Daiwa Capital Markets

Company

Financials / China
16 July 2015

The 10-second briefing

China South City
1668 HK

Target (HKD): **5.40 → 3.90**
Upside: **68.1%**
15 Jul price (HKD): **2.32**

Too cheap to ignore

- Current valuation looks attractive; company well positioned to benefit from China's ongoing urbanisation
- Near-term catalysts: 1) recurring income growth, and 2) asset restructuring; dividend yield should protect the share price
- Cutting FY16-17E EPS by 43-51%, but reiterate Buy (1) rating as most of the recent negative news already seems to be priced in

1 Buy (unchanged)
2 Outperform
3 Hold
4 Underperform
5 Sell

How do we justify our view?

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■ What's new

China South City (CSC) announced its FY15 results on 29 June and 1Q FY16 contract sales on 15 July. With the results missing expectations, we are cutting our FY16-17E earnings. However, we think the recent negative news flow is already priced in, and believe now is a good time to revisit the stock.

■ What's the impact

Since the spike in April, the share price has now returned to a more attractive level, close to where it was before Tencent (700 HK, HKD150, Buy [1]) invested on 15 January (HKD2.17). Near term, we believe strong recurring income growth and restructuring of its logistics business would be share-price catalysts. Also, we see more upside than downside to company guidance for close to flat YoY contract sales growth for FY16, with the launch in 1Q15 of its Chongqing logistics project.

In the long term, we remain positive on CSC's business model, under which it helps local governments relocate their wholesale markets to rural areas to fit in with China's urbanisation plan.

However, we are cutting our FY16-17E EPS by 43-51% to account for the weaker-than-expected FY15 results and lower-than-expected guidance on contract sales growth for FY16. As such, we now apply a larger discount to NAV of 70% to its property assets (previously 60%), which we estimate equates to HKD8.40/share. This, together with other recurring business (mainly logistics and e-commerce), leads us to cut our SOTP-based 12-month TP to HKD3.90 (from HKD5.40). We also introduce our FY18 forecasts.

■ What we recommend

However, we reiterate our Buy (1) rating, as we expect sentiment toward the stock to pick up over the next 12 months for the aforementioned reasons. Also, management intends to maintain the dividend at the HKD0.14 level, while a 6% dividend yield should protect the stock from share-price downside. The main risk to our call: lower-than-expected contract sales growth in FY16.

■ How we differ

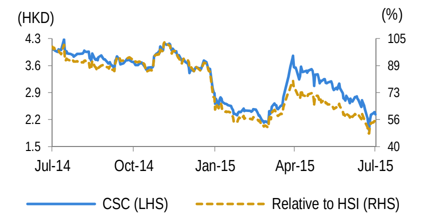
Our FY16-17E EPS are 18-26% lower than consensus as we exclude property revaluation gains. Moreover, we are more optimistic that the restructuring of its logistics assets will take place.

Forecast revisions (%)

Year to 31 Mar	16E	17E	18E
Revenue change	(25.9)	(36.7)	n.a.
Net profit change	(43.3)	(51.1)	n.a.
Core EPS (FD) change	(43.3)	(51.1)	n.a.

Source: Daiwa forecasts

Share price performance



12-month range	1.92-4.23
Market cap (USDbn)	2.39
3m avg daily turnover (USDm)	21.03
Shares outstanding (m)	8,001
Major shareholder	Cheng Chung Hing (30.5%)

Financial summary (HKD)

Year to 31 Mar	16E	17E	18E
Revenue (m)	13,511	14,692	16,415
Operating profit (m)	6,517	7,596	9,081
Net profit (m)	2,169	2,484	2,967
Core EPS (fully-diluted)	0.266	0.304	0.364
EPS change (%)	13.3	14.5	19.5
Daiwa vs Cons. EPS (%)	(17.5)	(26.3)	2.8
PER (x)	8.7	7.6	6.4
Dividend yield (%)	6.1	6.2	6.4
DPS	0.141	0.143	0.148
PBR (x)	0.7	0.6	0.5
EV/EBITDA (x)	5.7	5.1	4.5
ROE (%)	8.2	8.4	8.9

Source: FactSet, Daiwa forecasts

1 Buy (unchanged)
2 Outperform
3 Hold
4 Underperform
5 Sell

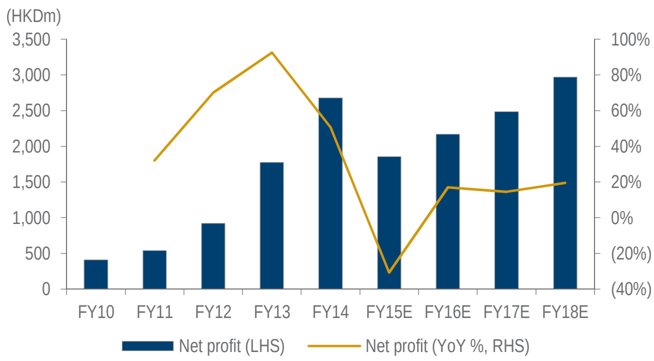
How do we justify our view?

