China Property Management

Navigating the blue ocean; initiate with a positive view

We initiate coverage of the China property management sector with a positive view, placing it at an early stage of structural expansion (market size surpassing Rmb1 trillion in 2021E and Rmb2 trillion in 2030E, or a 9% CAGR). Consolidation of big players will likely continue (Top 100 market share to jump from 27% in 2018 to 59% in 2030E), driving a 31% 18-22E earnings CAGR for covered names. In our *target* scenario, the 2-year implied return would be 107%, driven by rerating and earnings growth. Our top pick is **A-Living** (3319 HK). We also like **Country Garden Services** (6098 HK) and **Colour Life** (1778 HK).

- **A well-deserved premium:** The sector is trading at a 24x 20E P/E (developers: 6x P/E). We consider the premium justified because: (1) it is a structurally growing sector, tapping domestic consumption based on an expanding housing stock; (2) it is asset-light with positive operating cash flows from recurring income; (3) we see ample potential upside as the market is not mature yet; top 100 market share to rise from 27% in 2018 to 59% in 2030E; (4) we see huge growth potential from value-added services (VAS), which currently represent only 11% of total addressable market; (5) it is defensive due to low policy risk, stickier customer base and lower macro sensitivity. We project a 9% 18-30E CAGR in industry revenue, driving a 14% earnings CAGR among top 100 players. Sector market cap should jump from US$22 bn to >US$200 bn by 30E.
- **What drives share prices?** *Growth expectation* is the biggest share price driver, as seen by the high correlation between consensus earnings upgrades and share price (R-square: 86%). Thus, an increase in contracted GFA, M&A (if net cash), VAS profitability, etc., could all drive up market growth expectations (see Table 7). We also observe that when developers' financing gets tighter, property management names' multiples outperform those of developers as investors seek defensiveness.
- **How to value?** We think SOTP is the best approach. (1) For ***property management*** (57% of EBIT), we benchmark investment properties given recurring income (14-26x target P/E). (2) For ***community VAS*** (26% of EBIT), we reference B2C platform businesses (14-19x 3-year forward P/E). (3) For ***non-community VAS*** (17% of EBIT), we use a cyclical business P/E (8-15x). Our target P/Es are derived based on a multi-criteria scorecard (see Table 4).
- **Should we still chase given the outperformance?** The sector has surged 100% YTD (HSCEI: +4%), and is trading at 1 s.d. above mean. We believe the strong growth in GFA is priced in, but the market is not yet fully convinced by the sustainable growth of community VAS (EBIT psm to grow from Rmb1.66 in 1H19 to Rmb2.74 in 2021E) and third-party GFA, and thus rerating will still continue. In our *target* scenario, the 2-year potential return of covered names would be 107%. Even if companies only trade at current P/Es (no rerating), the 2-year return would still be 56%, driven solely by earnings growth (Table 1).
- **Prefer names with visible growth & good track record:** We like **A-Living** (organic growth ability not yet priced in), **Country Garden Services** (strongest growth but capability in community VAS is not yet priced in) and **Colour Life** (attractive valuation). We are Neutral on **Greentown Service** (mediocre track record in growth) and **COPH** (slow growth appetite).

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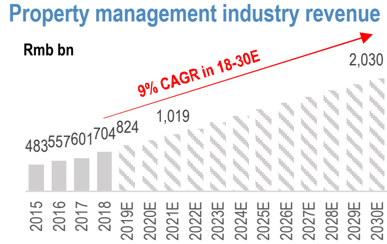
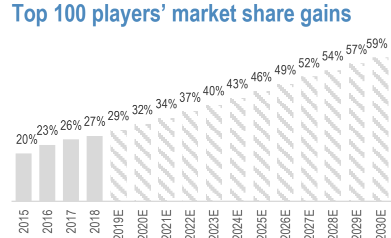
Property management industry revenue



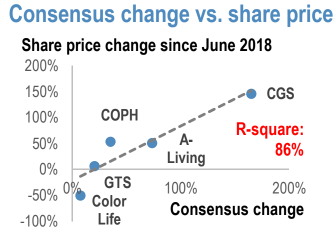
Source: CPMA, J.P. Morgan estimates.

Top 100 players' market share gains



Source: China Index Academy, J.P. Morgan estimates.

Consensus change vs. share price



Source: Bloomberg, J.P. Morgan.

See page 90 for analyst certification and important disclosures, including non-US analyst disclosures.

Equity Ratings and Price Targets

Company	Ticker	Mkt Cap ($ mn)	Price CCY	Price	Rating Cur	Rating Prev	Price Target Cur	Price Target End Date	Price Target Prev	Price Target End Date
Country Garden Services	6098 HK	8,456	HKD	24.85	OW	—	31.00	Dec-20	—	—
A-Living Services	3319 HK	3,740	HKD	22.00	OW	—	31.00	Dec-20	—	—
Greentown Service	2869 HK	2,908	HKD	8.21	N	—	8.80	Dec-20	—	—
China Overseas Property Holdings	2669 HK	1,886	HKD	4.50	N	—	4.60	Dec-20	—	—
Colour Life Services	1778 HK	726	HKD	4.00	OW	—	8.00	Dec-20	—	—

Source: Company data, Bloomberg, J.P. Morgan estimates. n/c = no change. All prices as of 22 Oct 19.

Table 1: Scenario analysis – implied valuation in Dec-20 & Dec-21 based on different 1-year forward P/E ratios

			Bullish Scenario					Status-quo Scenario					Bearish Scenario				
		Price	Target	Implied valuation (HK$)		Implied potential return		Current	Implied valuation (HK$)		Implied potential return		Historical Trough	Implied valuation (HK$)		Implied potential return	
Company	Ticker	HK$	P/E	21E	22E	Dec-20	Dec-21	P/E	21E	22E	Dec-20	Dec-21	P/E	21E	22E	Dec-20	Dec-21
Country Garden Services	6098 HK	24.9	39x	42.9	55.8	73%	124%	31x	34.4	44.7	38%	80%	17x	18.7	24.2	-25%	-2%
A-Living Service	3319 HK	22.0	20x	39.4	46.4	79%	111%	14x	28.0	32.9	27%	50%	9x	18.3	21.5	-17%	-2%
Greentown Service	2869 HK	8.2	29x	11.6	14.9	41%	82%	27x	10.8	13.9	32%	70%	16x	6.6	8.5	-20%	3%
China Overseas Prop Hdgs	2669 HK	4.5	24x	5.9	6.9	32%	53%	23x	5.8	6.7	29%	49%	11x	2.8	3.3	-37%	-27%
Colour Life	1778 HK	4.0	15x	9.3	10.5	133%	164%	7x	4.7	5.3	16%	32%	7x	4.7	5.3	16%	32%
Average			**25x**			**72%**	**107%**	**21x**			**29%**	**56%**	**12x**			**-17%**	**1%**

Source: Company data, Bloomberg, J.P. Morgan estimates.

Table 2: China property management sector – valuation summary

				JPM	Last	Market	P/E		Div Yield		P/B		P/S		18-21E	Avg	YTD	Southbound
	Stock	JPM		Price	Close	Cap	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	FY19E	FY20E	EPS	Turnover	Price	as % of
Company	Code	Rating	CCY	Target	22-Oct-19	US$ mn	(x)	(x)	(%)	(%)	(x)	(x)	(x)	(x)	CAGR	US$ mn	Perf.	Free Float
Country Garden Services	6098.HK	OW	HKD	**31.00**	24.85	8,457	40.0	31.0	0.6%	0.8%	11.3	8.7	7.9	5.6	42%	18.3	101%	7%
A-Living	3319.HK	OW	HKD	**31.00**	22.00	3,740	22.2	14.4	2.0%	3.1%	4.1	3.4	5.0	2.9	44%	12.7	113%	NA
Greentown Service	2869.HK	N	HKD	**8.80**	8.21	2,910	37.1	27.1	0.9%	1.3%	7.6	6.3	2.4	1.9	38%	4.7	39%	21%
China Overseas Ppty Holdings	2669.HK	N	HKD	**4.60**	4.50	1,886	28.7	23.4	1.0%	1.3%	9.9	7.6	3.3	2.7	23%	4.8	99%	15%
Colour Life	1778.HK	OW	HKD	**8.00**	4.00	726	8.8	7.3	4.3%	5.5%	1.3	1.2	1.2	1.1	18%	2.1	-1%	20%
Ever Sunshine	1995.HK	NC	HKD	-	4.40	862	30.6	18.7	1.1%	1.6%	5.6	4.6	3.4	2.3	40%	1.2	149%	NA
S-Enjoy Service	1755.HK	NC	HKD	-	9.12	951	23.5	16.5	NA	NA	NA	NA	NA	NA	-	3.4	141%	NA
Aoyuan Healthy Life	3662.HK	NC	HKD	-	5.68	526	22.0	13.8	1.7%	2.8%	4.4	3.6	4.2	2.7	35%	2.7	58%	NA
Kaisa Prosperity	2168.HK	NC	HKD	-	16.50	295	14.1	10.9	1.8%	2.3%	3.6	2.8	1.7	1.3	47%	0.5	126%	NA
Zhong Ao Home	1538.HK	NC	HKD	-	0.70	73	4.9	4.5	4.3%	4.3%	0.7	0.6	0.4	0.4	-	0.1	12%	NA
Property Management							**32.0**	**23.8**	**1.1%**	**1.6%**	**7.9**	**6.2**	**5.1**	**3.6**	**37%**	**11.4**	**93%**	**8%**

Source: Company data, Bloomberg, J.P. Morgan estimates. Note: "NC" refers to companies not under JPM coverage; estimates of which are Bloomberg consensus numbers.

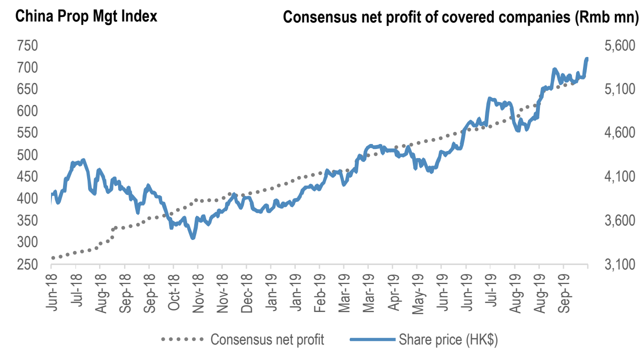
Figure 1: China Property Management Sector P/E vs. China Developers Sector P/E

Consistently trading at a premium, China property management sector multiple tends to outperform when developers' financing is tight as market seeks defensiveness.

Source: Bloomberg, HKEx, J.P. Morgan

Figure 2: China Property Management Share Price Index vs. covered companies' aggregate rolling 1-year forward consensus net profit

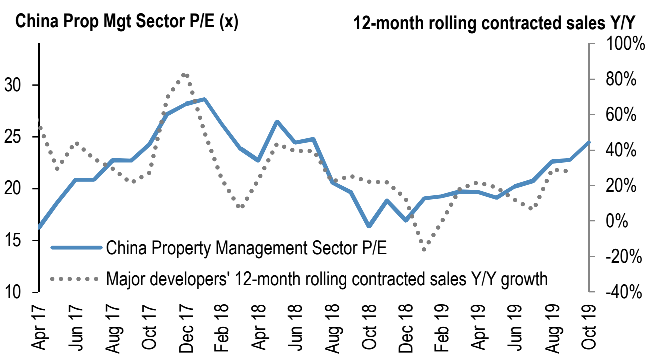
Growth expectation is a key share price driver, and thus property management companies' share prices have been closely tracking consensus earnings estimates.



Source: Bloomberg, J.P. Morgan

Figure 3: China Property Management Sector P/E vs. major developers' 12-month rolling contracted sales Y/Y growth

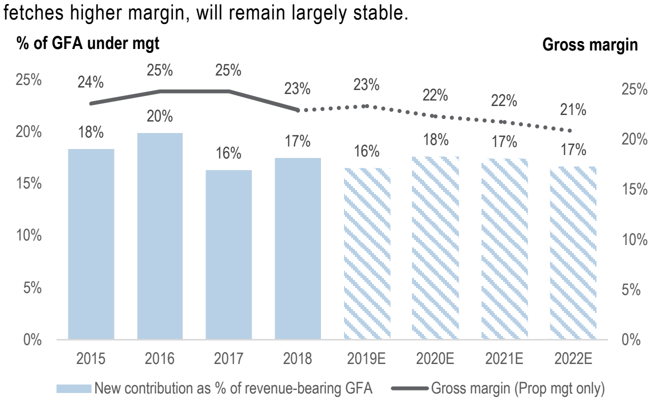
GFA under management is a result of developers' contracted sales, and therefore when sales growth trends up, the growth expectation on property management companies also picks up.



