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China Property

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HS CEI @ 12,063.0

12M hi/lo HK\$4.73/2.17

12M price target HK\$3.00
±% potential +4%

Shares in issue 8,012.4m
Free float (est.) 35.0%

Market cap US\$3,101m

3M average daily volume
HK\$94.4m (US\$12.2m)

Major shareholders

Cheng Chung Hing 30.5%
Chen's Int'l Investment 12.9%

Stock performance (%)

	1M	3M	12M
Absolute	(21.0)	(21.0)	33.2
Relative	(26.4)	(32.7)	12.4
Abs (US\$)	(21.1)	(21.0)	33.2



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Reset expectations

Sale miss in peak season. Reduced visibility, d'grade to U-PF

China South City's share price plummeted 17% in 2 days as 3Q15 contracted sales (Oct-Dec14), traditionally a peak season, came down 51% q-q/-70% y-y. YTD 9M15 achieved 49% of sales target (9M14: 89%). With such sale weakness during a traditional selling season, earnings visibility is clearly weakened and more concerns over inventory pile-up. Hence we downgrade the stock to U-PF with new TP HK\$3.0/shr.

Sales shortfall in peak season

CSC reported soft 3Q15 contract sales at HK\$2.0bn -51% q-q. GFA sold was down 46% q-q to 235,200sqm while ASP down -8% q-q to HK\$8,767psm. 2H is the trade centre developers' peak season, sales tend to follow after major trade fairs in Oct/Nov. YTD 9M15 sales HK\$8.9bn was down 29% y-y, securing 49% of 15F sales target of HK\$18bn sales (9M14: 89%). 2 key contributors in 4Q will be Chongqing (brand new) and Zhengzhou (new phase) projects with estimated contracted sales of HK\$1.2/ \$1bn respectively.

Inventory to trend higher

While delays in local governments' old trade centre relocations could be one reason for the sale shortfall, the sharp slowdown is still difficult to understand in a quarter of credit loosening in China. It also raises concerns over growing inventory: we expect completed unsold inventory to hit HK\$10bn or over 80% of full-yr sale by Mar 15. This will be up from the HK\$7.1bn or 50% of full-yr sales by Mar 14.

Earnings change

We cut our contract sales forecast by 35% to HK\$12bn for 15CL (which implies 15% decline y-y full-yr; and HK\$3.1bn sales in 4Q15) and 44% for 16-17CL; we also lower our GP margins 1.5-4ppts to 42-46% for 15-17CL (old: 46-47.5%) factoring in possible higher revenue contributions from residential units which yield lower margins (GPM: 35-40% vs 45-55% trade centre units). These result in 38-55% cut in 15-17CL earnings.

Downgrade to U-PF. TP HK\$3.0

Our new target price of HK\$3.0/shr is based on 45% discount to NAV (widened from 25% disc factoring in higher inventory risks & weakened earnings visibility) of HK\$5.4/shr (old: HK\$6.6). Downgrade to Underperform.

Financials

Year to 31 March	13A	14A	15CL	16CL	17CL
Revenue (HK\$m)	7,488	13,468	12,076	14,123	16,397
Rev forecast change (%)	-	-	(30.2)	(40.6)	(42.4)
Adjusted net profit (HK\$m)	1,776	2,678	1,898	2,003	2,147
NP forecast change (%)	-	-	(38.0)	(50.5)	(55.2)
Adjusted EPS (HK¢)	29.5	42.7	25.5	25.0	26.7
CL/consensus (10) (EPS%)	-	-	54	41	35
Adj EPS growth (% YoY)	91.3	44.8	(40.3)	(1.8)	6.9
Adjusted PE (x)	9.8	6.8	11.3	11.6	10.8
Dividend yield (%)	3.5	4.8	2.9	2.9	3.1
ROE (%)	19.1	19.5	8.5	7.7	7.7
Net debt/equity (%)	34.8	30.9	48.5	62.7	76.0

Source: CLSA

Sales shortfall in peak season

CSC's 3Q15 (Oct-Dec14) contracted sales was down 51% q-q and 70% y-y. The sharp sales slowdown is difficult to understand. Oct~Dec is traditionally trade centres developers' peak season, sales tend to follow after major trade fairs are held in Oct/Nov. Industry peer, Wuzhou International's (1369 HK, N-R) Oct-Dec 14 sales was up 50% q-q/ 15% y-y.