- Growth outlook ✔✔✔✔
- Valuation ✔✔✔✔✔
- Earnings revisions ✔✔✔✔

Growth outlook ✔✔✔✔

We forecast CSC to record net profit growth of 15-20% YoY for FY16-18E. For this period, we believe the major earnings contributor will be property sales from its projects in Zhengzhou, Chongqing, Nanchang and Xi'an. At the same time, we believe the EBIT contribution from recurring income will rise from 11% for FY15E to 25% for FY18E, due mainly to an increase in rental income. On the other hand, our forecasts assume that the EBIT contribution from e-commerce and its logistics & outlets will grow from 4% of total EBIT and 2% for FY15, to 8% and 3% for FY18E, respectively.

CSC: net profit and net profit growth

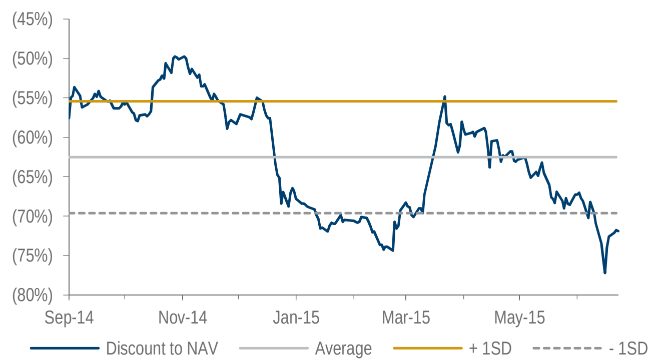


Source: Bloomberg, Daiwa forecasts

Valuation ✔✔✔✔✔

The stock is trading at a 72% discount to its property NAV, which is a much higher discount compared with the China property companies currently (based on the BBG consensus forecasts). We believe CSC deserves to trade at a higher valuation vs. these property companies, as it should benefit more from the ongoing urbanisation and relocation of old wholesale markets to rural areas. Thus, we think such a high discount is unjustified and believe the stock deserves to be rerated. Also, the stock is trading at a FY16E PER of 9x, which we see as undemanding in light of our net profit growth forecasts of 15-20% YoY for FY16-18E.

CSC: discount to property NAV (September 2014-YTD July)

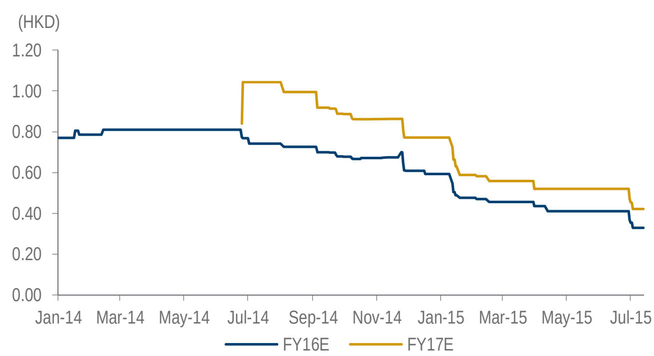


Source: Bloomberg, Daiwa forecasts

Earnings revisions ✔✔✔✔

The Bloomberg consensus has revised down its FY16-17 EPS forecasts by 45% since the start of 2015, due mainly to the weaker-than-expected FY15 results. Our FY16-17E EPS are 18-26% below consensus, as we exclude the property revaluation gain.

CSC: revisions to Bloomberg consensus EPS forecasts



Source: Bloomberg

Financial summary

■ Key assumptions

Year to 31 Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Contracted sales revenue growth (%)	0.0	0.0	15.6	71.9	(19.7)	0.1	4.3	6.7
E-commerce revenue growth (%)	n.a.	n.a.	0.0	0.0	6.7	90.0	50.0	20.0
Logistics revenue growth (%)	n.a.	n.a.	0.0	175.6	286.3	35.1	26.0	20.6

■ Profit and loss (HKDm)

Year to 31 Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Property development	2,046	3,431	7,179	12,813	8,654	11,818	12,218	12,968
Property Investment (rental income)	133	166	214	305	574	861	1,291	1,937
Other Revenue	54	73	95	351	530	833	1,183	1,510
Total Revenue	2,234	3,671	7,488	13,468	9,758	13,511	14,692	16,415
Other income	1,474	1,693	1,273	1,301	2,499	2,928	3,551	4,242
COGS	(901)	(1,435)	(3,311)	(6,921)	(4,582)	(7,625)	(8,295)	(8,948)
SG&A	(320)	(538)	(826)	(1,444)	(1,796)	(2,298)	(2,352)	(2,628)
Other op.expenses	0	0	0	0	0	0	0	2
Operating profit	2,487	3,391	4,624	6,404	5,878	6,517	7,596	9,081
Net-interest inc./(exp.)	(21)	(47)	(102)	(104)	(97)	(222)	(228)	(260)
Assoc/forex/extraord./others	(49)	(22)	(48)	(131)	78	(7)	(7)	(6)
Pre-tax profit	2,417	3,322	4,473	6,169	5,859	6,288	7,360	8,814
Tax	(909)	(1,258)	(1,606)	(2,472)	(2,145)	(2,301)	(2,693)	(3,225)
Min. int./pref. div./others	8	23	(117)	(202)	13	8	8	8
Net profit (reported)	1,517	2,088	2,750	3,494	3,728	3,995	4,675	5,597
Net profit (adjusted)	542	923	1,776	2,678	1,854	2,169	2,484	2,967
EPS (reported)(HKD)	0.254	0.349	0.456	0.557	0.487	0.499	0.584	0.700
EPS (adjusted)(HKD)	0.091	0.154	0.295	0.427	0.242	0.271	0.310	0.371
EPS (adjusted fully-diluted)(HKD)	0.090	0.154	0.295	0.378	0.235	0.266	0.304	0.364
DPS (HKD)	0.025	0.075	0.100	0.140	0.140	0.141	0.143	0.148
EBIT	2,487	3,391	4,624	6,404	5,878	6,517	7,596	9,082
EBITDA	2,523	3,415	4,653	6,473	5,974	6,602	7,820	9,373