Source: Bloomberg, Company data, HKEx, J.P. Morgan

Figure 4: New contribution as % of revenue-bearing GFA, vs. gross margin of property management segment (excluding VAS)

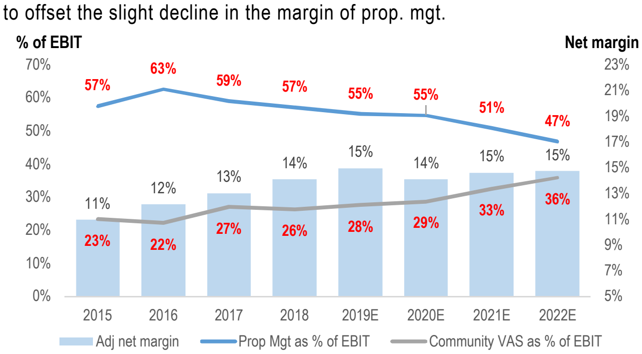
We believe gross margin of property management (excluding VAS) will only see a slight decline till 22E as the % of newly acquired GFA, which usually fetches higher margin, will remain largely stable.



Source: Company data, J.P. Morgan estimates. Note: for our 5 covered companies only.

Figure 5: Net margin vs. EBIT composite

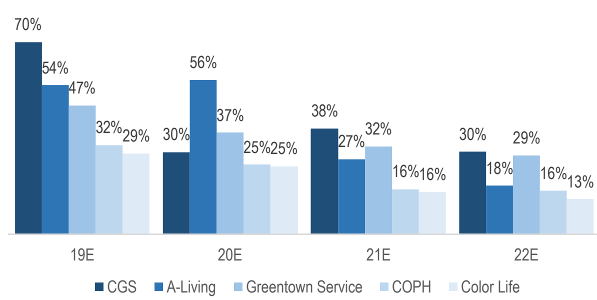
We expect net margin will remain stable in the coming 3-4 years, as contribution from community VAS, which fetches higher margin, will pick up to offset the slight decline in the margin of prop. mgt.



Source: Company data, J.P. Morgan estimates. Note: for our 5 covered companies only.

Figure 6: Core net profit Y/Y growth comparison

We forecast our covered companies will see a 31% earnings CAGR in 18-22E. CGS will see the strongest CAGR of 41%, followed by A-Living (38%). COPH & Colour Life's will be relatively weak at 20-22%



Source: J.P. Morgan estimates.

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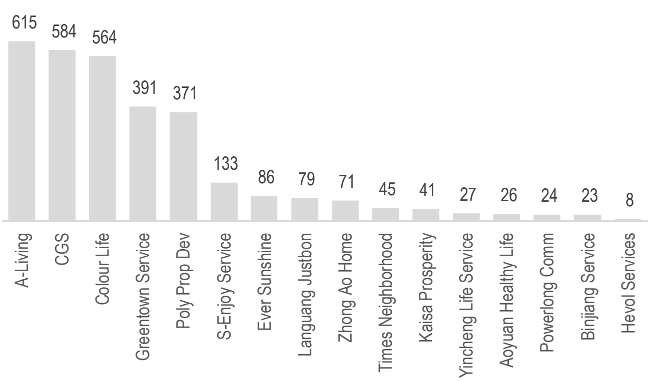
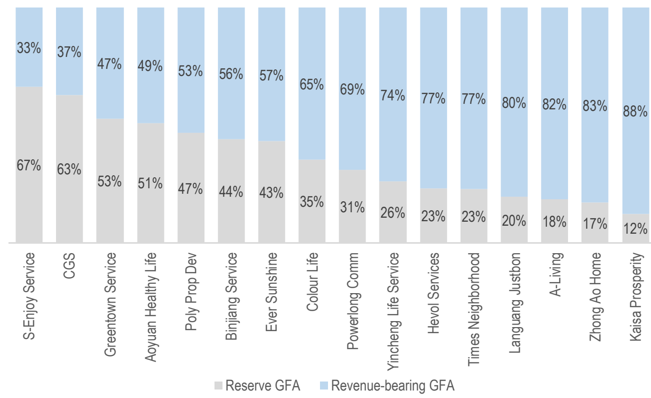
Peers comparison

Figure 7: Contracted GFA (total basis) - mn sqm



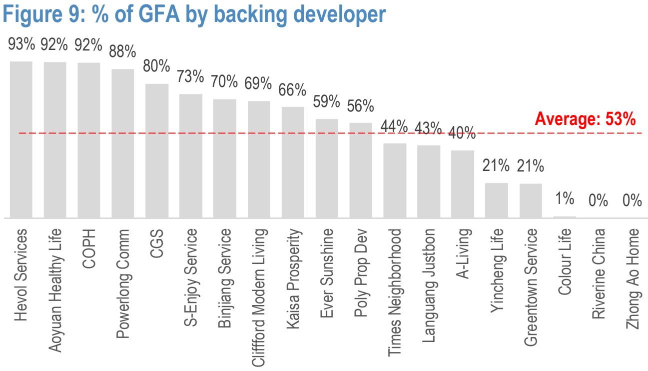
Source: Company data, HKEx, J.P. Morgan
Note: A-Living's includes acquisition of CMIG

Figure 8: Reserve GFA as % of Revenue-bearing GFA



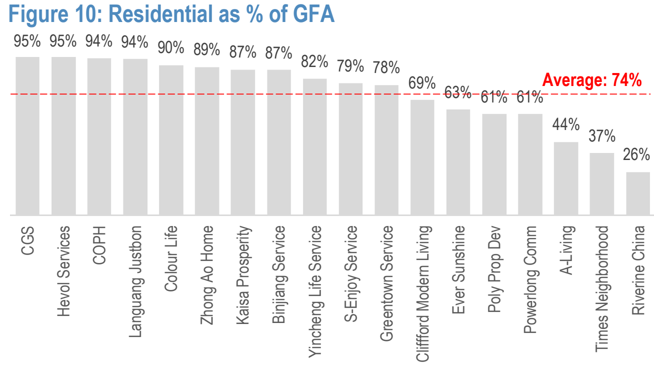
Source: Company data, HKEx, J.P. Morgan. Note: A-Living's includes CMIG acquisition.

Figure 9: % of GFA by backing developer



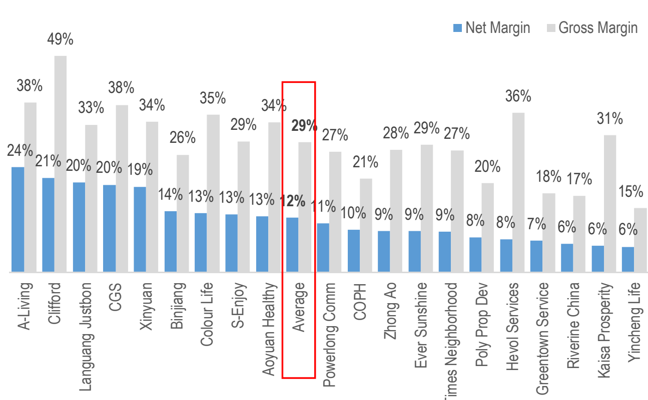
Source: Company data, HKEx, J.P. Morgan. Note: A-Living's includes CMIG acquisition.

Figure 10: Residential as % of GFA



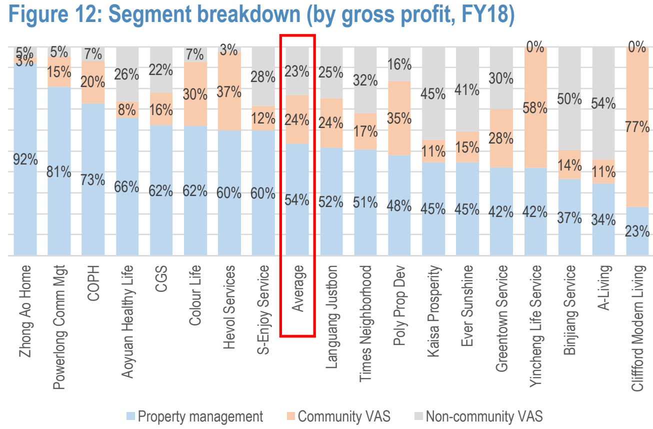
Source: Company data, HKEx, J.P. Morgan. Note: A-Living's includes CMIG acquisition.

Figure 11: Margin comparison (FY18)



Source: Company data, HKEx, J.P. Morgan

Figure 12: Segment breakdown (by gross profit, FY18)



Source: Company data, HKEx, J.P. Morgan

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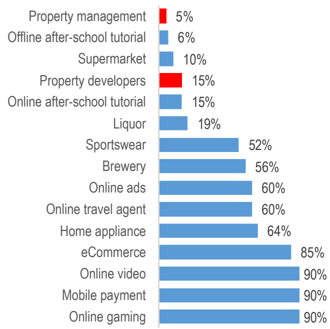
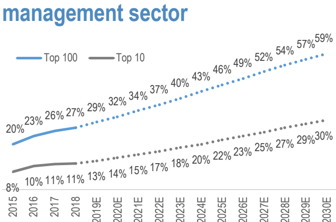
Executive summary

Figure 13: Top 3 players' market share, by sector in China (2018)



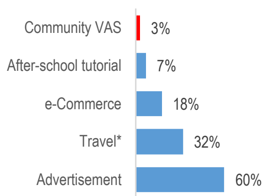
Source: Company data, NBS, Euromonitor, Frost & Sullivan, CIA, CEIC, J.P. Morgan estimates. Note: Liquor data is as of 2017.

Figure 14: Top 100 & Top 10 market share of Chinese property management sector



Source: CIA, J.P. Morgan estimates.

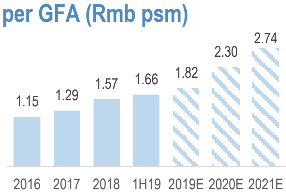
Figure 15: Online penetration of various sectors in China



Source: Company data, J.P. Morgan estimates.

For Community VAS, we estimate the penetration rate by assuming 30% of community VAS is conducted through online platforms, out of the 11% penetration rate in TAM.

Figure 16: Community VAS EBIT per GFA (Rmb psm)



Source: Company data, J.P. Morgan estimates

A Rmb2 trillion market in 2030E

The China property management sector saw an industry revenue of Rmb704 bn in FY18 (86% from property management and 14% from VAS, by our estimate), and we expect the total market size will surpass Rmb1 trillion in 2021E and Rmb2 trillion in 2030E. This represents a 9% 18-30E CAGR, driven by a 5% CAGR in revenue-bearing GFA, which is the proxy of our estimated 5% CAGR in total housing stock (assuming an average 3% annual decline in sales volume till 2030E).

Market consolidation to continue

We estimate the top 100 companies' market share (by absolute number) was 27% in FY18. Their growth will outpace the industry and we forecast market share to reach 59% in FY30E. We expect more consolidation, mainly due to (1) tailwinds from major developers' consolidation; (2) more M&A; (3) the rise of value-added services (VAS) crowding out smaller players; and (4) economies of scale. If we compare the top 3 players' market share with other sectors, property management's is only 5%, which is way below that of most other sectors, including developers (15%).

A sector with US$200 bn market cap is in the making

Currently the market cap of the HK-listed China property management sector is US$22 bn with 16 companies. We forecast that, by 2030, there could be >100 property management companies (PMCs) listed in Hong Kong, with a total market cap of >US$200 bn. Currently there are ~100 Chinese developers listed in Hong Kong and another ~130 listed on A-share markets. We believe both HK-listed & A-share developers are more inclined to spin off property management arms in Hong Kong, given the higher valuation and less lengthy approval process (CSRC has stricter requirements on "related party" transactions). The potential US$200 bn market cap can also be roughly cross-referenced by the case of FirstService, which currently accounts for 5% market share in North America. If we adjust its net margin to 10% (average of China PMCs), the implied market cap would be >US$200 bn.

Growth in community VAS & third-party GFA not yet fully priced in

The sector is trading at 24x 2020E P/E, which is in line with the multiple that the market gives to landlords with assets in tier-1 cities, and above global real estate services peers of 19x (albeit not direct comparables). FirstService, which we consider the closest global peer comparable, is trading at 30x 2020E P/E with a 27% EPS 18-21E CAGR, but China PMCs will see an average 37% CAGR for the same period. We think the market has priced in future growth in revenue-bearing GFA. However, (1) the growth in community VAS (it currently accounts for only 11% of the total addressable market (TAM); and we estimate only 3% of TAM is through online platforms. We also expect EBIT per GFA to rise from Rmb1.66 in 1H19 to Rmb2.74 in 2021 among our covered names), and (2) the capability to expand third-party GFA have not been priced in. We thus expect the multiple will still expand.

