

# China Property Sector

## Too optimistic to COVID-19 impact

- **Sales almost stopped after CNY.** COVID-19 has totally interrupted property sales in China recently. Chinese government banned property sales centers in 50 cities to avoid disease spread. Furthermore, secondary market was also affected, especially due to the closure of community. In the past eight years, property sales in 1Q on average accounted for 16% of total. Any sales delay in 1Q would not have huge impact to full year property sales. So we trim our contracted sales amount growth forecast in 2020 from 5% to -5% for our base case.
- **Sales in Hubei were hit so much.** Hubei is most seriously affected by COVID-19. People are quarantined in Hubei. Most of activities there are also stopped now. Luckily, companies under our coverage are national players. Land bank in Hubei generally accounted for less than 5%. However, Zhejiang and Guangdong are another two provinces after Hubei that are seriously affected by COVID-19. Since GBA and Eastern China are two major regions where majority developers invest in, if infection accelerates in these two regions, we are afraid it will hit property market and developers much.
- **Relaxation policies will be launched.** We believe Chinese government focuses on fighting COVID-19 now. We see some local governments have launched some relaxation policies for property market, such as deferring land premium and tax payments. However, full scale of support is not in place until epidemic is well control. Although housing policy relaxation can boost economic growth, Chinese government now focuses on stability.
- **Earnings impact is limited for base case.** Due to the slowdown of property sales, developers will pay attention to its cash flow management in order to avoid credit risk. They will decelerate construction pace and reduce land replenishment, even cutting dividend. Secondly, they can seek channel for further financing. On the base case, we believe impact on 2020 earnings is limited. Most of the property companies' revenue are locked-up by pre-sales. Some companies may lose some rental income due to rent recession plans during epidemic period.
- **"Only when the tide goes out do you discover who's been swimming naked".** We believe investors are under-estimating the impact of COVID-19. There are many uncertainties for COVID-19. Share prices of many property companies only corrected less than 10% for their 52-week peak. We believe that correction is not enough. Until there is another 10-15% retreat, we advise investors stand at the side-line.

### 2020 contracted sales scenario analysis

	Best case	Base case	Worst case
Assumption: Epidemic ended in	Feb 2020	Mar 2020	May 2020
Sales amount change	2%	-5%	-15%
Sales GFA change	-5%	-10%	-18%
ASP change	7%	6%	4%

Source: CMBIS estimates

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 (Maintain)

### China Property Sector

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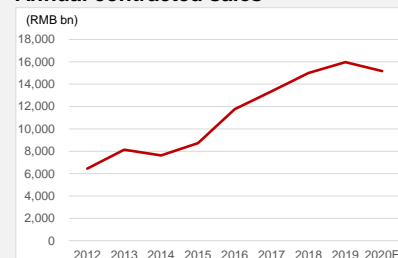
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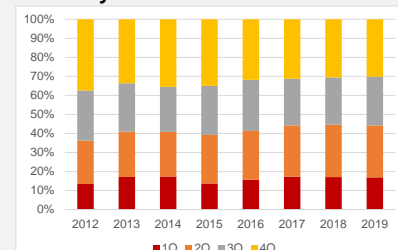
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### Annual contracted sales



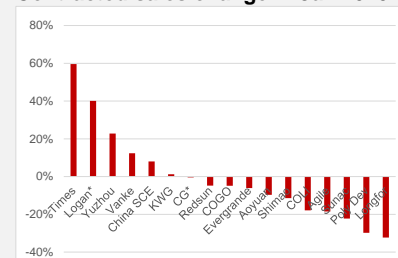
Source: NBS, CMBIS estimate

### Quarterly contracted sales breakdown



Source: NBS

### Contracted sales change in Jan 2020



Source: Company, CMBIS, \*Attributable

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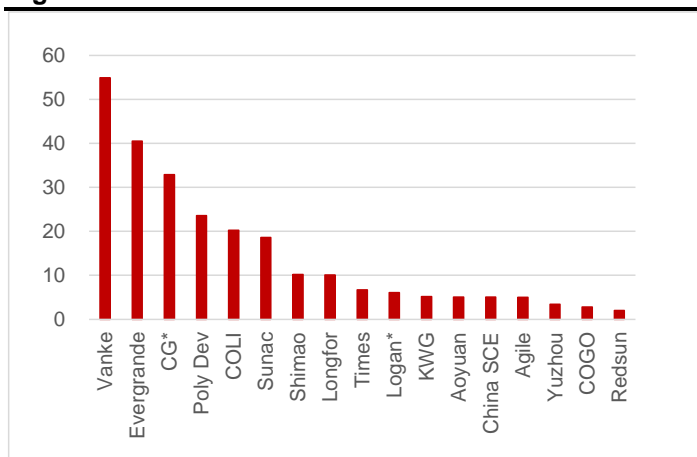
1. "China Property Sector – No Golden Sep this year" – 18 Sep 2019
2. "China Property Sector – Market is weakening" – 17 Jul 2019
3. "China Property Sector – Sluggish land replenishment shadows the outlook" – 18 Jun 2019

