

# Far East Consortium

## Earnings Update

### 1H17 strong beat; good visibility for FY17

#### 1H17 net profit a strong beat; interim DPS raised; maintain Buy

FEC reported a strong set of results for 1H17. 1H17 net profit was HK\$681 million (+169% yoy), c50% higher than our forecast and consensus forecast. Revenue was HK\$ 2.95bn (+59% yoy), beating our forecast by 12%. The dividend is also a surprise as the company raised interim dividend to 3.5 cents from 3 cents, first time since FY13. The earnings beat was attributable to 1) a faster-than-expected property development booking from UWS(Stage 4) in Melbourne and King's Manor in Shanghai; 2) better-than-expected profit from Evisca Crest in HK; 3) an improvement in cost efficiency. We maintain Buy on the stock as we see high visibility for FY17 earnings, a deep NAV discount (67%), a strong growth in unbooked property presales, and a recovery in Hong Kong hotel segment. We revised up our net profit forecast for FY17/18/19 by 16%/5%/16%, respectively.

#### Price target upgrade to HK\$4.11 (25% upside); deep NAV discount

We upgrade our PT to HK\$4.11 from HK\$4.00 to reflect newly added development projects. Our PT is derived by using sum-of-the-parts method. Current share price implies a 67% discount to our estimated Mar-17 Net Asset Value (NAV). We believe the deep discount to NAV reflects FEC's relatively small market capitalization. Should its market cap cross the US\$1bn hurdle, the NAV discount could significant narrow. We expect FEC to be eligible for the upcoming HK-SZ connect, a potential catalyst for the stock to outperform.

#### HK\$9.8bn unbooked presales secure strong growth in next 5-6 years

FEC currently has HK\$9.8bn residential development pipeline would imply strong growth in development revenue. The projects launched in 1H17 received very strong market response: 98% of The Royal Crest II in Shanghai were presold (launched in Apr-16); 60% of West Side Place (Tower 1&2) in Melbourne were presold (launched in Jun-16).

#### Active land acquisition with financial discipline

As of Sep-16, its net gearing ratio was 32%, a small drop from 38% at MAR-16. Net debt dropped by 16% hoh due to strong cash recycle from property sales and the company repaid some bank loans, despite the new USD 300m bond being issued. We expect net gearing to remain stable at 37-39% in the next 2-3 years. During 1H17, FEC continued to acquire quality lands including one in Manchester UK, one at Shatin Heights in HK, and one site in Perth, Australia and signed MOU to develop two casino sites in Gold Coast and Sydney.

#### Hotel segment showed some early sign of stabilization

Hotel segment revenue slightly declined yoy mostly due to adverse FX impact. Hong Kong hotels recorded a 1.5ppt improvement in occupancy rate. This echoes Hong Kong Tourism board's hotel industry data which showed stabilization of occupancy rate and room rate in 3Q16, especially for the 3-4 star segment FEC operates in, outperforming the 5-star segment. Hotels in China also reported strong improvement in RevPar.

Stock code: 35.HK

Rating: Buy

Price target (HK\$)	4.11
Previous Price target (HK\$)	4.00
Current price (HK\$)	3.29
Upside/downside %	25%
Market cap (HK\$ m)	7,288
Market cap (US\$ m)	940
Avg daily turnover (HK\$ m)	3.92

Source: Bloomberg, AMTD estimates

#### Key forecasts

(HK\$ m)	FY16	FY17e	FY18e	FY19e
Net profit	734	1,286	1,351	1,723
yoy %	-23%	75%	5%	28%
Revenue	3,995	5,772	6,932	9,348
yoy %	-22%	44%	20%	35%
EBITDA	1,505	2,271	2,472	3,009
Net gearing	38%	38%	39%	39%
EPS	0.37	0.60	0.63	0.81
BPS	4.76	5.18	5.62	6.19
DPS	0.16	0.18	0.19	0.24

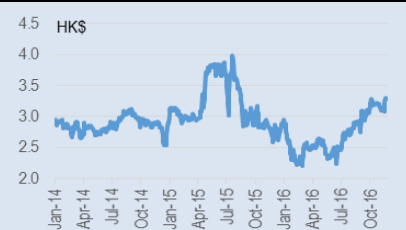
Source: Company data, AMTD estimates

#### Valuation

(HK\$ m)	FY16	FY17e	FY18e	FY19e
P/E	9.0	5.5	5.2	4.1
P/BV	0.69	0.64	0.59	0.53
Div yield	4.9%	5.5%	5.8%	7.4%
ROE	7.6%	12.1%	11.7%	13.7%
ROA	3.0%	4.7%	4.6%	5.4%