Key industry risks

(1) **Higher sensitivity to labor costs** (for every 5% change, we forecast a negative 12% impact on net profit); (2) **revival of social security reform** (which was proposed but not implemented) might hurt margins, but we think the impact on profitability is not big for our covered names; (3) **new industry regulations** (e.g. establishment of owners' associations becomes a requirement / "price cap" on management fees); and (4) **share placement**.

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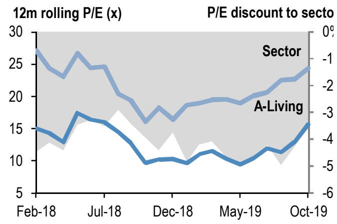
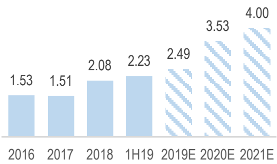
Figure 17: A-Living's P/E discount to sector



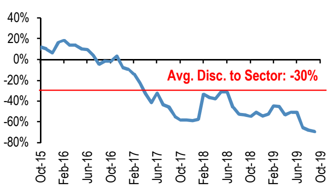
Source: Bloomberg, J.P. Morgan estimates.

Figure 18: CGS – community EBIT per residential GFA (Rmb psm)



Source: Company data, J.P. Morgan estimates.

Figure 19: Colour Life – P/E discount to sector



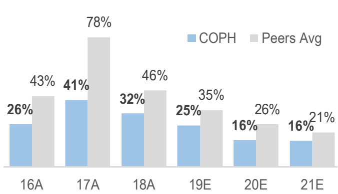
Source: Bloomberg, J.P. Morgan estimates.

Figure 20: Greentown Service's Y/Y growth vs. peers

	FY18	1H19
Revenue Y/Y		
Greentown Service	31%	25%
Peers Average	63%	38%
Gross Profit Y/Y		
Greentown Service	27%	28%
Peers Average	59%	31%
Net Profit Y/Y		
Greentown Service	-1%	7%
Peers Average	78%	37%

Source: Company data, J.P. Morgan.

Figure 21: COPH - Net profit Y/Y growth vs. peers



Source: Company data, J.P. Morgan estimates.

Stock picks

Overweight

A-Living (3319 HK) *top pick*

After the acquisition of CMIG in Sep 2019, A-Living has outperformed the HSCEI by 32%. However, we think rerating will still continue, as the market should gradually appreciate A-Living's shift in focus from M&A-centric to organic growth. We also argue that A-Living's P/E gap with the sector should further narrow (now still at a 39% discount) after the scale upgrade but this has yet to happen. With a 37% 18-22E core EPS CAGR but 14x FY20E P/E, we think risk-reward is attractive. Inclusion into Southbound (Stock Connect) is another potential catalyst in 1Q20.

Country Garden Services (6098 HK)

CGS is trading at the highest P/E (31x) in the sector, but it is expensive for good reasons, given (1) backing by China's largest developer by sales; (2) strong desire to expand third-party GFA; (3) visible growth (reserve GFA is 67% of revenue-bearing GFA); and (4) leadership positions in low-tier cities (less competition for third-party projects). We think the growth potential from VAS and third-party are not yet priced in, and more evidence on that should further rerate the stock, which offers a sustainable long-term growth pipeline (39% core EPS 18-22E CAGR).

Colour Life Services (1778 HK)

The company has seen a big derating since IPO due to lower growth expectation. While we agree that Colour Life deserves to trade at a discount to peers due to slower growth, higher leverage and lack of backing company support, we think it is significantly under-valued, given (1) 20% earnings CAGR in 18-22E is on par with COPH, which is trading at 23x FY20E P/E; (2) cash flows & leverage will improve; and (3) VAS still has a lot of growth potential. Colour Life is trading at trough P/E of 7x, which we think is too low for a company with a stably growing recurring income.

Neutral

Greentown Service (2869 HK)

After two sets of disappointing results, we think Greentown Service should be on track to see accelerated earnings growth (36% CAGR in 18-22E), which will be among the strongest in the sector. However, given the track record of consensus earnings miss and worsening efficiency in community VAS, we believe the current valuation of 27x FY20E P/E already appears fair. We could turn positive if we see a significant turnaround in the community VAS segment.

China Overseas Property Holdings (2669 HK)

For a structurally expanding sector that values growth, we think COPH is yet to demonstrate a strong growth appetite, with sluggish expansion to third-party GFA, lack of solid growth guidance and a passive approach to VAS. Currently trading at 23x P/E (2 standard deviations above mean) without visible catalysts, we think COPH's current valuation is fair for its underperforming growth (22% 18-22E CAGR vs. peers' average of 31%). We could turn more positive if COPH turns more aggressive in acquiring third-party GFA.

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Table 3: China property management sector - price target summary with breakdown by segment

		Property Management		Community VAS		Non-community VAS					Implied valuation			
		Target P/E	HKD/share	Target P/E	HKD/share	Target P/E	HKD/share	Dec-20 Price Target (HKD)	Current Price (HKD)	Potential upside	FY19E P/E	FY20E P/E	FY21E P/E	FY22E P/E
Country Garden Services	6098 HK	26x	19.0	19x	8.9	15x	2.7	31.0	24.9	25%	50x	39x	28x	21x
A-Living Service	3319 HK	24x	17.2	18x	7.6	11x	6.1	31.0	22.0	41%	31x	20x	16x	14x
Greentown Service	2869 HK	14x	2.2	19x	5.7	14x	0.9	8.8	8.2	7%	40x	29x	22x	17x
China Overseas Prop Hdgs	2669 HK	18x	2.4	14x	1.6	15x	0.7	4.6	4.5	2%	29x	24x	21x	18x
Colour Life	1778 HK	14x	4.1	15x	3.6	8x	0.2	8.0	4.0	100%	18x	15x	13x	11x

Source: Company data, Bloomberg, J.P. Morgan estimates. Priced as of close of 22 Oct 2019.

Valuation

SOTP approach

Listed property management companies (PMCs) usually have three main businesses, namely: (1) property management; (2) community value-added services; (3) non-community value-added services. Given the asset-light and recurring nature of these businesses, we think P/E is a fair valuation yardstick. However, as the drivers of these three businesses are quite different and the profit contributions vary among different developers, we believe SOTP is an appropriate approach to value a full-service property management company, instead of just applying a target P/E for the entire company.

Property management

The traditional property management business is a non-cyclical, asset-light business. The business itself is based on the contract entered between property owners and operators, and each contract typically lasts for 3-5 years (but in reality, as most projects lack an owners' committee, the management contract is automatically extended until home owners organize among themselves to terminate the contract). While the market itself is stable, uncertainty arises from whether the operator is able to retain the contract after expiry. However, given the 98% renewal rate among the top 100 companies, we think this is not a big concern at the moment.

Benchmarking investment properties

We believe the property management business can benchmark to investment properties, as (1) they are in a similar underlying market; (2) both rely on recurring income; (3) contracts usually last for 3-5 years; and (4) both are less prone to policy risks. However, property management is asset-light so service quality is crucial in renewing contracts with home owners, while investment properties are asset-heavy by nature, and there is more asset appreciation (capital gains) potential. Despite the differences in the asset nature between the two, given the same fundamentals of stable & recurring cash flows, we think we can apply the P/E range of investment properties (10-26x, benchmarking Hong Kong/China landlords) to the property management business.

Among the recent M&A activities in the property management sector, the average P/E is roughly 10-13x P/E. Therefore, we believe 10x P/E is a base for a typical PMC, and a premium should be added for those with (1) ability to grow third-party GFA (a measure of sustainable growth); (2) support from a backing/parent company;

(3) strength of backing company; and (4) economies of scale. For each of these criteria, we assign a maximum P/E premium, and score each company based on a particular measurement. Therefore, the maximum P/E premium a company can achieve is 26x (10x base case + 4x P/E premium in each of the four categories):

(1) **Ability to grow third-party GFA (4x P/E premium max):** We measure this by the 2015-18 CAGR in third-party GFA, because it shows how a company is able to achieve growth outside of the backing developer.

(2) **Support from backing company (4x P/E premium max):** This is measured by % of contracted GFA coming from the backing or parent company, as we think a premium should be given to those with a supportive developer behind them who can provide more certainty in growth in GFA, and is thus less reliant on M&A (more uncertain) to achieve growth. This does not contradict the first criterion (CAGR in third-party GFA) as the former measures absolute growth rate, while this looks at the proportion. For example, CGS is able to maintain a higher proportion of GFA from its backing company (80%) while growing third-party GFA, and this is the sweet spot. In contrast, while COPH enjoys strong support from COLI, its ability to acquire third-party projects is weaker, and thus a lower score.

(3) **Strength of backing company (4x P/E premium max):** We measure this by the absolute land bank size as a gauge of the strength of the backing company. For example, being backed by Country Garden or Greenland (top 5 developer) is better than being supported by Fantasia (top 50 developer).

(4) **Economies of scale (4x P/E premium max):** *Attributable* contracted GFA is our measure on this. We believe the absolute size should also play a role here as the larger a company is, the more potential acquisition opportunities as well as economies of scale.

For the expected earnings (the "E" in P/E), we use our estimate of "stabilized net profit" based on the latest reported contracted GFA (i.e. 1H19), instead of just revenue-bearing GFA. This is to capture the future growth which should have been accounted for by market, because in normal circumstances, contracted GFA will eventually become revenue-bearing, and thus the valuation should capture the total potential recurring income which has already been "contracted".

Table 4: Scorecard for Target P/E of property management segment (base target P/E = 10x)

		Ability to grow third-party GFA	Support from backing company	Strength of backing company	Economies of scale	P/E Premium	Target P/E
	Maximum P/E Premium	*4x*	*4x*	*4x*	*4x*	*16x*	
Country Garden Services	6098 HK	4x	4x	4x	4x	16x	**26x**
A-Living Services	3319 HK	4x	3x	4x	3x	14x	**24x**
Greentown Service	2869 HK	0x	1x	1x	2x	4x	**14x**
China Overseas Prop Hdgs	2669 HK	0x	4x	2x	2x	8x	**18x**
Colour Life	1778 HK	1x	0x	0x	3x	4x	**14x**

		Ability to grow third-party GFA	Support from backing company	Strength of backing company	Economies of scale
	Measure in numbers	*15-18 CAGR in third-party GFA*	*% of GFA from backing developer*	*Land bank as of 1H19 (mn sqm)*	*Attri. contracted GFA as of 1H19 (mn sqm)*
Country Garden Services	6098 HK	132%	80%	376	577
A-Living Services	3319 HK	170%	40%	237	417
Greentown Service	2869 HK	28%	21%	34	362
China Overseas Prop Hdgs	2669 HK	20%	92%	92	191
Colour Life	1778 HK	68%	1%	12	518

Source: J.P. Morgan

Community VAS

This is the sweet spot where property management companies extract value through building a strong base of property owners. By building an eco-system with a full range of value-added services, property management firms manage to be the preferred provider of various services such as home repairs, eCommerce, education, elderly services, etc.

Companies either provide the services directly to property owners (B2C), or they engage third-party vendors to provide services through a platform, usually an app (i.e platform for B2C). The latter is increasingly common and should become the mainstream as the eco-system grows. For example, for home repair services, management companies may initially provide such services with their own staff, but increasingly they match third-party vendors to customers through the app, and they earn the commission fees. Gross margin and thus ROE are high due to the asset-light nature, and since there is a wide range of potential services to be provided, growth drivers can come from both organic growth in existing services and new contribution from new offerings.

Benchmarking other B2C platform businesses

We believe the target P/E for this segment can benchmark the B2C platform businesses of tech companies (e.g. the in-store business of Meituan or eCommerce business of Alibaba), as they both charge commission fees by linking third-party vendors to home owners (members). In fact, community VAS probably should even deserve a premium because (1) the user base is theoretically stickier with less competition; and (2) they have physical accessibility to the community. For example, for repair services, owners tend to go for the property management company, while for eCommerce, there are more alternative platform choices for users.

Three-year forward target P/E

Given the strong-growth nature of community VAS, we think we should apply a three-year forward target P/E so that we can capture the growth aspect. To decide the P/E, we differentiate companies not by expected earnings growth (as otherwise this would double-count the growth element), but by efficiency, scale and track record. We set a base P/E of 10x, benchmarking the 10-15x three-year forward P/E of the B2C platform businesses, and then we give a premium based on the three criteria:

(1) **Efficiency (4x P/E premium max):** Given the components of community VAS vary significantly among property management companies, comparing margin alone would not give us the full picture. We therefore look at the EBIT per residential GFA under management (as community VAS focuses on residential properties), thus measuring how much profit each GFA can generate. Greentown Service stands out with the best efficiency, while Colour Life generates the least net profit out of each GFA managed.

(2) **Scale (3x P/E premium max):** Scale also matters, because a bigger serving population would mean more business opportunities and service offerings. A bigger size would also attract more collaboration opportunities with vendors.

