

Country Garden (2007 HK)

President Talk

We met with President, Mo Bin, and other senior management last week and studied the latest development of Country Garden's robotic business. The Company continues to develop property business in the third/fourth tier cities. Due to the advantages in cost, product and service, it can capture market share in these cities. Secondly, robotic business is under development. The Company had invested RMB3bn since Jul 2018 and expects it can save RMB10bn every year in construction CAPEX. Reiterate BUY. TP is maintained as HK\$15.2, which is equivalent to 45% discount to end-20 NAV of HK\$27.64.

- Steadily 10% per annum sales growth next three years.** Attributable contracted sales gained by 5.2% to RMB480bn in 10M19. Country Garden (CG) believes its sales pace will accelerate for the rest of the year because of the low bases in Nov/Dec 2018 (RMB33.8bn in Nov 2018 and RMB12.1bn in Dec 2018). Although property market in the third/fourth tier cities is polarized, CG is confident to gain market share there due to the advantages in cost, product and service. President Mo also revealed his 10% sales growth target rate next three years.
- No full scale price cut.** There are around 2,000 projects for sales now. Recently, ASP has around 5% volatility due to competition. Some price adjustments are affected by district and product structure. But gross margin is estimated to maintain at around 22-24%. Furthermore, inventories for sales are kept as 3-4x of monthly sales.
- To strengthen financial management.** CG would strengthen its SG&A budget management. SG&A expenses is set as 8% of revenue. CFO expressed the importance of cash flow management. She will set monthly sales and quarterly cash collection as financial management benchmark next year. Cash collection is estimated to be 90% till year end.
- Robotic business harvests next year.** CG founded robotic business (Bright Dream Robotics) in Jul 2018. Total investment in robotic business has amounted to RMB3bn. It develops a technology platform based on artificial intelligence and an integrated automation eco-system across the value chain. These robots can be used in construction, catering, property management, healthcare, agriculture, smart home and manufacturing. R&D staff totaled 3,000 and 1,200 patents are applied, of which 200 were granted. Management of Bright Dream Robotics revealed that operation of robotic management will be fruitful next year and about RMB10bn construction expenses can be saved each year if full scale of robots are used in the construction.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	226,900	379,079	479,880	547,814	597,808
YoY growth (%)	48.2	67.1	26.6	14.2	9.1
Net income (RMB mn)	26,064	34,618	41,079	45,548	50,676
EPS (RMB)	1.228	1.612	1.890	2.095	2.331
YoY growth (%)	135.4	31.3	17.2	10.9	11.3
P/E (x)	8.2	6.2	5.3	4.8	4.3
P/B (x)	2.3	1.8	1.4	1.2	1.0
Yield (%)	4.0	4.9	5.6	6.2	6.9
ROE (%)	27.8	28.5	27.2	24.8	23.0
Net gearing (%)	56.9	49.6	54.3	48.1	46.9

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	HK\$15.20
(Previous TP)	HK\$15.20)
Up/downside	+35.7%
Current Price	HK\$11.20

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Stock Data

Mkt Cap (HK\$ mn)	244,660
Avg 3 mths t/o (HK\$ mn)	238
52w High/Low (HK\$)	13.56/8.46
Total Issued Shares (mn)	21,845

Source: Bloomberg

Shareholding Structure

Yang Huiyan	57.47%
Ping An	8.97%
Free float	33.56%

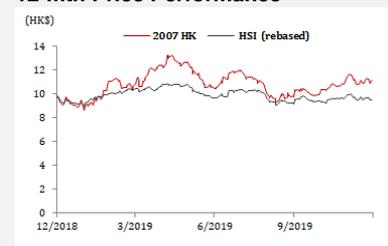
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-2.2%	0.6%
3-mth	11.8%	9.2%
6-mth	2.8%	5.0%
12-mth	13.3%	14.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers

Related Reports

- "Giant in property market" – 23 Aug 2019
- "Still the big three" – 19 Mar 2019
- "Higher spending on new business" – 4 Mar 2019

Appendix: Official Transcript

1. About recent operation and land acquisition

Cash collection is satisfactory with the cash collection ratio expected to be above 90% by the year-end. We expect an increasingly higher sales attributable ratio since the attributable ratio of our recently acquired land is catching up. We are selling at a gross margin of around 22%-24% at present. Although our ASP in the first 10 months of 2019 decreases by 5% YOY due to product mix difference, we have no plans to offer further discount at group level.

Around 80% of land acquisition budget has been used by Nov, and we expect to use up the annual budget of RMB 150 (attri.) -RMB 180bn (attri.) by the year end.

2. Sales momentum in the near future

The contracted sales have remained robust since March 2019, while monthly contracted sales growth in 2H2019 stays both MOM and YOY positive. Sales in the near future is expected to increase steadily and moderately by around 10%. The detailed sales plan for 2020 will be shared on our result briefing in March 2020.

3. Will Country Garden adjust KPIs for the sales department to achieve sales target of 2020?

The current KPI for the sales department is cash collection. In 2020, the sales department will both have a monthly assessment of sales volume and a quarterly assessment of cash collection.

