

# China / Hong Kong Industry Focus

## China Property Sector

Refer to important disclosures at the end of this report

DBS Group Research . Equity

25 Apr 2022

### Which is the best among top names?

- **Introducing an alternative angle to assess value and upside of top quality names: PB vs. core ROE**
- **More upside for Longfor, CR Land and COLI despite outperforming year-to-date**
- **Longfor poised to maintain valuation premium, while COLI offers the biggest re-rating potential**

#### Forward PB as an alternative angle to analyse valuation of quality names with sustainable scale and earnings outlook.

With the physical market likely peaking and an evident deleveraging trend taking place in the sector, the days of a high gearing and fast asset turnover operational model are now behind us. We believe investor attention will gradually shift from absolute earnings growth to core ROE, which will better reflect a developer's management quality and profit efficiency as there is now limited room for development margins to improve, plus distortion from asset turnover and leverage are now out of the equation. As such, using forward PE valuations may be phased out and forward PB, which has historically exhibited a closer relationship with core ROE (see chart on pg.3), may gradually be used to assess a developer's valuation.

**More upside despite being consensus picks - Longfor to maintain its valuation premium and COLI offers the biggest re-rating potential.** Our operational and financial metrics comparison of consensus' 3 top picks indicated that **Longfor has outperformed in all categories**, which in part has supported its higher and improving core ROE. CR Land and COLI are next. While their valuations seem rich on a PE perspective (at 7-9x FY22F PE) after their solid performances to-date, we believe **management quality and thus ability to efficiently generate returns have yet to be reflected** given the gap in forward PB multiples vs historical levels when both have similar core ROEs but different risk profiles. At this juncture, **COLI offers the high share price upside** with its forward PB at c.0.6x (vs c.1.0x when it achieved a similar c.10% core ROE in FY18).

**Pecking order of large caps: COLI, Longfor, CR Land.** These stocks are consensus' top picks and have delivered solid share price performances to-date. However, we believe their stronger fundamentals –specifically generating superior returns – have yet to be reflected in their share price and valuation. In order of preference based on relative fundamentals and current valuations, [COLI \(688 HK\)](#), [Longfor \(960 HK\)](#), and [CR Land \(1109 HK\)](#) are our large-cap picks to ride on the potential share price rally in anticipation of more policy support ahead. We also like [COGO \(81 HK\)](#) and [Yuexiu \(123 HK\)](#) among mid-caps.

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### Recommendation & valuation

	Price HK\$	Target Price HK\$	Rec	Mkt Cap US\$bn	FY22F PE x
<a href="#">COGO (81 HK)</a>	4.55	7.03	BUY	2.0	2.4
<a href="#">China Overseas (688 HK)</a>	24.90	31.89	BUY	34.7	6.4
<a href="#">CR Land (1109 HK)</a>	35.70	50.93	BUY	32.5	7.2
<a href="#">Longfor (960 HK)</a>	39.95	55.56	BUY	30.9	8.0
<a href="#">Yuexiu Property (123 HK)</a>	8.51	10.12	BUY	3.4	5.0

Source: Thomson Reuters, DBS Bank (Hong Kong) Limited ("DBS HK")

Closing price as of 22 Apr 2022

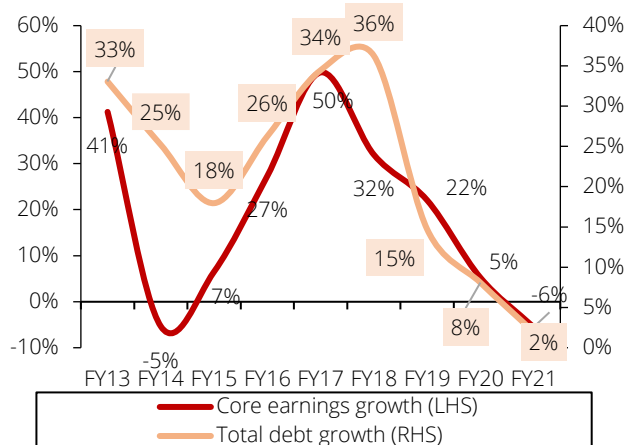


**Forward PB as valuation metric for quality developers with sustainable scale and earnings outlook**

Presales and core earnings growth has been the main performance metrics for the China property sector...