(3) **Track record (3x P/E premium max):** We believe track record can be best measured by the EBIT CAGR in the past three years, and this shows the capability of the company to expand this business segment.

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Table 5: Scorecard for Target P/E of community VAS segment (base target P/E = 10x)

		Efficiency	Scale	Track record	P/E Premium	Target P/E
	Maximum P/E Premium	*4x*	*3x*	*3x*	*10x*	
Country Garden Services	6098 HK	4x	3x	2x	9x	**19x**
A-Living Services	3319 HK	3x	2x	3x	8x	**18x**
Greentown Service	2869 HK	4x	2x	3x	9x	**19x**
China Overseas Prop Hdgs	2669 HK	2x	1x	1x	4x	**14x**
Colour Life	1778 HK	0x	3x	2x	5x	**15x**

		Efficiency	Scale	Track record
	Measure in numbers	*EBIT per res. GFA (Rmb)*	*No. of residents*	*EBIT 15-18 CAGR*
Country Garden Services	6098 HK	2.1	8.0	51%
A-Living Services	3319 HK	1.8	4.3	71%
Greentown Service	2869 HK	2.8	4.1	68%
China Overseas Prop Hdgs	2669 HK	1.2	3.9	30%
Colour Life	1778 HK	0.3	32.0	57%

Source: J.P. Morgan

Non-community VAS

This segment refers to ancillary businesses including property agency, sales office management, pre-sales services and consulting. The main customers are developers. We believe this is a function of residential sales, and is thus cyclical by nature. We therefore think we should set our target P/E at 8x for major developers as the base, but give a premium due to its asset-light nature and higher margin.

Table 6: Scorecard for Target P/E of non-community VAS segment (base target P/E = 8x)

		Sponsor strength	Growth	Track Record	P/E Premium	Target P/E
	Maximum P/E Premium	*4x*	*2x*	*2x*	*8x*	
Country Garden Services	6098 HK	4x	2x	2x	8x	**16x**
A-Living Services	3319 HK	3x	2x	2x	7x	**15x**
Greentown Service	2869 HK	4x	1x	1x	6x	**14x**
China Overseas Prop Hdgs	2669 HK	4x	2x	1x	7x	**15x**
Colour Life	1778 HK	0x	0x	0x	0x	**8x**

		Sponsor strength	Growth	Track Record
	Measure in numbers		*EBIT 18-22E CAGR*	*EBIT 15-18 CAGR*
Country Garden Services	6098 HK	Country Garden	27%	40%
A-Living Services	3319 HK	Agile	62%	118%
Greentown Service	2869 HK	Greentown	13%	17%
China Overseas Prop Hdgs	2669 HK	COLI	20%	53%
Colour Life	1778 HK	Fantasia	20%	-1%

Source: J.P. Morgan

A-Living's real estate agency business is valued separately

Given A-Living has a more unique situation where real estate agency business (90% for Agile & Greenland) accounts for around half of its non-community VAS EBIT, we value it separately by applying a conservative 8x P/E to this, and 15x P/E for the remaining. The blended target P/E for A-Living's non-community VAS business is therefore 11x.

Figure 22: Market price implied P/E on property management segment (excluding VAS)

	Market price-implied P/E	JPM target P/E
CGS	18x	26x
A-Living	16x	24x
Greentown Service	11x	14x
COPH	17x	18x
Colour Life	1x	14x

Source: J.P. Morgan estimates.
Note: The market price-implied P/E is deduced by deducting our target valuation on community VAS and non-community VAS from the market share price.

A fair multiple?

Property management companies are trading at 24x P/E. Our price targets on covered names imply a target P/E of ~25x. This is similar to the multiple that the market pays for landlords with tier-1 assets (20-25x). The premium is justified, in our view, due to PMCs' asset-light nature, higher growth, stickier user base and less sensitivity to macro environment (e.g. demand from both retail tenants and office tenants is more prone to macros).

If we strip out our target valuation on VAS (both community and non-community), the market price-implied valuation on traditional property management (using stabilized net profit from total contracted GFA) would be 12x only. Within our coverage, PMCs with strong support from a backing developer are trading at a higher implied P/E (18x for CGS and 17x for COPH), while those without a strong backing are trading at a relative discount. For example, the market price-implied P/E for Colour Life's property management segment is only 1x.

Considering the usual contract life is only 3-5 years, the market price-implied contractual period of 13 years is much longer, and we think this is because (1) renewal rate has been high at 98%; (2) the majority of residential communities do not have an owners' committee, and thus property management contracts are usually automatically extended; (3) if the majority of contracts can be extended for a "prolonged period of time", then the "contract" should theoretically be up to the entire land lease period of 40-70 years. This implies that market has an assumption that property management contracts could usually go way beyond 3-5 years, given the high renewal rate so far.

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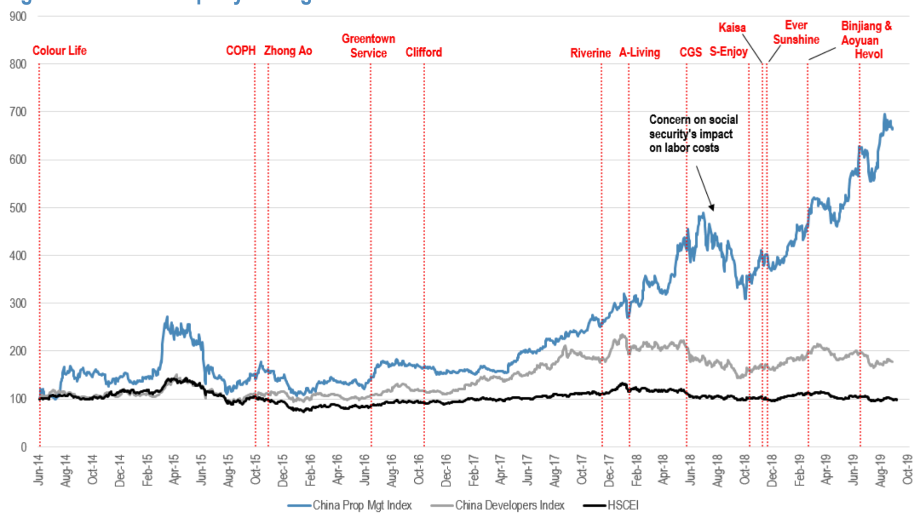
Share price drivers

Sector share price review

The China property management sector has jumped almost 7 times since Jun 2014, which a result of multiple expansion and strong earnings growth. Apart from 2H18 during which market was concerned about the impact of the new social security regulations on labor costs (which still has not come into effect with no visible implementation plans), share price has been mostly trending up, supported by the continuously growing consensus earnings.

Figure 23: China Property Management Share Price index

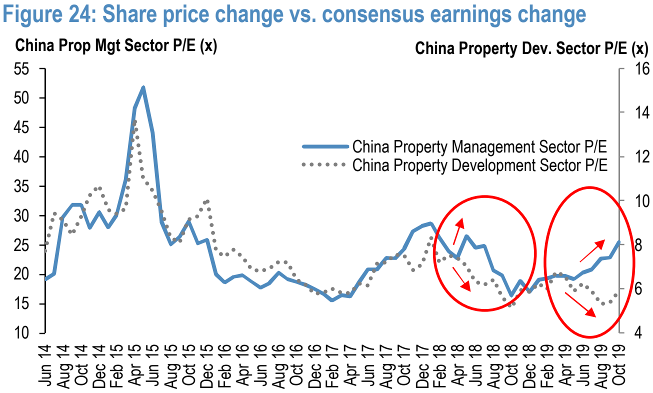


Source: Bloomberg, J.P. Morgan

Note: Red dotted lines denote IPO date.

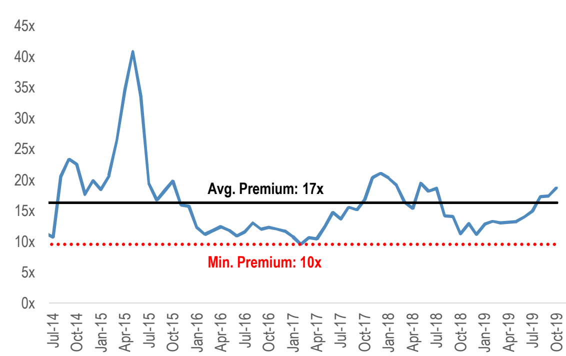
The sector P/E usually trades in a similar direction to developers, except when developers' financing is getting tight and property management P/E could outperform due to defensiveness. Historically, PMCs have traded at a 17x P/E premium over developers (minimum 10x P/E).

Figure 24: Share price change vs. consensus earnings change



Source: Bloomberg, HKEx, J.P. Morgan

Figure 25: China Property Management P/E premium over China Developers' P/E



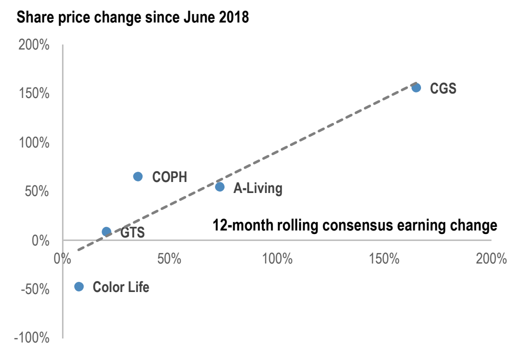
Source: Bloomberg, J.P. Morgan

Growth expectation is the key share price driver

Among various possible factors that impact share prices, we believe *growth expectation* is the biggest driver, as seen by the strong correlation (R-square: 86%) between share price and consensus earnings upgrades.

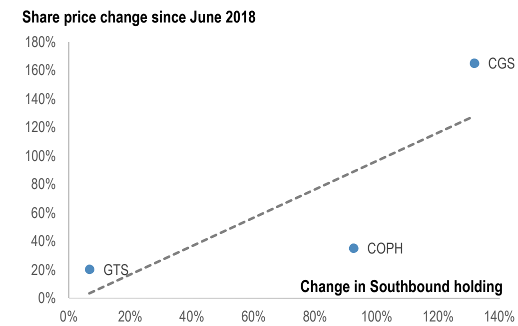
Meanwhile, Chinese PMCs typically see 10-20% of their free float coming from Southbound money (Stock Connect). For CGS, Greentown Service and COPH, we think Southbound holding has been another major share price driver, but that is not the case for Colour Life (we think this could be attributed to the fact that Southbound investors focus more on "growth story" and thus they buy into all possible names in the sector, but they focus less on fundamentals). A-Living's potential inclusion into Hang Seng indexes and thus Southbound in 1Q20 (as by now the company should have satisfied the market cap requirements) could thus be a catalyst.

Figure 26: Share price change vs. consensus earnings change



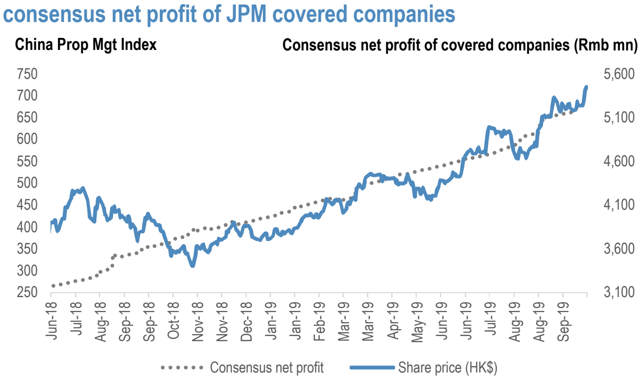
Source: Bloomberg, HKEx, J.P. Morgan

Figure 27: Share price change vs. change in Southbound holding



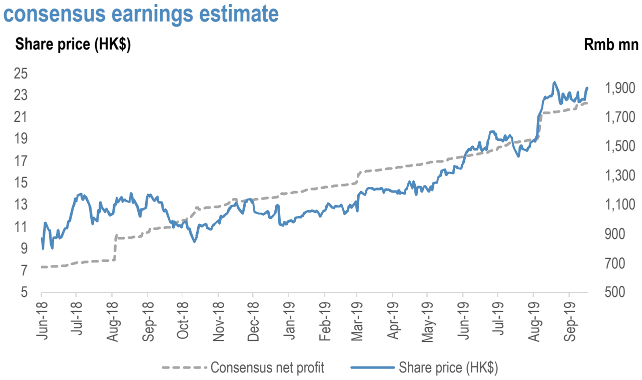
Source: Bloomberg, J.P. Morgan. Note: Colour Life is excluded.

