Daiwa Capital Markets

KWG Property (1813 HK)

Target price: **HKD7.41**

Share price (6 Nov): **HKD5.83** | Up/downside: **+27.1%**

Buy
(initiation)

Initiation: Sitting pretty in the city

- Has built up quality landbank in upper-tier cities before many others
- Prudent expansion but higher margins and dividend yield versus peers
- Initiating with a Buy (1) rating and target price of HKD7.41

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Investment case: We see KWG Property (KWG) as a quality niche player in China property which is awaiting further recognition.

We think KWG has pursued a strategy different from that of many mainstream players. It has not pursued aggressive landbanking, nor did it follow the crowd and go into tier-3 cities in 2011-12. Instead, it has focused on its key home market, Guangzhou, and selected upper-tier cities where it has gradually and steadily built up landbank and presence. Compared with most other players, it has paid a lot more attention to quality than quantity, maintaining margins rather than expanding its business scale and contract sales.

We believe this strategy has worked for KWG and resulted in favourable rewards: a quality landbank in a number of China's upper-tier cities acquired at a reasonable cost, higher-than-sector average gross margins, a high dividend yield, manageable gearing, and a track record for having some of the highest-quality products in the industry.

Such qualities have enabled KWG to attract various major players in the industry to set up joint-venture projects with it. Most importantly, these JV projects have allowed KWG to leverage on the experience and resources of its partners and provided it with an additional avenue for growth – we forecast its net profit to rise by 15-19% for 2015-17E.

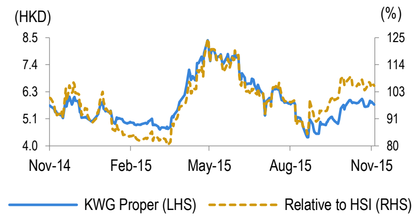
We forecast contract sales of CNY18.8bn for KWG this year (-8.3% YoY), which will fall short of its CNY22.5bn sales target as a result of delayed project launches. With the company having sufficient quality projects on hand and expecting to launch more projects in tier-1 cities in 2016, we forecast its contract sales to recover to 18% YoY growth for 2016.

Catalysts: The potential share-price catalysts we see are: 1) increased market interest in quality names outside the popular ones, 2) KWG's en bloc sale of an office project in Shanghai in 1H16, which could secure around CNY2-3bn in sales, and 3) growing recognition that KWG's dividend yield is high and sustainable.

Valuation: Our target price of HKD7.41 is based on a 50% target discount applied to our estimated end-2016E NAV of HKD14.82. This would translate into 2015 and 2016 PERs of 6.0x and 5.0x, respectively.

Risks: The key risks to our call include: 1) a deterioration in China's economy, and 2) rising land prices in tier-1 and major tier-2 cities which could make it difficult for KWG to replenish its landbank.

Share price performance



12-month range	4.36-8.39
Market cap (USDbn)	2.21
3m avg daily turnover (USDm)	5.41
Shares outstanding (m)	2,947
Major shareholder	Kong Jian Min (60.8%)

Financial summary (CNY)

Year to 31 Dec	15E	16E	17E
Revenue (m)	12,029	14,104	16,168
Operating profit (m)	2,724	3,215	3,626
Net profit (m)	3,006	3,566	4,117
Core EPS (fully-diluted)	1.020	1.210	1.396
EPS change (%)	15.4	18.6	15.4
Daiwa vs Cons. EPS (%)	(1.5)	(1.4)	4.6
PER (x)	4.7	3.9	3.4
Dividend yield (%)	7.2	7.9	8.8
DPS	0.342	0.375	0.419
PBR (x)	0.6	0.5	0.4
EV/EBITDA (x)	3.3	2.3	1.6
ROE (%)	13.7	14.1	14.1

Source: FactSet, Daiwa forecasts

Company

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Buy (initiation)

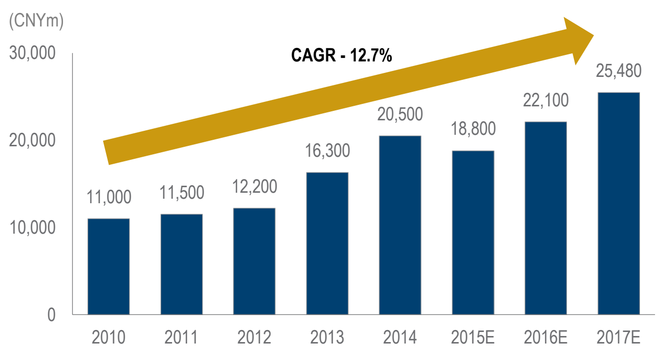
How do we justify our view?

Growth outlook	Valuation	Earnings revisions
✔✔✔✔	✔✔✔	✔✔✔

Growth outlook

As a result of a delay in KWG's project launches in Guangzhou, Shanghai and Beijing, we forecast KWG's contract sales to come in at CNY18.8bn for 2015, which is down 8.3% YoY and falls short of its CNY22.5bn sales target. However, we see this as mainly a timing issue and do not think this suggests that its products are not in demand – its attributable unbooked contract sales as at end-June 2015 amounted to CNY23bn. Also, we look for its contract sales to recover in 2016 to 17.6% YoY growth on the back of sufficient quality projects on hand and more projects in tier-1 cities likely to be launched. For 2017, we forecast the company to deliver 15.3% YoY growth in contract sales to reach CNY25.5bn.

KWG: contract sales

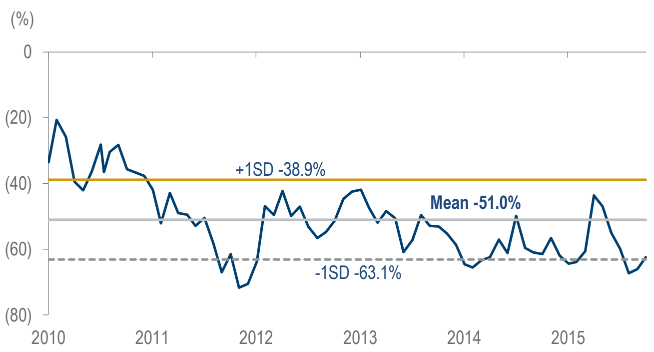


Source: Company, Daiwa

Valuation

KWG stock is trading currently at a 61% discount to its NAV, well below its 2010-15 mean discount of 51% and just slightly above its historical mean discount -1SD of 63%. Meanwhile, its mid-cap peers are trading at discounts of 50-70% to the market NAV. We think KWG's valuation deserves a premium to its peers given what we see as its right strategies and products, which lead to its reasonable land costs and higher-than-peer margins.

KWG: discount to NAV

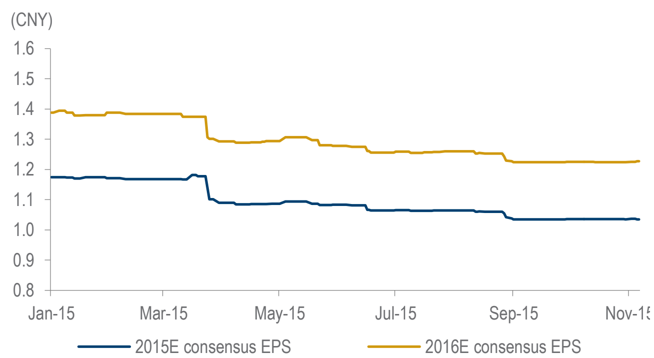


Source: Bloomberg, Daiwa

Earnings revisions

Our earnings forecasts for 2015-16 are largely in line with those of the Bloomberg consensus. Our 2017 earnings forecast is 4% above the market consensus, as we factor in higher growth in its share of profit from its JV and associate projects.

KWG Property: revisions to the Bloomberg-consensus EPS forecasts



Source: Bloomberg, Daiwa

Financial summary

Key assumptions

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Recognized GFA ('000 sqm)	784	918	796	937	845	987	1,021	1,108
Recognized ASP (CNY/sqm)	9,209	10,695	12,576	11,153	11,958	11,345	12,822	13,423
Rental income from office/retail (CNY m)	124	139	143	145	147	169	262	414
Hotel operation income (CNY m)	57	70	84	203	332	406	474	559

Profit and loss (CNYm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sale of properties	7,221	9,815	9,330	8,977	9,770	11,203	13,086	14,876
Gross rental income	124	139	143	145	147	169	262	414
Other Revenue	121	169	203	346	548	656	756	878
Total Revenue	**7,466**	**10,123**	**9,676**	**9,468**	**10,466**	**12,029**	**14,104**	**16,168**
Other income	45	48	26	32	50	55	62	69
COGS	(4,368)	(5,650)	(6,141)	(6,036)	(6,748)	(7,731)	(9,197)	(10,640)
SG&A	(657)	(764)	(894)	(1,014)	(1,093)	(1,275)	(1,467)	(1,649)
Other op.expenses	(5)	(6)	(1)	(1)	(313)	(354)	(288)	(322)
Operating profit	**2,481**	**3,750**	**2,667**	**2,449**	**2,362**	**2,724**	**3,215**	**3,626**
Net-interest inc./(exp.)	14	(79)	(23)	(171)	42	33	38	43
Assoc/forex/extraord./others	13	309	1,122	1,426	2,241	1,797	2,157	2,737
Pre-tax profit	**2,508**	**3,980**	**3,766**	**3,704**	**4,646**	**4,555**	**5,409**	**6,406**
Tax	(1,226)	(1,876)	(1,333)	(955)	(1,377)	(1,531)	(1,757)	(2,184)
Min. int./pref. div./others	0	(1)	(27)	1	4	(18)	(85)	(106)
Net profit (reported)	**1,282**	**2,103**	**2,406**	**2,750**	**3,272**	**3,006**	**3,566**	**4,117**
Net profit (adjusted)	**1,243**	**1,860**	**1,951**	**2,343**	**2,577**	**3,006**	**3,566**	**4,117**
EPS (reported)(CNY)	**0.443**	**0.727**	**0.832**	**0.950**	**1.122**	**1.020**	**1.210**	**1.397**
EPS (adjusted)(CNY)	**0.430**	**0.643**	**0.674**	**0.810**	**0.884**	**1.020**	**1.210**	**1.397**
EPS (adjusted fully-diluted)(CNY)	**0.430**	**0.643**	**0.674**	**0.810**	**0.884**	**1.020**	**1.210**	**1.396**
DPS (CNY)	**0.110**	**0.220**	**0.150**	**0.290**	**0.330**	**0.342**	**0.375**	**0.419**
EBIT	**16,293**	**19,884**	**22,914**	**2,449**	**2,362**	**2,724**	**3,215**	**3,626**
EBITDA	**16,342**	**19,942**	**22,984**	**2,449**	**2,362**	**2,724**	**3,215**	**3,626**

Cash flow (CNYm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	2,508	3,980	3,766	3,704	4,646	4,555	5,409	6,406
Depreciation and amortisation	33	36	76	69	150	171	192	212
Tax paid	(623)	(1,021)	(1,149)	(549)	(1,168)	(1,531)	(1,757)	(2,184)
Change in working capital	3,031	(997)	955	4,655	507	2,165	1,829	1,681
Other operational CF items	(631)	(1,532)	(2,638)	(3,823)	(4,512)	(3,778)	(4,308)	(5,037)
Cash flow from operations	**4,318**	**466**	**1,011**	**4,056**	**(376)**	**1,582**	**1,364**	**1,079**
Capex	(688)	(531)	(1,017)	(575)	(554)	(742)	(781)	(691)
Net (acquisitions)/disposals	(4,408)	(1,127)	(886)	(3,741)	(1,878)	(1,908)	(1,999)	(2,014)
Other investing CF items	1	1	(213)	(360)	8	(298)	(239)	(173)
Cash flow from investing	**(5,095)**	**(1,657)**	**(2,116)**	**(4,675)**	**(2,424)**	**(2,948)**	**(3,019)**	**(2,877)**
Change in debt	3,679	1,384	3,274	5,558	7,164	2,942	3,047	2,638
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(145)	(318)	(636)	(434)	(644)	(1,007)	(1,106)	(1,235)
Other financing CF items	(20)	(1,098)	(630)	2	(3,043)	91	99	108
Cash flow from financing	**3,514**	**(32)**	**2,007**	**5,126**	**3,477**	**2,026**	**2,041**	**1,512**
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	**2,737**	**(1,223)**	**902**	**4,507**	**677**	**659**	**387**	**(286)**
Free cash flow	3,630	(65)	(6)	3,481	(930)	840	583	388

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (CNYm)