## Sales almost stopped after Chinese New Year

Chinese New Year (CNY) came earlier in 2020 than 2019. During the holiday atmosphere, sales is relatively weak. Furthermore, COVID-19 is wide spread in China now. That further dampened the sentiment. Some developers complained that sales almost stopped after 21 Jan, 2020. In addition, Chinese government ordered sales centers in about 50 cities to close down in order to reduce the chance of epidemic transmission. Although some developers explored new sales channel through online means, effect is not significant.

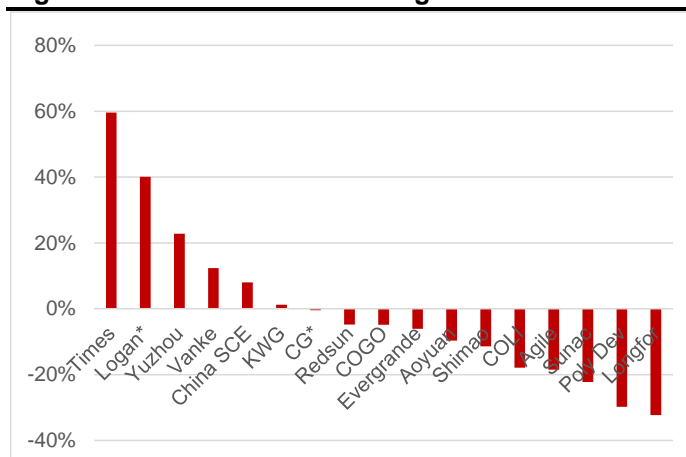
Within 15 developers under our coverage as well as Evergrande (3333 HK, NR) and Sunac (1918 HK, NR), 12 of them recorded sales drop in Jan 2020. Currently, we don't see any good sign for outbreak and we are not optimistic to the property sales in Feb 2020.

**Figure 1: Contracted sales amount in Jan 2020**



Source: NBS, CMBIS, \*Attributable

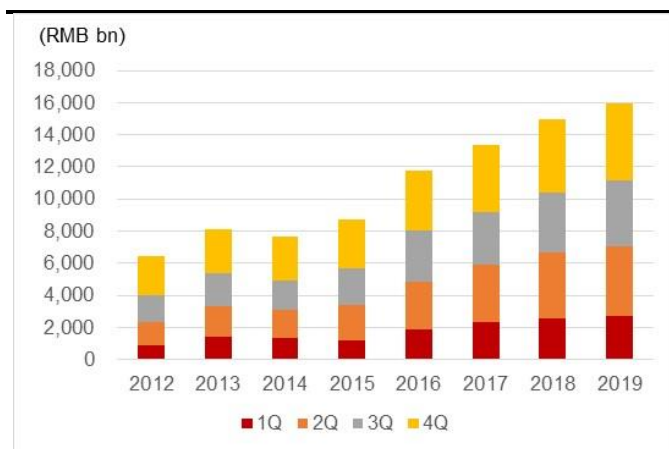
**Figure 2: Contracted sales change in Jan 2020**



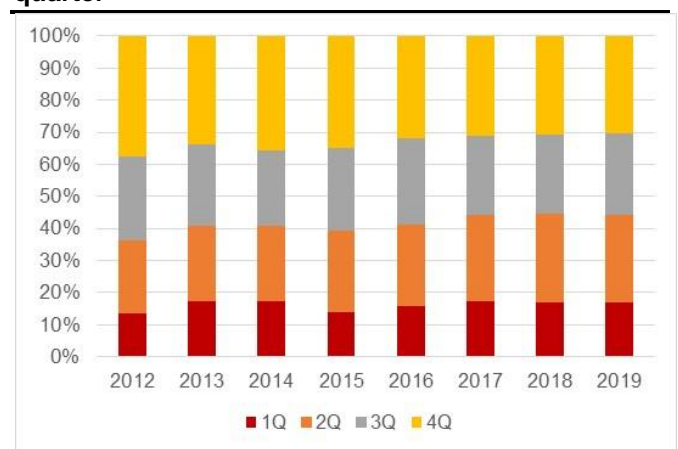
Source: NBS, CMBIS, \*Attributable

Not only primary property market is affected, but secondary too. Due to the closure of community in avoiding disease transmission, we are also afraid that secondary market will be bearish during outbreak. Therefore, we are cautious to the property sales in 1Q20.