■ Cash flow (HKDm)

Year to 31 Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Profit before tax	2,417	3,322	4,473	6,169	5,859	6,288	7,360	8,814
Depreciation and amortisation	36	24	27	70	96	85	224	291
Tax paid	(105)	(160)	(238)	(838)	(643)	(690)	(808)	(967)
Change in working capital	363	(687)	(1,078)	(1,736)	(2,018)	(1,400)	(1,812)	(1,937)
Other operational CF items	(1,386)	(1,564)	(1,071)	(962)	(1,732)	(2,649)	(3,218)	(3,878)
Cash flow from operations	1,325	936	2,114	2,703	1,561	1,634	1,746	2,322
Capex	(1,849)	(2,327)	(3,083)	(3,332)	(764)	(2,189)	(1,589)	(1,589)
Net (acquisitions)/disposals	(90)	256	49	557	0	0	0	0
Other investing CF items	(23)	21	(278)	46	(6,145)	(930)	(930)	(930)
Cash flow from investing	(1,962)	(2,050)	(3,312)	(2,729)	(6,908)	(3,119)	(2,519)	(2,519)
Change in debt	(146)	583	4,112	3,514	5,764	424	2,000	2,000
Net share issues/(repurchases)	0	0	0	1,497	823	0	0	1
Dividends paid	(120)	(150)	(454)	(903)	(967)	(1,120)	(1,128)	(1,142)
Other financing CF items	1,667	(576)	439	1,075	(4,322)	3,209	1,703	3,670
Cash flow from financing	1,402	(142)	4,096	5,182	1,297	2,513	2,575	4,528
Forex effect/others	62	51	51	(118)	0	0	0	0
Change in cash	827	(1,206)	2,949	5,038	(4,050)	1,028	1,802	4,331
Free cash flow	(524)	(1,391)	(969)	(629)	798	(555)	157	733

Source: FactSet, Daiwa forecasts

Financial summary continued ...

Balance sheet (HKDm)

As at 31 Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Cash & short-term investment	4,564	3,832	6,778	12,777	8,673	9,701	11,502	15,834
Inventory	483	7,763	9,381	13,455	22,970	25,970	28,970	31,970
Accounts receivable	34	867	643	729	654	654	654	654
Other current assets	905	784	1,626	3,081	1,967	4,147	5,445	6,462
Total current assets	5,986	13,245	18,428	30,042	34,264	40,471	46,571	54,919
Fixed assets	204	196	601	659	1,328	2,850	3,632	4,348
Goodwill & intangibles	20	20	0	34	34	34	34	35
Other non-current assets	15,174	17,205	23,316	29,226	37,628	38,919	40,962	43,695
Total assets	21,384	30,666	42,345	59,961	73,254	82,275	91,199	102,997
Short-term debt	1,696	2,740	4,418	6,023	9,576	3,000	3,000	3,000
Accounts payable	1,324	6,530	8,166	13,810	13,535	15,765	17,150	18,502
Other current liabilities	901	1,624	2,790	4,411	5,235	5,235	5,235	5,235
Total current liabilities	3,921	10,895	15,374	24,243	28,346	24,000	25,385	26,737
Long-term debt	4,446	3,878	7,435	10,668	15,427	25,927	29,927	35,927
Other non-current liabilities	2,399	2,898	3,493	4,906	4,459	4,459	4,459	4,459
Total liabilities	10,766	17,671	26,302	39,817	48,232	54,386	59,772	67,123
Share capital	60	60	61	4,684	7,035	7,035	7,035	7,035
Reserves/R.E./others	10,481	12,879	15,793	15,285	17,832	20,707	24,254	28,708
Shareholders' equity	10,541	12,939	15,853	19,970	24,867	27,742	31,289	35,743
Minority interests	77	57	190	175	155	147	139	131
Total equity & liabilities	21,384	30,666	42,345	59,961	73,254	82,275	91,199	102,997
EV	20,218	21,406	23,829	22,645	35,012	37,900	40,091	41,751
Net debt/(cash)	1,578	2,786	5,076	3,913	16,331	19,227	21,425	23,094
BVPS (HKD)	1.762	2.161	2.619	2.891	3.108	3.467	3.911	4.467

Key ratios (%)