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	6,804	5,373	6,444	10,859	10,871	11,530	11,917	11,631
Inventory	16,284	20,956	21,938	22,960	28,385	32,179	35,999	40,693
Accounts receivable	1,727	1,635	1,181	2,476	2,087	2,056	2,018	2,047
Other current assets	106	158	135	156	168	168	168	168
Total current assets	**24,920**	**28,123**	**29,699**	**36,451**	**41,512**	**45,933**	**50,102**	**54,538**
Fixed assets	1,344	1,779	2,688	3,176	3,584	4,015	4,496	4,856
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	13,770	14,684	16,478	21,963	26,451	30,691	35,298	40,456
Total assets	**40,034**	**44,586**	**48,864**	**61,590**	**71,547**	**80,639**	**89,897**	**99,850**
Short-term debt	2,282	3,410	3,100	3,065	3,465	2,745	2,898	2,916
Accounts payable	10,416	10,619	9,966	11,786	9,948	10,446	10,654	10,868
Other current liabilities	2,734	4,962	5,828	10,137	14,634	17,138	19,290	21,932
Total current liabilities	**15,432**	**18,991**	**18,895**	**24,987**	**28,048**	**30,329**	**32,842**	**35,715**
Long-term debt	10,050	10,425	13,090	17,840	21,048	24,709	27,604	30,224
Other non-current liabilities	2,958	1,478	1,526	921	2,015	2,106	2,206	2,314
Total liabilities	**28,440**	**30,893**	**33,511**	**43,748**	**51,111**	**57,144**	**62,652**	**68,254**
Share capital	280	280	280	280	285	285	285	285
Reserves/R.E./others	11,304	13,210	15,001	17,537	20,131	23,172	26,837	31,083
Shareholders' equity	**11,584**	**13,491**	**15,282**	**17,818**	**20,416**	**23,456**	**27,121**	**31,367**
Minority interests	10	202	72	25	21	38	124	229
Total equity & liabilities	**40,034**	**44,586**	**48,864**	**61,590**	**71,547**	**80,639**	**89,897**	**99,850**
EV	10,779	14,235	14,949	10,177	10,353	8,943	7,527	5,801
Net debt/(cash)	**5,528**	**8,461**	**9,746**	**10,047**	**13,642**	**15,924**	**18,585**	**21,510**
BVPS (CNY)	**4.004**	**4.663**	**5.282**	**6.159**	**7.002**	**7.960**	**9.204**	**10.645**

Key ratios (%)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	75.0	35.6	25.8	(2.2)	10.5	14.9	17.3	14.6
EBITDA (YoY)	116.5	51.2	(28.9)	(8.2)	(3.6)	15.3	18.0	12.8
Operating profit (YoY)	116.5	51.2	(28.9)	(8.2)	(3.6)	15.3	18.0	12.8
Net profit (YoY)	81.6	49.6	21.4	20.1	10.0	16.6	18.6	15.4
Core EPS (fully-diluted) (YoY)	81.6	49.6	21.4	20.1	9.1	15.4	18.6	15.4
Gross-profit margin	41.5	44.2	36.5	36.2	35.5	35.7	34.8	34.2
EBITDA margin	33.2	37.1	35.6	25.9	22.6	22.6	22.8	22.4
Operating-profit margin	33.2	37.1	35.5	25.9	22.6	22.6	22.8	22.4
Net profit margin	16.6	18.4	20.2	24.7	24.6	25.0	25.3	25.5
ROAE	11.3	14.8	19.8	14.2	13.5	13.7	14.1	14.1
ROAA	3.6	4.4	7.8	4.2	3.9	4.0	4.2	4.3
ROCE	11.5	14.6	17.6	7.0	5.6	5.7	5.9	5.9
ROIC	7.8	10.1	14.6	6.9	5.4	4.9	5.1	4.8
Net debt to equity	47.7	62.7	63.8	56.4	66.8	67.8	68.2	68.1
Effective tax rate	48.9	47.1	35.4	25.8	29.7	33.6	32.5	34.1
Accounts receivable (days)	56.9	60.6	15.5	70.5	79.6	62.9	52.7	45.9
Current ratio (x)	1.6	1.5	2.2	1.5	1.5	1.5	1.5	1.5
Net interest cover (x)	4.0	5.2	4.3	2.1	2.0	2.3	2.5	2.8
Net dividend payout	24.8	30.3	18.0	30.5	29.4	33.5	31.0	30.0
Free cash flow yield	26.2	n.a.	n.a.	25.2	n.a.	6.1	4.2	2.8

Source: FactSet, Daiwa forecasts

Company profile

KWG Property is based in Guangzhou and mainly focuses on the development of mid to high-end residential properties, serviced apartments, hotels, offices and retail space. The company has a total attributable landbank of 10.6m sq m in 12 cities, with Guangzhou, Foshan, Nanning and Chengdu accounting for 36%, 13%, 11% and 9% of its landbank, respectively.

What differentiates KWG?

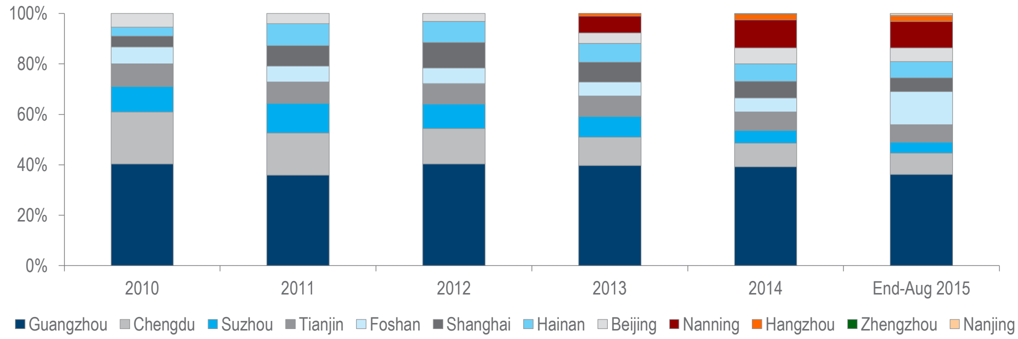
Consistent strategy with focus on upper-tier cities

10.6m sq m landbank in 12 cities

KWG started its property business in Guangzhou in 1995. It entered into Suzhou, Chengdu and Hainan in 2007, Beijing in 2008, Shanghai and Tianjin in 2010, Nanning and Hangzhou in 2013, Zhengzhou in 2014 and finally, Nanjing in 2015. As at end-August 2015, it had an attributable landbank of 10.63m sq m in 12 cities: Guangzhou (3.84m sq m), Foshan (1.40m sq m), Nanning (1.12m sq m), Chengdu (0.91m sq m), Tianjin (0.74m sq m), Hainan (0.68m sq m), Beijing, (0.59m sq m), Shanghai (0.57m sq m), Suzhou (0.45m sq m), Hangzhou (0.23m sq m), Nanjing (0.07m sq m) and Zhengzhou (0.03m sq m).

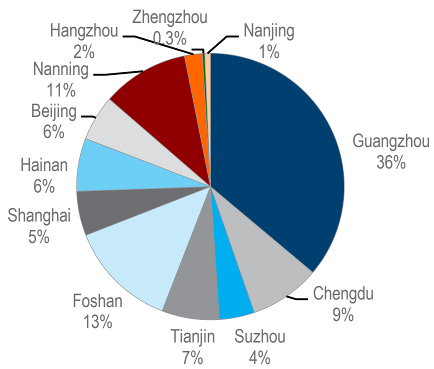
Landbank in upper-tier cities accounts for 80% of KWG's total landbank

KWG: landbank breakdown by city



Source: Company, Daiwa

KWG: landbank breakdown by city as at end-August 2015

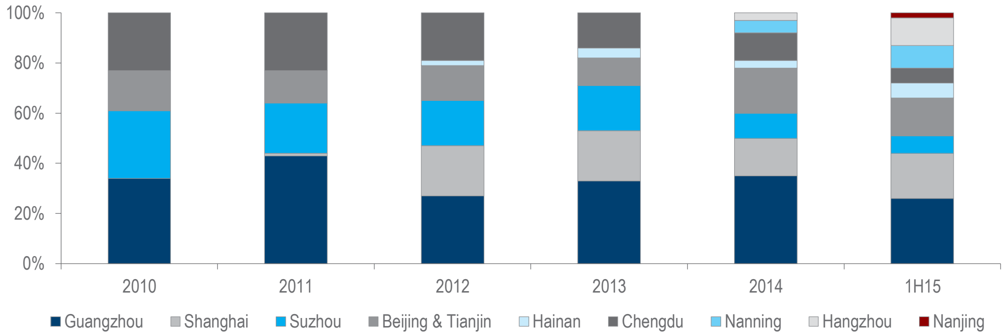


Source: Company, Daiwa

Adhered to development strategy of upper-tier city expansion

KWG focused on property development in Guangzhou, its home base, for 12 years before venturing out to other cities in 2007. In the subsequent 8 years, it stepped up its expansion plans and entered into 11 cities/regions, most of which were upper-tier cities (besides Foshan and Hainan). Throughout these years, the company adhered to its development strategy of expanding in upper-tier cities. Even in 2011-12 when home purchase restrictions (HPR) were in place in upper-tier cities and many developers aggressively expanded into lower-tier cities, KWG was able to maintain its strategy of focusing on upper-tier cities.

KWG: contract sales breakdown by city



Source: Company, Daiwa

In the right cities

Prudent landbank expansion and very selective in choosing cities

Many of the cities KWG has penetrated have strong economic growth, buoyant home sales and prices, and favourable inventory situations

Unlike some other developers, KWG has not always expanded its landbank at a rapid pace. In 2007-10, its attributable landbank increased rapidly, from 4.9m sq m in 2007 to 8.4m sq m in 2010. However, in the past 5 years since 2010, its landbank expansion has slowed considerably, with its attributable landbank only increasing by 2.2m sq m from 8.4m sq m in 2010 to 10.6m sq m as at end-August 2015.

Amid KWG's slow landbank expansion since 2010, it has been very selective in terms of the cities in which it has established a presence. Instead of becoming a national player, it aims to achieve decent sales and high profitability, and expand its market share in the few cities it has entered into which it sees as having good potential. So far, many of the cities KWG has penetrated have strong economic growth, buoyant home sales and prices, and favourable inventory situations.

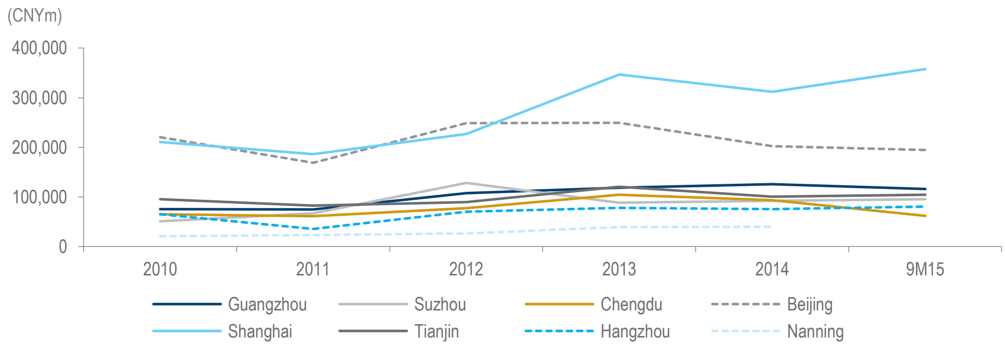
Fast economic growth in selected cities

In terms of economic growth, all of KWG's cities besides Beijing, Suzhou and Shanghai posted GDP CAGRs that were above or similar to the nationwide CAGR of 11.7% from 2010-14. This indicates that the economies of many of KWG's cities have been growing more quickly than the average pace.

Considerable growth in home sales and prices

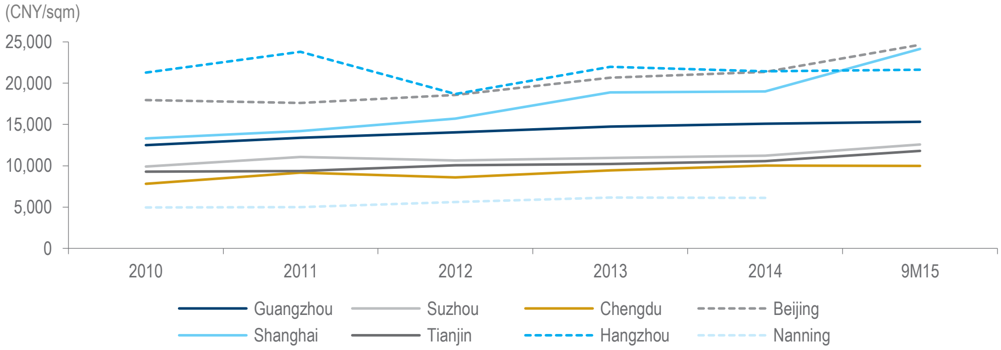
Given that KWG's property business is focused on tier-1 and major tier-2 cities, the local property markets in the cities to which it has exposure have generally been sturdy over the past few years, with home sales and ASPs having recorded considerable growth. Shanghai, Guangzhou, Nanjing, Suzhou, Chengdu and Nanning all saw >10% residential property sales CAGRs in 2010-14, while all the cities, with the exception of Hangzhou, recorded 23-82% growth in home prices in August 2015 compared to that in 2010.

