)					
Gross margin	31.0	32.5	32.3	31.8	31.8
EBIT margin	17.9	19.3	19.0	18.7	18.7
Operating margin	17.4	18.3	18.6	18.6	18.5
Net margin	10.7	9.7	9.8	9.8	9.7
Effective tax rate	23.4	26.9	27.0	27.0	27.0
Growth (%)					
Revenue	-5.2	32.7	29.5	25.4	15.5
Gross profit	1.4	38.9	28.8	23.6	15.4
EBIT	9.4	43.1	27.1	23.6	15.4
Operating profit	10.5	39.3	32.1	24.9	14.7
Net profit	25.9	20.9	30.7	24.9	14.7
Balance sheet ratios					
Current ratio (x)	1.8	1.7	1.7	1.6	1.6
Receivable turnover days	5	4	4	4	4
Payables turnover days	169	141	128	117	110
Inventory turnover days	1,587	1,319	1,270	1,241	1,241
Net debt / total equity ratio (%)	86.4	80.6	71.2	64.4	56.3
Returns (%)					
ROE	15.3	16.4	18.6	20.0	19.8
ROA	2.8	3.1	3.4	3.6	3.7
Per share					
EPS (RMB)	1.32	1.59	2.08	2.59	2.98
DPS (RMB)	0.400	0.500	0.623	0.778	0.893
BVPS (RMB)	8.59	9.69	11.14	12.96	15.03

Source: Company data, CMBIS estimates

Valuation

We estimate EPS of Poly Development to be RMB2.08/2.59/2.98 in FY19E/20E/21E. Current share price is trading at 6.5/5.3x FY19E/20E P/E, which is below its 5-year average forward P/E of 7.9x. We select 10 A-Share developers as peers. The peers are trading at 6.2/5.2x FY19E/20E P/E in average. As a leading developer with SOE background and ample land bank, we believe Poly Development deserves a valuation premium.

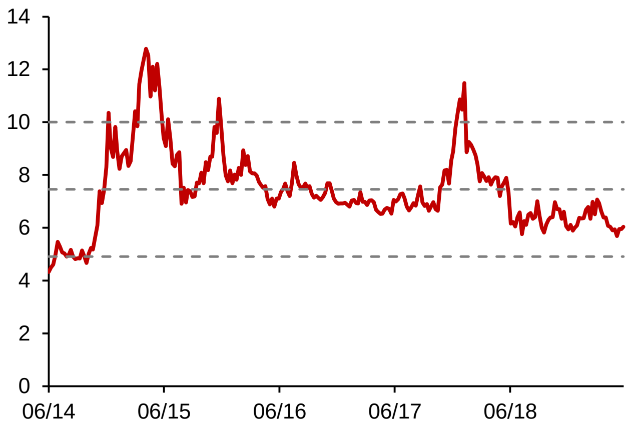
With 8.0x 19E P/E, which is peers' mean plus 1 standard deviation and also closed to its 5-year average forward P/E, our target price is derived at RMB16.64, indicating an upside potential of 29.8%. Initiate with **BUY**.