4. With the sales growth slowing down, will Country Garden increase its payout ratio?

As our development business is still rewarding therefore it is worth further investment, but we are aware of the proposal of raising payout ratio and we will have further internal discussion in the near future.

5. What do the management think of the sales performance of low tier cities in 2020?

Tier 3&4 cities differ in sales condition and we reckon cities with less competition and healthy supply-demand status are still performing well. That's why we didn't see sharp downturn in the whole tier3&4 cities in 2019.

As for 2020, Country Garden will strive to improve investment and inventory management capabilities. In addition to IRR and net margin, the supply-demand status of the city is also a key threshold before acquiring new land. Country Garden usually monitors the following four types of inventories: 1) Unsold GFA with sales permit; 2) GFA under construction yet to obtain sales permit; 3) GFA acquired but yet to start construction; 4) Potential GFA supply from government in the next 12 months. If the inventory cycle of a given city is less than 12 months, sales in such areas would usually be fine.

Figure 1: Inventory Status of COGARD's Portfolio in tier 3&4 cities: Most in short of supplies or in a healthy level

We monitor the following four types of inventories and average GFA consumption of a city:.	
Type I	Unsold GFA with sales permit
Type II	GFA under construction yet to obtain sales permit
Type III	GFA acquired but yet to start construction
Type IV	Potential GFA supply from government. in the next 12 months
S	Average GFA sold per month in the last 18 months

Supply and demand Status of COGARD's tier 3&4 cities				
Located in tier 3&4 cities	Inventory status	Shortfall	Healthy	Oversupplied
		(I+II)/S ≤ 12 and (I+II+III+IV)/S ≤ 24	(between shortfall and oversupplied)	(I+II)/S > 18 and (I+II+III+IV)/S > 36
	Numbers of cities	69	109	15
	Percentage	36%	56%	8%
	Attributable salable resources as of June 2019(bn)	211.5	647.2	78.4
	Percentage of salable resources	23%	69%	8%

Of the tier 3&4 cities where COGARD already has business presence, 92% are those where housing is in short supply or where supply nearly matches the demand. The value of the salable resources attributable to COGARD's equity stakes in such cities also accounts for 92% of COGARD's total in tier 3&4 cities.

Note:
1. The above data was obtained as of 1H19.

12

Source: Company research COGARD's *Take on Tier 3 & 4 Cities*

*Inventory cycle is calculated by the sum of type one and two inventories divided by average GFA consumption of the city.

Country Garden will also carry out comprehensive budgeting management focusing on its SG&A management (below 8% of revenue as in FY19) to improve its competitiveness. We are confident in expanding our market share.

6. Investment grade and financing cost

We will keep a healthy financial position and strive for investment grades from more rating agencies. Moody's has just upgraded our rating outlook from stable to positive, indicating a possible further upgrade to investment grade, so that we can contain potential credit spread in the future.

7. About SG&A control

We expected SG&A by the year-end will be kept below 8% of revenue after a series of effective management actions.

8. About adjustment of 'Partnership Scheme

The co-investment scheme has become more exclusive and more core-managers oriented. Managers on partnership scheme are more incentivized to enhance their performance as they are more invested now.

9. Does price control have a negative impact on 'Partnership Scheme'?

Price cap and market fluctuation have been priced in on our projection before land acquisition therefore co-investment afterwards is not likely to be affected.

10. About overseas markets

We expect the sales of forest city remain on track and a more diversified customer portfolio. Oversea assets account for less than 4% of the group's total asset, therefore minor fluctuation in a given single market wouldn't have major impact on our performance.

11. About robotics

Within our robotic business unit there are 8 research branches with 5000 staff members, many of whom are top talents in the robotics industry.

We hope our pilot robots can be put on field tests next year as we'd like to ensure the product integrity before mass production.

We now have applied for 1200 patents, among of which 200 have been approved.

The application of construction robots involves the integration of the industrial chain. In the future, we can also gain profit by providing systematic solutions, instead of only selling robots.

12. Will Country Garden expand investment properties or light-asset business such as agent-construction?

Country Garden won't strategically expand on external construction business and investment property business.

Source: Company data

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	226,900	379,079	479,880	547,814	597,808
Property development	220,157	369,405	468,000	533,600	580,636
Property investment	2,305	5,265	6,845	8,213	9,856
Property management	108	227	272	313	360
Land development	1,674	2,550	2,805	3,142	3,519
Project management	2,656	1,632	1,958	2,546	3,437
Cost of sales	(168,114)	(276,603)	(351,934)	(403,788)	(443,649)
Gross profit	58,785	102,476	127,947	144,026	154,159
Other income and gains	2,611	4,344	2,370	2,785	3,278
Distribution expenses	(10,002)	(12,533)	(16,316)	(18,078)	(19,728)
Administrative expenses	(7,608)	(17,777)	(21,595)	(21,913)	(21,521)
Other expenses	(693)	(1,224)	(1,680)	(1,917)	(2,092)
Operating profit	43,093	75,286	90,726	104,904	114,096
Finance expenses	3,276	1,348	1,105	727	781
Associates/JV	(352)	1,197	2,850	3,200	3,500
Exceptional	505	1,732	16	0	0
Pre-tax profit	46,522	79,563	94,697	108,830	118,377
Profits tax	(17,770)	(31,021)	(36,118)	(40,847)	(43,853)
Minority interest	(2,688)	(13,924)	(17,500)	(22,434)	(23,848)
Perpetual	0	0	0	0	0
Net profit	26,064	34,618	41,079	45,548	50,676
Core profit	24,690	34,130	41,067	45,548	50,676