Residential sales in cities to which KWG has exposure



Source: CREIS, Daiwa

Residential ASPs in cities to which KWG has exposure

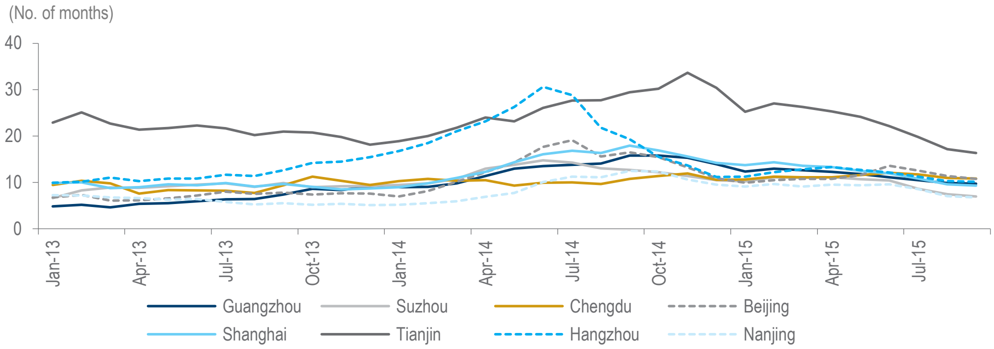


Source: CREIS, Daiwa

Healthy inventory turnover

The demand-supply dynamics in KWG's cities look healthy in general, thanks to its focus on upper-tier cities and its careful selection of the cities it chooses to enter into. After an improvement in home sales and more effort on the part of the company to clear inventory this year, both absolute inventory and inventory turnover have come down in many of KWG's focus cities. As at end-September 2015, other than Tianjin which has higher inventory turnover of 16 months, Beijing, Shanghai, Guangzhou, Chengdu, Hangzhou, Nanjing and Suzhou all saw low inventory turnover of 7-11 months, compared to the tier-1 and tier-2 cities' average inventory turnover of 9 and 13 months, respectively.

Inventory turnover in cities KWG has entered into



Source: CREIS, Daiwa

Will continue to focus on existing cities

KWG will continue to focus on existing cities and might explore business opportunities in provincial capitals

Going forward, KWG said it will continue to focus on property development in its existing cities/regions, except for Hainan, where sales have been slow. It plans also to explore development opportunities in capital cities of different provinces. Certain criteria for choosing new cities to enter into include population, GDP growth, disposable income per capita, the competitiveness of KWG's products and potential profit margins in the city, etc.

Consistent development strategy has paid off

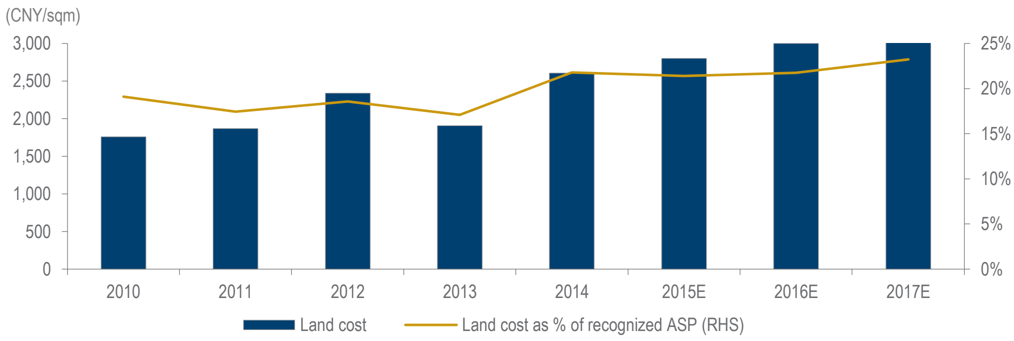
Reasonable land costs for quality landbank in upper-tier cities

KWG's perseverance in its focus on upper-tier cities has paid off well, in our view. Property markets in many lower-tier cities started deteriorating in 2012 as a result of housing oversupply and a drying-up of housing demand. Subsequently, many developers that had aggressively expanded in lower-tier cities have returned to upper-tier cities since 2014 due to better demand-supply dynamics in those cities. The return of the developers to upper-tier cities has pushed up land prices as a result of more competition over limited supply of land. Hence, expensive landbank in upper-tier cities and consequently, lower margins, is a potential problem that many of these developers could have to face.

Meanwhile, KWG has always focused on China's upper-tier cities and a large proportion of its landbank (4.3m sq m attributable GFA) was acquired at reasonable costs in 2011-13 when many other developers were venturing into lower-tier cities. As a result, we believe the company will be able to maintain a low land cost-to-ASP ratio for its recognised projects in the years to follow, unlike the developers that refocused on upper-tier cities and had to acquire expensive landbank in these cities. We forecast land cost-to-ASP ratios of 21.4%, 21.8% and 23.2% for KWG's recognised projects in 2015, 2016 and 2017, respectively, higher than its 18.8% average land cost-to-ASP ratio in 2010-14, but still at a low level.

We expect its land cost-to-ASP ratio in 2015-17E to stay in a reasonable range of 21-23%

KWG: land cost of recognised projects as % of recognised ASP



Source: Company, Daiwa forecasts

Low land costs and high ASPs for projects in tier-1 cities

As a lot of KWG's quality projects were acquired before many other developers started rushing back into the upper-tier cities in 2014, the land costs for these projects are quite low, leading to higher-than-average margins. We have listed out below some of the company's projects in China's tier-1 cities whose sites were acquired at reasonable costs and have fetched high ASPs.

KWG: land cost and current ASP of selected projects in the tier-1 cities

Name of project	City	Stake	Year of acquisition	Land cost (CNY/sq m)	Current ASP (CNY/sq m)
The Summit	Guangzhou	100%	2009	1,015	8,000
Top of World	Guangzhou	100%	2012	789	7,700
The Eden	Guangzhou	50%	2013	5,457	27,500
The Horizon	Guangzhou	35%	2014	3,930	11,000
Amazing Bay	Shanghai	50%	2011	5,394	54,000
Vision of the World	Shanghai	100%	2012	3,754	17,000
Fragrant Seasons	Beijing	100%	2008	3,960	18,000
La Villa	Beijing	50%	2013	5,450	24,000
Beijing Apex	Beijing	50%	2013	7,619	25,000
Summer Terrace	Beijing	100%	2013	20,000	66,000
Rose and Ginkgo Mansion	Beijing	33%	2014	7,801	33,000

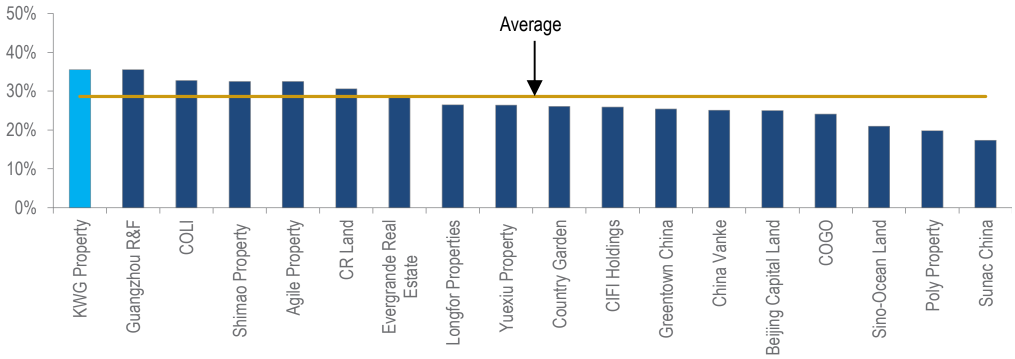
Source: Company, Daiwa

Higher-than-peer gross margins

With KWG's healthy land-cost-to-ASP ratio and its consistent focus on upper-tier cities where demand-supply dynamics are generally healthier than in lower-tier cities, it has been able to enjoy higher margins than many of its peers. In 2014, KWG recorded a gross margin of 35.5%, the highest among the China residential developers we track and well above the 27.2% average for these developers. Meanwhile, many of the developers that aggressively expanded in China's lower-tier cities in 2011-12 have been recording thin margins for projects in those cities as a result of slow sales and limited ASP upside. These developers are likely to see even lower margins in the next few years due to their huge inventory in those lower-tier cities and the generally higher land costs in upper-tier cities if they do decide to refocus on upper-tier cities.

KWG's gross margin of 35.5% in 2014 was well above its peers' average of 27.2%

China developers: 2014 gross margins

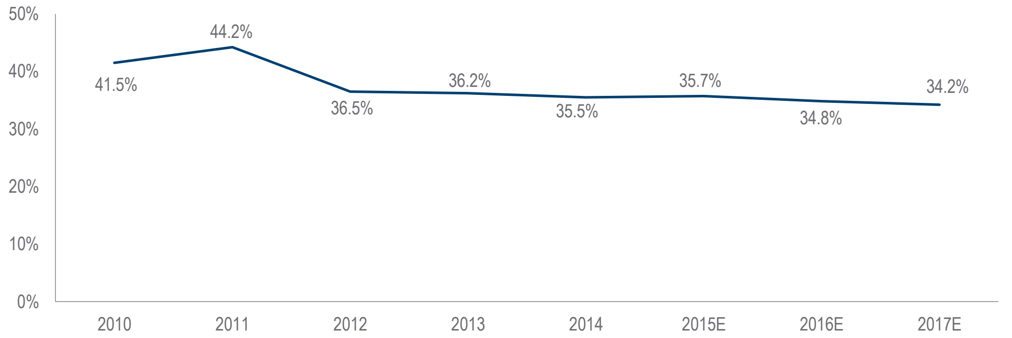


Source: Companies, Daiwa

Gross margins likely to stay at a high level despite the downtrend

Despite a downtrend in KWG's gross margin starting in 2011, which is a common trend in the industry, the company has been able to maintain a gross margin of above 35% over the past few years, which is higher than the sector average gross margin of <30%. In 2015, we forecast KWG to record a gross margin of 35.7%, lower than its 36.5% gross margin in 1H15, but slightly above the 35.5% it recorded for 2014. From 2016-17, while we believe a further decline in overall gross margins in the China property sector is inevitable, we think KWG will be no exception and will also see lower margins over the next 2 years. Nevertheless, we believe our gross margin forecasts of 34.8% and 34.2% for 2016 and 2017, respectively, for KWG would still be well above its peers' averages.

KWG: gross margin trend



Source: Company, Daiwa

Attractive dividend yield

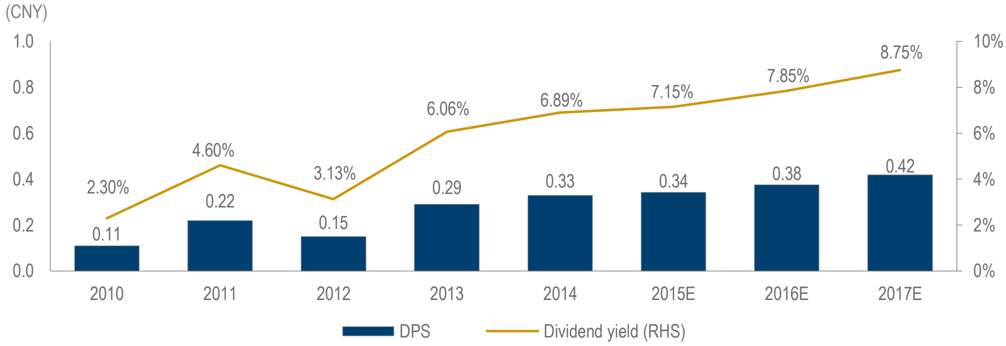
High dividend payout can be maintained

>7% dividend yield expected in 2015-17E

Thanks to its prudent landbank expansion and good cash flow management over the past few years, KWG has been consistently paying dividends. Starting from FY13, it became even more generous with its dividend payment, raising its dividend payout significantly to 30% of net profit from only 18% for FY12. Its dividend per share and dividend yield for 2013 instantly nearly doubled to reach CNY0.29 and 6.1%, respectively.

KWG's management mentioned that it will maintain a dividend payout of 25-30% of core net profit going forward. Hence, based on around a 30% dividend payout on our net profit forecasts for 2015-17, we forecast a DPS of CNY0.34 for 2015 (+3.6% YoY), CNY0.38 for 2016 (+9.6% YoY) and CNY0.42 for 2017 (+11.7% YoY). This translates into high dividend yields of 7.2%, 7.9% and 8.8% in each of the years in 2015-17, respectively.

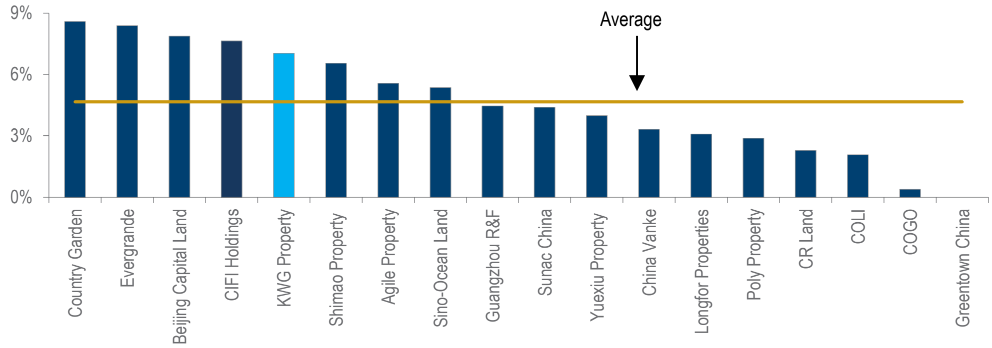
KWG: dividend per share and dividend yield



Source: Company, Daiwa forecasts

Compared with its peers, KWG had among the higher dividend yields for 2014, at 6.9%, well above the sector average of 4.7%.

