

# LVGEM China Real Estate Investment

Bloomberg: 95 HK Equity | Reuters: 0095.HK

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DBS Group Research . Equity

9 Jun 2022

## BUY

Last Traded Price (8 Jun 2022): HK\$1.25 (HSI : 22,015)  
Price Target 12-mth: HK\$1.89 (51% upside) (Prev HK\$2.74)

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### What's New

- Vanke's entrance as strategic investor for Baishizhou would alleviate concerns over LVGEM's ability to develop and complete the project
- Immediate cash from related party loan repayment and more intimate relationship with Vanke to help with near-term debt obligation repayments and negotiations
- Baishizhou phase 1 expected to see a slight delay due to COVID-19 lockdowns with an updated timeline to commence presales in 3Q23
- Maintain BUY with HK\$1.89 TP on a lower NAV discount target to reflect higher refinancing risk

## Major overhangs removed

### Investment Thesis

**Better positioned to handle its near-term repayment obligations.** A key concern surrounding LVGEM is its ability to settle near-term bond obligations, as its operating cash inflow alone will likely be insufficient to cover both its operating expenses and bonds coming due. To date, the company has settled its convertible bonds due in May 22 via partial repayment and partial extension, alongside a total of c.Rmb4.67bn up for repayment up to Jun 23. Vanke's entrance as a strategic investor for Baishizhou (BSZ) project will provide immediate cash (in form of related party loan repayment) to LVGEM and lend a strong hand to the developer's ability to negotiate for extensions/refinancing of these obligations.

**Presales of BSZ phase 1 will delay to 3Q23.** COVID-19 lockdown measures in Apr-May have resulted in c.2-3 months of delay on the construction progress of BSZ phase 1 versus LVGEM's original schedule, and thus have delayed the expected presales timeline from the original 1Q-2Q23 slightly by a quarter to 3Q22. Meanwhile, LVGEM has already obtained >90% consent on the compensation agreement for phases 2-4 combined, with an aim to reach 100% by end-22 to mid-23.

### Valuation:

Our TP is based on a target 67.5% discount to our FY22F assessed, fully diluted NAV of HK\$5.80/sh, which is equivalent to 2SD below the 10-year average NAV discount of HK developers (ex-MTRC (66 HK)) to reflect LVGEM's high asset quality and higher liquidity risk as well.

### Where we differ:

**Harvest time in sight.** With BSZ Ph1 up for presales launch in 3Q23 and overhangs relating to near-term repayment obligations removed, we believe uncertainties surrounding both the BSZ project and LVGEM should have dissipated, and its sizeable value (c.Rmb23.3bn of attributable GAV for BSZ alone) should start to get recognised by the market.

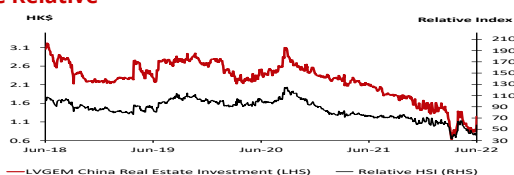
### Key Risks to Our View:

Inability to settle upcoming bond dues; further delays in Baishizhou project; further policy tightening in Shenzhen; and inability to meet capex requirements.

### At A Glance

Issued Capital (m shrs)	5,098
Mkt Cap (HKm/US\$m)	4,435 / 565
Major Shareholders (%)	
Wong (Hong King)	74.0
China Vanke Co Ltd	5.9
Free Float (%)	20.1
3m Avg. Daily Val. (US\$m)	2.70
GICS Industry: Real Estate / Real Estate Management & Development	