Figure 1

China South City's contract sales

	Sales HK\$m	GFA sold sqm	ASP HK\$psm	Sales y-y%	GFA sold y-y%	ASP y-y%	Sales q-q%	GFA sold q-q%	ASP q-q%
2Q+3Q12	2,095	171,500	12,216						
Oct-Dec12	2,223	157,880	14,080						
Jan-Mar13	3,882	377,470	10,284				75	139	(27)
Apr-Jun13	2,217	256,060	8,658				(43)	(32)	(16)
Jul-Sep13	3,570	370,840	9,627				61	45	11
Oct-Dec13	6,809	912,600	7,461	206	478	(47)	91	146	(22)
Jan-Mar14	1,504	210,500	7,145	(61)	(44)	(31)	(78)	(77)	(4)
Apr-Jun14	2,654	282,880	9,382	20	10	8	76	34	31
Jul-Sep14	4,183	437,920	9,552	17	18	(1)	58	55	2
Oct-Dec14	2,062	235,200	8,767	(70)	(74)	18	(51)	(46)	(8)

Source: Company data, CLSA

Figure 2

Industry peer, Wuzhou International's contract sales

	RMBmn	sqm	RMBpsm	% y-y	% y-y	% y-y	% q-q	% q-q	% q-q
1H13	2,257	279,000	8,090						
Jul-Sep13	1,063	167,000	6,365						
Oct-Dec13	1,872	233,045	8,033				76	40	26
Jan-Mar14	928	123,440	7,519				(50)	(47)	(6)
Apr-Jun14*	2,074	294,530	7,042				123	139	(6)
Jul-Sep14	1,440	204,979	7,026	35	23	10	(31)	(30)	(0)
Oct-Dec14	2,158	340,840	6,331	15	46	(21)	50	66	(10)

*Jun14 contract sales was historical high at Rmb1.3bn. Source: Company data, CLSA

We adjust 15-17CL contract sales forecast by 29-37%...

We cut FY15CL contract sales forecast by 32% to HK\$12bn, and 16-17CL by 44% to HK\$13.1-15.3bn. Our 15CL sales target implies HK\$3.1bn in 4Q/ HK\$5.1bn in 2H. Key contributors for 2H sales will be Zhengzhou (new phases) and Chongqing (brand new) projects, which contribute HK\$1.4bn and HK\$1.2bn on our estimate.

Figure 3 shows our contracted sales forecast by project and type. We expect residential sale as percent of total sales to 15% in 15CL (from 6%) and 15% in 16CL (from 5%). While residential units yield a lower gross margin (GPM: 30-35% compared to trade centre units of 45-55%), we lower our GP margins forecast by 1.5-4ppts in 15-17CL.

...and earnings cut by 38-55%

Figure 3

Summary of major changes

	14A	15CL	16CL	17CL
Contracted sales (HK\$m)				
Original	14,100	18,299	23,310	27,343
Revised	14,100	11,971	13,172	15,294
% change	0%	(32%)	(44%)	(44%)
Revenue - prop sale (HK\$m)				
Original	12,535	16,126	22,199	26,481
Revised	12,535	11,060	12,822	14,855
% change	0%	(31%)	(42%)	(44%)
GP margin - prop sale (%)				
Original	48.9	47.5	46.5	46.0
Revised	48.9	46.0	44.0	42.0
ppt chg	0.0%	(1.5%)	(2.5%)	(4.0%)
Underlying net profit (HK\$m)				
Original	2,678	3,062	4,046	4,796
Revised	2,678	1,898	2,003	2,147
% change	0%	(38%)	(51%)	(55%)

Source: Company data, CLSA

Figure 4

Contract sales breakdown by project

(HK\$m)	FY12A	FY13A	1H14A	FY14A	1H15A	15CL	16CL
Shenzhen	1,335	1,519	283	491	306	619	1,853
Trade centre (mall)	889	1,223	158	199	93	123	1,123
Trade centre (detached)	-	-	-	-	-	-	210
Office	411	182	39	135	88	171	180
Resi	35	114	86	158	126	324	340
Nanchang	3,063	2,304	757	1,118	901	1,355	1,533
Trade centre (mall)	2,076	1,490	743	1,103	292	509	662
Resi	987	814	14	15	609	846	871
Nanning	507	808	299	809	471	832	1,163
Trade centre (mall)	507	587	86	234	122	147	151
Trade centre (detached)	-	-	-	-	-	-	307
Resi	-	221	212	575	349	685	705
Xian	1,133	1,972	1,406	1,683	878	1,179	1,091
Trade centre (mall)	1,133	910	458	642	152	163	168
Trade centre (detached)	-	1,062	948	1,041	726	1,016	924
Zhengzhou	-	1,356	1,897	4,209	2,782	4,066	3,841
Trade centre (mall)	-	1,356	-	-	1,210	2,052	1,133
Trade centre (detached)	-	-	1,897	4,209	1,572	2,014	2,707
Harbin	-	248	1,147	1,323	805	1,394	1,191
Trade centre (detached)	-	248	-	1,323	805	1,394	1,191
Hefei	-	-	-	4,472	696	1,343	1,259
Trade centre (detached)	-	-	-	4,472	696	1,343	1,259
Chongqing	-	-	-	-	-	1,184	1,241
Trade centre (detached)	-	-	-	-	-	1,184	1,241
Heyuan	1,063	-	-	-	-	-	-
Total	7,101	8,206	5,787	14,106	6,838	11,971	13,172

Source: Company data, CLSA

CSC will have an operating cash outflow of HK\$9bn in 15CL, on our estimate, and company's net gearing sets to trend up to 43% by end-Mar15 (original forecast: 27.1%) from 23.7% at Mar14.