Source: Bloomberg, AMTD estimates

#### Share price performance



Source: Bloomberg

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Figure 1: FEC 1H17 earnings review – YoY, HoH comparisons and key ratios

P&L, HK\$ m	1H16	2H16	1H17	1H17e	Actual vs forecast	1H17 YoY %	1H17 HoH %	Comments
<b>Revenue</b>	<b>1,857</b>	<b>2,138</b>	<b>2,953</b>	<b>2,631</b>	<b>12%</b>	<b>59%</b>	<b>38%</b>	
Property development		1,089	1,960	1,593	23%	120%	80%	Faster-than-expected property development booking
Hotel		687	616	647	-5%	-3%	-10%	Some adverse impact from FX movement
Car park		324	309	327	-5%	4%	-4%	
Property investment		26	24	26	-9%	-8%	-8%	
Others		38	66	38	75%	91%	75%	
Cost of sales and services	(1,078)	(912)	(1,697)	(1,457)	16%	57%	86%	
Depreciation and amortisation of hotel&car park assets	(150)	(148)	(147)	(153)	-4%	-2%	-1%	
<b>Gross profit</b>	<b>629</b>	<b>1,078</b>	<b>1,109</b>	<b>1,020</b>	<b>9%</b>	<b>76%</b>	<b>3%</b>	
Property development		703	766	665	15%	156%	9%	
Hotel		289	233	271	-14%	-8%	-19%	
Car park		60	57	61	-7%	0%	-5%	
Leasing and others		25	53	23	131%	154%	113%	
Other income	12	11	7	0		-45%	-41%	
Other gains and losses	131	51	235	100	135%	80%	365%	Better-than-expected profit from Evisca Crest
Administrative expenses	(290)	(308)	(307)	(329)	-7%	6%	0%	Good cost efficiency
Selling and marketing expenses	(54)	(51)	(16)	(75)	-78%	-70%	-69%	
<b>EBIT</b>	<b>427</b>	<b>779</b>	<b>1,024</b>	<b>716</b>	<b>43%</b>	<b>140%</b>	<b>31%</b>	
Finance costs	(115)	(114)	(105)	(143)	-26%	-8%	-7%	
<b>Profit before tax</b>	<b>323</b>	<b>657</b>	<b>921</b>	<b>573</b>	<b>61%</b>	<b>185%</b>	<b>40%</b>	
Income tax expense	(48)	(173)	(233)	(132)	77%	382%	35%	
<b>Profit for the year</b>	<b>274</b>	<b>484</b>	<b>688</b>	<b>441</b>	<b>56%</b>	<b>151%</b>	<b>42%</b>	
Minority interest	(11)	35	7	0			-81%	
<b>Attributable net profit</b>	<b>253</b>	<b>481</b>	<b>681</b>	<b>441</b>	<b>54%</b>	<b>169%</b>	<b>42%</b>	
Tax rate	15.0%	26.4%	25.3%	23.0%	10%	69%	-4%	
<b>Ratios</b>	<b>1H16</b>	<b>2H16</b>	<b>1H17</b>	<b>Comments</b>				
Gross margin	34%	50%	38%					
Gross debt	9,404	11,669	12,097					
Net debt	5,617	7,931	6,688					
EBIT	427	779	1,024					
EBITDA	578	927	1,172					
Gearing ratio ex. Hotel revaluation gains (x)	63%	78%	65%					
Gearing ratio (x)	27%	38%	32%	A drop in gearing ratio				
Net debt/EBITDA (x)	9.7	8.6	5.7					
EBITDA cover (x)	5.0	8.2	11.1					
Selling and marketing expense % of revenue	2.6%	2.6%	2.6%					
Admin expense % of revenue	16%	14%	10%					
Avg interest cost	3.5%	3.5%	3.5%					
<b>ROA</b>	<b>2.3%</b>	<b>4.0%</b>	<b>5.1%</b>					
<b>ROE</b>	<b>5.6%</b>	<b>10.1%</b>	<b>13.3%</b>					

Source: Company data, AMTD Equity Research estimates

Figure 2: AMTD forecast revision

Revenue estimate, HK\$ m	FY17e	FY18e	FY19e	Attributable profit estimate, HK\$ m	FY17e	FY18e	FY19e
Old	5,757	6,915	9,115	Old	1,108	1,282	1,485
New	5,772	6,932	9,348	New	1,286	1,351	1,723
% change	0.3%	0.2%	2.6%	% change	16.1%	5.4%	16.0%