Year to 31 Mar	2011	2012	2013	2014	2015	2016E	2017E	2018E
Sales (YoY)	42.3	64.3	104.0	79.9	(27.6)	38.5	8.7	11.7
EBITDA (YoY)	14.7	35.4	36.3	39.1	(7.7)	10.5	18.4	19.9
Operating profit (YoY)	15.1	36.4	36.4	38.5	(8.2)	10.9	16.6	19.6
Net profit (YoY)	32.1	70.1	92.5	50.7	(30.8)	17.0	14.5	19.5
Core EPS (fully-diluted) (YoY)	16.3	70.6	91.6	28.5	(38.0)	13.3	14.5	19.5
Gross-profit margin	59.7	60.9	55.8	48.6	53.0	43.6	43.5	45.5
EBITDA margin	112.9	93.0	62.1	48.1	61.2	48.9	53.2	57.1
Operating-profit margin	111.3	92.4	61.7	47.5	60.2	48.2	51.7	55.3
Net profit margin	24.3	25.1	23.7	19.9	19.0	16.1	16.9	18.1
ROAE	5.6	7.9	12.3	14.9	8.3	8.2	8.4	8.9
ROAA	2.9	3.5	4.9	5.2	2.8	2.8	2.9	3.1
ROCE	16.6	18.6	19.5	19.8	13.5	12.2	12.5	13.1
ROIC	14.3	15.1	16.1	17.0	11.4	9.3	9.6	10.3
Net debt to equity	15.0	21.5	32.0	19.6	65.7	69.3	68.5	64.6
Effective tax rate	37.6	37.9	35.9	40.1	36.6	36.6	36.6	36.6
Accounts receivable (days)	9.8	44.8	36.8	18.6	25.9	17.7	16.2	14.5
Current ratio (x)	1.5	1.2	1.2	1.2	1.2	1.7	1.8	2.1
Net interest cover (x)	121.2	72.3	45.2	61.4	60.8	29.4	33.2	34.9
Net dividend payout	9.9	21.5	21.9	25.1	28.7	28.2	24.4	21.2
Free cash flow yield	n.a.	n.a.	n.a.	n.a.	4.3	n.a.	0.8	4.0

Source: FactSet, Daiwa forecasts

Company profile

CSC is a leading developer and operator of large-scale integrated logistics and trade centres in China, and focuses on small and medium-sized enterprises. The company aims to provide its clients and occupants of its trade centres with a one-stop supply chain solution, which includes a full range of integrated logistics services and facilities.

Key investment thesis

Apart from CSC's cheap valuation, we think its dividend payout will provide share-price support, while strong recurring rental income and the restructuring of its logistics business would be near-term share-price catalysts.

Valuation too cheap to ignore

Large discount to NAV

The stock is trading currently at a 72% discount to its property NAV, which is probably one of the largest discounts to NAV among all of the China residential and commercial property players if we consider the NAV of its property assets.

Also, as the share price has returned to close to the level (ie, HKD2.17) it was before Tencent invested on 15 January 2015, we now think the stock is cheap and that all the recent negative news flow (eg, disappointing FY15 results, negative reports related to the co-chairman [discussed further on]) has been priced in.

■ **Chinese property companies: price-to-NAV ratio**

Name	Bloomberg Code	Share price	NAV/ Share	Price to NAV (%)	PBR	Rating	1-Yr target price
		14-Jul-15	FY15E	FY15E			
China Wholesale market developers							
China South City Holdings	1668HK	2.38	8.4	-72%	0.8	Buy	3.90
China property developers							
China Overseas Land	688 HK	25.60	38.6	-33%	1.3	Buy	30.90
China Resources Land	1109 HK	22.30	37.9	-41%	1.2	Buy	30.20
Guangzhou R&F	2777 HK	8.83	25.8	-66%	0.7	Buy	12.90
China Overseas Grand Oceans	81 HK	3.48	16.1	-78%	0.6	Buy	6.45
HK property developers							
SHK Properties	16 HK	122.60	212.3	-42%	0.8	Buy	159.20
Henderson Land	12 HK	52.45	92.1	-43%	0.7	Buy	64.50
Sino Land	83 HK	12.30	25.5	-52%	0.6	Buy	15.30
Average				-53%	0.8		
Average, market-cap weighted				-42%	0.9		

Source: Bloomberg, Daiwa forecasts

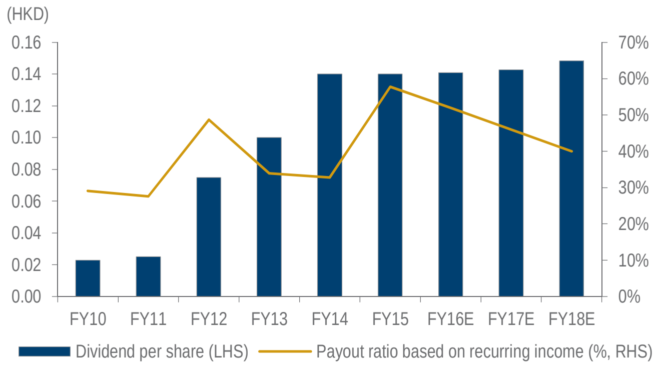
Dividend should protect the share price

CSC announced a DPS of HKD0.14 per share during its FY15 results meeting at the end of March 2015. This was better than we expected, given the 31% YoY decline in the company's recurring net profit for FY15.