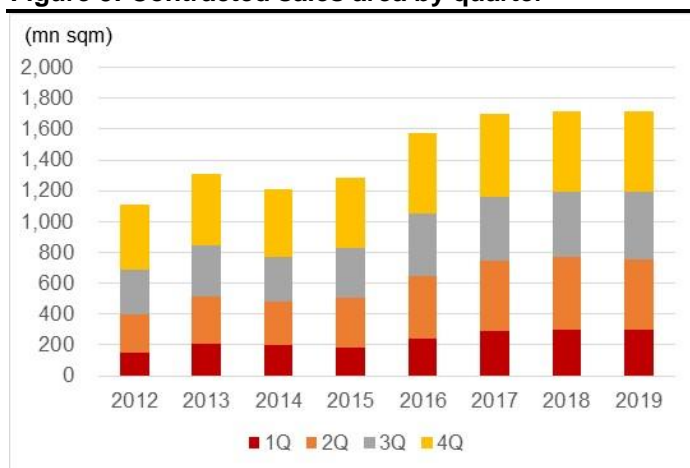
Luckily, property sales in 1Q is non-peak season according to the past eight years history. Property sales amount in 1Q/2Q/3Q/4Q on average accounted for 16.1%/25.4%/25.4%/33.2% of full year sales from 2012 to 2020. Any delay in sales plan in 1Q will be caught up in the rest of the year.

**Figure 3: Contracted sales amount by quarter**

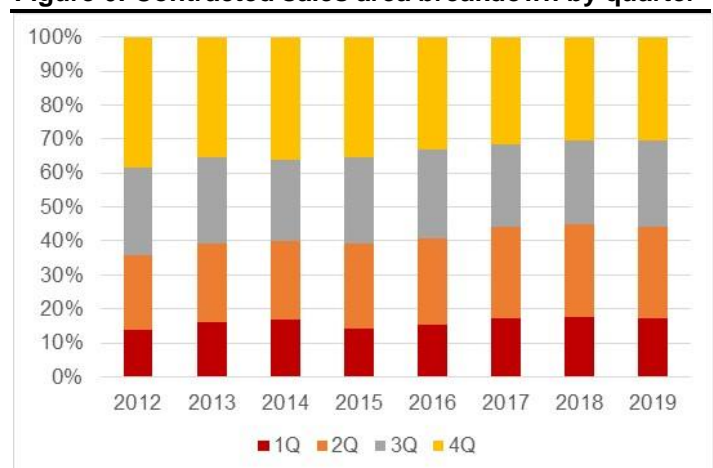
Source: NBS, CMBIS

**Figure 4: Contracted sales amount breakdown by quarter**

Source: Wind, CMBIS

**Figure 5: Contracted sales area by quarter**

Source: NBS, CMBIS

**Figure 6: Contracted sales area breakdown by quarter**

Source: NBS, CMBIS

**Scenario analysis**

It is difficult to tell when the outbreak will end. As at 13 Feb 2020, 46,550 cases were confirmed to be infected by COVID-19, of which 1,368 were reported dead. Different experts have different opinions. Some experts expect it will end by Feb. Some say it may be May due to the hot weather. Our economist believes that schools re-opening is a good indicator to the disease under-controlling. Schools in China plan to re-open on 2 Mar 2020 while schools in HK will be no earlier than 16 Mar 2020. Therefore, our assumptions in scenario analysis are as follows:

1. Base case: Epidemic ends in Mar 2020
2. Best case: Epidemic ends in Feb 2020
3. Worst case: Epidemic ends in May 2020

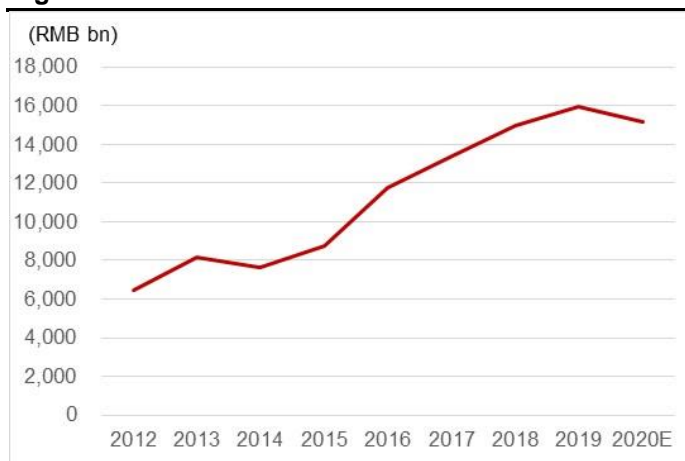
In our 2020 Strategy Report that published in Dec 2019, we forecast property sales amount will grow by 5% while property sales area will decline by 2% in 2020. However, the outbreak changed the picture. In the base case, we forecast property sales and area to decline by 5% and 10% in 2020, respectively. In the worst case, the effect not only limits to sales suspension, but also economy slowdown. If the business activities resume in May/Jun in the worst case, we are afraid that economy will be sluggish and unemployment will increase. So impact in the worst case is more serious.

**Figure 7: Scenario analysis**

	Best case	Base case	Worst case	Original
Assumption: Epidemic ended in	Feb 2020	Mar 2020	May 2020	No outbreak
Sales amount change	2%	-5%	-15%	5%
Sales GFA change	-5%	-10%	-18%	-2%
ASP change	7%	6%	4%	7%

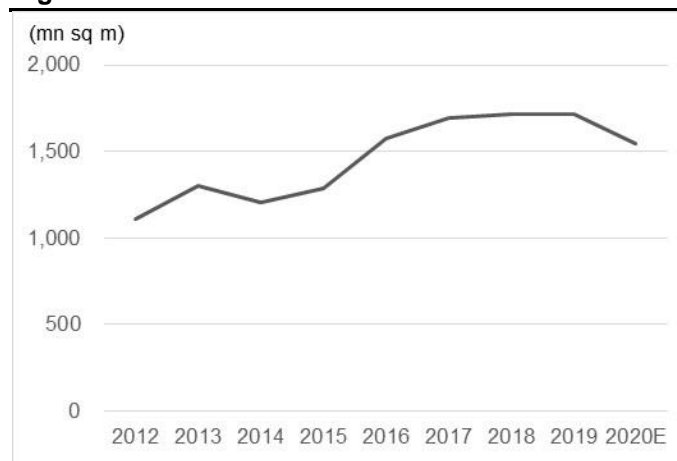
Source: CMBIS estimates

**Figure 8: Annual contracted sales amount**



Source: NBS, CMBIS estimate

**Figure 9: Annual contracted sales area**



Source: NBS, CMBIS estimate

## Sales in Hubei were hit so much

Wuhan is the original of COVID-19. According to WHO, total cases (including lab-confirmed and clinically diagnosed) of COVID-19 in Hubei was 54,406 on 15 Feb 2020, compared with 66,576 cases in China. Currently, all activities in Hubei are affected by COVID-19.

**Figure 10: Confirmed cases of COVID-19 acute respiratory disease reported by provinces, regions and cities in China, 15 Feb 2020\***

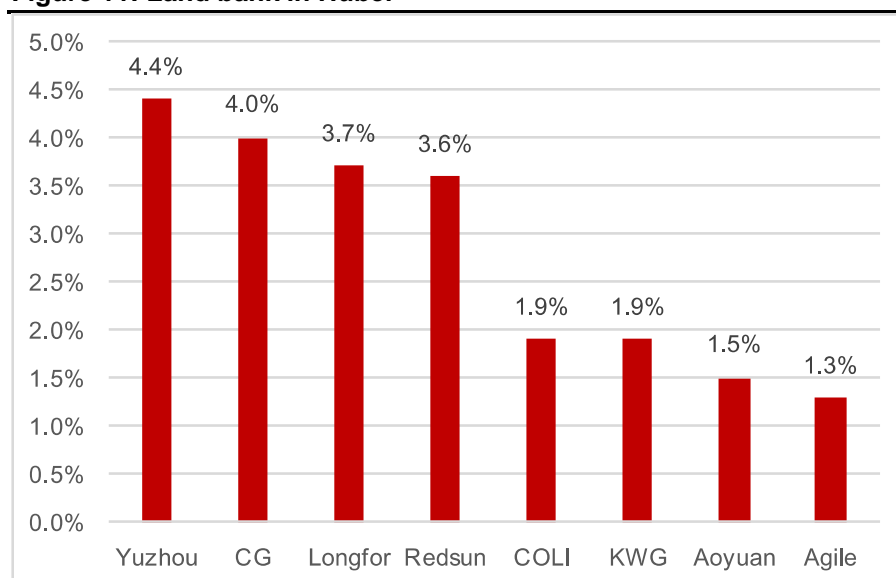
Province/ Region/City	Population (mn)	Laboratory confirmed	Cumulative		Deaths
			Clinically diagnosed	Total cases	
Hubei	59.17	37,884	16,522	54,406	1,457
Guangdong	113.46	1,294	0	1,294	2
Henan	96.05	1,212	0	1,212	13
Zhejiang	57.37	1,162	0	1,162	0
Hunan	68.00	1,001	0	1,001	2
Anhui	63.24	950	0	950	6
Jiangxi	46.48	913	0	913	1
Jiangsu	80.51	604	0	604	0
Chongqing	31.02	537	0	537	5
Shandong	100.47	530	0	530	2
Sichuan	83.41	470	0	470	1
Heilongjiang	37.32	425	0	425	11
Beijing	21.54	375	0	375	4
Shanghai	24.24	326	0	326	1