China developers: dividend yields for 2014



Source: Bloomberg, Daiwa

JV projects, a supplementary growth driver

A means to spread risks and leverage on JV partners' strength

Over the past few years, KWG has been increasingly relying on joint venture opportunities in its property development and investment business. Cooperating with other developers makes it easier for the company to obtain quality land plots amid strong competition among developers, which is likely to intensify going forward as the property business becomes more and more challenging and quality plots more and more scarce. At the same time, participating in JV projects lowers the risks and alleviates the financial burden on KWG. Not to mention that it can also leverage on and learn from the expertise of its JV partners in developing and running shopping malls.

Partnering with renowned developers

Some of the major players KWG partnered with include China Vanke, CR Land, Sun Hung Kai Properties, Hongkong Land

The company has been partnering with various reputable developers in recent years in property development and investment, and the results have been evident, with satisfactory sales performances and high margins being achieved.

Currently, of KWG's 55 projects, 20 are JV projects developed with well-known developers such as Guangzhou R&F, Agile Property, Shimao Property, Longfor Properties, China Vanke, CR Land, Greenland, Sun Hung Kai Properties and Hongkong Land.

KWG: current status of JV projects

Project	City	Stake	Attributable GFA ('000 sq m)	Partner	Current status
Suzhou Apex	Suzhou	90%	142	Suzhou Jinzhu	Residential portion launched in October 2010
Tianhui Plaza	Guangzhou	33.3%	91	Guangzhou R&F, Sun Hung Kai Properties	Serviced apartments launched in November 2011 Offices launched in September 2013
Global Metropolitan Plaza	Guangzhou	50%	73	GT Land	Offices launched in December 2013
The Eden	Guangzhou	50%	78	Fineland	Residential portion launched in October 2013
Chengdu Sky Ville	Chengdu	50%	405	Hongkong Land	Residential portion launched in October 2012
The Core of Center	Shanghai	50%	48	Shanghai Greenland	Residential portion and serviced apartments launched in 2011
Amazing Bay	Shanghai	50%	94	Guangzhou R&F	Residential portion launched in March 2012
Jinnan New Town	Tianjin	25%	650	Guangzhou R&F, Agile Property, Shimao Property	Residential portion launched in 2011
Leader Plaza	Suzhou	51%	37	Suzhou Jia An	Offices and serviced apartments launched in December 2013
La Villa	Beijing	50%	100	Shimao Property	Residential portion launched in March 2014
Beijing Apex	Beijing	50%	94	Shimao Property	Residential portion launched in April 2014
Oriental Bund	Guangzhou	50%	1,400	Sun Hung Kai Properties	Residential portion launched in April 2014
Rose and Ginkgo Mansion	Beijing	33%	69	Longfor Properties, Greenland	Residential portion and villas launched in June 2014
The Core of Center	Nanning	87%	567	Guangxi Beibu Gulf	Residential portion and villas launched in July 2014
Guangxi Top of World	Nanning	87%	486	Guangxi Beibu Gulf	Villas launched in December 2014 Residential portion expected to be launched in 2015
The Horizon	Guangzhou	35%	158	Fineland	Residential portion launched in January 2015
Shine City	Nanjing	50%	73	China Vanke	Residential portion launched in June 2015
Guangxi International Finance Place	Nanning	87%	62	Guangxi Beibu Gulf	Offices expected to be launched in 2015
Guangzhou Pazhou Project	Guangzhou	50%	50	Dongling Group	Offices expected to be launched in 2016
Guangzhou Finance City Project	Guangzhou	33.3%	102	Shimao Property, CR Land	Retail shops expected to be launched in 2015

Source: Company, Daiwa

Increasing profit contribution

KWG's JV projects started contributing to its profit in 2012, and since then, the contribution has become larger and larger. Looking at its proportionated revenue, the contribution from jointly-controlled entities (JCEs) increased from CNY1,226m in 2012 (11% of proportionated revenue) to CNY4,441m in 2014 (30% of proportionated revenue).

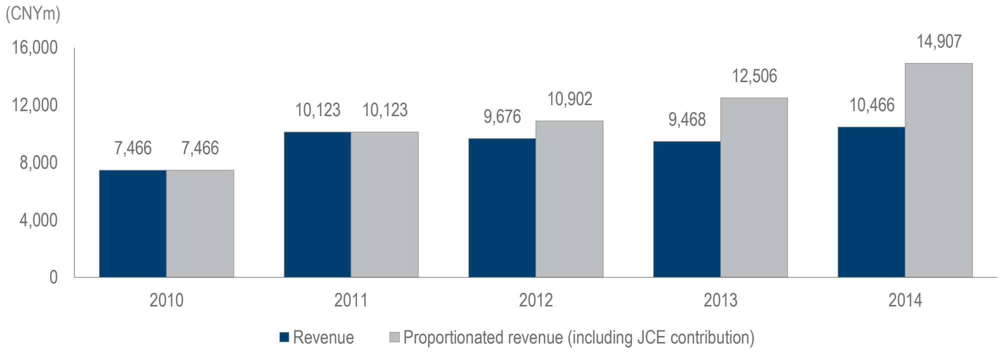
Alongside proportionated revenue from JCEs, KWG's delivered GFA from JCEs has also been increasing at a fast rate. In 2012, its JCEs delivered 43,000sq m GFA of properties, and this amount had increased to 99,000sq m in 2013 and 344,000sq m in 2014. Meanwhile, KWG's JCEs have been able to fetch generally higher ASPs for their projects compared to those for KWG's wholly-owned projects in all 3 years since 2012. In 2014, its recognised ASP for its wholly-owned projects was CNY11,563/sq m, while its proportionated recognised ASP including JCE contribution was some 3% higher at CNY11,958/sq m.

The contribution from JCEs in KWG's proportionated revenue jumped from CNY1,226m in 2012 to CNY4,441m in 2014

With KWG's JCEs being able to fetch higher ASPs for projects, their overall margins were higher than those for KWG's wholly-owned projects in 2012-14. In 2014, the gross margin for KWG's wholly-owned projects was 35.7% while the proportionated gross margin including JCE contribution was higher at 37.0%.

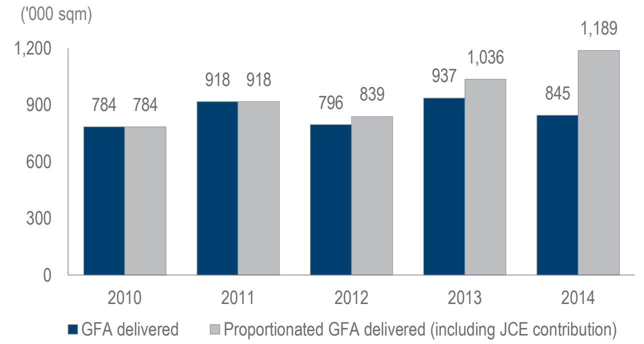
We anticipate that the profit contribution from KWG's JCEs will further increase in the next few years, especially if KWG will consider forming more JV projects as a means to acquire landbank at lower costs in upper-tier cities where competition for good land plots are intense.

KWG: revenue and proportionated revenue including JCE contribution



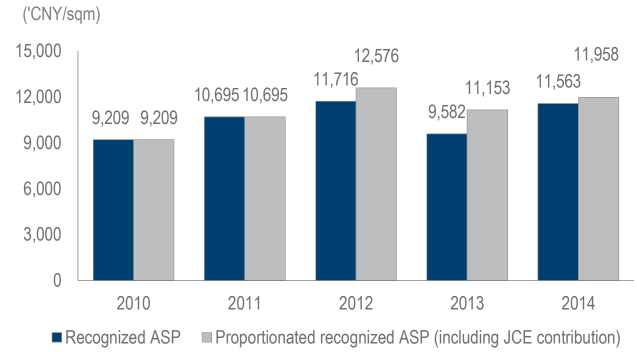
Source: Company, Daiwa

KWG: GFA delivered and proportionated GFA delivered



Source: Company, Daiwa

KWG: recognised ASP and proportionated recognised ASP



Source: Company, Daiwa

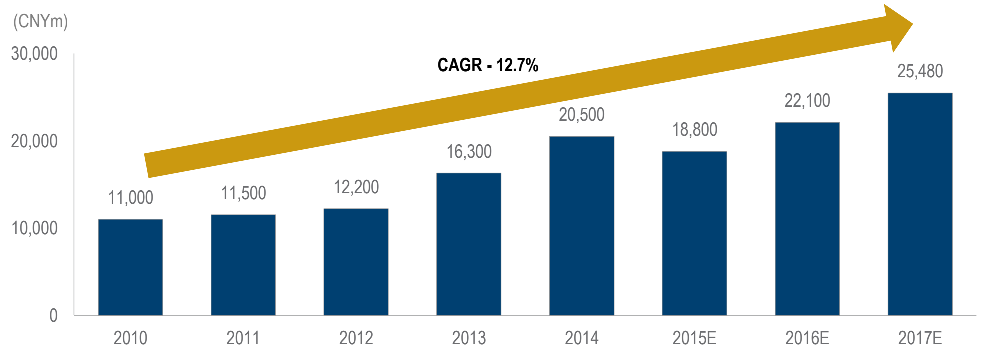
Contract sales and rental income to see decent growth

Contract sales expected to dip in 2015 before picking up in 2016-17

KWG has not always been a fast growth company. It saw very strong contract sales growth before 2011, with contract sales soaring from below CNY1.5bn in 2008 to CNY11.0bn in 2010. Nonetheless, the company's contract sales growth slowed down considerably in 2011-12 before picking up again in 2013-14. In 2014, KWG achieved contract sales growth of 25.8% YoY to reach CNY20.5bn, while its peers' saw average contract sales growth of 19% YoY. This year, we look for the company to see an 8% YoY decline in its contract sales to around CNY18.8bn as a result of the delay of a few of its project launches in 4Q15. However, its contract sales performance should recover in 2016 with 17.6% YoY growth to CNY22.1bn. For 2017E, we forecast KWG to deliver 15.3% YoY growth in contract sales to CNY25.5bn.

KWG's contract sales value is forecast to dip by 8% in 2015 to CNY18.8bn before seeing 15-18% annual growth to CNY22.1bn and CNY25.5bn in 2016 and 2017, respectively

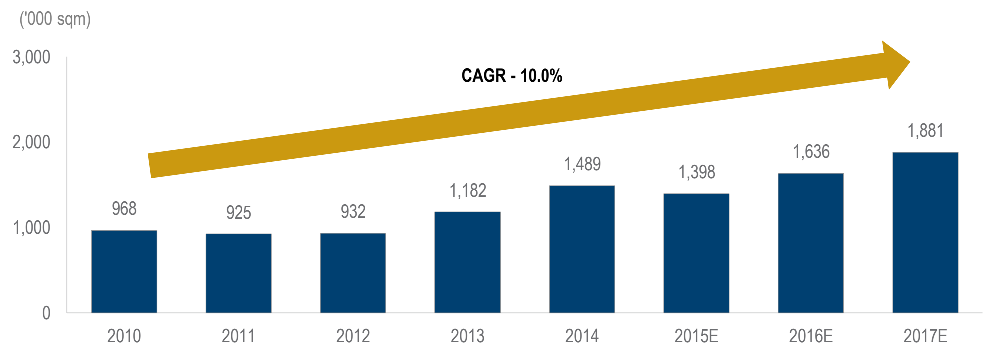
KWG: contract sales value



Source: Company, Daiwa forecasts

In terms of the contract sales amount in square metres, KWG has been able to achieve growth since 2010 besides the slight decline in 2011. For 2015, we forecast a dip in the company's contract sales amount to 1.40m sq m (-6.1% YoY) before picking up to reach 1.64m sq m in 2016 (+17.0% YoY) and 1.88m sq m in 2017 (+15.0% YoY).