### Price Relative



### Forecasts and Valuation

FY Dec (RMB m)	2020A	2021A	2022F	2023F
Turnover	5,425	4,378	3,876	6,546
EBITDA	6,012	4,349	796	2,047
Pre-tax Profit	4,316	2,450	(1,057)	(26)
Core Profit	(218)	(1,480)	(1,284)	(788)
Core Profit Gth (%)	N/A	(578.9)	13.2	38.7
Core EPS (RMB)	(0.04)	(0.29)	(0.25)	(0.15)
Core EPS (HK\$)	(0.05)	(0.34)	(0.30)	(0.18)
Core EPS Gth (%)	N/A	(576.1)	13.2	38.7
Core PE (X)	nm	nm	nm	nm
P/Cash Flow (X)	10.7	nm	2.9	0.8
EV/EBITDA (X)	5.0	7.7	41.9	14.0
DPS (HK\$)	0.00	0.00	0.00	0.00
Div Yield (%)	0.0	0.0	0.0	0.0
Net Gearing (%)	76.2	83.0	86.7	71.6
ROE (%)	18.3	4.6	(5.1)	(3.2)
Book Value (HK\$)	5.72	5.97	5.68	5.50
P/Book Value (X)	0.2	0.2	0.2	0.2

EPS Rev (%): n.m. n.m.

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters



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### WHAT'S NEW

#### Largest overhang removed

LVGEM announced on Tuesday night that the project company which holds 100% interest of the Baishizhou (BSZ) project has entered into a share subscription agreement with Vanke (2202 HK, BUY); the latter will be injecting a total of Rmb2.3bn into the project company for equity interest that represents c.8% of the project company's enlarged capital. Per the profit distribution arrangement entered into between the project company and Vanke, the developer will forgo voting rights and profit distribution rights in BSZ phase 1-2, but will be enjoying 20% of voting rights and profit distribution on Phase 3-4 of the project.

**LVGEM to receive in full the outstanding amount due of c.Rmb1.1bn from related party upon deal completion.** As at Dec-21, LVGEM provided c.Rmb1.1bn of loan to the BSZ project company. The outstanding loan will be repaid after the completion of Vanke's injection of capital into the BSZ project company – which is currently expected to be completed by late July to early Aug-22. The amount will be able to offer support for LVGEM to repay its offshore bond due of c.Rmb270m in Aug and Rmb267m in Dec-22.

**Vanke's entrance as project partner will address doubts over LVGEM's capability to complete BSZ project.** There have long been market doubts casted over LVGEM's operating and financial capability to run the BSZ project given the developer's relatively small operating scale. Vanke's entrance and its likely active role in the operation of the BSZ project (Vanke intends to intervene starting from the designing stage, thus their decision to only share profits on phase 3-4 where project planning has yet been concluded) will help to alleviate market doubts on this front. This may also better facilitate LVGEM's future negotiations with creditors in rolling over upcoming bonds due and development loans.

#### Upcoming offshore bonds due for LVGEM

Maturity	Nature of debt	Outstanding principal (Rmb mn)
26-Aug-22	Offshore bond	270
07-Dec-22	Offshore bond	267
10-Mar-23	Offshore bond	3,134
17-May-23	Convertible bond	667
18-May-23	Convertible bond	333
<b>Total</b>		<b>4,671</b>

Source: Company, Thomson Reuters, DBS HK

**Manageable impact on NAV.** We estimate the potential dilution impact on LVGEM's total assessed NAV, upon the completion of Vanke's subscription of new shares in Baishizhou project company and its profit entitlement arrangement on 20% of profit distribution from BSZ Phase 3-4, would amount to c.8% – a manageable magnitude, in our view.

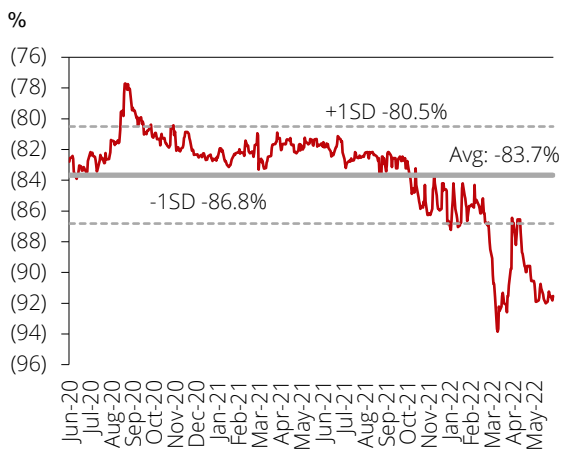
**Making good progress to address the stock's largest overhang; maintain BUY with HK\$1.89 TP.** We believe Vanke's entrance as a cooperating partner of the BSZ project will likely lend a strong hand to LVGEM in terms of addressing investor concerns over its ability to successfully develop and complete the project, a major overhang that has long served as a core reason that weighed on the company's share price performance and caused its deep discounts to NAV. The arrangement will also provide immediate cash for LVGEM to settle near-term repayment obligations, and may better facilitate its future negotiation with creditors/investors via leveraging on its closer relationship with Vanke. We, therefore, believe the development is a positive for LVGEM, and thus maintain our BUY call on the company with a TP of HK\$1.89/sh, pegged to a target 67.5% discount to our FY22F assessed, fully diluted NAV of HK\$5.80/sh, which is equivalent to 2SD below the 10-year average NAV discount of HK developers (ex-MTRC(66 HK)) to reflect LVGEM's high asset quality and higher liquidity risk as well.