Figure 28: China property management sector share price vs. consensus net profit of JPM covered companies



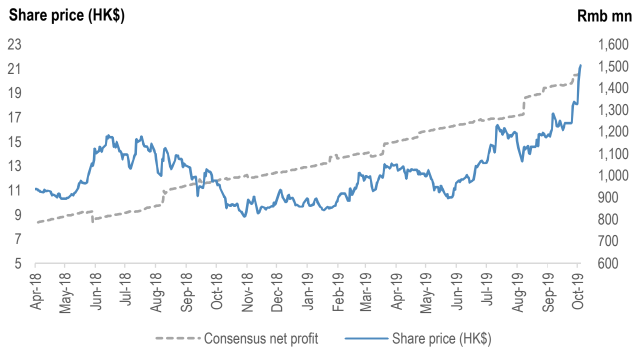
Source: Bloomberg, J.P. Morgan

Figure 29: Country Garden Services (6098 HK) share price vs. consensus earnings estimate



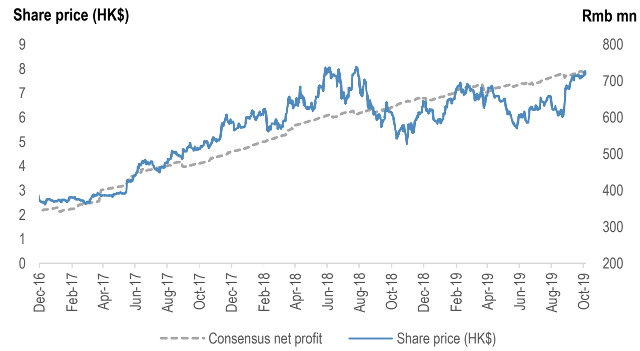
Source: Bloomberg, J.P. Morgan

Figure 30: A-Living (3319 HK) share price vs. consensus earnings estimate



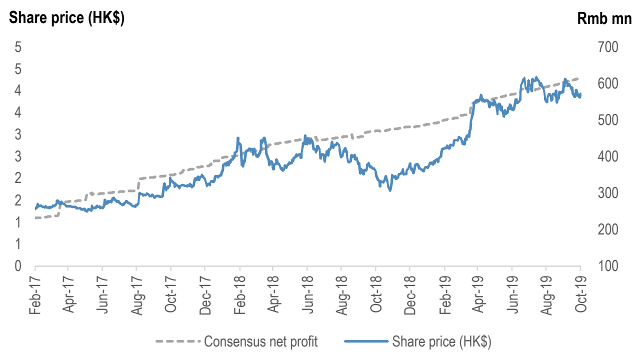
Source: Bloomberg, J.P. Morgan

Figure 31: Greentown Service (2869 HK) share price vs. consensus earnings estimate



Source: Bloomberg, J.P. Morgan

Figure 32: COPH (2668 HK) share price vs. consensus earnings estimate

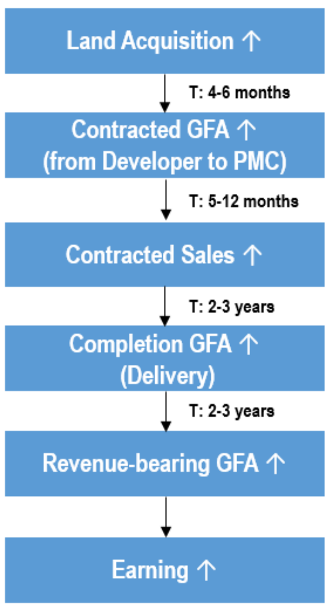


Source: Bloomberg, J.P. Morgan

Figure 33: Colour Life (1778 HK) share price vs. consensus earnings estimate change (12-month rolling)

Source: Bloomberg, J.P. Morgan

Figure 34: Flow of factors that drive earnings estimates upgrades (for typical developer-backed property management companies)



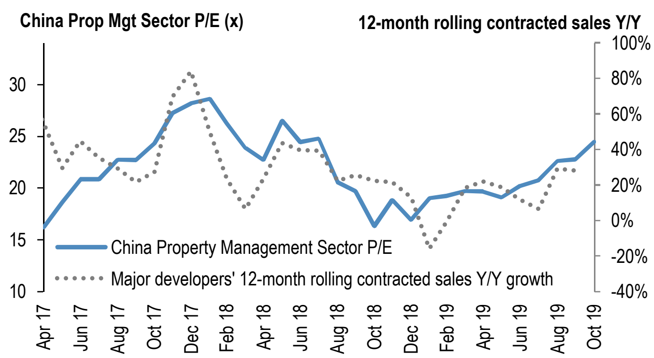
Source: J.P. Morgan

What drives consensus earnings upgrades?

As we know consensus earnings change is a key share price driver, the next logical question to ask is what drives this change. This is usually a result of (1) growth expectation in contracted/revenue-bearing GFA & margin trend; (2) land-banking & sales trend of backing developer; (3) M&A activities; (4) new growth drivers in VAS (e.g. new businesses); and (5) industry-wide policy that impacts margin. Analysts typically change their earnings estimates around results seasons, and we therefore look at how various "growth signals" drive subsequent share prices.

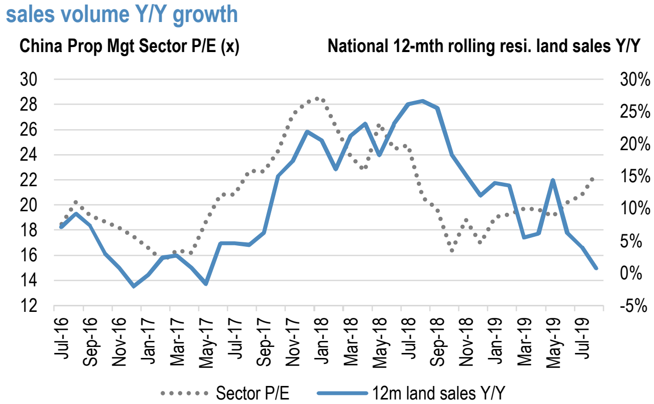
The sector P/E has been mostly tracking contracted sales trend of major developers. A similar trend can be seen in the national land sales trend, but the correlation is not as strong. This means the market has not fully looked into the increase in land-banking as a potential share price driver for the property management sector.

Figure 35: China Property Management Sector P/E vs. major developers' 12-month rolling contracted sales Y/Y growth



Source: Bloomberg, Company data, HKEx, J.P. Morgan

Figure 36: China Property Management Sector P/E vs. 12-month rolling national residential land sales volume Y/Y growth



Source: Bloomberg, CREIS, J.P. Morgan

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Testing “growth signals” against share price after results announcements

We have identified 7 possible "growth signals" (all of which are analysts’ considerations in consensus estimates changes), and we analyzed how relative share prices react along with these "growth signals" after results announcements.

For example, we believe "contracted GFA growth (>15% H/H)” and “community VAS EBIT growth (>25% Y/Y)" show stronger correlation (64-72% probability of same 7-day share price direction), which make sense for the former, as the higher the contracted GFA, the more likely it will be translated into revenue-bearing GFA in the future. For the latter, community VAS profit has lower forecast visibility and thus stronger growth would lead to more growth expectation in the future. These “growth signals” can thus induce more earnings upgrades and drive share prices.

In contrast, we think the results themselves are relatively less important, as they have already happened. This is why the growth in revenue-bearing GFA and margin trend are not as relevant.

Table 7: % of occurrences where “growth signals” go along the same direction to share price after results announcements of property management companies

Growth Signal	3-day	7-day
Contracted GFA growth (>15% H/H)	67%	72%
Community VAS (>25% Y/Y)	73%	64%
Earnings beat on consensus	67%	67%
Consensus earnings change (positive)	62%	62%
Core net profit Y/Y	64%	52%
Revenue bearing GFA (>10% H/H)	54%	58%
Margin uptrend	58%	54%

Source: J.P. Morgan

Table 8: Colour Life (1778 HK) – post-results share price performance vs. “growth signal” metrics

		Consensus earnings change			Contracted	Rev bearing	Core net profit	Core net profit	VAS EBIT	Gross Margin	Relative share price performance			
Results	Date	3-day	5-day	7-day	GFA H/H	GFA H/H	Y/Y	vs. cons	Y/Y growth	H/H growth	1-day	3-day	5-day	7-day
FY15	3/3/2016	-3%	-3%	-3%			-1%	-34%	18%	-29%	-1%	-2%	-1%	-2%
1H16	8/11/2016	-20%	-19%	-19%	12%	10%	-11%		77%	-1%	-3%	-6%	1%	-1%
FY16	3/20/2017	-13%	-13%	-13%	10%	14%	12%	-27%	70%	-1%	0%	2%	2%	-1%
1H17	8/25/2017	-1%	-1%	-1%	6%	0%	50%		21%	2%	-10%	-7%	-6%	-7%
FY17	3/20/2018	10%	10%	10%	4%	1%	49%	-6%	79%	-1%	6%	10%	13%	18%
1H18	8/23/2018	-1%	-1%	-1%	11%	14%	85%		116%	-9%	-3%	-16%	-24%	-28%
FY18	3/28/2019	0%	0%	0%	14%	9%	69%	-9%	42%	0%	0%	9%	8%	9%
1H19	8/21/2019	-4%	-5%	-5%	2%	0%	15%		-10%	-3%	-11%	-16%	-18%	-16%

Source: Bloomberg, J.P. Morgan

Table 9: Greentown Service (2869 HK) – post-results share price performance vs. “growth signal” metrics

		Consensus earnings change			Contracted	Rev bearing	Core net profit	Core net profit	VAS EBIT	Gross Margin	Relative share price performance			
Results	Date	3-day	5-day	7-day	GFA H/H	GFA H/H	Y/Y	vs. cons	Y/Y growth	H/H growth	1-day	3-day	5-day	7-day
1H17	8/28/2017	-2%	-3%	-3%	12%	12%	26%		76%	-1%	-2%	2%	6%	4%
FY17	3/26/2018	1%	2%	2%	14%	17%	37%	-1%	43%	0%	-2%	-5%	2%	-3%
1H18	8/27/2018	-2%	-1%	-1%	8%	9%	23%		22%	1%	0%	-2%	-4%	-4%
FY18	3/25/2019	-3%	-3%	-3%	17%	13%	-1%	-24%	11%	-2%	-10%	-8%	-3%	1%
1H19	8/26/2019	-1%	-1%	0%	8%	8%	7%		40%	2%	10%	16%	17%	16%

Source: Bloomberg, J.P. Morgan

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Table 10: A-Living (3319 HK) – post-results share price performance vs. "growth signal" metrics

		Consensus earnings change			Contracted	Rev bearing	Core net profit	Core net profit	VAS EBIT	Gross Margin	Relative share price performance			
Results	Date	3-day	5-day	7-day	GFA H/H	GFA H/H	Y/Y	vs. cons	Y/Y growth	H/H growth	1-day	3-day	5-day	7-day
FY17	3/20/2018	1%	1%	1%	NA	NA	79%	-26%	174%	NA	-2%	-4%	-10%	-9%
1H18	8/9/2018	5%	6%	6%	47%	39%				NA	7%	5%	-3%	-3%
FY18	3/18/2019	5%	5%	5%	24%	27%	166%	54%	250%	3%	-1%	8%	6%	6%
1H19	8/8/2019	6%	7%	7%	41%	53%	73%		183%	-3%	3%	3%	-1%	3%

Source: Bloomberg, J.P. Morgan

Table 11: Country Garden Services (6098 HK) – post-results share price performance vs. "growth signal" metrics

		Consensus earnings change			Contracted	Rev bearing	Core net profit	Core net profit	VAS EBIT	Gross Margin	Relative share price performance			
Results	Date	3-day	5-day	7-day	GFA H/H	GFA H/H	Y/Y	vs. cons	Y/Y growth	H/H growth	1-day	3-day	5-day	7-day
1H18	8/22/2018	20%	21%	21%	17%	11%	127%		72%	7%	0%	2%	2%	3%
FY18	3/19/2019	5%	6%	7%	31%	33%	119%	54%	98%	-2%	-7%	6%	6%	8%
1H19	8/23/2019	11%	11%	12%	16%	19%	68%		68%	3%	10%	17%	18%	18%

Source: Bloomberg, J.P. Morgan

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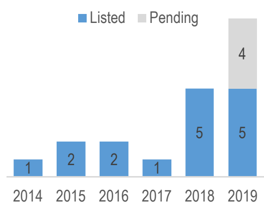
HK-listed property management space

Figure 37: No. of new listings in HK-listed China property management space



Source: HKEx, J.P. Morgan

Market cap is 5% of Chinese developers

The Hong Kong-listed China property management space is still tiny with a total market cap of ~US$22 bn, i.e. ~5% of HK-listed Chinese property developers (market cap: US$390 bn). The first IPO in the sector was Colour Life (1778 HK) in June 2014. Since then, more Chinese property management companies (mostly spun off from parent developers) have been listed in Hong Kong at higher valuation (average 17x 20E P/E for property management vs. ~5x P/E among developers).