Figure 34: Peers table

Name	BBG Ticker	Share Price	Mkt Cap	P/E				P/B		
		RMB	RMB bn	TTM	18A	19E	20E	18A	19E	20E
CHINA VANKE CO-A	000002 CH	27.84	311.3	9.0	9.1	7.5	6.5	2.0	1.6	1.4
CHINA MERCHANT-A	001979 CH	21.02	166.1	14.3	11.1	8.9	7.5	2.4	1.9	1.5
CHINA FORTUNE-A	600340 CH	32.70	98.2	8.0	8.6	6.7	5.3	2.8	1.9	1.5
SEAZEN HOLDING-A	601155 CH	40.30	90.9	8.7	8.6	6.8	5.3	3.1	2.1	1.6
GREENLAND HOLD-A	600606 CH	6.86	83.5	6.8	7.4	5.9	4.9	1.2	1.0	0.9
SHENZEN OVERSE-A	000069 CH	6.99	57.3	5.4	5.4	4.7	4.4	1.0	0.8	0.7
GEMDALE CORP-A	600383 CH	12.00	54.2	6.4	6.7	5.8	5.0	1.2	1.0	0.9
RISESUN REAL -A	002146 CH	9.51	41.4	5.3	5.5	4.3	3.5	1.2	1.0	0.8
JIANGSU ZHONG-A	000961 CH	8.70	32.3	14.1	14.7	8.1	4.7	1.9	1.6	1.2
JINKE PROPERTI-A	000656 CH	6.11	32.6	8.2	8.2	6.8	5.8	1.5	1.3	1.1
Average				**8.6**	**8.5**	**6.5**	**5.3**	**1.8**	**1.4**	**1.2**
POLY DEVELOPME-A	**600048 CH**	**12.82**	**152.5**	**8.0**	**8.1**	**6.2**	**4.9**	**1.3**	**1.2**	**1.0**

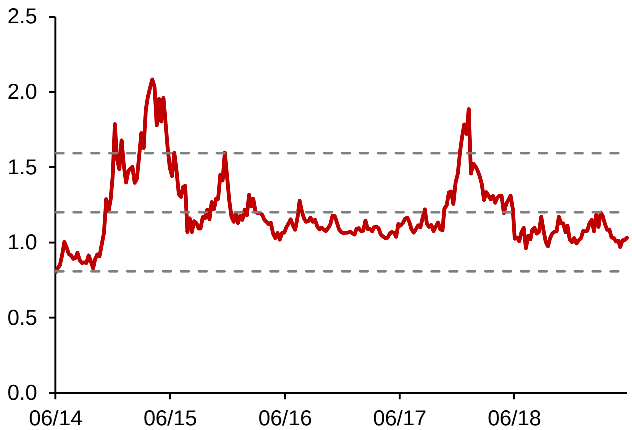
Source: Bloomberg, CMBIS estimates

Figure 35: 5-year forward P/E



Source: Bloomberg

Figure 36: 5-year forward P/B



Source: Bloomberg

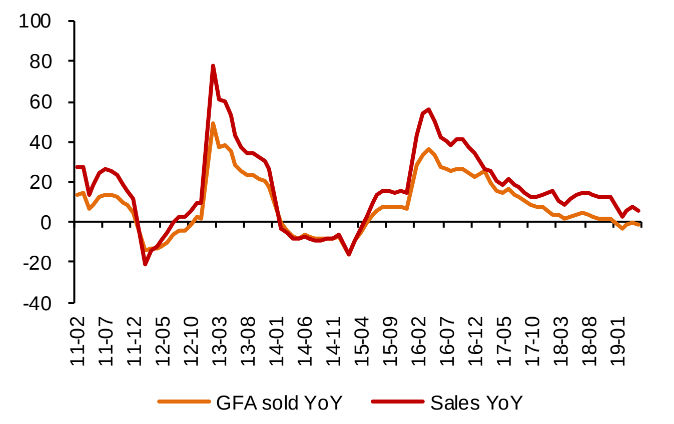
Industry analysis

National property sales grew 6.1% in 5M19 but volume declined 1.6%. Although new start area grew 10% YoY, land acquisition area and accumulated land auction premium reduced 33.2% and 35.6% YoY. Construction expenditure is recovering backed by the large new start area in 2H18, thus supporting the real estate investment (REI) in the near term.