Operating cash outflow to widen after contract sales shortfall

Figure 5

Cashflow projection

(HK\$mn)	FY13/14	15CL original	15CL revised
Cash inflows:			
Contract sales	14,100	18,299	11,967
Cash collection ratio%	80	80	75
Presale proceeds (90% cash collection)	11,280	14,639	8,975
Rental	305	327	317
Total inflows	11,585	14,966	9,292
Cash outflows:			
Land acquisitions	(1,481)	(1,740)	(1,740)
Construction capex	(7,413)	(10,801)	(10,801)
SG&A	(1,444)	(1,817)	(1,389)
Interest	(1,101)	(1,603)	(1,715)
Tax	(1,978)	(2,501)	(1,682)
Dividends	(603)	(878)	(878)
Total outflows	(14,020)	(19,339)	(18,205)
Operating cash inflows/(outflows)	(2,435)	(4,374)	(8,913)

Note: We factor in a higher percentage of contract sales in 15CL to residential unit buyers who generally have a higher % of using mortgage loans, thus reduce our cash collection ratio to 75% from 80%. Source: CLSA.

Our target price of HK\$3.0/shr is pegged to 45% discount to NAV of HK\$5.42. Table below shows detailed breakdown of our NAV by project:

Figure 6

FY16 NAV estimate

	Dev prop (RMBmn)	Dev prop (RMB/shr)	Dev prop (% GAV)	Invest prop (RMBmn)	Invest prop (RMB/shr)	Invest prop (% GAV)
Shenzhen	5,416	0.68	12.6	2,926	0.37	6.8
Nanchang	5,483	0.69	12.8	1,805	0.23	4.2
Nanning	3,763	0.47	8.8	2,690	0.34	6.3
Xian	1,964	0.25	4.6	1,424	0.18	3.3
Harbin	3,134	0.39	7.3	962	0.12	2.2
Zhengzhou	5,279	0.66	12.3	1,778	0.22	4.1
Hefei	3,550	0.44	8.3	1,524	0.19	3.6
Chongqing	982	0.12	2.3	172	0.02	0.4
Subtotal	29,571	3.70	69	13,282	1.66	31
Gross asset value (GAV)	42,853	5.36	100.0			
Net debt	(8,453)	(1.06)				
Net asset value (NAV)	34,400	4.30				
# of shares (mn)	8,001					
NAV per share (RMB/shr)	4.30					
NAV per share (HK\$/shr)	5.42					

Source: CLSA

Figure 7

China property valuation summary

	Rec	Last close (HK\$)	Target (HK\$)	NAV (HK\$)	NAV disc (%)	15CL PE (x)	16CL PE (x)	15CL yield (%)	16CL yield (%)
Property developers									
Agile	U-PF	4.9	5.0	16.9	(71.1)	3.7	3.2	6.8	7.7
Vanke H	BUY	17.7	20.0	N.A.	N.A.	7.0	6.7	4.3	4.5
COLI	BUY	24.3	31.1	29.5	(17.8)	7.4	6.4	2.7	3.1
Country Garden	SELL	3.2	2.5	8.5	(62.2)	4.6	4.0	7.8	9.0
CRL	BUY	22.0	28.0	31.1	(29.4)	10.6	9.2	2.5	2.9
Evergrande	SELL	3.4	3.0	7.3	(53.4)	3.4	2.9	8.8	10.2
Guangzhou R&F	U-PF	9.6	9.9	27.0	(64.5)	5.2	4.0	5.7	7.4
KWG	BUY	5.4	7.5	11.7	(53.8)	3.4	2.9	7.5	9.4
Longfor	BUY	11.0	13.8	21.0	(47.4)	5.6	4.2	3.6	4.8
Shimao	BUY	18.4	22.4	26.2	(29.9)	4.9	3.8	5.8	7.3
Soho China	U-PF	5.7	6.5	11.9	(52.1)	16.8	15.7	5.6	5.6
COGO	U-PF	4.3	4.3	15.5	(72.5)	3.5	3.3	4.9	5.1
Sunac	O-PF	7.2	8.7	11.0	(34.3)	3.4	3.0	3.3	3.3
Trade centre developers									
China South City	U-PF	2.9	3.0	5.4	(44.6)	12.6	12.0	2.9	2.9
Hydoo*	N-R	1.7	N-R	N-R	N-R	2.5	1.8	13.8	18.9
Wuzhou Int'l*	N-R	1.4	N-R	N-R	N-R	5.1	3.2	4.5	6.8