Currently there are 16 major Chinese property management companies listed, with 4 in the pipeline (applications submitted to HKEx). Going forward, we would expect more Chinese developers (e.g. Vanke, CR Land) to look into separately listing their property management arms.

Market cap may reach US$200 bn in 10 years' time

In 10 years' time, we expect there could potentially be ~100 listed property management companies in Hong Kong. Currently, there are ~100 listed China property developers stocks in Hong Kong and another ~130 listed on A-share markets. For property management, both HK-listed and A-share developers are inclined to list their property management arms in Hong Kong. In 10 years' time, we estimate the market cap of the sector could potentially reach US$200 bn.

Table 12: Summary of HK-listed Chinese property management companies

Property Management Company						Backing company		
IPO date	Ticker	Company (Eng)	Company (Chi)	Market cap (US$ bn)	20E P/E (x)	Company	Ticker	20E P/E (x)
6/30/2014	1778 HK	Colour Life	彩生活	0.7	7x	Fantasia	1777 HK	-
10/23/2015	2669 HK	China Overseas Property Holdings	中海物业	1.9	23x	COLI	688 HK	5x
11/25/2015	1538 HK	Zhong Ao Home	中奥到家	0.1	5x	Nil	-	-
7/12/2016	2869 HK	Greentown Service	绿城服务	2.9	27x	Greentown	3900 HK	5x
11/8/2016	3686 HK	Clifford Modern Living	祈福生活服务	0.1	-	Clifford Group	-	-
12/11/2017	1417 HK	Riverine China Holdings	浦江中国	0.1	-	Nil	-	-
2/9/2018	3319 HK	A-Living Service	雅生活服务	3.7	14x	Agile	3383 HK	4x
6/19/2018	6098 HK	Country Garden Services	碧桂园服务	8.5	31x	Country Garden	2007 HK	4x
11/6/2018	1755 HK	S-Enjoy Service	新城悦服务	1.0	16x	Future Land	1030 HK	5x
12/6/2018	2168 HK	Kaisa Prosperity	佳兆业美好	0.3	11x	Kaisa	1638 HK	4x
12/17/2018	1995 HK	Ever Sunshine Lifestyle	永升生活服务	0.9	19x	CIFI	884 HK	4x
3/15/2019	3316 HK	Binjiang Service	滨江服务	0.2	-	Binjiang	002244 CH	7x
3/18/2019	3662 HK	Aoyuan Healthy Life	奥园健康	0.5	14x	Aoyuan	3883 HK	4x
7/12/2019	6093 HK	Hevol Services	和泓服务	0.1	-	Nil	-	-
10/11/2019	1895 HK	Xinyuan PM	鑫苑服务	0.1	-	Xinyuan	XIN US	-
10/18/2019	2606 HK	Languang Justbon	蓝光嘉宝	1.0	12x	Sichuan Languang	600466 CH	4x
Application submitted								
7/2/2019*	-	Yincheng Life Service	银城生活服务	-	-	Yincheng	1902 HK	-
8/6/2019*	-	Poly Property Development	保利物业发展	-	-	Poly Developments	600048 CH	6x
8/20/2019*	-	Powerlong Commercial Mgt	宝龙商业管理	-	-	Powerlong	1238 HK	5x
9/9/2019*	-	Times Neighborhood Holdings	时代邻里	‘-	-	Times China	1233 HK	4x
Average					16x			5x

Source: Company data, HKEx, Bloomberg, J.P. Morgan

Note: * refers to listing file date.

Listing approaches

Spin-off from the parent company is the most typical way for a property management company to get listed in Hong Kong. Among the spin-offs, some remain consolidated into the parent company, e.g. A-Living (3319 HK) remains under Agile Group (3383 HK), but some are deconsolidated, e.g. Country Garden Services (6098 HK) is no longer under Country Garden Holdings (2007 HK). In terms of fund-raising, some companies did not require additional capital and thus were listed by introduction (e.g. COPH). Apart from spin-offs, some are separate property management companies despite their ties to the backing developer (i.e. they have not been under the listed company). The best example of this is S-Enjoy, which has been a sister company to Future Land (1030 HK), and thus its listing was not considered a spin-off, yet it enjoys backing from Future Land.

Why not list in A-share markets?

Currently there is only one listed A-share property management company, Nacity Property Service (南都物业; 603506 CH). The company is trading at 19x P/E, which is similar to the average P/E among those listed on HKEx, but the sample size is too small to draw any meaningful conclusion as to whether HKEx or the A-share markets give a higher valuation premium to property management companies. As for why most companies have not opted for A-share listings, we see two major reasons:

- Approval time on the HKEx is less lengthy.
- CSRC has more stringent requirements, particularly in terms of related party transactions. Therefore, for developers who intend to spin off their property management arm, getting approval for an A-share listing is less likely due to a higher proportion of revenue coming from a "related party".

More companies are turning from NEEQ to HKEx

For NEEQ, since 2014, there have been more than 70 new listings of property management companies, but 15-20 of these have already been delisted for various reasons (e.g. being acquired). Also, more of them are switching to list on the HKEx, such as Ever Sunshine (1995 HK) and Poly Property Development (application submitted). One major factor is that more of these high-growth companies have grown enough to meet the requirements to list on HKEx (e.g. 3-year combined net profit has to be >HK$50 mn), and thus they turn to HKEx as it offers a wider investor base with better liquidity.

Table 13: Unlisted property management businesses by major Chinese developers

	GFA under management (mn sqm)	Revenue (Rmb mn)	EBIT (Rmb mn)
Vanke	500	5,283	633
Evergrande	180	2,322	364
Longfor	120	1,951	446
CR Land	110	2,400	-
Shimao	84	1,610	-
SUNAC	34	700	-

Source: Company data, J.P. Morgan

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Table 14: Peers comparison summary

			Market cap	GFA (mn sqm) as of 1H19				Revenue (Rmb mn)			Net profit (Rmb mn)			Net margin			P/E	EPS CAGR	Gross Margin				Gross profit breakdown		
Company	Ticker	Backing Company	(US$ bn)	Contracted	Revenue-bearing	% from backing company	% residential	2018A	2019E	2020E	2018A	2019E	2020E	2018A	2019E	2020E	2020E	18-20E	Prop Mgt	Community VAS	Non-community VAS	Overall	Property management	Community VAS	Non-community VAS
Country Garden Services*	6098.HK	Country Garden	8.45	584	217	80%	95%	4,675	7,686	10,943	878	1,490	1,934	19%	19%	18%	31x	48%	29%	58%	44%	38%	62%	16%	22%
A-Living*	3319.HK	Agile/Greenland	3.74	615	501	40%	44%	3,377	5,399	11,586	767	1,181	1,843	23%	22%	16%	14x	55%	27%	41%	49%	38%	34%	11%	54%
Greentown Service*	2869.HK	Greentown	2.91	391	185	21%	78%	6,710	8,664	11,211	379	555	760	6%	6%	7%	27x	42%	11%	34%	36%	18%	42%	28%	30%
China Overseas Prop Holdings*	2669.HK	COLI	1.89	NA	142	92%	94%	4,155	5,052	5,983	397	515	632	10%	10%	11%	23x	26%	21%	54%	22%	18%	73%	20%	7%
Ever Sunshine	1995.HK	CIFI	0.86	86	49	59%	63%	1,076	1,779	2,662	101	215	334	9%	12%	13%	19x	82%	21%	63%	22%	29%	45%	15%	41%
Colour Life*	1778.HK	Fantasia	0.73	564	365	1%	90%	3,614	4,200	4,790	447	556	701	12%	13%	15%	7x	25%	35%	82%	58%	35%	62%	30%	7%
S-Enjoy Service	1755.HK	Future Land	0.95	133	44	73%	79%	1,150	1,685	2,322	150	215	308	13%	13%	13%	16x	43%	28%	82%	26%	29%	60%	12%	28%
Aoyuan Healthy Life	3662.HK	Aoyuan	0.53	26	13	92%	-	619	997	1,520	78	166	261	13%	17%	17%	14x	83%	-	-	-	34%	66%	8%	26%
Kaisa Prosperity	2168.HK	Kaisa	0.29	41	36	66%	87%	896	1,230	1,627	54	146	189	6%	12%	12%	11x	87%	33%	36%	28%	31%	45%	11%	45%
Binjiang Service	3316.HK	Binjiang	0.24	23	13	70%	87%	509	-	-	70	-	-	14%	-	-	-	-	16%	50%	42%	26%	37%	14%	50%
Xinyuan Property Management	1895.HK	Xinyuan	0.14	33	16	74%	95%	393	-	-	76	-	-	19%	-	-	-	-	21%	68%	50%	34%	41%	39%	20%
Riverine China	1417.HK	-	0.10	-	6	0%	26%	392	-	-	25	-	-	6%	-	-	-	-				17%	-	-	-
Clifford Modern Living	3686.HK	Clifford	0.08	-	10	69%	69%	342	-	-	73	-	-	21%	-	-	-	-	74%	44%	-	49%	23%	77%	-
Zhong Ao Home	1538.HK	-	0.07	71	59	0%	89%	1,023	1,117	1,259	96	101	113	9%	9%	9%	5x	8%	27%	23%	35%	28%	92%	3%	5%
Hevol Services	6093.HK	Hevol Real Estate	0.07	8	6	93%	95%	224	-	-	17	-	-	8%	-	-	-	-	27%	55%	16%	36%	60%	37%	3%
Languang Justbon	2606.HK	Sichuan Languang	-	79	63	43%	94%	1,464	-	-	297	-	-	20%	-	-	-	-	28%	34%	52%	33%	52%	24%	25%
Yincheng Life Service	Pending	Yincheng	-	27	20	21%	82%	468	-	-	27	-	-	6%	-	-	-	-	8%	40%	-	15%	42%	58%	0%
Poly Property Development	Pending	Poly Developments	-	371	198	56%	61%	4,229	-	-	334	-	-	8%	-	-	-	-	14%	48%	20%	20%	48%	35%	16%
Powerlong Commercial Mgt	Pending	Powerlong	-	24	16	88%	61%	1,200	-	-	133	-	-	11%	-	-	-	-	14%	-	-	27%	81%	15%	5%
Times Neighborhood	Pending	Times China	-	45	35	44%	37%	696	-	-	64	-	-	9%	-	-	-	-	24%	56%	26%	27%	51%	17%	32%
														12%	13%	13%	17x	50%	25%	51%	35%	29%	53%	25%	23%

Source: Company data, HKEx, J.P. Morgan estimates. Priced as of close on 22 Oct 2019.
Note: Companies marked with * are under JPM coverage. All other companies' estimates are based on Bloomberg consensus.

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Industry overview

A brief history

The Chinese property management industry burgeoned in 1981 when the first domestic property management company was established in Shenzhen. 2003 was an industry milestone when the *Provisions on Property Management*（物业管理条例）were officially adopted by the Chinese government, as this formed the regulatory framework for the industry going forward. Subsequently, the following major policies were implemented to support the development of the sector.

Table 15: China property management industry – summary of major policies

Year	Policy / Measure	Details
2003 (effective in 2004)	Administrative Measures on Property Management Company Fees 物业服务收费管理办法 *(promulgated by NDRC & MOHURD)*	Permits property management companies to charge property owners management fees
2014	Opinions of Relaxing Price Controls in Some Services 国家发展改革委关于放开部分服务价格意见的通知 *(issued by NDRC)*	Requires provincial-level price administration authorities to **abolish price control** and guidance policies on residential properties other than affordable housing, and allows property management companies to freely negotiate fees with property owners
2016 (trial started in 2012)	"Three Supplies & One Property" Reform 三供一业改革	Gradually transfers the water supply, heat supply power supply and property management functions of SOEs' staff living areas (国有企业职工家属区) to private property management companies

Source: NDRC, MOHURD, HKEx, J.P. Morgan

How big is the property management market?

Figure 38: China property management sector – 2018 revenue breakdown

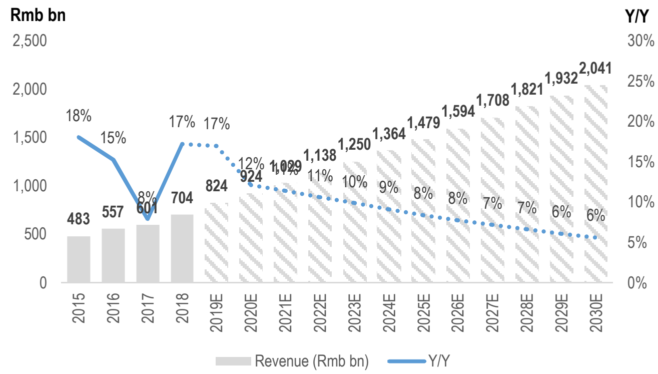
Source: CPMA, J.P. Morgan estimates.