Market cooling down after Mar/Apr

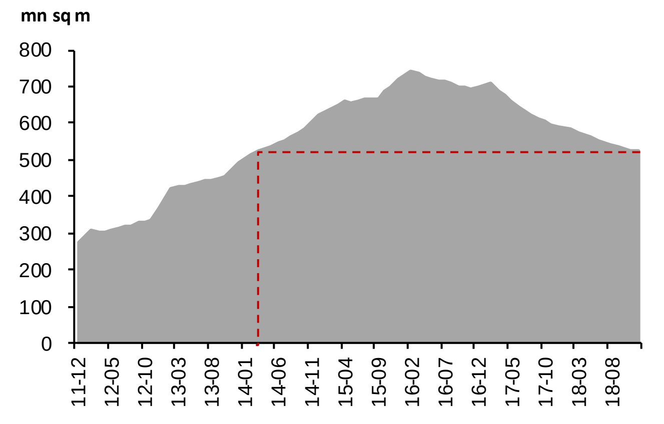
National Bureau of Statistics (NBS) released China property market data for 5M19. National property sales grew 6.1% YoY to RMB5.17tn but shadowed by 2.0ppt MoM growth decline (4M19: 8.1%) and 1.6% decline in sales volume. We believe volume decline is caused by weakening demand in tier 3/4 property market after its rally in 2017 and 2018. However, completed properties for sale continues to drop for 27 consecutive months since Feb 2017 to the same level of Feb 2014. Month for digestion has also dropped to 3.7 months. Thus, we do not expect an extensive policy relaxation or any strong stimulus to property market. But we expect local governments in second tier cities to marginally relax housing policy in a timely manner to attract population and maintain local market stability.

Figure 37: Volume decline slightly expanded 1.3ppt



Source: Wind, CMBIS

Figure 38: Current inventory is closed to Feb 2014

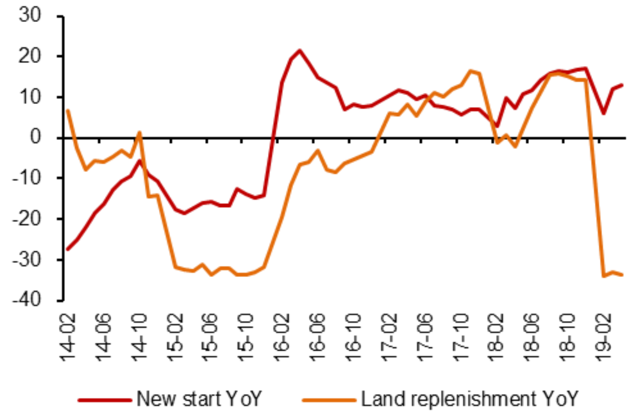


Source: Wind, CMBIS

New start declerates with sluggish land replenishment

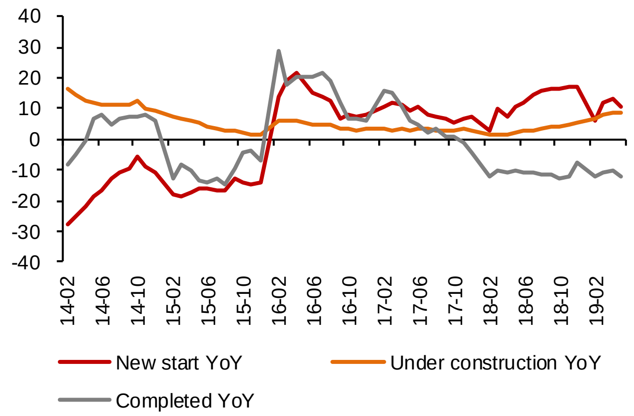
New start area grew 10% YoY, while MoM growth slowed down by 2.6ppt in May. Furthermore, land acquisition area and accumulated land auction premium significantly reduced 33.2% and 35.6% YoY, respectively. It may reflect the prudent attitude of property developers and weakening land market in third/fourth tier cities. Land acquisition area is a leading indicator of new start area. We expect new start area to continue to decelerate.

