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IDEA

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China Property

Structural Factors to Fuel More Re-Rating; Attractive

We see near-term share price correction as a good entry point for for the industry. Consolidation and decline in land supply are two structural drivers for the industry over the next five years. We see three near-term catalysts. Our top picks: COLI, Sunac, Agile, R&F, CIFI, KWG, and Times.

Consolidation to drive further re-rating, 16% CAGR in contracted sales for the top 5 developers in the next five years: We see industry consolidation speeding up in view of increasing divergence in funding cost and rising reliance on M&A to acquire land because of the government's reduction of land supply. We expect the top five players' market share to rise from 17% now to 33% by 2021, implying 16% CAGR in contracted sales, despite flattish industry sales. This should drive re-rating for the industry, since it increases growth outlook and lowers volatility.

Long-term decline in land supply: In order to preserve farmland, the State Council's 2016-30 land supply plan suggests a 30% decline of annual land supply in the next five years, a positive for the industry because it reduces the risk of overbuilding and facilitates consolidation.

Is valuation expensive after the 95% YTD rally? No: We think industry consolidation and margin improvement have driven the rally so far. We think further re-rating is merited by much reduced inventory risk (owing to reduced land supply) and better growth outlook thanks to consolidation. We expect listed developers' contracted sales to grow at 20% in 2018. The industry average for market cap / trailing 12M (up to Sep-2017) contracted sales is 0.59x, below the 2012-17 median of 0.69x. Industry average P/E is 6.2x for 2018e, and we project 23% earnings CAGR for 2017-19e, vs. 13% for 2012-16.

We lift our price targets and NAV estimates by 33% and 22% on average: Reflecting structural decrease in land supply, we narrow our target NAV discount from 40% on average to 30%. We also raise our NAV estimates and 2017-19e earnings by 22% and 20% on average, reflecting stronger contracted sales growth YTD and into 2018, plus higher margin assumptions.

Three near-term catalysts: 1) Adoption of HKFRS 15 in 2018, 2) Guangdong-HongKong-Macau Greater Bay Area announcement by end-2017, 3) strong margins into 2018.

We highlight five stock-picking criteria: 1) land bank quality, 2) 2018 contracted sales growth, 3) exposure to the Greater Bay Area, 4) HKFRS 15 adoption, and 5) valuation.

Where we could be wrong: Sharper-than-expected mortgage tightening, sharp Rmb depreciation.

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Asia Pacific

IndustryView **Attractive**

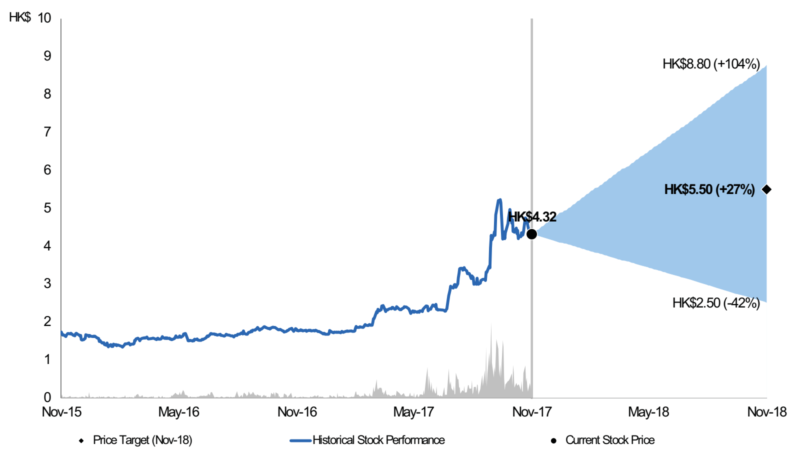
Exhibit 1: Rating and Price Target changes

		Rating		Price Target		
Ticker	Company	New	Old	New	Old	Change
3883.HK	Aoyuan	OW	EW	5.50	3.30	67%
0884.HK	CIFI	OW	OW	5.25	4.85	8%
2007.HK	COGARD	EW	EW	12.20	8.70	40%
0081.HK	COGO	OW	OW	5.40	4.80	13%
0207.HK	Joy City	OW	OW	1.75	1.35	29%
1813.HK	KWG	OW	OW	11.00	7.00	57%
3380.HK	Logan	OW	OW	10.00	9.00	11%
0960.HK	Longfor	EW	EW	19.80	12.70	56%
600048.SS	Poly (A)	OW	OW	12.60	11.20	13%
0119.HK	Poly (H)	UW	UW	3.00	2.00	50%
2777.HK	R&F	OW	EW	24.30	15.45	57%
0813.HK	Shimao	OW	OW	20.20	16.80	20%
3377.HK	Sino Ocean	OW	OW	6.60	5.40	22%
1918.HK	Sunac China	OW	OW	47.00	28.00	68%
1233.HK	Times	OW	OW	8.71	7.10	23%
000002.SZ	Vanke (A)	UW	UW	22.60	18.40	23%
2202.HK	Vanke (H)	EW	EW	26.50	21.50	23%
0123.HK	Yuexiu Property	OW	OW	2.00	1.64	22%

Source: Morgan Stanley Research

China Aoyuan: Risk-Reward (3883.HK, OW; PT HK$5.50)

Asset turnover improvement and margin recovery



Source: Thomson Reuters, Morgan Stanley Research

Price Target HK$5.50

Our price target is set at a 45% discount to our base-case forward NAV estimate.

Bull HK$8.80

30% discount to bull-case forward NAV

A new round of monetary easing drives property prices higher: We assume (1) the central government provides a new round of aggressive monetary stimulus to reach its GDP targets, driving investment demand and asset prices higher in 2017; (2) 10% growth in property prices across the board over the next 12 months

Base HK$5.50

45% discount to bull-case forward NAV

ASP holds steady: We expect (1) sales volumes to decline 5% YoY in 2017, pressured by tightening measures in tier 1-2 cities; and (2) ASP to be flattish in tier 1-2 cities but increase 5% YoY in tier 3 cities, supported by healthy inventory, limited land supply, and expensive land prices transacted in 2016, buoying our NAV forecast for developers. Our 45% discount to NAV reflects Aoyuan's ranking in our scorecard.

Bear HK$2.50

70% discount to bull-case forward NAV

Liquidity tightens sharply: We assume (1) further tightening of financial conditions and slower sell-through rates at the national level that weigh on developers' balance sheets and cash flows in 2017, forcing them to further soften asking prices; and (2) 10% property price declines over the next 12 months. We apply a 70% discount to NAV, which reflects the low end of the range of similar stocks in our scorecard.

Investment Thesis

- Aoyuan's solid scale (Rmb150bn in saleable resources) should drive earnings growth in 2017-18
- The potential addition to Shenzhen-Hong Kong Stock Connect may lead to valuation re-rating given Aoyuan stock is trading at 3.9x 2018 P/E, on our estimates, vs. its H-share peers' average of 6.2x 2018 P/E

Key Value Drivers

- Property prices
- contracted sales
- Transaction volumes

Potential Catalysts

- Better than expected 2017 contracted sales growth and margin recovery
- Special dividend announcement
- Successful launch of urban renewal projects

Risks to Achieving Price Target

- Greater-than-expected margin decline
- Sales decline in 2019