Source: WHO COVID-19 Situation Report - 26

\*Deaths include both lab-confirmed cases and clinically diagnosed cases of COVID-19

Luckily, companies under our coverage are national players. Land bank in Hubei generally accounted for less than 5%. Any deterioration of business activities in Hubei would not seriously affected our rated companies. For the non-rated developers, about 16.9% and 6.1% of Yuxiu (123 HK, NR) and CIFI (884 HK, NR) land bank are in Hubei.

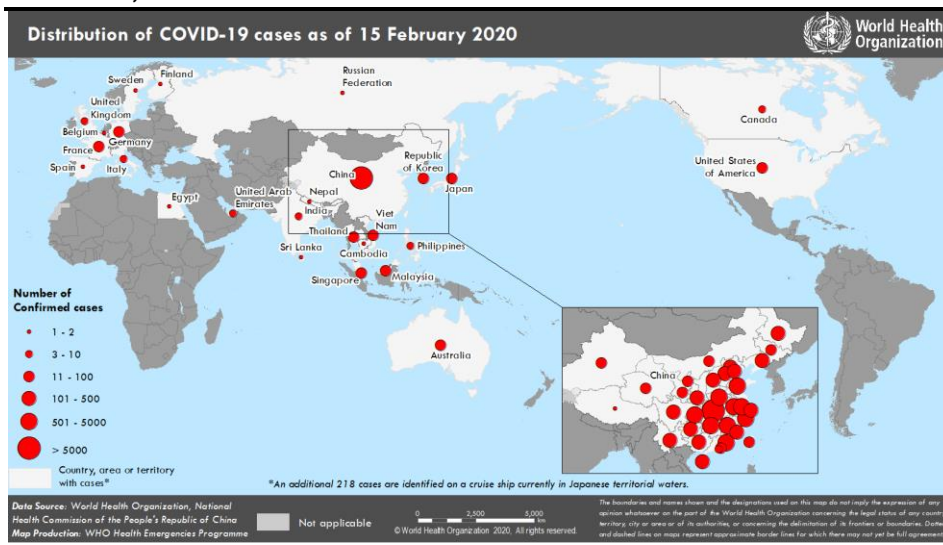
**Figure 11: Land bank in Hubei**



Source: Companies data, CMBIS

However, Guangdong and Zhejiang are another two provinces after Hubei that are seriously affected by COVID-19. According to WHO, confirmed cases of COVID-19 in Guangdong and Zhejiang were 1,294 and 1,162 on 15 Feb 2020, respectively. In our worst case scenario, COVID-19 outbreak is expected to be under control in May 2020. There may have great chance that infection in Zhejiang and Guangdong increases substantially in the worst case scenario. Since GBA and Eastern China are two major regions where majority developers invest in. If infection accelerates in these two regions, we are afraid it will hit property market and developers much.

**Figure 12: Countries, territories or areas with reported confirmed cases of COVID-19, 15 Feb 2020**



Source: WHO COVID-19 Situation Report - 26

## Housing policies will be relaxed

Even if there is no COVID-19, we expect policy relaxation stimulating property demand will be launched in 2H20 because of the US-Sino trade war.

Now, COVID-19 is raging. We believe the top priority of China government is to fight against the disease. Although we read the news that some local governments or banks introduced some policies helping property market, majority of these policies aims to developers. For example, defer land premium and tax payments or ease some property loan quotas. Furthermore, we expect there are some relaxations in debt financing, especially for the Top-50 developers with healthy gearing. It can avoid systematic risk for property developers. These kinds of support will only help property companies for their cash outflow and financing. It will not help end-users demand or developers' operating cash inflow.

