

January 13, 2015

## China South City 1668 HK

**BUY**

**TP: HK\$ 4.74**

Rating: ◆ TP: ▼ EPS: ▼

### 1-3QFY15 sales disappointing; cut TP to HK\$4.74

**Disappointing sales performance; cut TP to HK\$4.74.** We revise down our earnings forecasts for CSC due to worse-than-expected sales and cut our TP from HK\$5.51 to HK\$4.74. However, we maintain our BUY rating for this commercial property player, given its established leadership position in a niche market and solid end-user demand.

**3QFY15 sales plunged 70%.** CSC announced disappointing third quarter sales, with contracted sales plunging 69.7% YoY to HK\$2.1bn. The company's cumulative sales in 1-3QFY15 reached HK\$8.9bn, falling 29.4% YoY. GFA sold dropped 37.9% YoY to 956k sqm though ASP rose 13.8% YoY, mainly due to a different product mix. Historically, the third quarter has been a good season for CSC's property sales. In 3QFY14, the company recorded 48.3% of its annual sales. However, the scenario seems different this year.

**Stock market seems more attractive.** We believe the reasons include: 1) China's slowing economy, which is weakening SMEs' buying power; 2) domestic investment interest shifting to the stock market from other areas like commercial properties. CSC's major products for sale are trade centers and most of its buyers are SMEs or investors, who are very sensitive to investment alternatives. The domestic stock market has been very hot in recent months and is expected to provide attractive returns in 2015.

**Annual sales target challenging.** Management has committed to more aggressive sales and promotions in the coming months. Moreover, the first batch of the new Chongqing project will be launched for sale in the final quarter of FY15. However, the annual target of HK\$18bn looks challenging, in our view. There is only one quarter left, but the company has reached only half its annual target. In 1-3QFY14, the company recorded over 89% of its total annual sales. We believe it is very likely that the company will miss its FY15 sales target. A full-year figure of about HK\$15bn, which represents single-digit growth, seems more achievable.

**Earnings forecast adjustments.** We revise down our EPS forecasts for FY15/FY16 by 11.7%/13.1% respectively and cut our TP from HK\$5.51 to HK\$4.74, which represents a larger NAV discount of 40% (previously 30%). Worse-than-expected sales suggest less investment demand in the short run, but that does not necessarily mean shrinking end-user demand (logistics and trading space for the retail industry) in the long run. We maintain our positive view on the niche market of logistics and trading properties, in which CSC has an established leadership position. We maintain our BUY rating.

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	3/13A	3/14A	3/15E	3/16E	3/17E		
Revenue (HK\$ mn)	7,488	13,468	14,840	20,450	25,044	Rating/Prev. Rating	BUY/(BUY)
EBITDA (HK\$ mn)	3,378	5,242	5,648	8,308	10,451	TP/Prev. TP (HK\$)	4.74 /5.51
Net profit, pre-exceptional (HK\$ mn)	1,893	2,880	3,113	4,735	6,295	Price (Jan. 13, 2015, HK\$)	2.89
EPS (HK\$)	0.31	0.46	0.39	0.59	0.79	% Upside/Downside	64%
- % change from prev. EPS	-	-	-11.7	-13.1	-12.7	Market Cap (HK\$/US\$m)	23,156 /2,987
- % vs. Consensus EPS	-	-	-12.7	2.3	1.9	Free float (%)	31
EPS growth (%)	109.0	46.2	-15.4	52.1	32.9	Daily vol - 6M avg (mn)	29
ROE (%)	13.1	16.1	14.5	18.9	21.1	Daily val - 6M avg (US\$m)	14
Net debt (cash)/equity (%)	31.6	24.4	37.7	39.1	32.1	Major shareholder/%	Cheng & Leung /40%
P/E (X)	9.2	6.3	7.4	4.9	3.7		
P/B (X)	1.1	0.9	1.0	0.9	0.7		
EV/EBITDA (X)	6.9	4.9	6.1	4.4	3.5		
Dividend yield (%)	3.4	4.8	5.5	7.9	9.7		