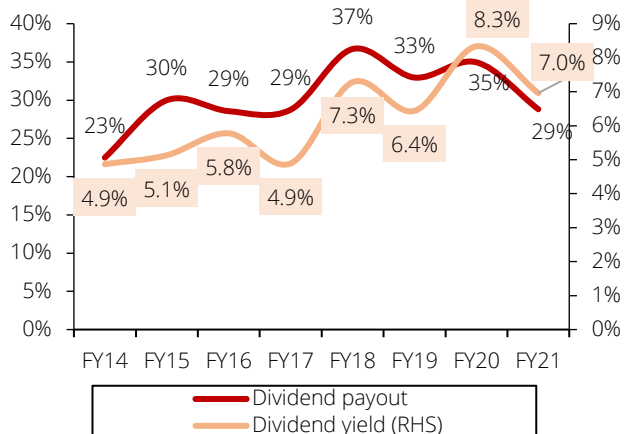
Alongside the multi-year growth cycle in the physical property market, developers have been gearing up to accelerate asset turnover and expand their operational scale to drive core earnings growth. Developers have also maintained attractive dividend payout policies on core earnings. These have accordingly directed investor focus to developers' absolute presales and earnings growth, and less on their management quality and efficiency to generate returns.

**Sector's core earnings growth and total debt growth**



Source: Companies, DBS HK

**Sector's average dividend payout ratio and dividend yield**



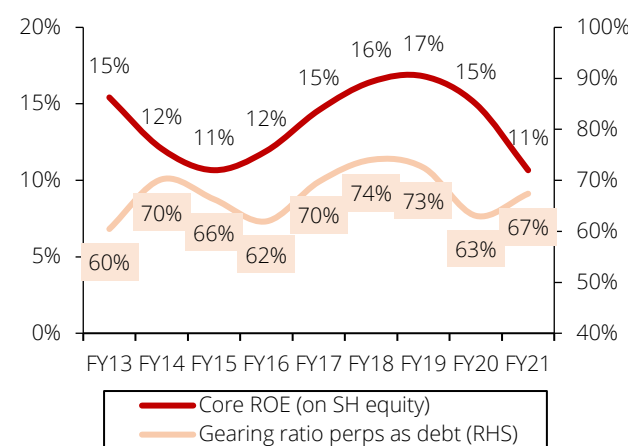
Note: Dividend yield calculated based on closing price of the last trading day for the year

Source: Bloomberg Finance L.P., Companies, DBS HK

... but we may see a gradual shift back to core ROE going forward. With 1) the likely peaking out of the physical market, and 2) tighter liquidity and investors' increasingly more sceptical views on the sector and the currently closed refinancing window, the China property sector has reached a turning point. The sector is now seeing a shift away from its previous fast asset turnover and high gearing operational model. Additionally, most developers may not be able to maintain a similar high dividend payout as in the past, as seen during the recent results season.

Thus, with the above drivers largely out of the picture now, the importance of absolute earnings growth is likely to be less, while management quality will gradually return to investors' spotlight and play a greater role in differentiating one developer from the next. For quality developers that can maintain their operating and earnings scale alongside a relatively stable and secure book value (without significant impairments, etc), we believe core ROE would progressively be the performance metric that investors will look at. The reason being that core ROE metric is driven and determined more by management quality, and there will be little distortion from asset turnover and leverage going forward, as well as limited room for land cost and ASP to improve - thus development margins to recover.