## LVGEM China Real Estate Investment

### Company Background

Listed via a reverse takeover in 2015 along with Vanke and Ping An as strategic investors, LVGEM is a redevelopment specialist in Shenzhen with a good reputation and strong track record. As at Dec 21, c.90% of its existing saleable GFA under construction and for future development were urban renewal projects, as well as a few other projects currently held by the controlling shareholder pending future injections. LVGEM also has a decent portfolio of shopping malls and offices at hand, with >25 investment properties under its portfolio as at Dec 21 that were mainly accumulated from previous urban renewal projects.

### Discount to NAV



Source: Thomson Reuters, DBS HK

## LVGEM China Real Estate Investment

### Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
<b>Revenues (RMB m)</b>					
Sales of properties	5,962	4,513	3,392	2,827	5,459
Comprehensive services	321	292	343	353	364
Rental	619	620	643	695	722
Others	0	0	0	0	0
<b>Total</b>	<b>6,902</b>	<b>5,425</b>	<b>4,378</b>	<b>3,876</b>	<b>6,546</b>

Source: Company, DBS HK

### Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Turnover	6,902	5,425	4,378	3,876	6,546
Cost of Goods Sold	(2,472)	(2,759)	(2,190)	(2,376)	(3,146)
<b>Gross Profit</b>	<b>4,430</b>	<b>2,666</b>	<b>2,188</b>	<b>1,500</b>	<b>3,400</b>
Other Opg (Exp)/Inc	0	0	0	0	0
<b>Operating Profit</b>	<b>3,833</b>	<b>5,975</b>	<b>4,311</b>	<b>759</b>	<b>2,010</b>
Associates Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(1,163)	(1,419)	(1,642)	(1,816)	(2,036)
Exceptional Gain/(Loss)	696	(239)	(220)	0	0
<b>Pre-tax Profit</b>	<b>3,367</b>	<b>4,316</b>	<b>2,450</b>	<b>(1,057)</b>	<b>(26)</b>
Tax	(1,617)	(865)	(1,115)	(228)	(703)
Minority Interest	0	2	(182)	0	(59)
<b>Net Profit</b>	<b>1,750</b>	<b>3,453</b>	<b>1,153</b>	<b>(1,284)</b>	<b>(788)</b>
<b>Core Profit</b>	<b>1,103</b>	<b>(218)</b>	<b>(1,480)</b>	<b>(1,284)</b>	<b>(788)</b>
Sales Gth (%)	52.9	(21.4)	(19.3)	(11.5)	68.9
Net Profit Gth (%)	41.4	97.3	(66.6)	N/A	38.7
Core Profit Gth (%)	44.1	N/A	(578.9)	13.2	38.7
Gross Mgn (%)	64.2	49.1	50.0	38.7	51.9
Core Profit Margin (%)	16.0	(4.0)	(33.8)	(33.1)	(12.0)
Tax Rate	48.0	20.0	45.5	N/A	N/A