*Bloomberg consensus. Source: CLSA

Summary financials

Year to 31 March	2013A	2014A	2015CL	2016CL	2017CL
Summary P&L forecast (HK\$m)					
Revenue	7,488	13,468	12,076	14,123	16,397
Op Ebitda	3,353	5,013	4,090	4,529	5,031
Op Ebit	3,326	5,013	4,090	4,529	5,031
Interest income	29	43	57	38	41
Interest expense	(133)	(153)	(86)	(107)	(132)
Other items	1,252	1,266	-	-	-
Profit before tax	4,473	6,169	4,061	4,459	4,939
Taxation	(1,606)	(2,472)	(2,102)	(2,386)	(2,711)
Minorities/Pref divs	(117)	(202)	(60)	(71)	(82)
Net profit	2,750	3,494	1,898	2,003	2,147
Summary cashflow forecast (HK\$m)					
Operating profit	3,326	5,013	4,090	4,529	5,031
Operating adjustments	76	3	0	0	0
Depreciation/amortisation	27	0	0	0	0
Working capital changes	(1,078)	(1,009)	(9,931)	(6,654)	(5,418)
Net interest/taxes/other	(238)	(1,978)	(1,682)	(1,909)	(2,168)
Net operating cashflow	2,114	2,029	(7,523)	(4,034)	(2,555)
Capital expenditure	-	-	-	-	-
Free cashflow	2,114	2,029	(7,523)	(4,034)	(2,555)
Acq/inv/disposals	(3,340)	31	(66)	(72)	(80)
Int, invt & associate div	29	43	57	38	41
Net investing cashflow	(3,312)	74	(9)	(35)	(39)
Increase in loans	4,112	3,452	3,119	5,719	6,719
Dividends	(454)	(603)	(878)	(626)	(661)
Net equity raised/other	439	86	1,491	(380)	(1,529)
Net financing cashflow	4,096	2,936	3,732	4,712	4,529
Incr/(decr) in net cash	2,898	5,038	(3,800)	644	1,935
Exch rate movements	51	0	0	0	0
Opening cash	3,316	6,265	11,303	7,503	8,147
Closing cash	6,265	11,303	7,503	8,147	10,082
Summary balance sheet forecast (HK\$m)					
Cash & equivalents	6,265	11,303	7,503	8,147	10,082
Debtors	937	2,806	5,798	8,431	11,490
Inventories	9,953	13,701	20,640	24,660	27,019
Other current assets	1,273	2,233	2,233	2,233	2,233
Fixed assets	2,983	3,592	3,658	3,731	3,811
Intangible assets	-	34	34	34	34
Other term assets	20,935	26,292	27,494	28,756	30,081
Total assets	42,345	59,961	67,360	75,991	84,748
Short-term debt	4,418	5,842	7,259	8,498	9,491
Creditors	8,166	13,810	13,810	13,810	13,810
Other current liabs	2,790	4,592	5,012	5,489	6,031
Long-term debt/CBs	7,435	11,677	12,369	16,849	22,575
Provisions/other LT liabs	3,493	3,896	3,896	3,896	3,896
Minorities/other equity	190	175	235	306	388
Shareholder funds	15,853	19,970	24,778	27,143	28,557
Total liabs & equity	42,345	59,961	67,360	75,991	84,748
Ratio analysis					
Revenue growth (% YoY)	104.0	79.9	(10.3)	16.9	16.1
Ebitda growth (% YoY)	48.4	49.5	(18.4)	10.7	11.1
Ebitda margin (%)	44.8	37.2	33.9	32.1	30.7
Net profit margin (%)	36.7	25.9	15.7	14.2	13.1
Dividend payout (%)	33.9	32.8	33.0	33.0	33.0
Effective tax rate (%)	35.9	40.1	51.8	53.5	54.9
Ebitda/net int exp (x)	32.0	45.6	139.8	65.0	54.9
Net debt/equity (%)	34.8	30.9	48.5	62.7	76.0
ROE (%)	19.1	19.5	8.5	7.7	7.7
ROIC (%)	9.6	10.9	5.5	4.7	4.4
EVA@/IC (%)	0.4	1.7	(3.3)	(4.1)	(4.4)

Source: CLSA

Companies mentioned

China South City (1668 HK - HK\$2.89 - UNDERPERFORM)
 Wuzhou International (1369 HK, N-R)

Recommendation history of China South City Holdings Ltd 1668 HK



Date	Rec	Target	Date	Rec	Target
05 Sep 2014	BUY	5.00			

Source: CLSA



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