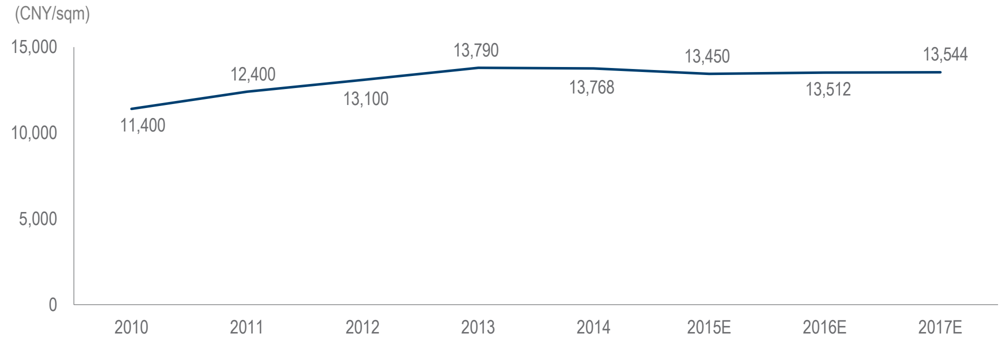
KWG: contract sales amount



Source: Company, Daiwa forecasts

As a result of KWG's consistent focus on mid- to high-end property development in China's upper-tier cities, its contracted ASPs over the past few years have been generally higher than those of many of its peers, and have seen considerable growth on the back of increasing home prices in the major cities. Nonetheless, we expect the company's contracted ASPs in 2015-17 to stay mostly flat at CNY13,450-13,544/sq m due to a more balanced sales contribution from tier-1 and tier-2 cities. That said, we believe its average contracted ASPs in the next few years should still be higher than those of many China developers.

KWG: contract sales ASP



Source: Company, Daiwa forecasts

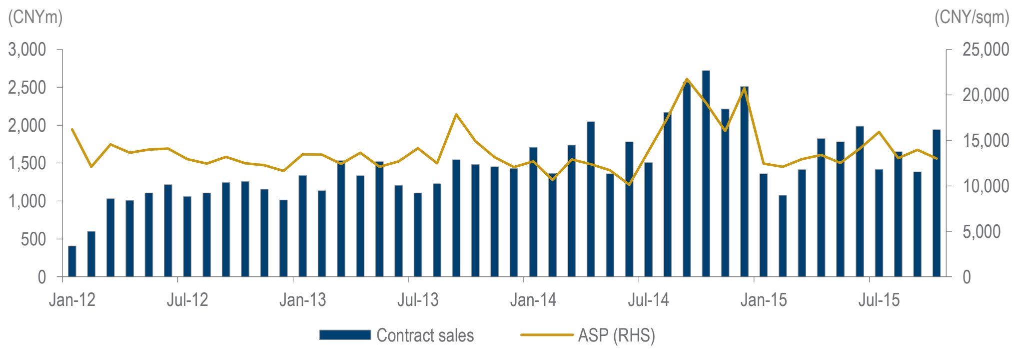
Contract sales performance in the first 10 months

Sales for 10M15 declined by 16% YoY

KWG's 10M15 contract sales were down 16% YoY, underperforming the 8% growth for its peers

For 2015, KWG has set a contract sales target of CNY22.5bn, which is some 10% above its achieved sales of CNY20.5bn in 2014. In the first 10 months of this year, the company recorded CNY15.8bn in contract sales value or 1.19m sq m of sales amount, down 16% and 3% YoY, respectively. The contracted ASP achieved during the period was around CNY13,296/sq m, 14% below its contracted ASP of CNY15,405/sq m in 9M14. In terms of sales target completion, KWG has completed 70% of its CNY22.5bn sales target so far this year.

KWG: monthly contract sales and ASP



Source: Company, Daiwa

Sales performance and target completion underperformed peers

Comparing KWG's contract sales performance and sales target completion in 10M15 with its peers, KWG clearly underperformed. The company's 16% YoY sales decline in 10M15 was well below the sector average of 8% sales growth during the period, while its 70% sales target completion is lower than peers' 77% average completion.

Guangxi office project to be launched in 4Q15

One brand new project to be launched in the remainder of this year, which is an office project in Nanning

KWG originally had total saleable resources of CNY38bn for 2015 and 9 brand new projects to be launched for sale. However, one of these brand new projects, namely the Shanghai Pudong office project, will be sold en bloc and the sale of this project is unlikely to be completed within this year. Another office project in Guangzhou, namely Guangzhou Finance City, will now be held for investment purposes rather than being sold. Meanwhile, its Beijing Tongzhou project will be launched next year instead, due to a delay in obtaining pre-sales permit. Hence, KWG has 6 brand new projects for launch in 2015. Two of these brand new projects, Tianjin Boulevard Terrace I and The Horizon in Nansha in Guangzhou, were launched in 1H15 and over 60-70% of the units launched have already been sold at these projects. Guangzhou Essence of City and Tianjin Boulevard Terrace II were both launched in July and have received a favourable response from the market. Hangzhou The

More was launched right before "Golden Week" in October and hence, we should start to see a sales contribution from this project in October.

The remaining one brand new project for this year, Guangxi International Finance Place, an office project, is scheduled for launch in 4Q15. The project has a saleable area of about 30,000sqm and the estimated ASP is around CNY10,000-12,000/sq m.

CNY18.8bn of sales forecast for 2015, falling short of its target

As a result of the delay in new project launches and the switching of an office project into an investment property, we forecast KWG to achieve only around CNY18.8bn in contract sales for 2015, which is 8.3% below its achieved sales of CNY20.5bn in 2014. In terms of sales target completion, we anticipate the company will fall short of its CNY22.5bn contract sales target by 16%. However, we see this as mainly a timing issue and do not think this suggests that its products are not in demand – its attributable unbooked contract sales as at end-June 2015 amounted to CNY23bn.

Potential sales target miss largely factored into recent weak share price

The next focus is on 2016 contract sales performance

We believe KWG's slow sales this year and potential sales target miss have been largely factored into its recent weak share-price performance. With its weak 2015 sales behind it, we think the next thing investors will look for in KWG will be its 2016 sales performance, and how it will improve its sales from the weak performance in 2015. For 2016, we forecast contract sales of around CNY22.1bn for the company, up 17.6% from our estimated sales of CNY18.8bn for 2015. The brand new projects that are saleable include Shanghai Pudong office project, Beijing Tongzhou I and II, The Star in Guangzhou and also, the Zhengzhou project.

More emphasis on profitability instead of merely chasing sales growth

KWG's management is guiding for 10-20% annual sales growth for the next few years. It will put more emphasis on high profitability instead of high sales growth going forward

According to KWG's management, the company will put more emphasis on achieving high profitability instead of just chasing contract sales growth going forward. It guides for around 10-20% annual sales growth in the next few years. We think the company is heading in the right direction amid a rational adjustment and tougher operating environment in the China property industry. It appears to us that some developers have been too obsessed with chasing scale and contract sales numbers which has only resulted in falling margins and minimal growth in earnings. Now that the industry is normalizing and becoming more rational, we think the key for success for developers is to achieve steady sales growth and at the same time, maintain profitability.

Top and bottom lines should still see decent growth over the next few years

Unbooked contract sales sufficient to support growth

Despite our forecast for lower contract sales this year for KWG, we believe the company will still be able to see decent growth in revenue and earnings over the next few years. As at end-June 2015, KWG had unbooked attributable contract sales (proportionated) of CNY23bn, which is sufficient to support our revenue growth forecasts of 14.9% and 17.2% to reach CNY12,029m for 2015 and CNY14,104m in 2016, respectively.

Meanwhile, as we believe KWG to be able to maintain its high margins, we also expect decent growth in its net profit to CNY3,006m for 2015 (+16.6% YoY) and CNY3,566m in 2016 (+18.7% YoY).

On the right track to develop its commercial properties

Investment property portfolio contributed to 5% of 2014 revenue

While KWG currently derives most of its revenue from property development, it is looking to expand its investment property portfolio to generate stable recurring cash inflow. As at end-June 2015, the company had 6 investment property projects in operation, including International Finance Place in Guangzhou, Four Points by Sheraton in Guangzhou, Sheraton Resort in Guangzhou, W hotel in Guangzhou, The Mulian Guangzhou and also, The Mulian Hangzhou. These investment properties generated about CNY479m and CNY257m of revenue in 2014 and 1H15, respectively, accounting for 4.6% and 6.5% of KWG's total revenue during the 2 periods.

U Fun, a shopping mall in Shanghai jointly developed with Guangzhou R&F, will be launched early next year and was 80% preleased as at end-October 2015

Six investment property projects in the pipeline

KWG has 6 more investment property projects in the pipeline, including U Fun in Shanghai, Tian Hui Plaza in Guangzhou, the Conrad Hotel in Guangzhou, M. Cube in Beijing, a shopping mall at Chengdu Cosmos and another shopping mall at Suzhou Apex.

U Fun, a shopping mall in the Shanghai Amazing Bay project jointly developed with Guangzhou R&F, will be launched early next year and will be KWG's first shopping mall. As at end-October 2015, the mall was 80% preleased and anchor tenants include global fashion brands (ie, UNIQLO, H&M), a supermarket and a children's playground.

To leverage on experience and knowledge gained from JV projects

KWG's next mall to start operating will be Tian Hui Plaza in Pearl River New Town in Guangzhou, which we expect to be launched in 1Q16. This is a JV project with Sun Hung Kai Properties, which will lead the development and operations of the mall. With the experience and knowledge on commercial property development and management that KWG will learn from these JV projects, we believe it will be equipped and prepared for its wholly owned shopping malls in Beijing and Chengdu, due to launch in 4Q16.

KWG: investment property portfolio

Project	Location	Stake	Product type	Attributable GFA ('000 sqm)	Year opened/ Expected launch date	More info
International Finance Place	Pearl River New Town, Guangzhou	100%	Office	61	2007	Above 95% occupancy in recent 3 years
Four Points by Sheraton	Dongpu, Guangzhou	100%	Hotel	35	2009	Urban four-star hotel targeted at business people
Sheraton Resort	Huadu, Guangzhou	100%	Hotel	25	2011	First internationally renowned five-star resort hotel in Guangzhou
W Hotel	Pearl River New Town, Guangzhou	100%	Hotel	80	2013	First W Hotel in Mainland China
The Mulian Guangzhou	Pearl River New Town, Guangzhou	100%	Hotel	8	2014	First boutique hotel owned and managed by KWG
The Mulian Hangzhou	Future Science City, Hangzhou	100%	Hotel	18	2015	Located in the "Silicon Valley" district of Hangzhou; across from the Alibaba headquarters in Hangzhou
U Fun	Xinjiangwan, Shanghai	50%	Shopping mall	107	1Q16	JV with Guangzhou R&F, which is responsible for the development of the mall
Tian Hui Plaza	Pearl River New Town, Guangzhou	33.3%	Shopping mall	115	1Q16	JV with Sun Hung Kai Properties, which will lead the development and operations of the mall
Conrad Hotel	Pearl River New Town, Guangzhou	33.3%	Hotel	40	2H16	Part of the Tian Hui Plaza development
M. Cube	Chongwenmen, Beijing	100%	Shopping mall	30	4Q16	First wholly owned shopping mall
Shopping mall of Chengdu Cosmos	Tianfu New Town, Chengdu	100%	Shopping mall	150	1H17	Upscale shopping mall next to the W Hotel
Shopping mall of Suzhou Apex	Mudu Town, Suzhou	90%	Shopping mall	120	2H17	Residential portion already launched in 2010
Total				**789**		

Source: Company, Daiwa

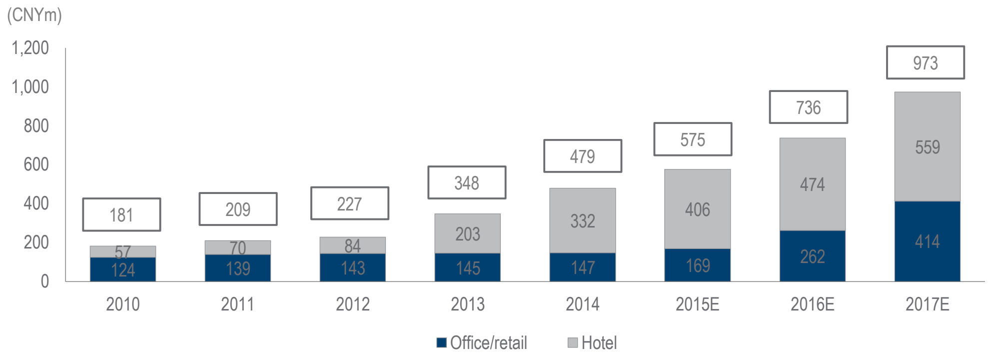
Investment property revenue to see more than at least 20% YoY growth for each of 2015-17

With 5 shopping malls and 1 hotel to be launched from 2016, we anticipate that KWG's income from its investment property portfolio will see rapid growth in the following years. We forecast its investment property revenue to reach CNY575m for 2015 (+20% YoY), CNY736m for 2016 (+28% YoY) and CNY973m for 2017 (+32% YoY).

We forecast KWG's investment property revenue to reach CNY575m, CNY736m and CNY973m for 2015-17 respectively

Meanwhile, as more shopping malls will be launched in 2016-17, we expect the proportion of its investment property income coming from offices and retail to increase. We forecast the proportion of KWG's rental income from its offices and retail space to rise from only 29% for 2015 (CNY169m, +15% YoY) to 36% for 2016 (CNY262m, +55% YoY) and 43% for 2017 (CNY414m, +58% YoY).