Figure 39: Land replenishment dropped significantly



Source: Wind, CMBIS

Figure 40: Construction area is recovering

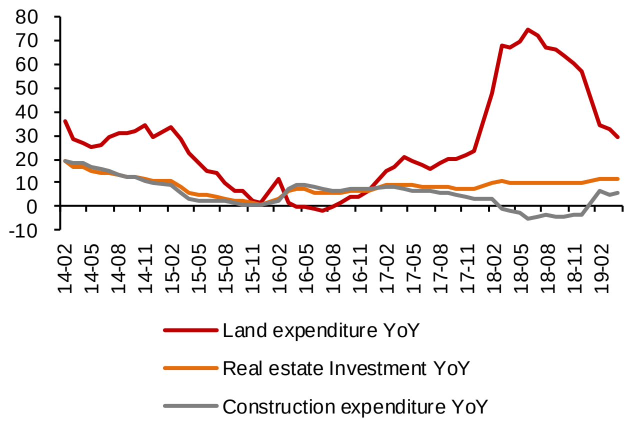


Source: Wind, CMBIS

REI supported by construction expenditure

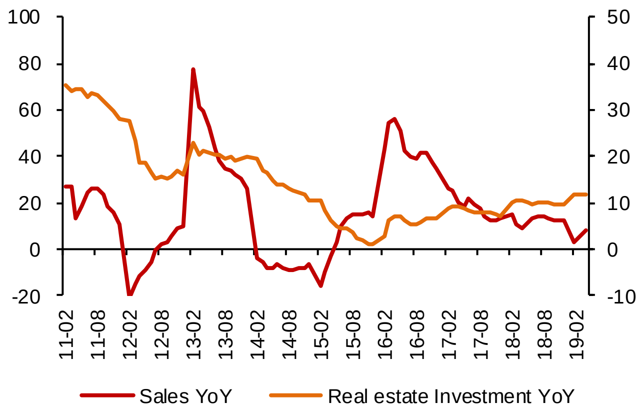
REI grew 11.2% YoY for 5M19, slightly decelerating from 4M19 (11.9%) but still maintaining a double-digit growth. So far there is no data on 5M19 land expenditure and construction expenditure. But for 4M19, land expenditure and construction expenditure grew 29.7% and 5.6% YoY, respectively. For the past 10 months, growth of land expenditure gradually decelerated which is consistent with land auction premium. However, construction expenditure or construction area, on the other hand, is recovering backed by the large new start area in 2H18. Looking forward, we think growth of construction expenditure will offset the diminishing new start and support the REI in the near term.

Figure 41: Construction expenditure to support REI



Source: Wind, CMBIS

Figure 42: Sales is a long term indicator of REI



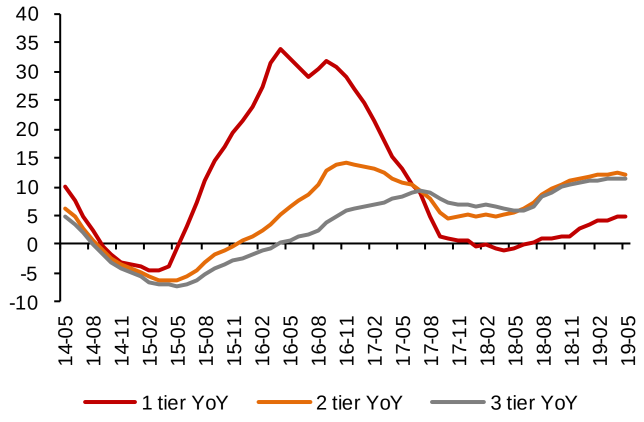
Source: Wind, CMBIS

Housing price rose steadily in 5M19 but still controllable

Several local governments have already marginally relaxed its housing restriction from the beginning of 2019 in order to attract population and support local economy. With sufficient mortgage supply in the beginning of year and declined mortgage rate, housing price in all tiers of cities rose in 5M19, but in a very slow way. Under current regulation framework of "One-city-one-policy", local government would quickly react to any significant change of local property market, especially the housing price.