Source: AMTD Equity Research estimates

Figure 3: FEC price target derivation

HK\$ m	2017 NAV	NAV per share (HK\$)	Multiple applied	Target valuation	Valuation per share (HK\$)
Property development	19,346	9.08	60% discount	7,739	3.63
Hotel	7,779	3.65	15% discount	6,612	3.10
Car parks	746	0.35	9.3x PE	746	0.35
Property investment	1,875	0.88	20% discount	1,500	0.70
<b>Total valuation</b>	<b>29,746</b>	<b>13.95</b>	<b>0</b>	<b>16,597</b>	<b>7.79</b>
Net debt	(8,315)	(3.90)	0	(8,315)	(3.90)
<b>Net valuation (Mar-17)</b>	<b>21,431</b>	<b>10.05</b>		<b>8,281</b>	<b>3.88</b>
<b>Price target (Sep-17)</b>					<b>4.11</b>
Current share price (HK\$)					3.29
<b>Implied upside</b>					<b>25%</b>
<b>Share price discount to NAV</b>					<b>-67%</b>

Source: AMTD Equity Research estimates

Figure 4: FEC P&amp;L forecast

HK\$ m							YoY growth %				
P&L	FY14	FY15	FY16	FY17e	FY18e	FY19e	FY15	FY16	FY17e	FY18e	FY19e
<b>Revenue</b>	<b>4,066</b>	<b>5,110</b>	<b>3,995</b>	<b>5,772</b>	<b>6,932</b>	<b>9,348</b>	<b>26%</b>	<b>-22%</b>	<b>44%</b>	<b>20%</b>	<b>35%</b>
Property	2,060	2,962	1,979	3,639	4,552	6,766	44%	-33%	84%	25%	49%
Hotel	1,222	1,454	1,321	1,340	1,551	1,715	19%	-9%	1%	16%	11%
Car park	613	616	623	641	673	707	1%	1%	3%	5%	5%
Property investment	122	56	51	52	55	60	-54%	-9%	1%	7%	8%
Others	50	78	73	100	100	100	54%	-6%	37%	0%	0%
Cost of sales and	(2,298)	(2,884)	(1,990)	(3,016)	(3,695)	(5,440)	25%	-31%	52%	23%	47%
Depreciation and	(215)	(279)	(299)	(307)	(335)	(335)	30%	7%	3%	9%	0%
<b>Gross profit</b>	<b>1,553</b>	<b>1,946</b>	<b>1,706</b>	<b>2,449</b>	<b>2,902</b>	<b>3,573</b>	<b>25%</b>	<b>-12%</b>	<b>44%</b>	<b>19%</b>	<b>23%</b>
Property	729	1,086	1,002	1,752	2,068	2,630	49%	-8%	75%	18%	27%
Hotel	652	691	541	518	647	749	6%	-22%	-4%	25%	16%
Car park	129	124	117	123	129	135	-4%	-6%	5%	5%	5%
Leasing and others	43	45	46	56	58	59	5%	2%	22%	2%	3%
Other gains and losses	485	299	181	235	20	0	-38%	-39%	30%	-91%	-100%
Administrative expenses	(538)	(642)	(598)	(616)	(647)	(712)	19%	-7%	3%	5%	10%
Selling and marketing	(70)	(93)	(105)	(104)	(139)	(187)	33%	14%	-1%	33%	35%
<b>EBIT</b>	<b>1,457</b>	<b>1,536</b>	<b>1,206</b>	<b>1,964</b>	<b>2,137</b>	<b>2,674</b>	<b>5%</b>	<b>-21%</b>	<b>63%</b>	<b>9%</b>	<b>25%</b>
Finance costs	(281)	(224)	(228)	(260)	(345)	(396)	-20%	2%	14%	33%	15%
<b>Profit before tax</b>	<b>1,246</b>	<b>1,328</b>	<b>979</b>	<b>1,704</b>	<b>1,792</b>	<b>2,278</b>	<b>7%</b>	<b>-26%</b>	<b>74%</b>	<b>5%</b>	<b>27%</b>
Income tax expense	(220)	(330)	(221)	(392)	(412)	(524)	50%	-33%	77%	5%	27%
<b>Profit for the year</b>	<b>1,026</b>	<b>998</b>	<b>758</b>	<b>1,312</b>	<b>1,380</b>	<b>1,754</b>	<b>-3%</b>	<b>-24%</b>	<b>73%</b>	<b>5%</b>	<b>27%</b>
Minority interest	112	41	24	26	28	31	-63%	-43%	10%	10%	10%
<b>Attributable net profit</b>	<b>914</b>	<b>957</b>	<b>734</b>	<b>1,286</b>	<b>1,351</b>	<b>1,723</b>	<b>5%</b>	<b>-23%</b>	<b>75%</b>	<b>5%</b>	<b>28%</b>
Tax rate	17.6%	24.9%	22.6%	23.0%	23.0%	23.0%					
Adjusted cash profit	n.a.	836	853	1,593	1,686	2,058	n.a.	2%	87%	6%	22%
Dividend payout ratio	30%	34%	47%	30%	30%	30%					
DPS	0.15	0.16	0.16	0.18	0.19	0.24	7%	0%	13%	5%	28%
EPS	0.51	0.48	0.37	0.60	0.63	0.81	-6%	-23%	65%	5%	28%