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
EBIT	43,093	75,286	90,726	104,904	114,096
D&A	825	1,044	1,562	1,521	1,696
Change in working capital	(348,551)	8,606	(31,033)	(5,000)	6,000
Income tax paid	(19,115)	(35,698)	(41,125)	(43,847)	(48,853)
Others	347,831	(19,857)	(31,473)	(35,720)	(63,979)
Net cash from operating	24,084	29,381	(11,343)	21,856	8,960
Capex	(9,642)	(16,892)	(339)	(6,358)	(3,933)
Associates/JV	(16,682)	(13,191)	(3,341)	(6,000)	(6,000)
Other	(18,060)	17,814	(1,250)	(800)	(800)
Net cash from investing	(44,385)	(12,269)	(4,930)	(13,158)	(10,733)
Equity raised	(1,216)	3,378	0	0	0
Change of Debts	80,577	78,645	(6,475)	800	32,200
Dividend paid	(5,382)	(9,432)	(11,563)	(12,609)	(13,914)
Other	(1,157)	1,241	0	0	0
Net cash from financing	72,822	73,832	(18,038)	(11,809)	18,286
Net change in cash	52,521	90,944	(34,311)	(3,111)	16,513
Cash at the beginning	84,647	137,084	228,343	194,082	191,021
Exchange difference	(84)	315	50	50	50
Cash at the end	137,084	228,343	194,082	191,021	207,584
Pledged deposit	11,318	14,200	14,514	14,514	14,514
Cash at BS	148,402	242,543	208,596	205,535	222,098

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	181,754	229,944	253,450	282,250	336,650
Fixed asset	21,628	23,421	23,800	28,000	30,000
Investment properties	8,338	16,435	15,000	15,800	16,200
Associates/JV	30,930	46,659	50,000	56,000	62,000
Intangible assets	392	670	650	650	650
Other non-current assets	120,466	142,759	164,000	181,800	227,800
Current assets	867,915	1,399,750	1,498,596	1,585,035	1,714,098
Cash	148,402	242,543	208,596	205,535	222,098
Account receivable	270,541	443,491	465,000	480,000	510,000
Inventories	393,060	680,097	788,000	860,000	940,000
Other current assets	55,912	33,619	37,000	39,500	42,000
Current liabilities	769,537	1,219,406	1,303,000	1,372,300	1,495,000
Borrowings	68,281	126,097	112,000	98,800	105,000
Trade and other payables	330,884	498,821	540,000	592,000	638,000
Contract liabilities	346,747	562,800	620,000	650,000	720,000
Deferred taxation	21,607	30,783	30,000	30,000	30,000
Other current liabilities	2,017	905	1,000	1,500	2,000
Non-current liabilities	163,521	236,880	240,200	251,200	272,200
Borrowings	146,484	202,378	210,000	224,000	250,000
Other non-current liabilities	17,037	34,502	30,200	27,200	22,200
Shareholders' equity	93,671	121,330	150,846	183,785	220,548
Minority interest	22,941	52,078	58,000	60,000	63,000
Perpetual bond	0	0	0	0	0
Total equity	116,612	173,408	208,846	243,785	283,548

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Property development	97.0	97.4	97.5	97.4	97.1
Property investment	1.0	1.4	1.4	1.5	1.6
Property management	0.0	0.1	0.1	0.1	0.1
Land development	0.7	0.7	0.6	0.6	0.6
Project management	1.2	0.4	0.4	0.5	0.6
Total	100.0	100.0	100.0	100.0	100.0
Profit & loss ratios (%)					
Gross margin	25.9	27.0	26.7	26.3	25.8
Pre-tax margin	19.0	19.9	18.9	19.1	19.1
Net margin	11.5	9.1	8.6	8.3	8.5
Effective tax rate	38.2	39.0	38.1	37.5	37.0
Balance sheet ratios					
Current ratio (x)	1.1	1.1	1.2	1.2	1.1
Receivable day	435.2	427.0	353.7	319.8	311.4
Payable day	532.3	480.3	410.7	394.4	389.5
Inventory day	853.4	897.4	817.3	777.4	773.4
Net gearing ratio (%)	56.9	49.6	54.3	48.1	46.9
Returns (%)					
ROE	27.8	28.5	27.2	24.8	23.0
ROA	2.5	2.1	2.3	2.4	2.5
Per share data					
EPS (RMB)	1.23	1.61	1.89	2.10	2.33
DPS (HK\$)	0.40	0.49	0.56	0.62	0.69
BVPS (RMB)	4.40	5.61	6.97	8.49	10.19

Source: Company data, CMBIS estimates

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