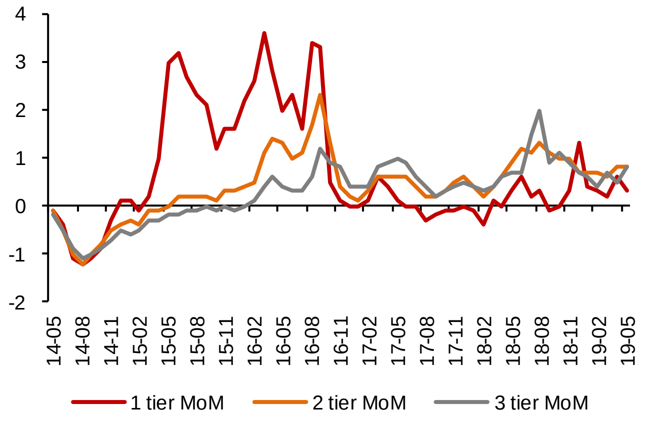
In the long run, we believe housing price in first tier cities can be supported by population influx and local industry. Housing price among second tier cities may vary by cities, depending on local economy and population growth. With the completion of shanty town redevelopment, some third tier cities may be hard to find a support if new demand is weak.

Figure 43: YoY CHG of 70 major cities by tiers



Source: Wind, CMBIS

Figure 44: MoM CHG of 70 major cities by tiers



Source: Wind, CMBIS

Figure 45: 5M19 sales of selected developers

Ticker	Company	5M19 (RMB bn)	5M2019 YoY	2019 Target RMB bn	Target Completion	Note	2018 (RMB bn)	2018 YoY	2019 Target vs 2018 sales
3383 HK	Agile	**45.6**	20%	113.0	40%		102.7	14.4%	10%
3883 HK	Aoyuan	**38.3**	35%	114.0	34%		91.3	100.2%	25%
3333 HK	Evergrande	**231.5**	-9%	600.0	39%		551.3	10.1%	9%
817 HK	Jinmao	**54.5**	-4%	150.0	36%		124.9	115.4%	20%
688 HK	COLI	**123.6**	34%	292.0	42%	HKD	250.7	28.6%	16%
81 HK	COGO	**19.4**	-5%	58.0	34%	HKD	50.5	36.3%	15%
1109 HK	CR Land	**90.3**	37%	242.0	37%		210.7	38.5%	15%
1966 HK	SEC China	**26.8**	55%	70.0	38%		51.4	54.5%	36%
2202 HK	Vanke	**267.6**	12%	N.A	N.A		607.0	14.5%	N.A
884 HK	CIFI	**66.1**	30%	190.0	35%		152.0	46.2%	25%
2007 HK	Country Garden	**188.5**	-5%	N.A	N.A	Attributable	501.9	31.6%	N.A
600383 CH	Gemdale	**64.7**	33%	N.A	N.A		162.3	15.3%	N.A
3900 HK	Greentown	**37.0**	5%	180.0	21%		101.2	-2.0%	78%
2777 HK	R&F	**44.2**	2%	160.0	28%		131.1	60.1%	22%
1638 HK	Kaisa	**27.8**	75%	87.5	32%		70.1	56.7%	25%
1813 HK	KWG	**28.5**	11%	85.0	34%	Attributable	65.5	128.3%	30%
3380 HK	Logan	**34.5**	19%	85.0	41%		71.8	65.4%	18%
960 HK	Longfor	**84.2**	11%	220.0	38%		200.6	28.5%	10%
600048 CH	Poly Real Estate	**189.0**	22%	N.A	N.A		404.8	30.9%	N.A
1238 HK	Powerlong	**22.5**	86%	50.0	45%		41.0	96.5%	22%
3301 HK	Ronshine	**46.6**	4%	140.0	33%		121.9	142.6%	15%
813 HK	Shimao	**71.9**	39%	210.0	34%		176.2	74.8%	19%
3377 HK	Sino-Ocean	**43.4**	41%	140.0	31%		109.5	55.2%	28%
1918 HK	Sunac	**163.4**	12%	550.0	30%		460.8	27.3%	19%
1233 HK	Times China	**25.1**	23%	75.0	34%		60.6	45.6%	24%
123 HK	Yuexiu	**28.9**	53%	68.0	42%		57.8	41.4%	18%
1628 HK	Yuzhou	**21.3**	15%	68.0	31%		56.0	38.9%	21%
Average			**24%**		**35%**			**52%**	**22%**