A Rmb2 trillion market in 2030E

According to China Index Academy (CIA), the industry's total revenue-bearing GFA as of 2018 was 21.2 billion sqm GFA. According to China Property Management Association (CPMA), the industry revenue was Rmb704 bn as of FY18 (86% from property management and 14% from VAS, by our estimate), we expect the total market size will surpass Rmb1 trillion in 2021E.

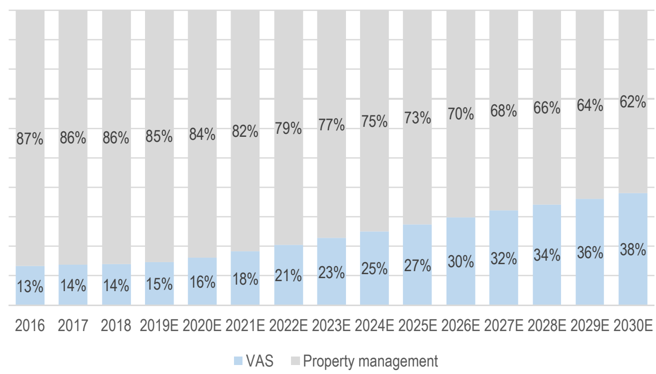
We expect the market revenue will surpass Rmb3 trillion in 2030E (9% CAGR), driven by a 5% CAGR in revenue-bearing GFA which is the proxy of our estimated 5% CAGR in the GFA of China's housing stock (we have assumed an average 3% annual decline in sales volume till 2030E).

Figure 39: Property management industry revenue



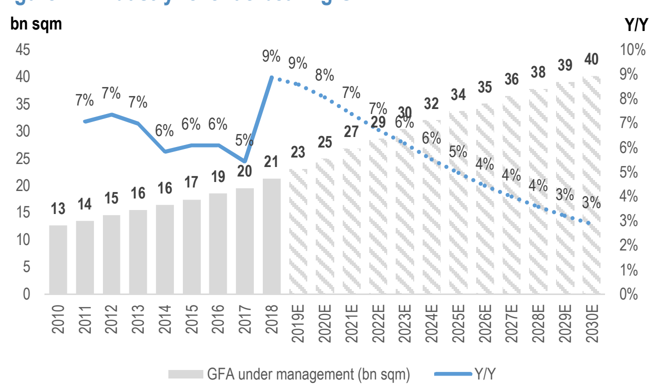
Source: China Property Management Association, J.P. Morgan estimates.

Figure 40: Industry revenue breakdown by business segment



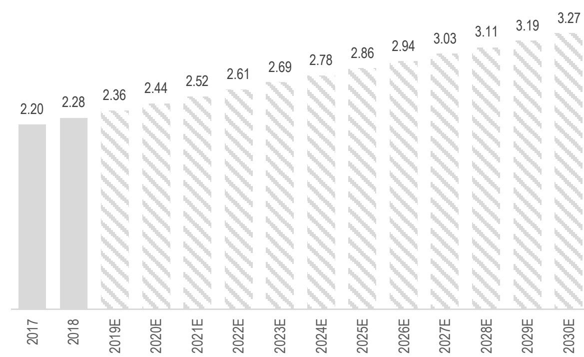
Source: China Property Management Association, J.P. Morgan estimates.

Figure 41: Industry revenue-bearing GFA



Source: China Index Academy, J.P. Morgan estimates.

Figure 42: Industry revenue per GFA (Rmb psm per month)



Source: China Property Management Institute, J.P. Morgan estimates.

Note: Including revenue from VAS

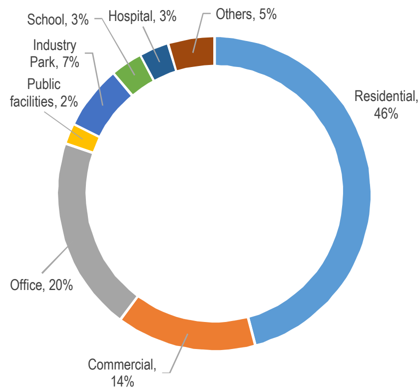
Revenue-bearing GFA to grow at 5% CAGR till 2030E

We expect the industry's revenue-bearing GFA to grow at a 5% CAGR till 2030E. While the Y/Y growth of accumulated completions of commodity housing has been on a decline, this can be offset by more contribution from management in public facilities/institutions.

Property management is not just about residential

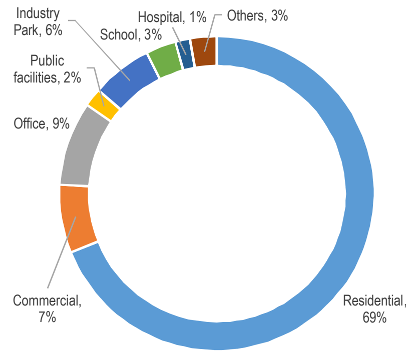
Within the sector (using the "top 100 property management companies" published by CIA as proxy), the three traditional "commodity housing" segments (i.e. residential, commercial and office) altogether account for 80% of industry revenue and 85% of GFA, while the rest are industry parks, public facilities (e.g. train stations), institutions (schools/hospitals) and parks etc. Among all, residential is the largest segment, constituting 69% of the industry's GFA and 46% of revenue.

Figure 43: Property management sector - breakdown by type (in terms of revenue)



Source: China Index Academy, J.P. Morgan

Figure 44: Property management sector - breakdown by type (in terms of GFA)



Source: China Index Academy, J.P. Morgan estimates.
Note: Estimated based on average management fee in each category.

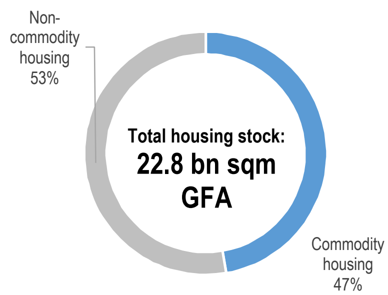
Residential property management is serving 254 million homes

Residential is the largest segment of the property management sector, and as its business is essentially the on-going after-service after a property is delivered to its home owner, theoretically the market size is proportionate to the total property sales and completion over time. However, as China's commodity housing market was not opened up until 1998 after the land market reform, what developers have built over the past two decades actually only accounts for roughly half of the total market size, and the rest are still non-commodity housing such as social housing.

With an estimated housing stock of 254 million homes in China (or 22.8 bn sqm GFA if assuming an average home size of 90 sqm), we estimate that commodity housing (based on accumulated residential completions since 1999) accounts for 10.8 bn sqm GFA (47% of housing stock).

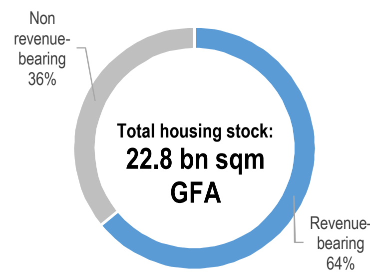
As residential accounts for 69% of revenue-bearing GFA (i.e. 14.6 bn sqm GFA), it means that 64% of housing stock is currently under the "revenue-bearing" categorization. For the remaining, we believe they are mostly those social housing units which are still managed by SOEs or institutions.

Figure 45: Total housing stock breakdown by commodity/non-commodity housing



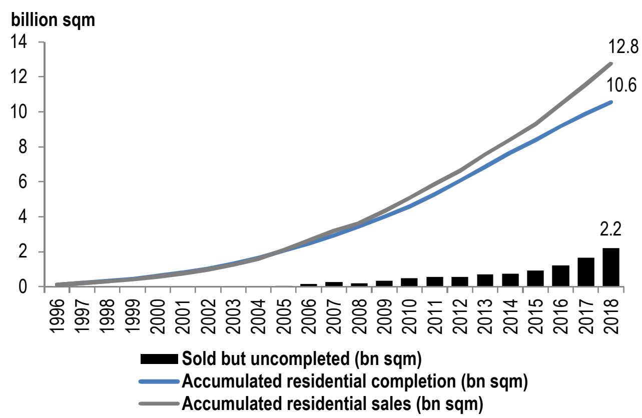
Source: CREIS, J.P. Morgan estimates.

Figure 46: Total housing stock breakdown by revenue-bearing status



Source: China Index Academy, CREIS, J.P. Morgan estimates.

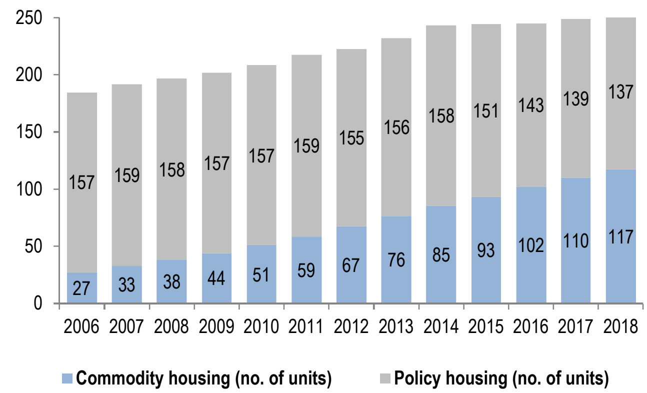
Figure 47: Residential GFA under management in China



Source: China Property Management Institute, J.P. Morgan estimates.

*Adjustments are made to the sales numbers to reconcile with listed developers' trend

Figure 48: Housing stock in China



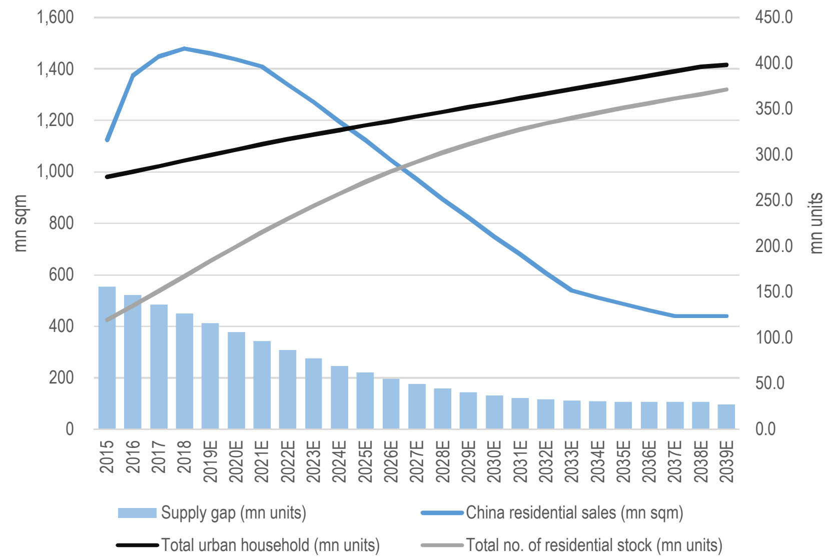
Source: NBS, CEIC, J.P. Morgan estimates.

Future market growth comes from (1) new sales and completion, and (2) the sold but undelivered homes.

China residential new home sales were 1.48 bn sqm in 2018, which has likely peaked given the demographic situation. We expect 2019 sales volume to be down 1% to 1.46 bn sqm, and down further to 1.44 bn sqm in 2020E. Based on IMF expectations, China's population will peak in 2022 at 1.4 billion, and stabilize thereafter, so incremental home sales will mainly be serving (1) household formation from smaller household size, and (2) newly urbanized households.

Considering the demographic, urbanization and existing stock in the market, we expect total home sales in China to shrink to 1-1.1 bn sqm by 2025, 750 mn sqm by 2030, and stabilize at around 400-450 mn sqm by 2040. On this we have already assumed a partial redevelopment of the existing 130 mn sqm of social housing built in the first four decades (1949-1980s) of the establishment of the PRC.

Figure 49: Supply gap between residential stock & urban household



Source: IMF, CEIC, NBS, J.P. Morgan estimates

Competitive landscape

A low entry barrier, but big players are consolidating

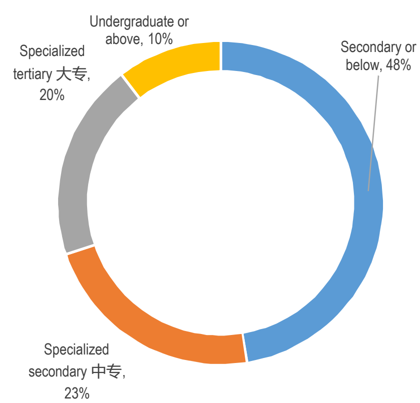
Entry barriers to the property management industry are low, mainly because the initial capital requirement is not high (only Rmb0.5 mn capital is needed) and the business itself is not that sophisticated (only 10% of employees are university graduates). As a result, the property management business is very scattered with >100K companies.