Source: Company data, HTI

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## Financials

### Income Statement\*

(HK\$ mn except otherwise indicated)	FY13	FY14	FY15E	FY16E	FY17E
<b>Revenue (net of business tax)</b>	<b>7,488</b>	<b>13,468</b>	<b>14,840</b>	<b>20,450</b>	<b>25,044</b>
YoY growth	104.0%	79.9%	10.2%	37.8%	22.5%
<b>COGS</b>	<b>(3,311)</b>	<b>(6,921)</b>	<b>(7,669)</b>	<b>(10,308)</b>	<b>(12,509)</b>
<b>Gross profit</b>	<b>4,177</b>	<b>6,547</b>	<b>7,171</b>	<b>10,141</b>	<b>12,535</b>
YoY growth	86.8%	56.8%	9.5%	41.4%	23.6%
Gross profit margin	55.8%	48.6%	48.3%	49.6%	50.1%
Selling & marketing expenses	(289)	(581)	(637)	(873)	(1,029)
General and administration expenses	(537)	(863)	(886)	(960)	(1,056)
Other operating income/loss	27	139	-	-	-
<b>EBITDA</b>	<b>3,378</b>	<b>5,242</b>	<b>5,648</b>	<b>8,308</b>	<b>10,451</b>
YoY growth	51.3%	55.2%	7.8%	47.1%	25.8%
EBITDA margin	45.1%	38.9%	38.1%	40.6%	41.7%
Depreciation	-	-	-	-	-
Amortization	-	-	-	-	-
<b>EBIT</b>	<b>3,378</b>	<b>5,242</b>	<b>5,648</b>	<b>8,308</b>	<b>10,451</b>
YoY growth	51.3%	55.2%	7.8%	47.1%	25.8%
EBIT margin	45.1%	38.9%	38.1%	40.6%	41.7%
Interest income	31	49	-	69	76
Interest expense	(133)	(153)	(190)	(292)	(184)
Profit/loss from associates	-	-	-	-	-
Profit/loss from acquisition/disposal	-	-	-	-	-
Other non-operating income/loss	-	-	-	-	-
<b>Pretax income</b>	<b>3,276</b>	<b>5,138</b>	<b>5,458</b>	<b>8,085</b>	<b>10,343</b>
YoY growth	49.8%	56.9%	6.2%	48.1%	27.9%
PBT margin	43.7%	38.1%	36.8%	39.5%	41.3%
Income tax	(1,266)	(2,056)	(2,345)	(3,350)	(4,049)
Effective tax rate	38.6%	40.0%	43.0%	41.4%	39.1%
Minority interest (1/5 item)	117	202	-	-	-
<b>Net income, post-exceptionals</b>	<b>1,893</b>	<b>2,880</b>	<b>3,113</b>	<b>4,735</b>	<b>6,295</b>
YoY growth	110.4%	52.1%	8.1%	52.1%	32.9%
Net margin	25.3%	21.4%	21.0%	23.2%	25.1%
Post-exceptional items - gain/(loss)	-	-	-	-	-
<b>Net income, pre-exceptionals</b>	<b>1,893</b>	<b>2,880</b>	<b>3,113</b>	<b>4,735</b>	<b>6,295</b>
YoY growth	110.4%	52.1%	8.1%	52.1%	32.9%
Net margin	25.3%	21.4%	21.0%	23.2%	25.1%

\* Excluding the effect of non-recurrent items

### Cash Flow Statement

(HK\$ mn except otherwise indicated)	FY13	FY14	FY15E	FY16E	FY17E
<b>Operating activities</b>					
Profit before taxes	4,473	6,169	6,976	9,946	11,983
Depreciation and amortization	27	-	-	-	-
Net profit/loss on asset sales	1	-	-	-	-
Increase/decrease in working capital	(1,078)	1,235	(5,201)	(4,465)	(3,442)
Other operating cash flow items	(1,310)	(3,677)	(3,766)	(5,138)	(5,705)
<b>Net CF flow from operating activities</b>	<b>2,114</b>	<b>3,726</b>	<b>(1,991)</b>	<b>344</b>	<b>2,836</b>
<b>Investing activities</b>					
Capital expenditure	(627)	(372)	(141)	(154)	(107)
Acquisition/divestiture	-	-	-	-	-
Proceeds from disposal of assets	322	-	-	-	-
Other investment cash flow items	(3,007)	953	(427)	(76)	(73)
<b>Net CF flow from investing activities</b>	<b>(3,312)</b>	<b>581</b>	<b>(569)</b>	<b>(230)</b>	<b>(181)</b>
<b>Financing</b>					
Dividends paid	(454)	(878)	(1,275)	(1,839)	(2,257)
Share repurchase/issue	-	(508)	-	-	-
Increase/decrease in debt/notes payable	5,039	5,847	4,958	3,606	2,117
Change in Minority interests	13	-	-	-	-
Other financing cash flow items	(502)	(153)	(190)	(292)	(184)
<b>Net CF flow from financing activities</b>	<b>4,096</b>	<b>4,308</b>	<b>3,492</b>	<b>1,475</b>	<b>(324)</b>
<b>Total cash flow</b>	<b>2,898</b>	<b>8,615</b>	<b>932</b>	<b>1,588</b>	<b>2,332</b>