On 16 Feb 2020, Hengyang government of Hunan introduced a trial program of stamp tax exemption or subsidiary for the property buyers. We think it is too early to relax housing policies targeting individual buyers at full scale. For example, lifting of restriction on purchase and lowering down payment ratio. It is not the end of epidemic. We do not believe any relaxation of housing policies targeting individual buyers would stimulate a lot of demand. Furthermore, economic growth will be slowed down and unemployment will raise if the outbreak lasts for longer period of time. It is unwise to encourage individual to buy property now.

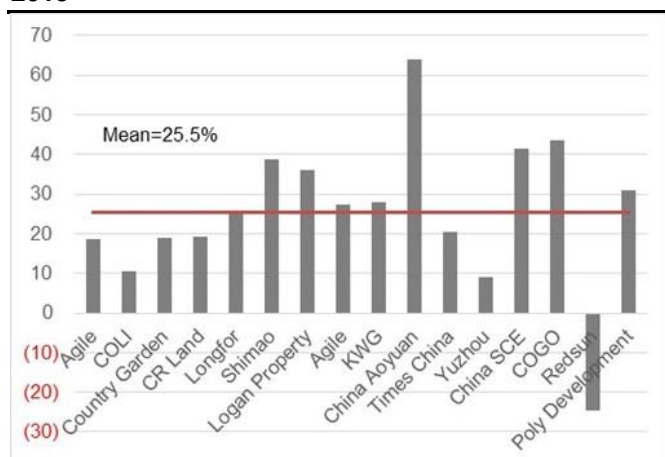
In conclusion, Chinese government still insists "House is for living, not for speculation". In other words, any overheat in property market will bring into austerity measures.



## Limited impact to earnings in base case

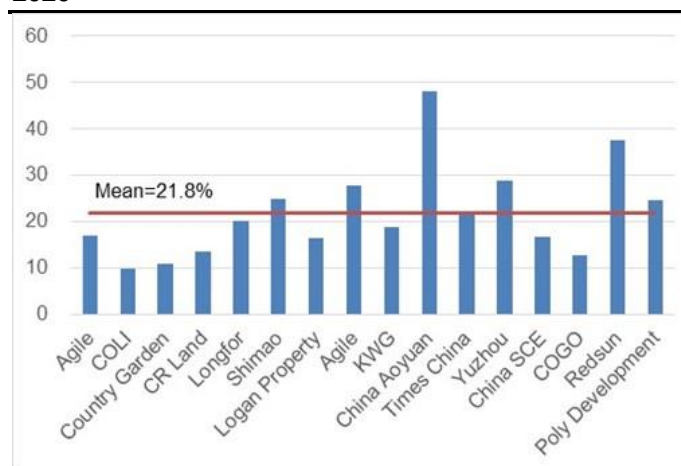
Due to the pre-sales, revenue of property developers are high visibility. Before the outbreak, we forecast average EPS growth of our rated developers to be 25.5% in 2019 and 21.8% in 2020. Since Redsun (1996 HK, BUY) went to public in 2018, its EPS is expected to decline in 2018 due to share dilution. Excluding Redsun, we expect average EPS growth of our rated developers to be 29% in 2019.

**Figure 13: Core EPS is forecasted to grow by 26% in 2019**



Source: CMBIS estimate

**Figure 14: Core EPS is forecasted to grow by 22% in 2020**



Source: CMBIS estimate

In our base case, we don't expect there is huge difference of our 2020 EPS estimate before and after the outbreak. We roughly estimate there may have 5% discrepancy for 2020 earnings forecasts after the outbreak because of rise in administrative expenses for donation as well as rent free or reduction during epidemic period.

According to newspapers and companies' WeChat, a few companies would provide rental concessions to their tenants in Feb. We believe this impact to their bottom-line is limited. Firstly, rental concessions period is short. Secondly, rental income only accounts for small percentage of total income (less than 3%) for most property companies.