KWG: revenue from investment property portfolio



Source: Company, Daiwa forecasts

Solid earnings growth & stable financial position

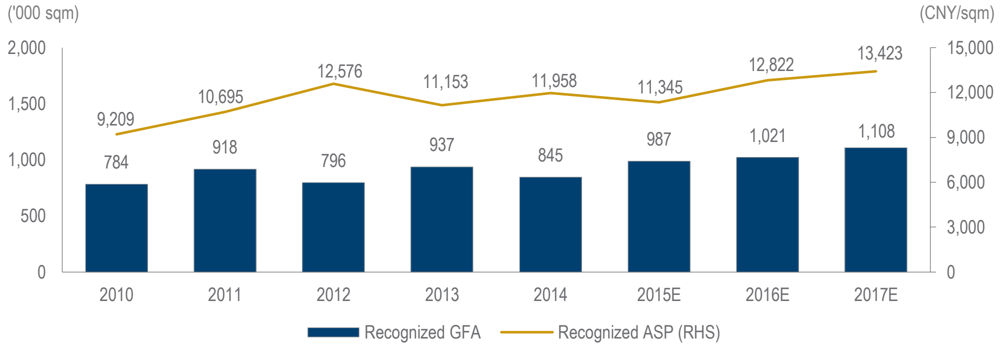
Earnings outlook

Higher recognised GFA but we expect a lower ASP for 2015

For 2015, we forecast decent YoY growth of 16.8% for KWG's recognised GFA, reaching 987,000sqm. The major projects to be booked in the top-line will include The Summit in Zengcheng, The Sapphire in Suzhou, Suzhou Apex, Suzhou Jade Garden, Suzhou Emerald, The Core of Center in Nanning. For 2016 and 2017, we forecast further growth in the company's recognised GFA, to 1,021,000sqm (+3.4% YoY) and 1,108,000sqm (+8.5% YoY).

In terms of recognised ASP, we expect a slightly lower ASP of CNY11,345/sq m for 2015 (-5.4% YoY) due to the booking of projects with a lower ASP, ie, The Summit in Zhengcheng, The Sapphire and Suzhou Apex in Suzhou. However, we expect to see a higher recognised ASP of CNY12,822/sq m (+13.0% YoY) for 2016, due to the booking of more projects in China's tier-1 cities, which have higher ASPs. For 2017, we forecast a slightly higher recognised ASP of CNY13,423/sq m (+4.7% YoY).

KWG: recognised GFA and ASP



Source: Company, Daiwa forecasts

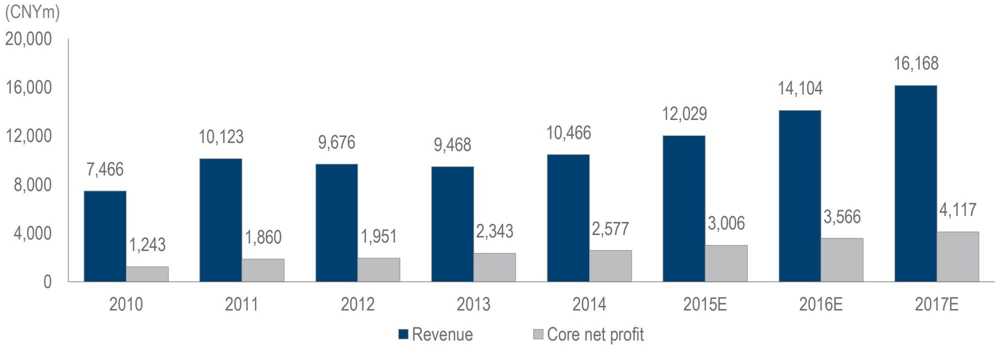
We expect core profit to see higher growth than revenue over 2015-17

We forecast KWG's revenue to see 14.9% YoY, 17.2% and 14.6% growth in 2015-17 respectively. Meanwhile, we expect its core profit to record 16.6%, 18.7% and 15.4% YoY increases over the same period

Given our forecasts of a higher recognised GFA and no huge declines in recognised ASPs in the following years, we anticipate double-digit revenue growth for KWG for each of the 3 years over 2015-17. We forecast revenue to reach CNY12,029m for 2015 (+14.9% YoY), CNY14,104m for 2016 (+17.2%) and CNY16,168m for 2017 (+14.6%).

We expect to see higher growth in KWG's core net profit than its revenue over the same period, largely due to the rapid growth in its share of profit from its JV projects. We estimate that the company's share of profit from its JV projects will rise, from CNY1,542m for 2014 to CNY1,795m for 2015 (+16.4% YoY), CNY2,247m for 2016 (+25.2% YoY) and CNY2,823m for 2017 (+25.6% YoY). Meanwhile, we forecast a core profit (excluding valuation gains on investment properties) of CNY3,006m for 2015 (+16.6% YoY), CNY3,566m for 2016 (+18.7% YoY) and CNY4,117m for 2017 (+15.4% YoY).

KWG: revenue and core net profit



Source: Company, Daiwa forecasts

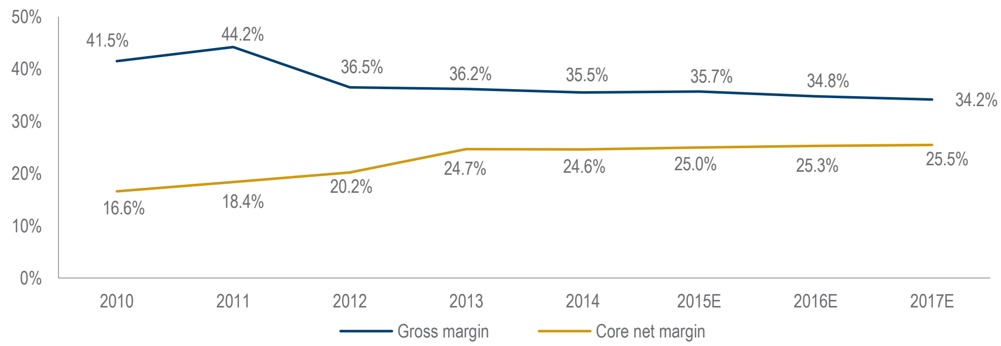
Declining gross margin but higher net margin

Due to more competition over quality land plots and, hence, higher land costs in the upper-tier cities, we expect KWG, like many other China developers, to see a down trend in its gross margin over 2015-17. We forecast the gross margin to rise slightly for 2015 to 35.7% (+0.2pp) before trending down to 34.8% for 2016 (-0.9pp) and 34.2% for 2017 (-0.6pp). According to KWG's management, the company aims to maintain a gross margin of 30-35% in the medium term.

Despite our forecasts of a declining gross margin over 2015-17, we expect a higher net margin for KWG over this period as a result of the increasing profit contribution from its JVs and associates. We forecast a core net margin of 25.0% for 2015 (+0.4pp), 25.3% for 2016 (+0.3pp) and 25.5% for 2017 (+0.2pp).

Net margin is on an uptrend despite a declining gross margin, due to higher profit contribution from JVs and associates

KWG: gross margin and core net margin



Source: Company, Daiwa forecasts

Financial position

We expect operating net cash inflow for the whole of 2015

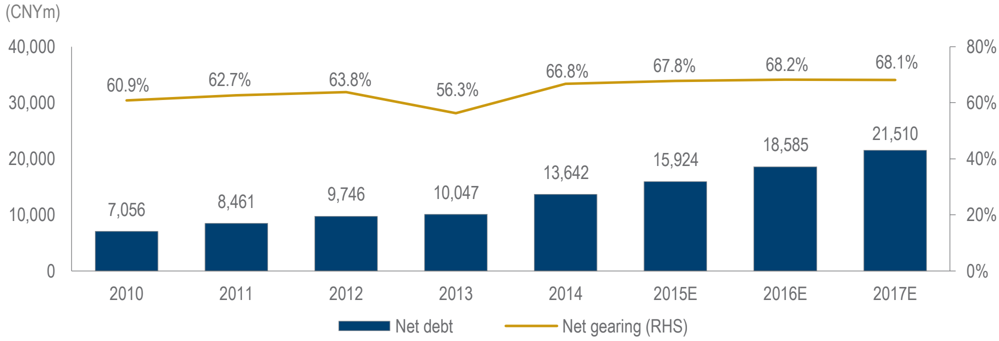
For 2015, we forecast an operating net cash inflow of CNY980m. We estimate cash collected from contract sales of around CNY17,480m (largely from CNY18,400m of contract sales for 2015E, and partly from CNY20,500m of contract sales for 2014). We estimate an operating cash outflow of CNY16,500m for 2015, including CNY1,000m in land premiums, CNY9,000m in construction costs, CNY1,600m in selling, marketing and administration expenses, CNY2,300m in interest expenses and CNY2,600m in taxes.

Net gearing to remain at acceptable levels despite higher net debt in 2015-17

KWG's net debt level nearly doubled, from CNY7,056m for 2010 to CNY13,642m for 2014. Nonetheless, the company has been able to maintain its net gearing ratio at an acceptable level. As at end-2014, it recorded a net gearing of 66.8%, which is in line with the average of its peers, at 67.9%. Over 2015-17, we forecast KWG's net debt to rise further, reaching CNY15,924m for 2015 (+16.7% YoY), CNY18,585m for 2016 (+16.7% YoY) and CNY21,510m for 2017 (+15.7% YoY). In terms of net gearing, we estimate this will remain at an acceptable level of 67.8% for 2015 (+1.0pp), 68.2% for 2016 (+0.4pp) and 68.1% for 2017 (-0.1pp).

We expect KWG's net gearing to be flat, at around 68% for 2015-17

KWG: net debt and net gearing



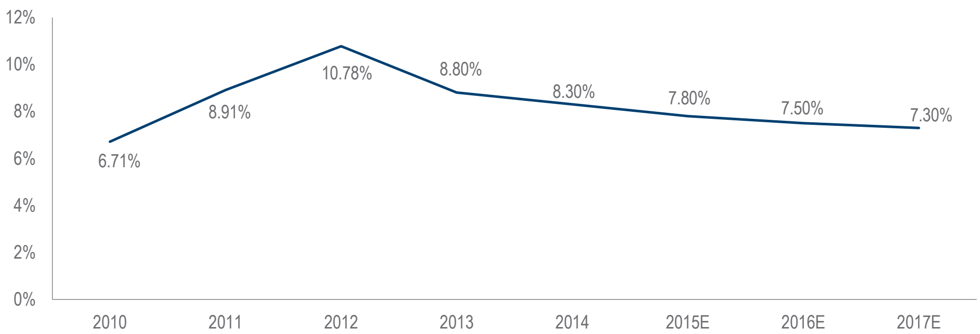
Source: Company, Daiwa forecasts

We anticipate declining average borrowing costs for KWG, reaching 7.80% for 2015, 7.50% for 2016 and 7.30% for 2017

Average borrowing cost on a down trend

KWG saw its weighted average borrowing cost peak at 10.78% for 2012, before falling to 8.80% for 2013 and 8.30% for 2014. For 2015, we expect its average borrowing cost to see a considerable decline, reaching 7.80% as a result of the 5 interest rate cuts since November 2014. For 2016, we anticipate a further decline in the average borrowing cost to 7.50%, as the company is planning a domestic corporate bond issuance at a lower cost to repay its higher-cost debt. As for 2017, we forecast a slightly lower average borrowing cost of 7.30%.

KWG: weighted average borrowing cost



Source: Company, Daiwa forecasts

Valuation

Initiate with Buy (1) rating and target price of HKD7.41

Our NAV estimate and target discount to NAV

NAV is our preferred approach to value property companies

We regard the NAV as the best approach to value property companies, as it is based on the market value of a company's property assets. Moreover, property companies typically trade at a discount to their appraised NAV to reflect: 1) their capabilities in project execution and property sales, as well as their long-term sales growth potential, 2) their market risk and diversification, and 3) their corporate risk (eg, corporate governance and financial position).

We value KWG's end-2016 NAV at HKD14.82/share

Based on KWG's existing landbank of 10.6m sq m, we estimate an end-2016 total GAV of CNY60,292m by discounting its estimated future net cash flow to be generated using a WACC of 12.68%. The company's development properties account for 68% of the GAV, and its investment properties account for the remaining 32%.

Assuming an end-2016 net debt of CNY18,585m and outstanding land premium of CNY2,000m, we calculate an end-2016 NAV of CNY39,707m. Based on outstanding share capital of 2,947m shares, as at end-June 2015, we derive a NAV per share of CNY13.47 or HKD14.82 for KWG.