### Balance Sheet

(HK\$ mn except otherwise indicated)	FY13	FY14	FY15E	FY16E	FY17E
<b>Assets</b>					
Cash and cash equivalents	6,265	12,777	13,710	15,298	17,630
Pledged deposits	513	-	224	246	271
Bill and trade receivables	1,580	3,535	2,968	4,090	2,504
Inventories	9,381	13,455	16,350	16,224	19,212
Other receivables	-	-	148	204	250
Other current assets	689	275	330	396	475
<b>Total current assets</b>	<b>18,428</b>	<b>30,042</b>	<b>33,730</b>	<b>36,459</b>	<b>40,342</b>
<b>Net PP&amp;E (including AUC)</b>	<b>20,027</b>	<b>24,693</b>	<b>26,233</b>	<b>28,117</b>	<b>29,841</b>
<b>Net intangibles</b>					
Equity investments	-	-	-	-	-
Investments in securities or other	30	52	52	52	52
<b>Total investments</b>	<b>30</b>	<b>52</b>	<b>52</b>	<b>52</b>	<b>52</b>
LT deferred tax assets	586	1,033	1,136	1,250	1,375
LT trade and bills receivables	-	-	-	-	-
Other long term assets	3,274.6	4,141.0	4,260.5	4,391.9	4,475.7
<b>Total assets</b>	<b>42,345</b>	<b>59,961</b>	<b>65,412</b>	<b>70,270</b>	<b>76,086</b>
<b>Liabilities</b>					
Accounts payable	10,956	18,220	15,348	11,879	9,839
Short-term debt	4,418	6,023	7,830	9,396	10,335
Other current liabilities	-	-	-	-	-
<b>Total current liabilities</b>	<b>15,374</b>	<b>24,243</b>	<b>23,178</b>	<b>21,275</b>	<b>20,175</b>
Long-term debt	7,435	11,677	14,828	16,868	18,046
LT trade and bills payable	-	-	-	-	-
Deferred tax liabilities	3,493	3,896	4,286	4,715	5,186
Other LT liabilities	-	-	-	-	-
<b>Total non-current liabilities</b>	<b>10,928</b>	<b>15,573</b>	<b>19,114</b>	<b>21,583</b>	<b>23,232</b>
<b>Total liabilities</b>	<b>26,302</b>	<b>39,817</b>	<b>42,292</b>	<b>42,858</b>	<b>43,406</b>
<b>Common shareholders' equity</b>					
Issued capital	61	4,684	4,684	4,684	4,684
Reserves	15,793	15,285	18,261	22,553	27,820
<b>Common shareholders' equity</b>	<b>15,853</b>	<b>19,970</b>	<b>22,946</b>	<b>27,237</b>	<b>32,505</b>
Minority interests	190	175	175	175	175
<b>Total liabilities and equity</b>	<b>42,345</b>	<b>59,961</b>	<b>65,412</b>	<b>70,270</b>	<b>76,086</b>

### Ratio Analysis\*

	FY13	FY14	FY15E	FY16E	FY17E
<b>Valuation</b>					
P/E (x)	9.2	6.3	7.4	4.9	3.7
P/B (X)	1.1	0.9	1.0	0.9	0.7
EV/EBITDA (X)	6.9	4.9	6.1	4.4	3.5
Dividend yield(%)	3.4	4.8	5.5	7.9	9.7
FCF yield (%)	1.2	2.9	0.3	0.3	0.4
<b>Profitability</b>					
Gross margin (%)	55.8	48.6	48.3	49.6	50.1
EBIT margin (%)	45.1	38.9	38.1	40.6	41.7
Net margin (%)	25.3	21.4	21.0	23.2	25.1
SG&A/revenue (%)	11.0	10.7	10.3	9.0	8.3
ROE (%)	13.1	16.1	14.5	18.9	21.1
ROA (%)	5.2	5.6	5.0	7.0	8.6
<b>Liquidity &amp; Leverage</b>					
Current Ratio (X)	1.2	1.2	1.5	1.7	2.0
Quick Ratio (X)	0.6	0.7	0.7	1.0	1.0
Net debt/equity (%)	31.6	24.4	37.7	39.1	32.1
Total debt/equity (%)	74.8	88.6	98.7	96.4	87.3
Total liabilities/total assets (%)	62.1	66.4	64.7	61.0	57.0
EBIT interest coverage ration (x)	25.3	34.3	29.7	28.5	56.9
<b>Efficiency</b>					
Inventory days	944.8	602.1	709.3	576.7	517.0
A/R days	72.4	69.3	80.0	63.0	48.1
A/P days	1053.2	769.3	798.8	482.0	316.9

\* Excluding the effect of non-recurrent items

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	Rating	Remark
<b>Stock</b> (9 - 12 months)	Buy	Target price +15% or more above the current price
	Hold	Target price within 0% to +15% of the current price
	Sell	Target price below the current price
<b>Sector</b>	Overweight	Relative performance over Hang Seng Index $\geq 10\%$
	Neutral	Relative performance within Hang Seng Index $-10\%$ to $+10\%$
	Underweight	Relative performance below Hang Seng Index $\leq -10\%$

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