**Figure 15: Rental concession plan**

Company	Rental Concession	Concession period
CR Land	All	Jan 25-Feb 9
Powerlong	Half	Jan 25-Feb 2
Longfor	Half(incl. management fee)	Jan 25-Mar 31
Poly Development	All	Jan 25-Jan 30
Guangzhou R&F	All	Jan 24-Feb 2
KWG	Half	Jan 25-Feb 15
Yuzhou	Half	Jan 25-Feb 2
Vanke	Half	Feb 1-Feb 29
China SCE	Half	Jan 25-Feb 8
Aoyuan	All	Jan 25-Feb 8

Source: Newspaper, Companies WeChat, CMBIS



### Construction delay may result in booking postponement

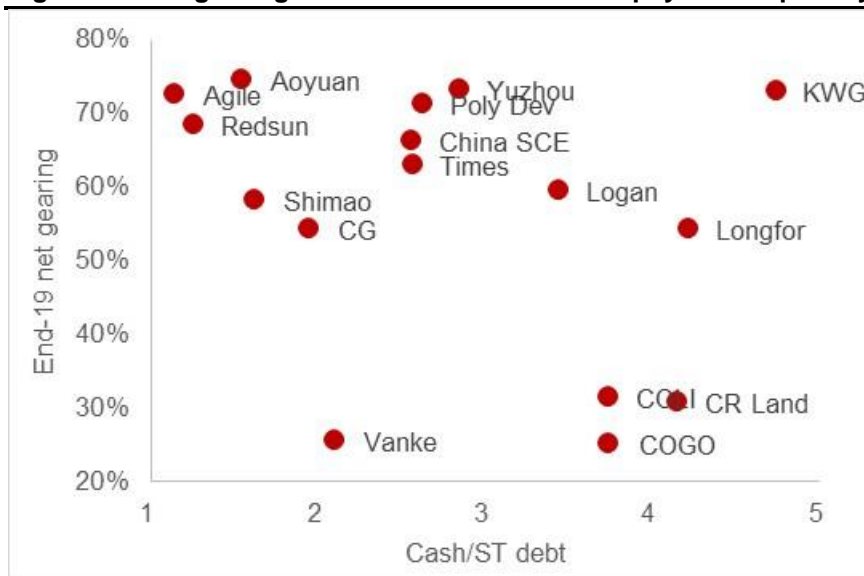
If worst case happens, construction work may postpone. According to accounting policy, revenue recognition for property development business is partially linked with properties delivery. As a result, part of revenue in 2020 will be delayed in case of the worst case.

### Focus more on cash management

Due to the slowdown of property sales, developers will pay attention to its cash flow management in order to avoid credit risk. They will decelerate construction pace and reduce land replenishment, even cut dividend. Secondly, they can seek channel for further financing, including debt or equity.

China property companies bear high net gearing ratio. However, high net gearing ratio translates to vulnerable to financial stability. On the other hand, higher in cash/short term debt ratio means higher resistance to short term shock. Companies located in the upper left quadrant have higher financial instability. In contrast, companies located in the lower right quadrant enjoy higher financial stability.

**Figure 16: Net gearing ratio vs Short-term debt repayment capability**



Source: Companies data, CMBIS estimates

## Investors are over-optimistic

Warren Buffett said, "Only when the tide goes out do you discover who's been swimming naked".

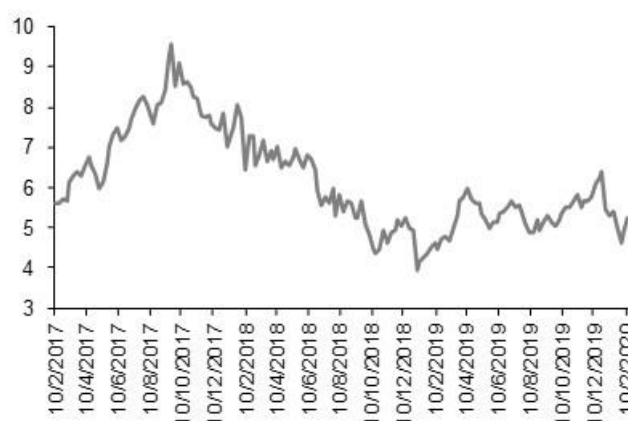
For the companies under our coverage, most of them are just 10% below their 52-week high. Longfor (960 HK, HOLD) and KWG (1813 HK, BUY) were 1% and 3% below their respective 52-week high based on the latest closing price. We believe it is not enough to reflect current epidemic situation. In the coming 2019 results announcement, it may be delayed due to the audit works or companies will cut dividend to maintain cash position.