According to management, the company is committed to its long-term dividend policy, and plans to maintain the absolute dividend amount, despite the significant 31% YoY decline in the recurring net profit for FY15.

We estimate management will maintain the DPS at around HKD0.14 to HKD0.15 for FY16-18E, although it may not be able to maintain a 60% dividend payout (which is based on recurring net profit), and could adjust it down gradually until management reaches its target of a 30% dividend payout ratio. However in the near term, we believe the 6% dividend yield should protect against potential share-price downside.

■ **CSC: dividend per share and payout ratio**



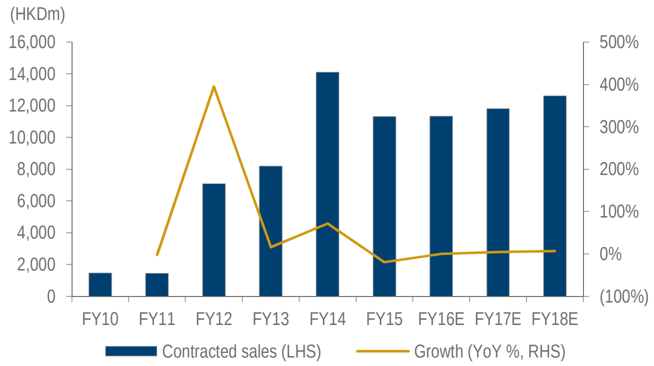
Source: Company, Daiwa forecasts

Market has low contract sales expectations for FY16

CSC expects its contract sales revenue to be close to flat YoY at HKD11-12bn for FY16. As the company launched a number of projects late in the previous fiscal year (FY15), in particular the new trade centre in Chongqing, and with the low base for projects in FY15, we expect FY16 to see a strong rebound in contract sales.

In our view, the company's contract sales target of close to flat YoY should be achievable, and we see more upside than downside to this goal. Investment sentiment toward CSC stock would likely pick up should its contract sales exceed management's guidance for FY16. We assume FY16 contract sales reach HKD11.3bn, flat YoY, and gradually pick up by 4% YoY for FY17E and 7% YoY for FY18E.

■ CSC: contract sales and growth



Source: company, Daiwa forecasts

Asset spin-off should help to broaden its financing channels

On 13 April 2015, CSC announced plans to list subsidiary (75%-owned) Shenzhen HOBA Home Furnishing Chain Store (HOBA) on the National Equities Exchange and Quotation System (NEEQ) (NEEQ is known as the New Third Board, a national over-the-counter market in China regulated by the China Securities Regulatory Commission [CSRC]. It provides a platform for the sale of existing shares or directed share placements for SMEs). The HOBA spin-off aims to broaden the company's financing channels.

In the future, CSC expects to spin off more of its stable businesses to further expand its financing channels. And we think there is a high chance that the company will restructure its logistics business and eventually spin it off, as this segment has seen the most solid earnings growth, on the back of the increase in its GFA. Any spin-off of its logistics business would boost investor sentiment toward the stock, in our view.

Long-term earnings growth story is intact

Relocation plan in line with country's urbanisation trend

We remain positive on CSC's model of developing integrated wholesale markets (referred to by CSC as third-generation trade centres) in rural areas, as this is helping to solve the traffic congestion problems around many of the old second-generation wholesale markets, which are now mostly situated in busy urban areas, given that many cities have expanded over the past decade. This is in line with the government's moves to promote urbanisation, which involves relocating old industrial facilities away from city areas to rural areas.

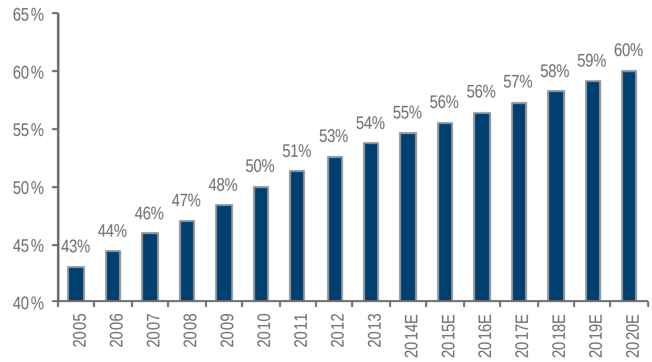
We also think that after being relocated to rural areas, CSC's trade centres provide more logistics and IT support to the SMEs located within the centres. This includes helping SMEs to develop their online-to-offline (O2O) platforms, which allows the SMEs that are located inside the trade centres to progress to fourth-generation trade-centre operations. For CSC, this increases the attractiveness of its trade centres for SMEs, enticing more of them to locate to CSC's centres.

We expect CSC to post strong recurring revenue growth (from logistics, e-commerce and rental income) for FY16-18E, which would help the stock be rerated in the next 3 years.

■ **CSC: 1st-4th-generation trade centre/wholesale markets**

Source: Company

■ **China: urbanisation rate**



Source: NBS, Daiwa forecasts

Corporate governance concerns seem to have been removed

On 14 January 2015, Sina.com reported that CSC's co-chairman, Mr. Cheng Chung Hing, had been included in a list of Shenzhen property developers who could be investigated. Even though CSC issued a clarification on 15 January 2015, saying that Mr Cheng had denied the reports and was not being investigated, investment sentiment toward the stock, has weakened since then.