KWG: WACC

Rate assumptions	
Risk-free rate	3.1%
Risk premium	10.0%
Beta	1.34
Cost of equity	16.5%
Cost of debt	5.6%
Debt/Assets	35.0%
WACC	12.68%

Source: Daiwa forecasts

KWG's development properties and investment properties account for 68% and 32% of its end-2016 total GAV respectively

KWG: NAV breakdown

(CNY m)	End-2016 NAV	% of GAV
Development properties:		
Guangzhou	15,296	25.4
Foshan	1,605	2.7
Shanghai	3,287	5.5
Suzhou	403	0.7
Chengdu	2,828	4.7
Beijing	5,389	8.9
Tianjin	796	1.3
Hainan	4,742	7.9
Hangzhou	700	1.2
Nanning	4,636	7.7
Zhengzhou	362	0.6
Nanjing	940	1.6
Development property NAV	40,983	68.0
Investment properties:		
Guangzhou	9,989	16.6
Shanghai	2,106	3.5
Beijing	445	0.7
Chengdu	1,877	3.1
Suzhou	1,820	3.0
Hainan	2,003	3.3
Nanning	461	0.8
Foshan	337	0.6
Hangzhou	139	0.2
Tianjin	132	0.2
Investment property NAV	19,309	32.0
GAV	**60,292**	**100.0**
Net debt	(18,585)	
Outstanding land premium	(2,000)	
NAV	**39,707**	
Shares (m)	2,947	
NAV/Share (CNY)	**13.47**	
NAV/Share (HKD)	**14.82**	

Source: Daiwa forecasts

We apply a 50% discount to KWG's NAV

Based on our estimated NAV of HKD14.82/share for KWG and its last trading price of HKD5.83 on 6 November, its shares are now trading at a 61% discount to NAV. KWG's current NAV discount is in line with that of its Hong Kong-listed mid-cap peers' average of 50-70% discount to market NAV.

We believe KWG deserves a narrower NAV discount compared to its peers due to its consistent development strategy, its quality landbank in the upper-tier cities, potentially higher margins and better profitability than peers in the following years, and healthy financial position due to its prudent landbank expansion. Hence, we decide to apply a 50% target discount to KWG's NAV, which is at the lowest end of the mid-cap Hong Kong-listed China developers' current valuation range.

Initiate coverage with a Buy (1) rating and target price of HKD7.41

Applying a 50% target discount to KWG's end-2016 NAV per share of HKD14.82, we arrive at our target price of HKD7.41, which translates into 2015E PER of 6.0x and 2016E PER of 5.0x. As the stock was trading at HKD5.83 (6 November), our target price of HKD7.41 represents 27% upside potential from current share price levels. We have a Buy (1) rating on KWG.

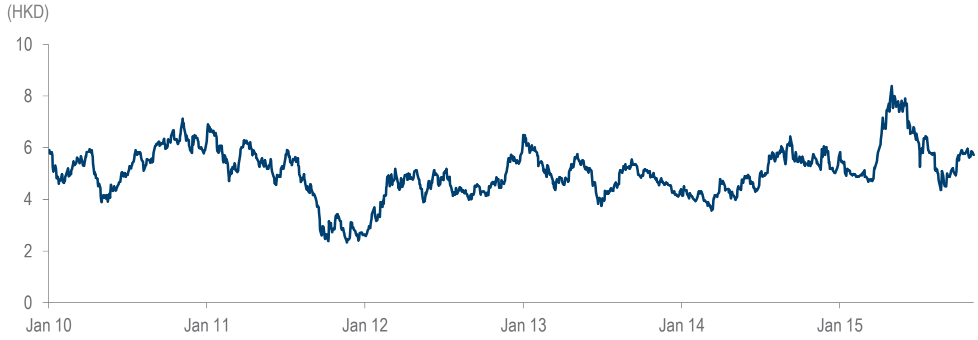
KWG's share price has underperformed that of its peers' in the past month but has outperformed peers' YTD

Share-price performance and current valuation

Share-price has outperformed peers YTD

In the past one month (6 October-5 November) the share prices of the China property sector picked up by 7% on average, above the 1% increase in the HSCEI. During the past month, KWG's share price dropped by 1%, underperforming its peers, which we think is largely attributable to its slow sales relative to peers and because investors expect it to miss its sales target. However, KWG's share price has outperformed its peers so far this year. YTD, its share price has risen by 8%, compared to the 3% overall increase for the China property players.

KWG: share price



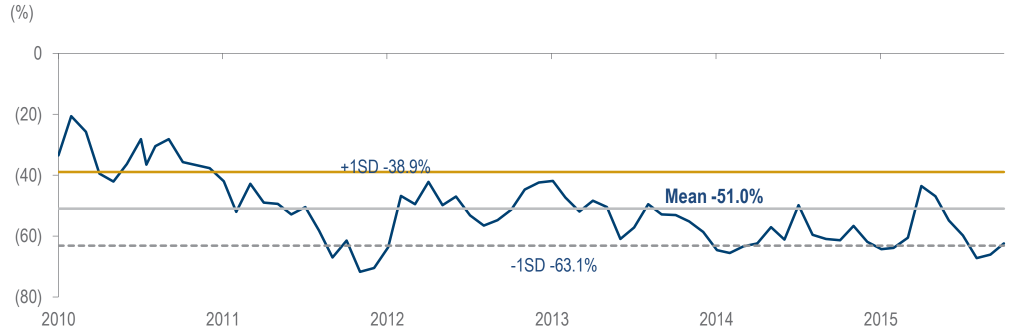
Source: Bloomberg, Daiwa

KWG is now trading at a 61% discount to our NAV estimate, in line with the average discount of 50-70% for its mid-cap peers, but well below its 2010-15 mean discount of 51%

Current NAV discount at 2010-15 mean discount -1SD

Currently, KWG is trading at a 61% discount to our end-2016 NAV estimate of HKD14.82, in line with the average discount of its mid-cap peers of 50-70% to market NAV. Compared to its 2010-15 valuation, KWG's current discount of 61% is much lower than its 2010-15 mean discount of 51%, and just slightly above its 2010-15 mean discount -1SD of 63%. This indicates that its current valuation is cheap.

KWG: historical discount to NAV

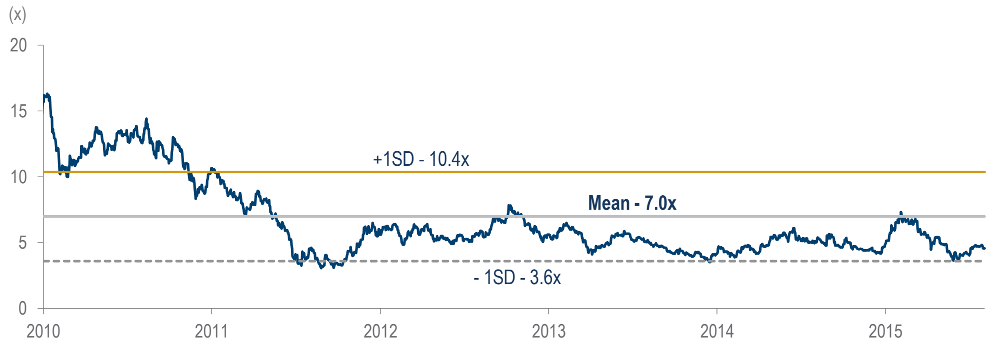


Source: Bloomberg, Daiwa

2015E and 2016E PERs below 2010-15 mean PER

In terms of PER, KWG's share price is now trading at 4.7x 2015E PER and 3.9x 2016E PER. Compared to its peers' average 2015E and average 2016E PER of 7.3x and 6.2x respectively (based on Bloomberg consensus forecasts), KWG's 2015-16E PERs are much lower. Compared to its own 2010-15 PER, the company's 2015E and 2016E PERs are in between its 2010-15 mean PER -1SD of 3.6x and 2010-15 mean PER of 7.0x, which is also relatively cheap.

KWG: PER



Source: Bloomberg, Daiwa

2015E and 2016E PBR close to a 2010-15 mean PBR -1SD

Our financial estimates for KWG translate into 2015E and 2016E PBR of 0.6x and 0.5x respectively. These are slightly lower than peers' Bloomberg consensus 2015E and 2016E PBR of 0.8x and 0.7x respectively. However, its 2015E and 2016E PBR are much lower than its 2010-15 mean PBR of 0.8x and are close to its 2010-15 mean PBR -1SD of 0.5x.

KWG: historical PBR

Source: Bloomberg, Daiwa

Risks

Housing demand dries up as economy deteriorates

Since 2011 when home purchase restrictions (HPR) were introduced in China, the property market has been largely supported by first-home buyers. In 2014, the HPR was removed in most China cities and many upgraders have since entered the market. This year, we observe that housing demand from these end-users has generally slowed down. Despite a few interest rate and reserve requirement ratio cuts, we have not seen a meaningful pickup in home sales. With overall growth in the China economy set to slow in 2016, we are concerned that housing demand will become even slower, which would drag down the contract sales performances of the China developers, including KWG's, in the years to come. We would see this as the main risk to our Buy (1) rating on the stock.

Delays in new project launches, which could affect KWG's contract sales performance

With 10.6m sq m of GFA of attributable landbank on hand and 47% located in China's tier-1 cities, KWG's saleable resources is more than sufficient to support our annual contract sales growth forecasts of 17.6% YoY for 2016 and 15.3% YoY for 2017 for the company. Nonetheless, there is always a possibility that its project launches will be delayed due to the delayed issuance of pre-sales permits by the housing authorities or internal decisions at KWG to push back projects. Under these circumstances, the company's contract sales performance would be affected and our sales growth forecasts might not be realised. We see this as the secondary risk to our call on the stock.

Intense competition in the upper-tier cities over land plots

As many developers have expressed the intention of expanding their property businesses in the upper-tier cities, where housing demand-supply dynamics are more balanced and margins are generally higher, competition over quality land plots has become more intense. Consequently, land costs have been pushed higher and a downtrend in gross margins seems highly likely. KWG could potentially face the same problems of higher land costs and lower margins in the upper-tier cities when it has to replenish its landbank in these cities.

Appendix I: company background

Mid- to high-end property developer

10.6m sqm landbank in 12 cities

Based in Guangzhou, KWG Property was established by Chairman Kong Jian Min in 1995. Over 1995-2006, the company focused on the development of mid- to high-end residential properties in Guangzhou. Since 2007, it has expanded outside of Guangzhou and entered 10 cities. Currently, it focuses mainly on the development of mid- to high-end residential properties, serviced apartments, hotels, offices and retail space. It has 55 projects with a total attributable landbank of 10.6m sq m in 12 cities, including Guangzhou (36.1%), Foshan (13.2%), Nanning (10.5%), Chengdu (8.6%), Tianjin (6.9%), Hainan (6.4%), Beijing (5.5%), Shanghai (5.4%), Suzhou (4.3%), Hangzhou (2.2%), Nanjing (0.7%) and Zhengzhou (0.3%).

KWG: Corporate milestones

1995	- Chairman Kong Jian Min established KWG
1995-2006	- Property development in Guangzhou
	- Became a high-end market leader with quality projects in Pearl River New Town
2007	- Entered Suzhou, Chengdu and Hainan
	- Listed in Hong Kong in July 2007
2008	- Launched first project in Suzhou
	- Entered Beijing
2009-2010	- Launched projects in Beijing and Chengdu
	- Entered Tianjin and Shanghai
2011	- Launched projects in Tianjin and Shanghai
2012	- Launched projects in Hainan
2013	- Entered Nanning and Hangzhou
2014	- Launched projects in Nanning and Hangzhou
	- Entered Zhengzhou
2015	- Entered Nanjing

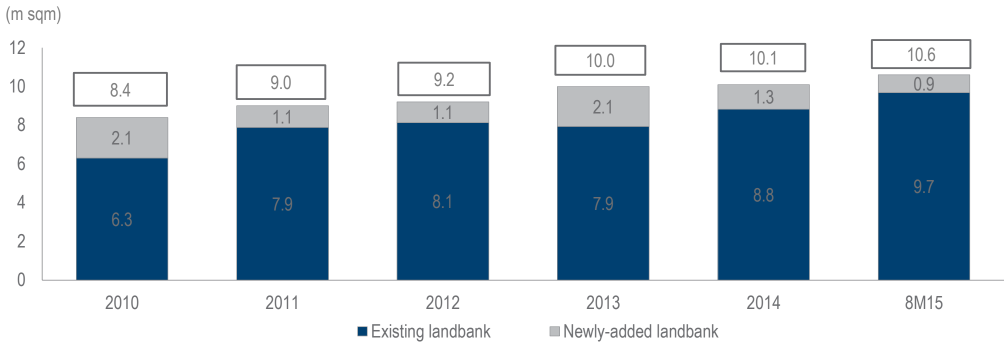
Source: Company, Daiwa

KWG has been prudent in its landbank expansion and has only increased its landbank by 2.2m sq m to 10.6m sq m over 2010-15

Prudent landbank expansion

KWG has been prudent in its landbank expansion. Over 2007-10, its attributable landbank increased very rapidly from 4.9m sq m in 2007 to 8.4m sq m in 2010. However, in the past 5 years since then, KWG's landbank expansion has slowed considerably as its attributable landbank has only increased by 2.2m sqm from 8.4m sqm in 2010 to 10.6m sqm as at end-August 2015.