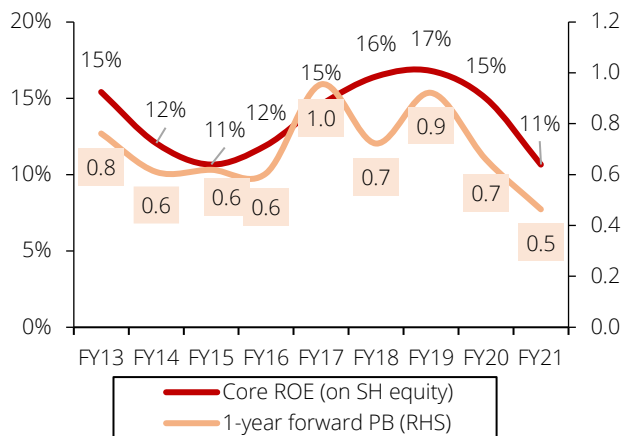
**Sector's average Core ROE: Sector ROE peaked out in FY19 as 1) development margins started to fall as higher-cost land was starting to be reflected in the P&L; and 2) sector's gearing started to fall from FY20 upon the implementation of "Three Red Lines" policy**



Source: Companies, DBS HK

Price-to-book may become a relevant valuation method for quality developers with sustainable earnings outlook. As absolute earnings growth may no longer be meaningful, we believe using PE as a valuation metric may gradually fade going forward. Instead, on the anticipation that core ROE will better reflect a company's management quality and capability to generate returns, the use of forward price-to-book ratios – which goes hand-in-hand with ROE changes – could be a better alternative to assess the value of quality developers.

**Sector's average forward PB ratio to Core ROE: The relationship of forward PB and Core ROE saw some decoupling in FY18 as the sector started to gear up and accelerate asset turnover**



Note: Core ROE calculated via average shareholder equity in T and T-1 year

Source: Bloomberg Finance L.P., Companies, DBS HK

China Property Sector

Assessing the three market consensus picks

Our large-cap top picks of COLI, Longfor and CR Land are now market consensus picks as well for their evidently superior fundamentals. Given that their superiority is already well-known by the market, the question is whether the strong fundamentals are fully priced in.

**Longfor ticks the boxes for valuation outperformance...** In our cross comparison between Longfor, CR Land and COLI, Longfor has by-and-large outperformed in most of the operational and financial metrics – from presales outlook (based on gross land premium to presales ratio), recurring income (recurring income as % of revenue), core earnings growth, dividend payout ratio, and core ROE.

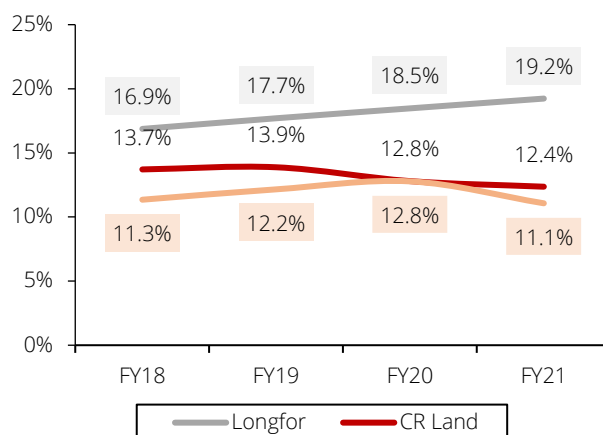
Operational metric comparison for Longfor, CR Land and COLI

Ticker Developer	960 HK Longfor	1109 HK CR Land	688 HK COLI
<b>Land acquisition % of presales</b>			
FY18	58%	79%	53%
FY19	44%	59%	46%
FY20	54%	48%	38%
FY21	53%	47%	37%
<b>Core earnings growth</b>			
FY18	32%	12%	-1%
FY19	21%	12%	10%
FY20	20%	12%	11%
FY21	20%	10%	-4%
FY22F	11%	10%	-4%
<b>Recurring income % of revenue</b>			
FY18	6.1%	7.9%	2.1%
FY19	6.8%	7.3%	2.3%
FY20	7.4%	6.5%	2.2%
FY21	8.4%	7.5%	1.9%
<b>Dividend payout</b>			
FY18	46%	38%	27%
FY19	45%	32%	29%
FY20	46%	36%	29%
FY21	46%	37%	30%

Note: Highlighted in green refers to the most favourable among the three in the particular year  
Source: Companies, DBS HK

Notably, Longfor’s core ROE has been on a continuous uptrend since 2016 and is now higher at 19%, compared to the other two that recorded consecutive years of a drop in core ROE to c.11-12% in FY21. This serves as solid justification for Longfor’s premium valuation to CR Land and COLI.