**Figure 17: Latest share price and 52-week high**

Company	Ticker	Closing price (LLC)	52-W High (LLC)	Closing price/ 52-W High	52-W Low (LLC)
CHINA VANKE-H	2202 HK	31.70	35.6	89%	26.3
CHINA OVERSEAS	688 HK	28.65	31.3	92%	23.7
COUNTRY GARDEN	2007 HK	11.02	13.6	81%	9.2
CHINA RES LAND	1109 HK	36.20	40.5	89%	28.9
LONGFOR GROUP HO	960 HK	37.70	38.3	99%	23.1
SHIMAO PROPERTY	813 HK	28.70	32.1	89%	18.4
LOGAN PPT	3380 HK	13.56	14.3	95%	9.7
AGILE GROUP HOLD	3383 HK	11.50	13.5	85%	8.8
KWG GROUP HOLDIN	1813 HK	11.70	12.1	97%	5.6
CHINA AOYUAN GRO	3883 HK	11.90	13.1	91%	5.7
TIMES CHINA HOLD	1233 HK	15.26	16.5	92%	8.9
YUZHOU PROPERTIE	1628 HK	4.13	4.8	86%	3.0
CHINA SCE GROUP	1966 HK	4.54	4.9	93%	3.1
CHINA OVERSEAS G	81 HK	5.74	6.1	94%	3.0
REDSUN PROPERTIE	1996 HK	2.48	3.6	69%	2.2
CHINA VANKE CO-A	000002 CH	30.80	33.6	92%	25.6
POLY DEVELOPME-A	600048 CH	15.90	16.8	95%	12.0
Average				90%	

Source: CMBIS estimate

**Figure 18: 1 year forward PE**



Source: Bloomberg, CMBIS

In terms of valuation, companies under our universe are on average trading at 5.7x 2020E P/E or 40.8% discount to NAV. In the trough, they can be trading at 4.0-5.0x forward P/E or 50% discount to NAV. We believe sell off for China property stocks is not heavy. Unless there is 10-15% retreat, we advise investors to stand at the side-line.

In case, there is a need. We prefer safe-haven, some big companies or market leader. Our Top pick should be Vanke (2202 HK, BUY, TP: HK\$35.9) and Country Garden (2007 HK, BUY, TP: HK\$15.2).

**Figure 19: Valuation table**

Company	Ticker	Last price (LC)	Mkt Cap (LC mn)	Rating	TP (LC)	P/E			NAV/share (LC)	Discount to NAV
						18A	19E	20E		
Vanke - H	2202 HK	31.70	383,101	<b>BUY</b>	35.90	9.3	7.9	6.7	44.87	29.4%
COLI	688 HK	28.65	313,895	<b>HOLD</b>	28.36	7.0	6.4	6.3	40.51	29.3%
Country Garden	2007 HK	11.02	240,836	<b>BUY</b>	15.20	6.2	5.2	4.7	27.64	60.1%
CR Land	1109 HK	36.20	258,140	<b>BUY</b>	42.15	9.3	8.0	8.4	60.21	39.9%
Longfor	960 HK	37.70	225,603	<b>HOLD</b>	26.06	12.2	11.3	10.3	37.23	-1.3%
Shimao	813 HK	28.70	99,287	<b>HOLD</b>	28.64	9.8	6.9	5.8	40.92	29.9%
Logan Property	3380 HK	13.56	74,662	<b>BUY</b>	13.10	8.2	6.4	5.7	26.20	48.2%
Agile	3383 HK	11.50	45,046	<b>BUY</b>	16.05	5.6	4.1	4.4	29.19	60.6%
KWG	1813 HK	11.70	37,168	<b>BUY</b>	11.40	8.3	4.0	5.8	19.00	38.4%
China Aoyuan	3883 HK	11.90	32,016	<b>BUY</b>	14.30	11.9	6.5	4.7	28.60	58.4%
Times China	1233 HK	15.26	29,632	<b>BUY</b>	16.20	5.7	5.0	4.1	27.20	43.9%
Yuzhou	1628 HK	4.13	21,565	<b>BUY</b>	5.28	4.8	4.2	3.6	8.80	53.1%
China SCE	1966 HK	4.54	18,987	<b>BUY</b>	4.83	4.7	4.5	4.3	8.05	43.6%
COGO	81 HK	5.74	19,650	<b>BUY</b>	5.23	7.7	5.1	4.6	10.47	45.2%
Redsun	1996 HK	2.48	8,234	<b>BUY</b>	3.37	3.7	5.0	4.2	5.60	55.7%
Vanke - A	000002 CH	30.80	344,484	<b>BUY</b>	33.92	10.1	8.5	7.0	40.38	23.7%
Poly Development	600048 CH	15.90	189,730	<b>BUY</b>	20.72	10.0	7.6	6.1	24.61	35.4%
<b>Average</b>						<b>7.9</b>	<b>6.3</b>	<b>5.7</b>		<b>40.8%</b>

Source: Company data, CMBIS estimates

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