However, in the interim, there has been no further news flow on the investigation. Thus, we think the media report on 14 January was probably untrue. Accordingly, investor concerns about the company's corporate governance should diminish, and are unlikely to have any impact on CSC's business plans in the long run.

Recurring income to lead to a rerating of the stock

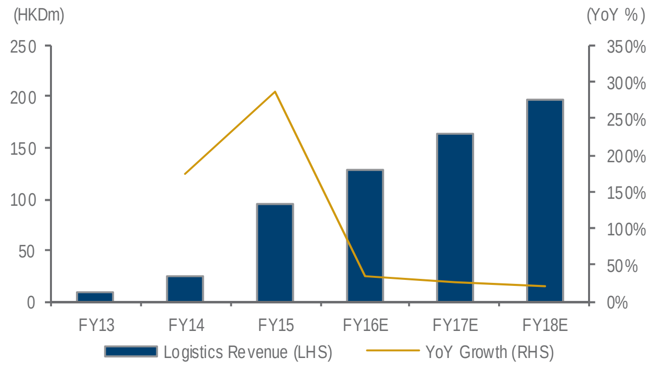
Logistics business is the most solid

Among all of the company's recurring businesses, we see the most solid earnings growth coming from its logistics business over our forecast period. According to management, the company has 489,900 sq m of land designated for the development of logistics and warehouses in the next 2-3 years. And we estimate that this would translate into a 21-35% YoY increase in its logistics revenue for FY16-18E.

Longer term, we believe the company's Logistics Information Exchange Platform (LIEP) will become more attractive to heavy goods vehicle (HGV) drivers, as it will help them secure a cargo load for their return journeys, which would have previously been unused, and hence not earning revenue.

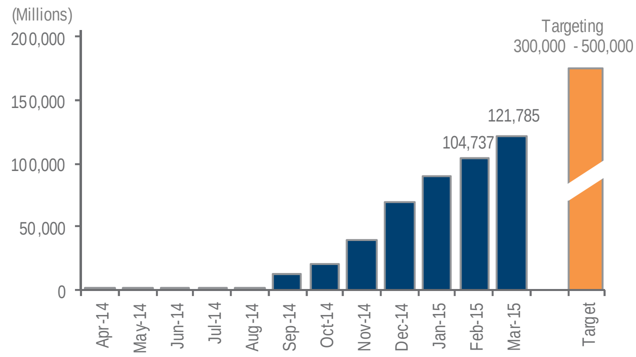
Currently, the LIEP project has been rolled out in only Nanning and Shenzhen, but we expect it to be extended to other cities in the long term (such as Zhengzhou). This should further strengthen the logistics function of CSC's trade centres and increase the EBIT contribution from these centres. However, in the shorter term, we still expect the most solid earnings growth to come from the increase in logistics warehouse space, with the company concrete plan for 489,900 sq m, which it aims to complete over FY16-18.