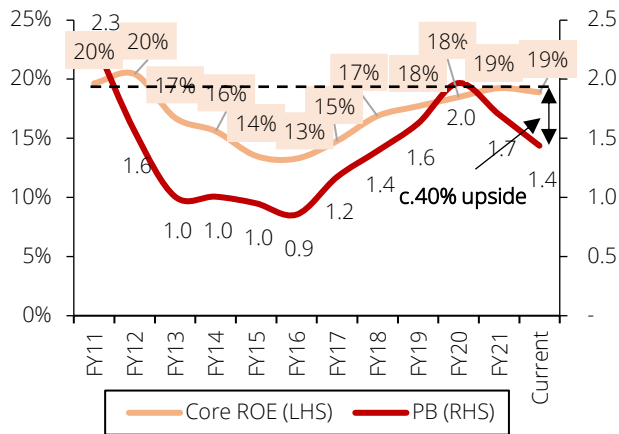
Longfor, CR Land and COLI’s core ROE



Note: Core ROE calculated via avg. shareholder equity in T and T-1 year  
Source: Companies, DBS HK

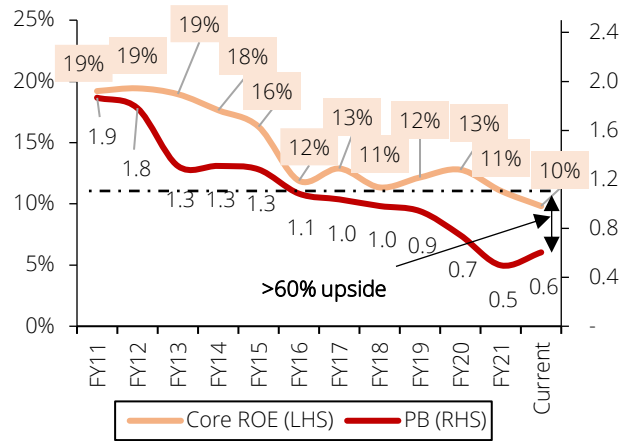
**... and deserve to trade higher than its current valuation...** On a forward PE perspective, reasons to justify Longfor’s sector-leading valuation multiple seems limited. Having said that, the case is different if we look at forward PB ratios. Longfor is currently trading at c.1.4x forward PB on FY22F core ROE of c.20%, but the company has been trading at c.2.0x forward PB historically on core ROE of c.19-20% (FY11-12: 1.6-2.3x PB; FY20-21: 1.7-2.0x) when the risk profile was higher (smaller operational and earnings scale, higher leverage). Based on this angle, we believe there is room for Longfor’s valuation to re-rate.

**Longfor's core ROE to 1-year forward PB**



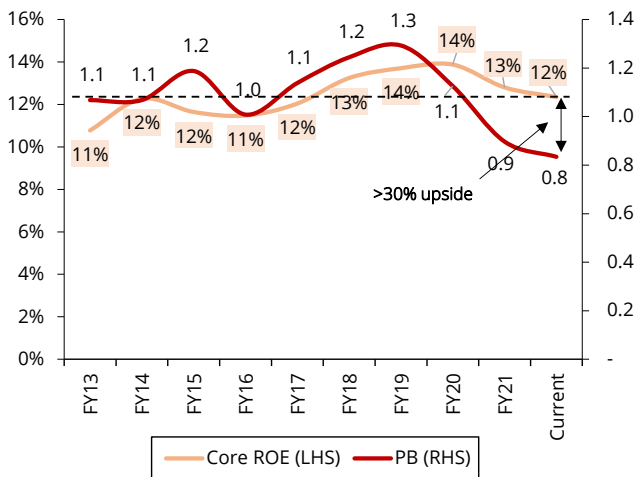
Source: Bloomberg Finance L.P., Company, DBS HK