Source: Company data, AMTD Equity Research estimates

**Figure 5: FEC balance sheet forecast**

<b>Balance sheet, HK\$ m</b>	<b>FY14</b>	<b>FY15</b>	<b>FY16</b>	<b>FY17e</b>	<b>FY18e</b>	<b>FY19e</b>
<b>Non-current Assets</b>	<b>11,785</b>	<b>12,031</b>	<b>12,460</b>	<b>12,859</b>	<b>12,876</b>	<b>13,174</b>
Investment properties	2,678	3,154	3,304	3,613	3,781	4,139
Property, plant and equipment	7,407	7,492	7,720	7,811	7,660	7,600
Prepaid lease payments	579	541	522	522	522	522
Goodwill	68	68	68	68	68	68
Others	1,053	775	845	845	845	845
<b>Current Assets</b>	<b>10,200</b>	<b>10,185</b>	<b>13,701</b>	<b>15,874</b>	<b>17,138</b>	<b>19,922</b>
Properties for sale	5,655	5,452	8,640	10,959	12,127	15,295
Completed properties	57	201	584	584	584	584
Properties for/under development	5,598	5,252	8,056	10,376	11,543	14,711
Debtors, deposits and prepayments	654	393	527	527	527	527
Deposits receivable from stakeholders	686	417	587	587	587	587
Investment securities	1,012	1,150	1,218	1,218	1,218	1,218
Pledged deposits	174	273	25	25	25	25
Restricted bank deposits	63	51	162	162	162	162
Bank balances and cash	1,829	2,274	2,358	2,212	2,309	1,926
Others	128	174	183	183	183	183
<b>Total assets</b>	<b>21,985</b>	<b>22,216</b>	<b>26,161</b>	<b>28,732</b>	<b>30,014</b>	<b>33,097</b>
<b>Current Liabilities</b>	<b>6,238</b>	<b>6,103</b>	<b>6,471</b>	<b>7,981</b>	<b>7,837</b>	<b>10,225</b>
Creditors and accruals	1,138	737	829	829	829	829
Customers' deposits received	515	575	2,460	3,970	3,826	6,214
Obligations under finance leases	3	4	3	3	3	3
Tax payable	209	333	183	183	183	183
Bank borrowings	4,252	3,087	2,933	2,933	2,933	2,933
Bonds	33	1,250	-	-	-	-
Others	88	116	63	63	63	63
<b>Non-current Liabilities</b>	<b>5,796</b>	<b>5,852</b>	<b>9,422</b>	<b>9,738</b>	<b>10,238</b>	<b>9,861</b>
Bank borrowings	3,271	4,468	7,863	5,863	6,363	6,863
Obligations under finance leases	4	5	5	5	5	5
Amounts due to shareholders of non-wholly owned subsidiaries	-	-	247	247	247	247
Bonds	2,253	1,005	868	3,184	3,184	2,307
Derivative financial instruments	-	59	77	77	77	77
Deferred tax liabilities	268	315	362	362	362	362
<b>Total liabilities</b>	<b>12,034</b>	<b>11,955</b>	<b>15,893</b>	<b>17,719</b>	<b>18,075</b>	<b>20,086</b>
<b>Equity</b>						
Share capital	185	191	213	213	213	213
Share premium	2,802	2,982	3,731	3,731	3,731	3,731
Reserves	5,763	5,970	6,196	6,916	7,814	8,853
<b>Shareholder's equity</b>	<b>8,750</b>	<b>9,144</b>	<b>10,140</b>	<b>10,860</b>	<b>11,758</b>	<b>12,797</b>
Minority interest	1,201	1,117	127	153	181	213
<b>Total equity</b>	<b>9,951</b>	<b>10,261</b>	<b>10,267</b>	<b>11,013</b>	<b>11,939</b>	<b>13,010</b>
Hotel revaluation surplus	8,114	10,976	10,732	10,732	10,732	10,732
Adjusted shareholder's equity	18,065	21,237	20,999	21,745	22,671	23,742