Source: Company data, Bloomberg

Major risks

Real estate market downturn

Poly Development's business and prospects depend on the performance of the PRC property market. Property markets in where the Company has operation are affected by local, regional, national and global factors, including economic and financial condition, speculative activities in local markets, demand for and supply of properties, investor confidence, availability of alternative investment choices for property buyers, inflation, government policies, interest rates and availability of capital. Any market downturn in China generally or cities in which Poly Development has or expects to have operations may materially and adversely affect the Company's business, financial condition and results of operations.

Unfavorable housing policy

China property business is subject to extensive governmental regulation, and in particular sensitive to policy changes in the PRC property sector. The PRC Government has promulgated various control measures in recent years, which aimed at cooling the property sector, and the government may adopt further measures to regulate this sector. If local governmental authorities adopt stricter regulation on property market in where Poly Development has or expects to have operations, it may have an adverse effect on the Company's business, financial position and results of operations.

Tightened financing condition

Property development usually requires substantial capital investment throughout the process of project development. Poly Development's property development projects have been generally funded through cash generated from operations including proceeds from the pre-sale of its properties, bank loans, corporate bonds, asset-backed securities programs and other financing arrangements. We expect the Company to continue to fund its projects through these sources. However, it cannot be ensured that such funds will be sufficient or any additional financing can be obtained on satisfactory or commercially reasonable terms, or at all. Meanwhile, the Company may experience negative net cash flow from its operating activities in the future. A negative net cash flow position for operating activities could impair the Company's ability to make necessary capital expenditures, constrain operational flexibility and adversely affect its ability to expand business and enhance liquidity.

Intense competition from other real estate developers

There are a large number of property developers in the PRC and we expect the level of competition to increase over time. Intense competition among property developers in China for land, financing, construction materials and skilled management and human resources may result in increased cost for land acquisition and construction, an oversupply of properties available for sale, a decrease in property prices, a slowdown in the rate at which new property developments are approved or reviewed by the relevant PRC Government authorities and an increase in administrative costs for hiring or retaining qualified contractors and personnel. If Poly Development fails to compete effectively, its business operations and financial condition will suffer.

Substantial level of borrowings

Poly Development maintained a substantial level of borrowings to finance its operations during FY17 and FY18. As of FY16/17/18, the Company's total outstanding interest-bearing borrowings amounted to about RMB112.2bn/204.7bn/263.7bn, respectively. Accordingly, its net gearing ratio, as calculated by dividing total borrowings less cash and bank balances and restricted cash by total equity, was approximately 55.2%/86.4%/80.6%, respectively, in FY16/17/18. High indebtedness may increase the Company's vulnerability to adverse conditions and limit its flexibility in the planning for, or reacting to, changes in the business.

Potential failure on completing projects

The schedules of the Company's project developments and whether a project can be completed within the planned budgets depend on a number of factors, including the performance and efficiency of the Company's third-party contractors and its ability to finance construction and the associated financing costs. Construction delays or failure to complete the construction of a project according to its planned specifications, schedule and budget may harm the Company's reputation as a property developer, leading to loss of or delay in recognizing revenues and lower returns. In addition, if a property project is not completed on time, the purchasers of pre-sold units may be entitled to compensation for late delivery or may be able to terminate the pre-sale agreements and claim damages.

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