**COLI's core ROE to 1-year forward PB**



Source: Bloomberg Finance L.P., Company, DBS HK

**CR Land's core ROE to 1-year forward PB**



Source: Bloomberg Finance L.P., Company, DBS HK

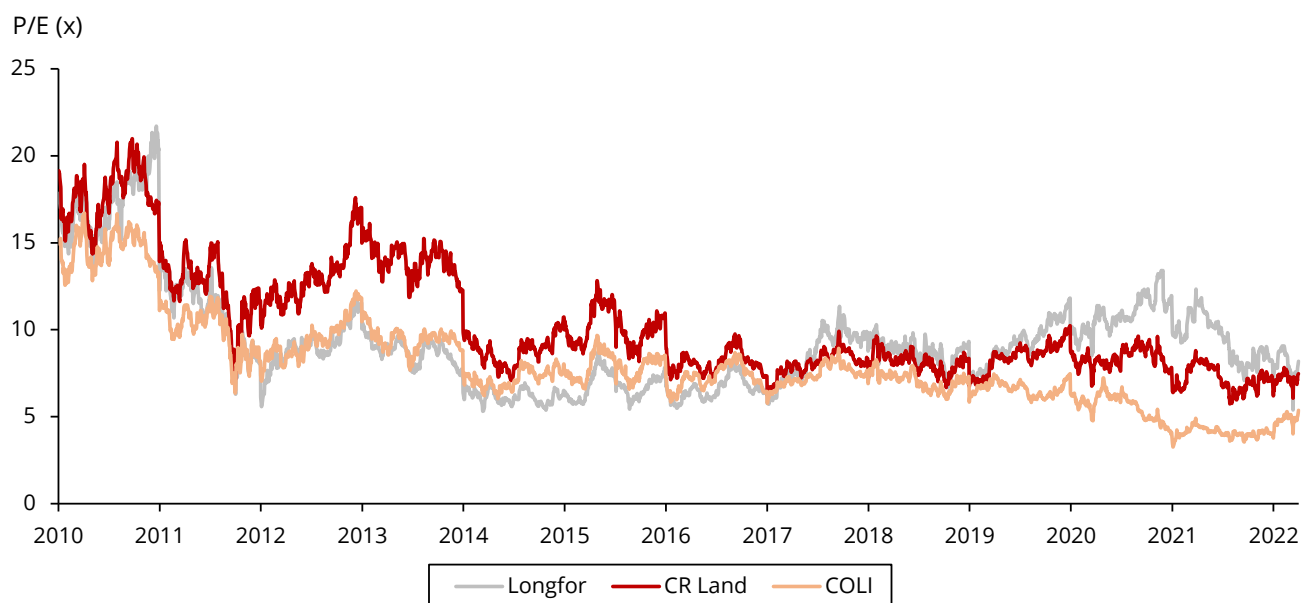
... but COLI offers the largest valuation re-rating potential. Meanwhile, despite COLI's weaker attributes in all aspects, we believe these are more than reflected in its **low 1-year forward PB multiple of c.0.6x, which is unwarranted**. At our estimated FY22F core ROE of c.10%, we think **the company should be able to trade to c.1.0x forward PB, a similar level back in 2018 when its ROE was 11%**. This would represent >60% upside from its current share price despite its seemingly narrower valuation gap with Longfor and CR Land in terms of PE valuation.

**Re-rating potential under forward PB perspective**

Company	Current FY22F PB (x)	Historical PB at similar ROE (x)	Potential re-rating upside
COLI	0.6	1.0	>60%
Longfor	1.4	2.0	c.40%
CR Land	0.8	1.1	>30%

Source: Companies, DBS HK

### COLI, CR Land and Longfor's 1-year forward PE



Source: Company, Bloomberg Finance L.P., DBS HK

Our pecking order is COLI, Longfor and CR Land based on fundamentals and current valuations. Taking into account the stocks' relative operational attributes and current valuations with reference to core ROE and forward PB multiples, **COLI is our preferred name** among the three quality names. Despite its seemingly weaker relative operational metrics, **this is more than priced in at its valuation of c.0.6x forward PB** and the stock offers the largest potential for valuation re-rating. **Longfor is next given that it has the strongest operational metrics and there is decent upside.** Longfor is trading at c.1.4x forward PB against our estimated FY22F core ROE of c.19% vs c.2.0x forward PB back in FY11-12 when it reported a similar core ROE of 19-20%. CR Land is also a decent quality play, but further share price upside at its current level is smaller and thus is less preferred among the three stocks.