■ CSC: revenue from logistics business



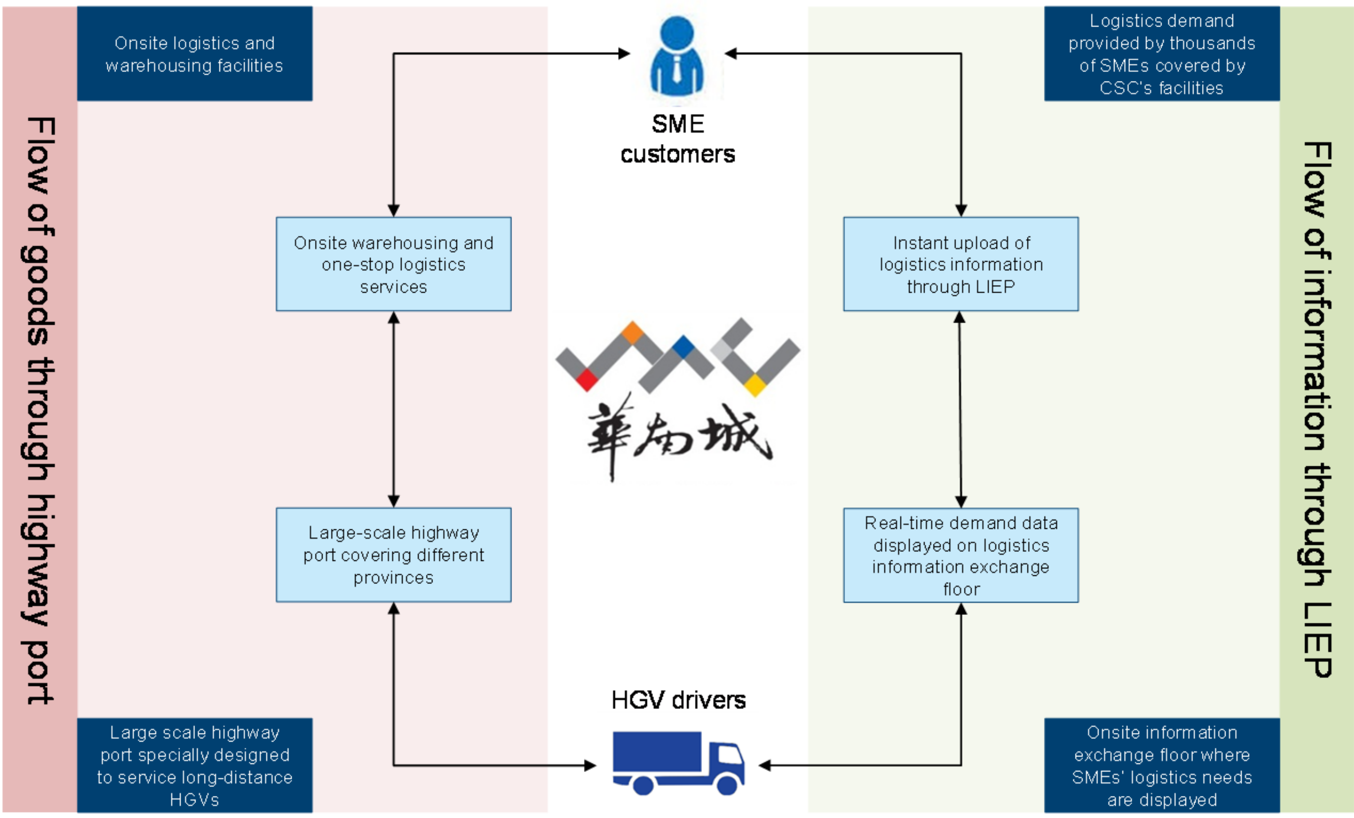
Source: Company, Daiwa forecasts

■ CSC: number of registered LIEP carriers



Source: Company

■ CSC: Logistics Information Exchange Platform (LIEP)

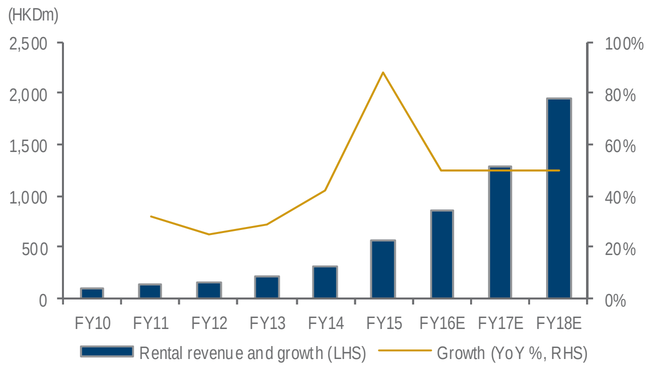


Source: Company, Daiwa

Rental growth likely to extend to other cities

For FY15, the company derived most of its rental income from CSC Shenzhen and HOBA Furniture. For FY16-18, we expect additional rental income to come from Zhengzhou, Nanning and Nanchang, as each of these projects commenced operations last year. Hence, we forecast a 50% CAGR in CSC's rental income for FY16-18E.

■ CSC: rental revenue and growth (FY10-18E)



Source: Company, Daiwa forecasts

E-commerce mostly in-house

For FY15, CSC derived most of its e-commerce revenue from its online membership programme, offered by CSC Zhengzhou, where CSC provides training and services designed to help traditional offline SMEs to go online. As well as providing membership fees, the programme helps to build awareness among traditional SMEs of the value of the Internet in generating new orders. According to the company, around 13,000 SMEs have signed up to the programme to date, a rise of 86% YoY.

In the long term, we expect CSC to provide value-added services in conjunction with Tencent, such as online payments, promotions through Wechat, JD.com, etc, and Big Data services. However, as there will likely be a lead time before cooperation with Tencent starts to yield results, we expect the e-commerce business to be driven by CSC itself through the expansion of its online membership programme. All told, we forecast CSC's e-commerce revenue to increase by 20-90% YoY over FY16-18E.

■ CSC: online membership programme progress

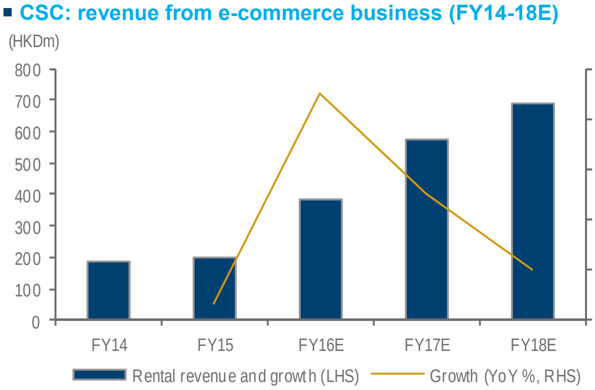
First Online Platform	
Key Content	– Help SMEs set up online showrooms using CSC online platform – Provide technical support to help SMEs master different e-commerce tools
Result	– Over 3,000 SMEs in CSC Zhengzhou set up their first online platforms during the fiscal year – Over 40,000 products from CSC Zhengzhou are made available online
Enhance Online Business	
Key Contents	– Use online matchmaking service to help SMEs find business orders online – Create new demand through online platforms
Result	– Facilitates over 540 online orders
Cultivate IT Talents	
Key Content	– Provide extensive training for SMEs seeking to expand their e-commerce operations – Cooperates with local universities and colleges to help students start up e-commerce businesses in CSC projects
Result	– Cooperates with 39 universities and colleges in Nanchang and Zhengzhou – Provides practical e-commerce training to over 7,000 students – Helps students start up over 1,600 e-commerce projects

Source: Company

■ CSC: planned cooperation with Tencent to develop e-commerce

Source: Company

■ CSC: revenue from e-commerce business (FY14-18E)



Source: Company, Daiwa forecasts

Valuation and recommendation

With the stock now trading at a 72% discount to its property NAV, we believe now is a good time to buy.