Source: Company data, AMTD Equity Research estimates

**Figure 6: FEC cash flow forecast**

Cash flow forecasts, HK\$ m	FY14	FY15	FY16	FY17e	FY18e	FY19e
Property sales	1,397	3,053	3,784	4,664	3,664	8,036
EBIT from hotel operation	415	166	223	99	211	266
EBIT from investment properties	361	95	155	56	58	59
Tax paid	-110	-140	-372	-392	-412	-524
Depreciation	215	279	299	286	314	314
<b>Cash flow from operation (CFFO)</b>	<b>2,279</b>	<b>3,454</b>	<b>4,088</b>	<b>4,714</b>	<b>3,835</b>	<b>8,152</b>
Capex	-4,825	-2,527	-5,263	-4,670	-4,939	-7,922
Acquisition of assets	-	-	-403	-	-	-
Disposal of assets	174	-	-	-	-	-
Others	183	-51	88	0	0	-0
<b>Free operating cash flow (FOCF)</b>	<b>-2,191</b>	<b>875</b>	<b>-1,489</b>	<b>43</b>	<b>-1,104</b>	<b>230</b>
Interest paid	-419	-393	-380	-308	-428	-492
Dividend	-74	-107	-79	-100	-100	-100
Dividends paid to shareholders of non-wholly owned subsidiaries	-41	-37	-19	-20	-20	-20
<b>FCF</b>	<b>-2,724</b>	<b>338</b>	<b>-1,966</b>	<b>-384</b>	<b>-1,652</b>	<b>-382</b>
Equity issuance	16	14	6	-	-	-
Share buyback	-	-	-82	-	-	-
New debt	5,690	2,776	6,193	3,316	3,000	3,000
Repayment of debt	-3,725	-2,660	-4,251	-3,000	-1,500	-3,377
Shareholder loan	-	-	246	-	-	-
Others	-18	-2	-28	-	-	-
Change in FX	-51	-55	-33	-	-	-
<b>Change in cash position</b>	<b>-813</b>	<b>377</b>	<b>85</b>	<b>-68</b>	<b>-152</b>	<b>-759</b>
Cash balance - period beginning	2,621	1,829	2,274	2,358	2,290	2,138
Cash balance - period end	1,829	2,274	2,358	2,290	2,138	1,379

Source: Company data, AMTD Equity Research estimates

**Figure 7: FEC key ratios**

Ratios	FY14	FY15	FY16	1H17	FY17e	FY18e	FY19e
Gross margin	38%	38%	43%	38%	42%	42%	38%
Gross debt	9,813	9,815	11,669	12,097	11,985	12,485	12,108
Net debt	6,910	6,340	7,931	6,688	8,315	8,967	9,350
EBIT	1,457	1,536	1,206	1,024	1,964	2,137	2,674
EBITDA	1,672	1,815	1,505	1,172	2,271	2,472	3,009
Gearing ratio ex. Hotel revaluation gains (x)	79%	69%	78%	65%	75%	75%	71%
Gearing ratio (x)	38%	30%	38%	32%	38%	39%	39%
Net debt/EBITDA (x)	4.1	3.5	5.3	5.7	3.7	3.6	3.1
EBITDA cover (x)	5.9	8.1	6.6	11.1	8.7	7.2	7.6
Selling and marketing expense % of revenue	1.7%	1.8%	2.6%	0.5%	1.8%	2.0%	2.0%
Admin expense % of revenue	13%	13%	15%	10%	11%	9%	8%
Avg interest cost	4.7%	4.0%	3.5%	n.a.	2.6%	3.5%	4.0%
ROA	4.4%	4.3%	3.0%	5.1%	4.7%	4.6%	5.4%
ROE	10.9%	10.7%	7.6%	13.3%	12.1%	11.7%	13.7%

Source: Company data, AMTD Equity Research estimates

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## IMPORTANT DISCLOSURES

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### AMTD Investment Ratings

Industry Rating	
<b>Overweight</b>	Industry sector expected to outperform the market over the next 12 months
<b>Neutral</b>	Industry sector expected to perform in-line with the market over the next 12 months
<b>Underweight</b>	Industry sector expected to underperform the market over the next 12 months

Stock Rating	
<b>Buy</b>	Stock with potential return of over 20% over the next 12 months
<b>Hold</b>	Stock with potential return of -20% to +20% over the next 12 months
<b>Sell</b>	Stock with potential loss of over 20% over the next 12 months

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### Analyst Certification

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