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China Property Service Sector

Marketing feedback – Remain bullish

OUTPERFORM (Maintain)

China Property Service Sector

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Recently we conducted marketing with clients and discussed on both property and PM sectors. For property sector, investors were generally concerned about tightening and lack of long-term growth so the fund allocation remains low. For PM sector, they remain bullish but may chase the high-growth second-tier players rather than leaders due to valuation. Below are the key debates:

- **Key debate 1: Could industry VAS per GFA (RMB4/sq m) catch up with the level of US/Japan (RMB50-56/sq m)?** As our key thesis in our industry report, we think it is achievable in the mid-long term because 1) China PM firms can provide more types of services than peers in US/Japan. The leading firms in US/Japan (First Service/Nihon housing) are mainly doing brokerage of secondary housing/insurance and equipment maintenance to boost their VAS. However, China peers can extend to high-margin businesses (new retail and media) and this may help drive up the VAS potential for successful players. 2) The occupancy and penetration rate has room to improve. The average occupancy rate remains low in the industry due to the high portion of new delivery. We estimate only 39% of industry managed GFA has an age of >3 years, which implies occupancy rate to be 55-60%. We think this has room to improve as well compared to mature market in US/Japan.
- **Key debate 2: Could PM firms really succeed in the VAS expansion given the lack of know-how?** We agree that most of PM firms lack experience and team to build up high-margin businesses. However, based on US/Japan experience, upstream acquisition and integration would be the key to monetize the large base of residents. Market leaders such as CGS already made first-move advantage to purchase media/insurance companies in 2020 and we think this could be the trend going forward.
- **Key debate 3: For community retail, how to compete with internet giants?** Investors like the potential of retail but find it challenging to compete with giants such as PDD or Alibaba. We think there still be room for PM firms as 1) fast organic growth of residents per year due to GFA growth; 2) the current average spending per capita via PM platform is only RMB100-200/year vs. RMB5,000-9,000 by market leaders. 3) Last-mile delivery to merge Online/offline: PM staff could provide last-mile delivery to connect online platform to the offline retail shops. However, we think the challenge is coming from the SKU/logistics/Price. CGS could make use of parentco's large retail chains "Phoenix's selection" for SKU/logistics and the price is relatively attractive between PDD and JD based on our channel check.
- **Key debate 4: Is the current valuation rich?** The industry is trading at 25x 2022E PE with a consensus CAGR of 30-35% net profits growth, which looks fair. However, we think the consensus earnings have not reflected the potential of VAS and the coming 2020E earnings announcement would give more confidence and progress on VAS. This could drive up the earnings perspective, especially for VAS leaders.
- **Top picks:** We prefer CGS/Ever Sunshine (on VAS and high earnings visibility) and CR MixC Lifestyle/Powerlong Commercial (on shopping mall).

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