Source: Company, DBS HK

## LVGEM China Real Estate Investment

### Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Fixed Assets	996	932	857	819	782
Invts in Assocs & JVs	528	528	528	528	528
Other LT Assets	25,464	24,966	31,493	31,493	31,493
Cash & ST Invts	8,347	9,410	6,747	7,278	12,562
Other Current Assets	13,930	38,960	45,846	47,119	48,362
<b>Total Assets</b>	<b>48,736</b>	<b>74,267</b>	<b>84,942</b>	<b>86,709</b>	<b>93,198</b>
ST Debt	10,827	10,137	9,852	9,852	9,852
Creditors	4,290	3,373	6,927	9,479	16,196
Other Current Liab	2,644	2,393	2,393	2,393	2,393
LT Debt	15,150	20,514	21,336	21,836	22,336
Other LT Liabilities	2,791	9,965	14,993	14,993	14,993
Minority Interests	107	3,162	3,512	3,512	3,570
Shareholder's Equity	12,928	24,724	25,929	24,645	23,857
<b>Total Capital</b>	<b>48,736</b>	<b>74,267</b>	<b>84,942</b>	<b>86,709</b>	<b>93,198</b>
Share Capital (m)	4,983	5,076	5,098	5,098	5,098
Net Cash/(Debt)	(17,629)	(21,241)	(24,441)	(24,410)	(19,626)
Working Capital	6,996	33,193	36,526	35,248	29,772
Net Gearing (%)	135.2	76.2	83.0	86.7	71.6

Source: Company, DBS HK

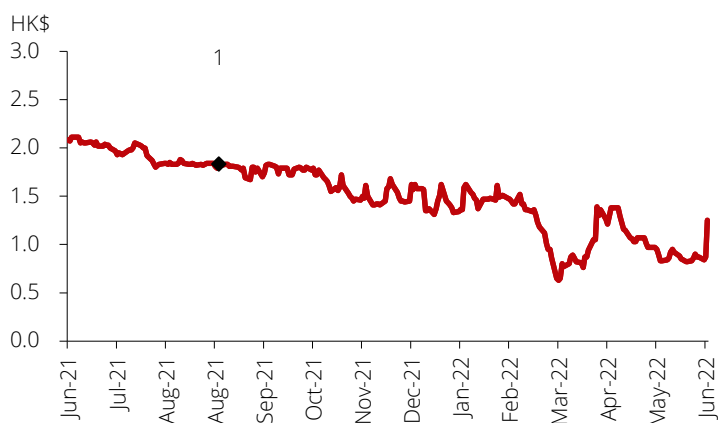
### Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Profit Before Tax	3,367	4,316	2,450	(1,057)	(26)
Assoc. & JV Inc/(loss)	0	0	0	0	0
Tax Paid	(857)	(687)	(427)	(228)	(703)
Depr/Amort	37	67	37	37	37
Chg in Wkg.Cap.	(1,966)	(638)	(2,998)	1,278	5,475
Other Non-Cash	572	(2,457)	(1,000)	1,816	2,036
<b>Operating CF</b>	<b>1,140</b>	<b>507</b>	<b>(2,021)</b>	<b>1,847</b>	<b>6,820</b>
Net chg in inv.	0	0	0	0	0
Assoc, MI, Invsmt	608	(1,412)	830	0	0
<b>Investing CF</b>	<b>608</b>	<b>(1,412)</b>	<b>830</b>	<b>0</b>	<b>0</b>
Net Chg in Debt	2,076	2,716	852	500	500
New Capital	0	0	0	0	0
Dividend	(234)	(283)	(1)	0	0
Other Financing CF	(1,298)	(1,177)	(572)	(1,554)	(2,036)
<b>Financing CF</b>	<b>544</b>	<b>1,257</b>	<b>279</b>	<b>(1,054)</b>	<b>(1,536)</b>
Chg in Cash	2,311	335	(923)	793	5,284
Chg in Net Cash	(1,895)	(3,611)	(3,200)	31	4,784

Source: Company, DBS HK

**LVGEM China Real Estate Investment**

**Target Price & Ratings History**



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	2-Sep-21	HK\$1.79	HK\$2.74	Buy

Source: DBS HK

Analyst: Jason Lam  
 Danielle Wang  
 Ken He  
 Zoe Zhang  
 Dexter Chun  
 Ben Wong

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

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**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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