Valuation and recommendation

Large discount to property NAV

CSC stock is trading currently at a 72% discount to its property NAV, one of the largest such discounts among China property companies. Also, the share price is close to the level it was prior to Tencent coming on board as a strategic shareholder in January 2014.

Separately, we consider CSC's FY16E PER of 9x to be undemanding relative to our forecast for a net earnings growth of 15-20% YoY for FY16-18E.

We continue to use SOTP methodology to value CSC, which we believe best reflects the value of the company's trade centre, logistics and e-commerce businesses. But we now apply a discount of 70% to its property NAV (formerly 60%) in view of the weaker-than-expected market sentiment toward CSC's property valuation, backed by our forecast for 0-7% YoY growth in its contract sales for FY16-17E (compared with 1-23% YoY previously). As a result, our 12-month target price falls to HKD3.90, from HKD5.40 previously.

■ CSC: SOTP valuation summary

Segment	Methodology	Value (HKD m)	Value per share
Logistics and residential property	70% discount to property NAV	67,447	HKD 2.5
E-commerce	PER 15 * Earnings * 100% held by CSC	8,627	HKD 1.1
Logistics and others	PER 15 * Earnings * 100 % held by CSC	2,677	HKD 0.3
Value per share			HKD 3.90

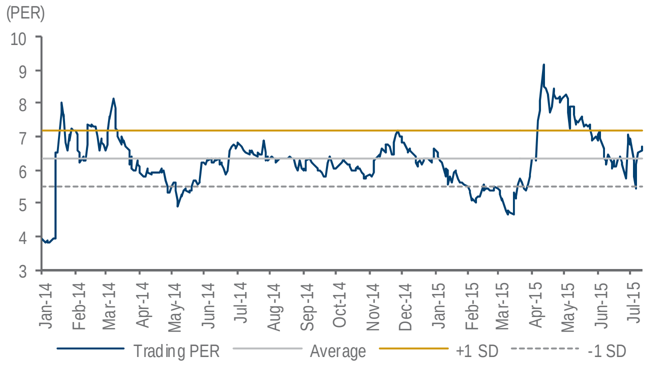
Source: Daiwa forecasts

Reiterating Buy (1) rating

We consider CSC to be attractively valued, given the stock's large discount to its property NAV, our forecast for strong recurring income growth in FY16-18E, and our view of CSC as a beneficiary of ongoing urbanisation. Also, asset restructuring stands an additional potential share-price catalyst, in our view. The stock remains on our Buy (1) list.

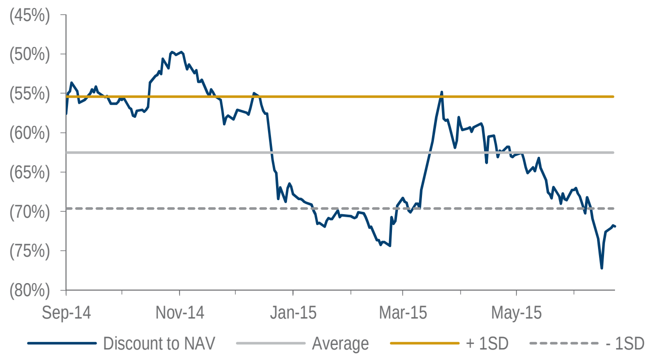
Although sentiment toward CSC stock has weakened since its contract sales growth for 3Q FY15 undershot management guidance, we believe the shares will find strong support from investors at around the HKD2 level, the price at which CSC traded prior to Tencent's investment. At the same time, the 6% dividend yield for FY16E should provide downside protection.

■ CSC: 12-month forward PER (since January 2014 – July YTD)



Source: Bloomberg

■ CSC: discount to property NAV (September 2014-YTD to July)



Source: Bloomberg, Daiwa forecasts

Risks to our call

Slower-than-expected sales of trade centres

CSC's net earnings remain heavily reliant upon sales of its trade centres (once completed). Hence, slower-than-expected sales of trade centres would be a big risk to our view of the stock. Also, a slowdown in property sales would reduce cash inflows to CSC, with implications for the development of new projects.

Delays in relocation process

For CSC's real-estate projects, the government has to relocate the existing residents in order to turn the land over to commercial use. Delays in this process could push back CSC's construction plans and hence its timetable for property sales.

Lower rental and occupancy rates

Rental and occupancy rates depend partly on broader economic and geographical (ie, where the project is located) conditions. Rents and occupancy rates could fall short of expectations in the event of an economic downturn or a similar trade centre being built nearby.

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Disclosure of investment ratings

Rating	Percentage of total
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Source: Daiwa

Notes: data is for single-branded Daiwa research in Asia (ex Japan) and correct as of 30 June 2015.
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