## Valuation comparison

Company Name	Code	22-Apr Price HK\$	Mkt Cap US\$bn	3-mth daily trading value		12-m target HK\$	EPS gth		PE		Yield		ROE		Net Gearing Dec-21 %	P/Bk 22F x	NAV (Prem) to NAV HK\$	Disc/ to NAV %	
				US\$m	Recom		22F %	23F %	22F x	23F x	22F %	23F %	22F %	23F %					
<b>Large cap</b>																			
China Overseas*	688 HK	24.90	34.7	92.4	BUY	31.89	(4)	(0)	6.4	6.4	4.7	4.7	9.5	8.9	24.5	0.6	50.7	50.9	
CR Land*	1109 HK	35.70	32.5	62.3	BUY	50.93	10	9	7.2	6.6	5.2	5.6	11.8	11.8	24.4	0.8	66.9	46.6	
China Vanke 'H'*	2202 HK	18.84	34.4	28.6	BUY	34.45	4	n.a.	4.1	n.a.	8.5	8.9	16.6	0.0	30.1	0.6	41.1	54.1	
Country Garden*	2007 HK	5.37	15.8	58.1	BUY	8.62	(5)	(5)	3.8	4.0	6.9	6.6	12.3	10.7	45.4	0.4	17.1	68.6	
Longfor*	960 HK	39.95	30.9	44.0	BUY	55.56	11	10	8.0	7.3	5.6	6.2	18.9	18.7	46.7	1.4	81.4	50.9	
<b>Average</b>							<b>3.1</b>	<b>3.2</b>	<b>5.9</b>	<b>6.1</b>	<b>6.2</b>	<b>6.4</b>	<b>13.8</b>	<b>10.0</b>	<b>34.2</b>	<b>0.8</b>		<b>54.2</b>	
<b>Mid cap</b>																			
China Jinmao Hldgs*	817 HK	2.50	4.0	10.0	HOLD	3.00	27	11	4.4	4.0	9.0	9.9	10.2	8.1	63.0	0.4	9.0	72.2	
CIFI Holdings*	884 HK	3.77	4.2	29.6	BUY	5.09	(13)	3	4.1	3.9	4.5	4.7	15.5	14.2	67.2	0.6	6.2	39.2	
Seazen	1030 HK	3.46	2.9	12.1	NR	n.a.	(18)	(0)	2.5	2.5	11.4	11.8	16.0	10.3	49.8	0.4	n.a.	n.a.	
Guangzhou R&F	2777 HK	2.93	1.4	6.3	NR	n.a.	n.a.	9	2.4	2.2	9.4	8.8	4.2	1.2	123.3	0.1	n.a.	n.a.	
Shenzhen Inv	604 HK	1.67	1.9	1.3	NR	n.a.	n.a.	6	3.4	3.2	11.0	11.0	7.9	8.4	28.2	0.2	n.a.	n.a.	
Sino-Ocean Land	3377 HK	1.57	1.5	1.7	NR	n.a.	0	2	3.6	3.5	9.9	11.5	4.5	4.4	85.2	0.2	n.a.	n.a.	
Yuexiu Property*	123 HK	8.51	3.4	4.1	BUY	10.12	5	6	5.0	4.7	8.1	8.5	8.8	8.8	47.1	0.4	32.9	74.1	
<b>Average</b>							<b>0.2</b>	<b>5.3</b>	<b>3.6</b>	<b>3.4</b>	<b>9.0</b>	<b>9.5</b>	<b>9.6</b>	<b>7.9</b>	<b>66.3</b>	<b>0.3</b>		<b>61.8</b>	
<b>Small cap</b>																			
China Merchants Land	978 HK	0.76	0.5	0.2	NR	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	8.8	n.a.	65.3	n.a.	n.a.	n.a.	
China SCE	1966 HK	1.42	0.8	1.6	NR	n.a.	11	8	1.4	1.3	17.6	19.1	13.2	11.8	70.7	0.2	n.a.	n.a.	
COGO*	81 HK	4.55	2.0	4.0	BUY	7.03	7	3	2.4	2.4	8.2	8.4	17.1	15.3	35.6	0.4	16.8	72.9	