KWG: existing and newly added landbank



Source: Company, Daiwa

Changing landbank mix to diversify and optimise its landbank

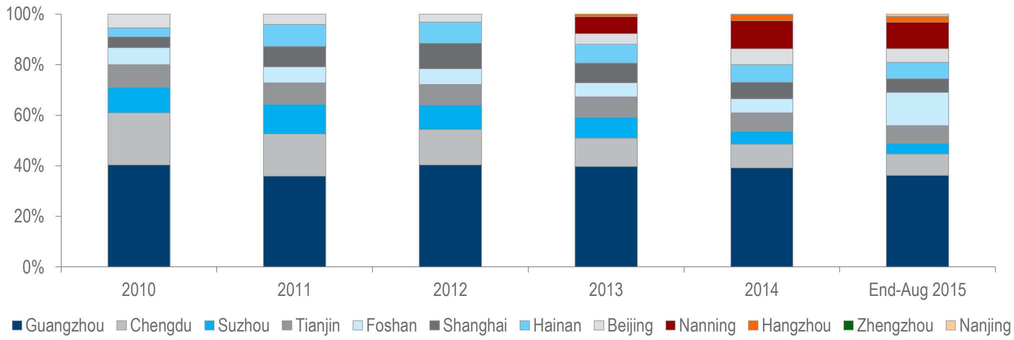
KWG has been changing its landbank mix by city to diversify and optimise its landbank, but Guangzhou has remained a major focus of its property business

Despite KWG's slow landbank expansion since 2010, it has been changing its landbank mix by city to diversify and optimise its landbank. Guangzhou has remained a major focus of the company's property business and has accounted for 35-40% of its total landbank since 2010. It has been increasing its landbank exposure in Beijing and Nanning over the past 5 years, which now account for 6% and 10% of its total attributable landbank respectively. Meanwhile, we have seen a considerable decline in the company's landbank exposure in Chengdu and Suzhou, as it has ventured into other new cities like Nanning, Hangzhou, Zhengzhou and Nanjing. As at the end of August 2015, KWG's landbank exposure in Chengdu and Suzhou accounted for 9% and 4% of its total attributable landbank respectively, compared with 21% and 10% in 2010.

KWG: map of its landbank

Source: Daiwa

KWG: landbank breakdown by city



Source: Company, Daiwa

Experienced management team

KWG has a well-organised and experienced property development management team. Most of the team have been with the company for a long time and have extensive experience in operations, management or the property-development business.

Management profile

	Position	Brief introduction
Kong Jian Min	Founder, Chairman and executive director	Mr Kong has over 20 years' experience in property development and investment. He is primarily responsible for KWG's development strategies and supervising project planning, business operations and sales and marketing.
Kong Jian Tao	CEO and executive director	Mr Kong is a brother of Kong Jian Min and Kong Jian Nan. He has over 20 years' experience in property development and is responsible for the overall operations of KWG's project.
Kong Jian Nan	Executive vice-president and executive director	Mr Kong is a brother of Kong Jian Min and Kong Jian Tao. He is responsible for coordinating and managing HR, administrative management, IT management and KWG's legal affairs.
Li Jian Ming	Vice President of operations management and executive director	Mr Li joined KWG in 1995 and once held the position of vice-president in the engineering management division. He is now responsible for internal and regional engineering management, tenders, group procurement and product standardisation at KWG.
Tsui Kam Tim	CFO, Company Secretary and executive director	Mr Tsui joined KWG in January 2007 as CFO and was appointed an executive director in November 2007. He is primarily responsible for the financial management and supervision of financial reporting, corporate finance, treasury, tax, risk management and other finance-related matters.

Source: Company, Daiwa

KWG: landbank summary

Name of project	City	Stake	Product type	Attributable GFA ('000 sq m)	Attributable End-2016 NAV (CNYm)
The Summit	Guangzhou	100%	Residential/ villas/ serviced apt/ office/ retail	1,885	6,627
Global Metropolitan Plaza	Guangzhou	50%	Office/ retail	73	1,555
Tian Hui Plaza (The Riviera, Top Plaza)	Guangzhou	33.3%	Serviced apt/ office/ hotel/ retail	91	1,448
The Star (Biological Island I & II)	Guangzhou	100%	Serviced apt/ office/ retail	199	1,722
Top of World	Guangzhou	100%	Villas/ serviced apt/ office/ retail/ hotel	567	2,087
The Eden	Guangzhou	50%	Residential/ retail	78	517
Zengcheng Gua Lv Lake	Guangzhou	100%	Villas/ hotel	43	495
Essence of City (Ta Gang Project)	Guangzhou	100%	Residential/ villas/ retail	344	1,627
Guangzhou Pazhou Project	Guangzhou	50%	Office/ retail	50	420
Guangzhou Finance City Project	Guangzhou	33.3%	Serviced apt/ office/ retail	102	2,380
The Horizon (Nansha Project)	Guangzhou	35%	Residential/ retail	158	1,034
International Finance Place	Guangzhou	100%	Office/ retail	61	2,460
Four Points by Sheraton Guangzhou	Guangzhou	100%	Hotel	35	635
Sheraton Guangzhou Huadu Resort	Guangzhou	100%	Hotel	25	155
W Hotel/W Serviced Apartments	Guangzhou	100%	Hotel/ serviced apt	80	1,463
The Mulian Guangzhou	Guangzhou	100%	Hotel/ retail	8	161
Residual projects	Guangzhou			41	498
Oriental Bund	Foshan	50%	Residential/ retail/ serviced apt/ office/ hotel	1,400	1,942
Pearl Coast	Hainan	100%	Villas/ residential/ hotel	236	2,387
Moon Bay Project	Hainan	100%	Villas/ residential/ retail/ hotel	447	4,358
The Sapphire	Suzhou	100%	Residential/ hotel/ serviced apt/ office/ retail	114	1,010
Suzhou Apex	Suzhou	90%	Residential/ hotel/ serviced apt/ retail	142	1,111
Suzhou Emerald	Suzhou	100%	Residential/ retail	71	-
Leader Plaza	Suzhou	51%	Serviced apt/ office/ retail	37	-
Wan Hui Plaza (CRH New City)	Suzhou	100%	Office/ retail	60	-
Suzhou Jade Garden	Suzhou	100%	Residential/ retail	10	-
Residual projects	Suzhou			18	201
Hangzhou Jade Garden	Hangzhou	100%	Residential	47	-
Hangzhou La Bali (Science City II)	Hangzhou	100%	Residential/ villas	58	-
The More (Science City III)	Hangzhou	100%	Residential	106	700
The Mulian Hangzhou	Hangzhou	100%	Hotel/ retail	18	139
Pudong Project	Shanghai	100%	Office/ retail	78	-
The Core of Center	Shanghai	50%	Residential/ serviced apt/ retail/ office	48	-
Shanghai Apex	Shanghai	100%	Residential/ serviced apt/ retail/ hotel	69	535
Shanghai Sapphire	Shanghai	100%	Serviced apt/ hotel/ retail	76	1,844
Shanghai Emerald	Shanghai	100%	Residential/ retail	7	-
Amazing Bay	Shanghai	50%	Residential/ office/ retail/ serviced apt/ retail	94	771
Vision of the World	Shanghai	100%	Residential/ serviced apt/ retail	200	1,688
Shine City	Nanjing	50%	Residential/ office/ retail	73	940
The Core of Center	Nanning	87%	Residential/ villas/ office/ retail	567	794
Guangxi International Finance Place	Nanning	87%	Office/ retail	62	-
Guangxi Top of World	Nanning	87%	Residential/ villas/ hotel/ retail	486	4,859
Fragrant Seasons	Beijing	100%	Residential/ villas/ serviced apt/ retail	28	-
La Villa	Beijing	50%	Residential/ office/ retail	100	512
Beijing Apex	Beijing	50%	Residential/ villas/ serviced apt/ office/ retail	94	1,018
Chong Wen Men	Beijing	100%	Retail	16	445
Summer Terrace (Haidian Project)	Beijing	100%	Residential/ villas/ retail	27	-
Beijing Tongzhou I	Beijing	100%	Serviced apt/ office/ retail	128	1,742
Beijing Tongzhou II	Beijing	100%	Serviced apt/ office/ retail	125	1,646
Rose and Ginkgo Mansion	Beijing	33%	Residential/ villas	69	371
Jinnan New Town	Tianjin	25%	Residential/ serviced apt/ retail	650	928
Boulevard Terrace I (Shuanggang I)	Tianjin	100%	Residential/ retail	55	-
Boulevard Terrace II (Shuanggang II)	Tianjin	100%	Residential/ villas/ retail	32	-
The Vision of the World	Chengdu	100%	Residential/ serviced apt/ retail	5	-
Chengdu Cosmos	Chengdu	100%	Residential/ office/ serviced apt/ retail/ hotel	499	1,877
Chengdu Sky Ville	Chengdu	50%	Residential/ office/ serviced apt/ retail/ hotel	405	2,828
Zhengzhou Project	Zhengzhou	100%	Residential/ retail	29	362
Total				**10,626**	**60,292**

Source: Company, Daiwa

Appendix II: major development properties

The Summit

The Summit	
Location	Zengcheng, Guangzhou
Stake	100%
Attributable GFA	1,885,000 sq m
Products	Residential, serviced apt, office, retail
Date of first launch	Mar 2010
Current/expected ASP	Apartments - CNY8,800/sq m

Source: Company, Daiwa

Oriental Bund

Oriental Bund	
Location	Chancheng District, Foshan
Stake	50%
Attributable GFA	1,400,000 sq m
Products	Residential, serviced apt, retail, office
Date of first launch	Apr 2014
Current/expected ASP	CNY9,000/sq m

Source: Company, Daiwa

The Core of Center

The Core of Center	
Location	Wuxiang New District, Nanning
Stake	87%
Attributable GFA	567,000 sq m
Products	Apartments, villas, office, retail
Date of first launch	Jul 2014
Current/expected ASP	Apartments – CNY7,500/ sq m

Source: Company, Daiwa

Vision of the World

Vision of the World	
Location	Fengxian District, Shanghai
Stake	100%
Attributable GFA	200,000 sq m
Products	Residential, serviced apt, retail
Date of first launch	2014
Current/expected ASP	CNY27,000/ sq m

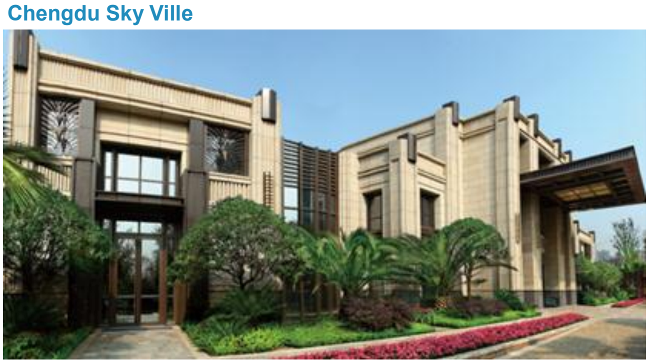
Source: Company, Daiwa

Beijing Apex

Beijing Apex	
Location	Fangshan District, Beijing
Stake	50%
Attributable GFA	94,000 sq m
Products	Residential, villas, serviced apt, office, retail
Date of first launch	Apr 2014
Current/expected ASP	Residential – CNY20,000/ sq m; LOFT – CNY17,000/ sq m

Source: Company, Daiwa

Chengdu Sky Ville



Chengdu Sky Ville	
Location	Jinjiang District, Chengdu
Stake	50%
Attributable GFA	405,000 sq m
Products	Residential, serviced apt, office, retail
Date of first launch	Oct 2012
Current/expected ASP	Residential – CNY17,000/ sq m

Source: Company, Daiwa

Investment properties (Offices and shopping malls)

International Finance Place

International Finance Place	
Year opened	2007
Type	Office
Location	Pearl River New Town, Guangzhou
Stake	100%
Other details	Grade A office held for investment purposes
	Above 95% occupancy rate in recent 3 years

Source: Company, Daiwa

Tian Hui Plaza

Tian Hui Plaza	
Expected launch date	1Q16
Type	Shopping mall
Location	Pearl River New Town, Guangzhou
Stake	33.3%
Other details	JV with Guangzhou R&F and Sun Hung Kai Properties
	Serviced apt launched in Nov 2011; Offices launched in Sep 2013

Source: Company, Daiwa

Shopping mall in Chengdu

Shopping mall at Chengdu Cosmos	
Expected launch date	1H17
Type	Shopping mall
Location	Tianfu New Town, Chengdu
Stake	100%
Other details	Upscale shopping mall next to the W Hotel
	Residential portion (Chengdu Cosmos) launched in Dec 2013

Source: Company, Daiwa

U Fun

U Fun	
Expected launch date	1Q15
Type	Shopping mall
Location	Xinjiangwan, Shanghai
Stake	50%
Other details	JV with Guangzhou R&F
	Residential portion (Amazaing Bay) launched in Mar 2012

Source: Company, Daiwa

M. Cube

M. Cube	
Expected launch date	4Q16
Type	Shopping mall
Location	Chongwenmen, Beijing
Stake	100%
Other details	First wholly owned mall
	Boutique shopping mall with trendy brands and stylish F&B setting

Source: Company, Daiwa

Shopping mall in Suzhou

Shopping mall at Suzhou Apex	
Expected launch date	2H17
Type	Shopping mall
Location	Mudu Town, Suzhou
Stake	90%
Other details	One-stop-shop large-scale family-friendly mall
	Residential portion (Suzhou Apex) launched in 2010

Source: Company, Daiwa

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