Gemdale Props	535 HK	0.86	1.8	2.4	NR	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	54.2	n.a.	n.a.	n.a.	
Greenland	337 HK	1.66	0.6	0.8	NR	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	59.6	0.6	n.a.	n.a.	
Greentown	3900 HK	13.92	4.4	15.0	NR	n.a.	44	19	6.1	5.1	4.9	6.0	12.4	12.3	52.0	0.7	n.a.	n.a.	
Hopson Dev	754 HK	15.08	4.6	6.0	NR	n.a.	28	2	3.2	3.1	7.6	7.7	8.7	n.a.	69.8	0.6	n.a.	n.a.	
Joy City	207 HK	0.32	0.6	0.3	NR	n.a.	59	31	4.2	3.2	5.0	n.a.	n.a.	n.a.	89.3	n.a.	n.a.	n.a.	
LVGEM*	95 HK	1.15	0.7	2.4	BUY	2.74	n.a.	n.a.	n.a.	16.0	0.0	0.0	(2.9)	1.2	72.8	0.2	10.3	88.8	
Minmetals Land	230 HK	0.76	0.3	0.0	NR	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	68.6	n.a.	n.a.	n.a.	
Poly (Hong Kong)	119 HK	1.96	0.9	1.5	NR	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	102.7	n.a.	n.a.	n.a.	
Powerlong	1238 HK	2.54	1.3	4.5	NR	n.a.	(21)	7	1.8	1.7	18.8	18.4	9.5	7.8	88.1	0.4	n.a.	n.a.	
Road King	1098 HK	6.68	0.6	0.2	NR	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	149.3	n.a.	n.a.	n.a.	
Ronshine China	3301 HK	2.08	0.4	1.0	NR	n.a.	(41)	2	3.8	3.7	8.7	8.9	4.1	n.a.	66.4	n.a.	n.a.	n.a.	
Shui On Land	272 HK	1.14	1.2	1.0	NR	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	45.3	n.a.	n.a.	n.a.	
Yanlord Land*^	YLLG SP	1.19	1.7	1.5	BUY	1.43	6	5	4.2	4.0	5.9	5.9	7.4	7.3	48.4	0.3	3.3	64.0	
Zhenro Properties	6158 HK	0.65	0.4	14.0	NR	n.a.	212	(60)	0.9	2.3	16.8	n.a.	4.4	3.6	159.4	0.1	n.a.	n.a.	
Zhong An	672 HK	0.300	0.2	0.0	NR	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	77.5	n.a.	n.a.	n.a.	
<b>Average#</b>							<b>31.4</b>	<b>2.3</b>	<b>3.0</b>	<b>4.0</b>	<b>11.1</b>	<b>11.6</b>	<b>8.1</b>	<b>8.2</b>	<b>74.2</b>	<b>0.4</b>		<b>79.2</b>	
<b>Average (Overall)#</b>							<b>16.9</b>	<b>3.3</b>	<b>3.9</b>	<b>4.3</b>	<b>8.5</b>	<b>8.6</b>	<b>10.0</b>	<b>8.7</b>	<b>67.0</b>	<b>0.5</b>		<b>62.0~</b>	

^ Denominated in SGD for price

~ Simple average discount to NAV; Market cap weighted average NAV = 57%

# Exclude outliers ~ Gross Gearing

^^ FY22: FY23; FY23: FY24

Source: Thomson Reuters, \*DBS HK



DBS HK recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

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