Table 16: Main criteria of qualifications for property management companies

Qualification level	First	Second	Third
Registered capital (Rmb)	>5mn	>3mn	>0.5mn
Mgmt / Technical employees	>=30	>=20	>=10
Managerial grade employees	>=20	>=10	>=5
Area allowed to manage	No restriction	<300,000 sqm (res) <80,000 sqm (non-res)	<200,000 sqm (res) <50,000 sqm (non-res)

According to the Regulations on Property Management (物业管理条例) (Order No. 379 of the State Council), which came into effect on Sept 1, 2003 and was amended on Aug 26, 2007, a qualification system for companies engaging in property management activities has been adopted, and registered capital of only Rmb0.5mn is required.
Source: MOHURD, J.P. Morgan.

Figure 50: Educational background of top 100 property management companies



Source: CIA

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Market consolidation

Absolute top 100 market share to rise from 27% to 42% in 10 years

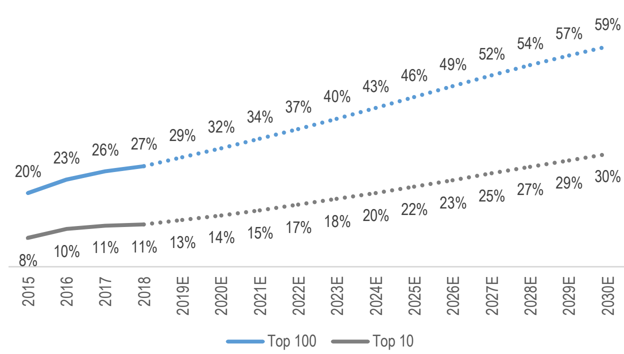
Per China Index Academy, the "top 100" property management companies had a market share of 38.9% as of FY18. However, their "top 100" definition actually includes > 200 companies. By *absolute number*, we estimate that the top 100 companies' market share was 27% as of FY18, and their growth will continue to outpace the industry's, reaching 59% in FY30E.

We expect more consolidation over the next 10-15 years, mainly due to (1) tailwinds from developers' consolidation; and (2) new capital raised to drive more M&A activities. Moreover, the rise of value-added services (VAS) will also increase the entry barriers of the industry. This is because the increasing contribution from VAS, which carries a higher margin and profitability, should induce existing players to be more aggressive in property management pricing. We believe this will eventually crowd out smaller players without major VAS exposure. Eventually when market share is big enough, the operational data could even be sold as big-data to third parties.

Top 10 market share gains will outpace the rest due to M&A

The top 10 companies' market share was 11% as of FY18, which is way below the top 10 Chinese developers' market share of 32%. We expect their market share gains to even outpace that of top 11-90 PMCs because of more M&A activities (e.g. how A-Living acquired CMIG).

Figure 51: Top 100 & Top 10 property management companies' market share (by absolute number)



Source: China Index Academy, J.P. Morgan estimates.

Key industry risks

1) High sensitivity to labor costs

As a labor-intensive industry, property management companies' margins are sensitive to changes in labor costs, which account for 58% of the cost structure. While we have already factored in an annual increment in labor costs, should the magnitude be more than expected, there would be an impact on our earnings estimates. By our analysis, for every 5% incremental change in labor costs, the average earnings impact among our covered names would be -12% for FY19E, among which COPH and Greentown Service would see a higher sensitivity due to lower net margin.

Figure 52: Top 100 property management companies' cost structure (2018)

Type	% of cost
Labor	58%
Miscellaneous	14%
Maintenance	10%
Cleaning	8%
Security	5%
Admin	3%
Landscape	2%
Insurance	1%

Source: CIA, J.P. Morgan estimates.

Table 17: Sensitivity of incremental change in labor cost on FY19E core net profit

% change	-10%	-5%	0%	5%	10%
CGS	8%	10%	0%	-10%	-19%
A-Living	13%	7%	0%	-7%	-13%
Greentown Service	32%	16%	0%	-16%	-32%
COPH	38%	19%	0%	-19%	-38%
Colour Life	16%	8%	0%	-8%	-16%
Average	**21%**	**12%**	**0%**	**-12%**	**-24%**

Source: J.P. Morgan estimates.

2) Revival of the proposed social security reform

As seen by the sector's derating in 2H2018, one key market concern is the earnings impact of the social security reform proposed in July 2018. Although the policy was supposed to have been enacted in 1 Jan 2019, to date there has been no further announcement from government on implementation, after private companies raised concerns on the additional financial burden and Premier Li Keqiang said the government intends to keep the burden unchanged. While there is no more clear timeline of when this will be rolled out (or if it will be implemented at all), this remains a risk.

Figure 53: Companies' social security expense as % of salaries (2018)

CGS	14%
A-Living	12%
Greentown Service	15%
COPH	12%
Colour Life	13%

Source: Company data, J.P. Morgan estimates.

That said, we don't think the new social security rule, even if implemented in the end, will have any significant earnings impact on our covered companies because:

1. Premier Li made it clear that the government does *not* intend to exacerbate the financial burden of companies. Therefore, the reform could be conducted in a manner that ensures the overall costs for companies will remain largely stable (e.g. by lowering the contribution ratio).
2. Our covered companies should, in most cases, have paid the social security contribution in full (particularly COPH, which is an SOE) and thus under-payment over the years should not be too much. However, the impact on smaller players could be bigger as there might be more under-reporting cases.
3. Companies can shift the additional costs to contractors by outsourcing more functions.
4. Employers' required contribution rates for pensions (养老保险) have already been trending down since early 2019. In most provinces, the required rate has been lowered from 20% to 19% (Xinhua).

The average social security expense as a % of salaries is in a range of 12-15% among our covered companies. This is far below the standard contribution ratio of 26-34%, but can be explained by the fact that there are many deductibles and adjustments, and for companies with more GFA under commission basis (e.g. Colour Life), there will be no accounting impact on P&L as such costs will have been absorbed before recognizing as revenue. As COPH, as an SOE, is likely to have been fully compliant, and while its 12% ratio is already in the lower range, we can estimate that the other four names have also at least mostly been paying their social security contribution. Therefore, we expect that the impact will be minimal.

Recap of the proposed social security policy reform in July 2018

In July 2018, the State Council proposed a new rule that requires social security to be collected by local tax authorities, instead of local social security bureaus. This aims to mitigate the risk of companies understating their salary expenses as local tax authorities would have a more accurate assessment of companies' P&L.

In response to market concerns that this would greatly hurt labor-intense companies' profitability, Premier Li Keqiang announced in Sep 2018 that, under the proposed new social security role, the burden on companies should theoretically remain unchanged. Therefore, while local tax authorities would be more stringent in determining the actual social security that employers have to contribute for their employees, the required contribution ratio could potentially be lower.

The original effective date is 1 Jan 2019. However, as of now there has been no new update from the government as to whether this would still be implemented.

3) New regulations on the property management sector

Regulations on the property management sector are still relatively loose given it is a newly regulated industry. As the industry grows, we think there could be more regulations that may not necessarily benefit property management companies. A few possible examples:

1. **To require establishment of owners' associations:** Currently, China does not require residential communities to establish their own owners' associations. Therefore, for projects without an owners' association (which are the majority in most cases), property management contracts can be automatically extended until (1) an owners' association is officially established to negotiate the contract; or (2) owners voluntarily kick out the property management company by organizing through themselves, but this would require more coordination. Therefore, if the Chinese government requires all residential communities to have a legally recognized owners' association, this might affect the contract renewal rate as when owners are more organized, they will have more bargaining power.
2. **To regulate management fees:** Management fees are currently not regulated (except for the first contract with the developer, where the fee has to be under the local government guidance range), and therefore in communities where the property management company has more bargaining power, the management fee can be determined freely as long as property owners agree. At the current stage where property management companies focus on

growing their owners' base, we think they will be conservative in raising management fees, and thus home owners' interest is not unfairly treated in most cases. However, just like the property sales market, if management fees happen to become out of control, we think there is a chance that government could step in and regulate management fees (just like how they introduce price caps in residential sales). Although we don't think this will happen in the near future, this remains a regulatory risk.

4) Share placement risk

We think it is possible that our covered names could place new shares to either (1) raise money for large-scale M&A, or (2) introduce strategic shareholders who may create synergies, such as international real estate services companies that may provide certain expertise, or internet companies that may support community VAS.

For placements that targets M&A, we think the market might take it more positively given the earnings boost. However, if the placements are for strategic shareholders to support community VAS, we think the market might be more cautious on that, as the positive earnings impact could not be proven until results, as seen by Colour Life's share placement to JD.com & 360.com in July 2019.

Table 18: Share placement history of HK-listed property management companies

Company	Stock Code	Type	Announce date	Last Trading Price ($)	Placement Price (HK$)	Placement Discount (%)	P/E at placement	New shares as % of existing capital	Total proceeds (HK$ bn)	Type
Colour Life	1778 HK	Primary	7/19/2019	5.45	5.22	**-4%**	11x	7%	0.5	Strategic shareholder (JD & 360)
CGS	6098 HK	Primary	1/11/2019	12.90	11.61	**-10%**	21x	7%	1.9	Top-up to public
Colour Life	1778 HK	Primary	12/20/2017	5.32	5.00	**-6%**	18x	9%	0.4	Top-up to public

Source: HKEx, Company data, J.P. Morgan estimates.

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Learning from global peers

Table 19: Property management sector - global comparison

Company	Country	Ticker	Market cap (US$ bn)	2018 Financials Revenue (US$ mn)	Net Profit (US$ mn)	Net margin (%)	P/E 2019E (x)	2020E (x)
Compass Group	UK	CPG LN	39.58	30,776	1,521	4.9%	23x	21x
CBRE	USA	CBRE US	17.71	21,340	1,063	5.0%	14x	13x
Sodexo	France	SW FP	15.97	24,331	776	3.2%	19x	17x
ServiceMaster	USA	SERV US	7.63	1,900	(41)	-2.2%	38x	33x
Jones Lang LaSalle	USA	JLL US	7.43	16,318	485	3.0%	12x	11x
ISS	Denmark	ISS DC	4.64	11,662	45	0.4%	13x	12x
FirstService	**Canada**	**FSV US**	**4.28**	**1,931**	**66**	**3.4%**	**33x**	**30x**
Cushman & Wakefield	USA	CWK US	4.04	8,220	(186)	-2.3%	11x	10x
Colliers	USA	CIGI US	2.91	2,825	98	3.5%	16x	15x
Savills	UK	SVS LN	1.75	2,352	102	4.4%	13x	12x
LHN Group	Singapore	LHN SP	0.03	81	4	4.9%	-	-
Global Comps						**2.6%**	**20x**	**19x**
Country Garden Services	China	6098.HK	8.46	707	140	19.7%	40x	31x
A-Living	China	3319.HK	3.74	511	121	23.7%	22x	14x
Greentown Service	China	2869.HK	2.91	1,015	73	7.2%	37x	27x
China Overseas Property Holdings	China	2669.HK	1.89	530	51	9.7%	29x	23x
S-Enjoy Service	China	1755.HK	0.95	174	23	13.1%	24x	16x
Ever Sunshine	China	1995.HK	0.86	163	15	9.3%	30x	19x
Colour Life	China	1778.HK	0.73	547	73	13.4%	9x	7x
Aoyuan Healthy Life	China	3662.HK	0.53	94	12	12.6%	20x	12x
Nacity	China	603506 CH	0.34	160	14	8.7%	20x	16x
Kaisa Prosperity	China	2168.HK	0.29	136	8	6.0%	14x	11x
Binjiang Service	China	3316.HK	0.24	77	11	13.8%	-	-
Xinyuan Property Management	China	1895.HK	0.14	60	12	19.3%	-	-
Riverine China	China	1417.HK	0.10	59	4	6.5%	-	-
Cliffford Modern Living	China	3686.HK	0.08	52	11	21.3%	-	-
Zhong Ao Home	China	1538.HK	0.07	155	15	9.4%	5x	5x
Hevol Services	China	6093.HK	0.07	34	3	7.5%	-	-
China Property Management						**12.6%**	**31x**	**23x**

Source: Bloomberg, Company data, J.P. Morgan estimates. Priced as of close on 22 Oct 2019.
Note: All estimates are based on Bloomberg consensus numbers, except the five companies under our coverage.

No similar sector around the world

Around the globe, we don’t see many comparables (in terms of business model & serving target) to Chinese property management companies. For example, CBRE / Jones Lang LaSalle (JLL) are mature real estate services companies which provide a comprehensive range of services, and their property management business is <30% of revenue, with more focus on commercial. For China property management companies, on top of the growing property owners’ base, a major growth driver is the build-up of a platform for community VAS that serves millions of residents. This is not commonly found among global peers whose clients tend to be more institutional (e.g. offices). The focus of the eco-systems are essentially different. Another difference is the much lower margin (average 2.6%) of global peers, vs. China PMCs’ average of 12.6%.

FirstService is the best comparable

Among all, we think FirstService Corporation (FSV US), the largest property manager in North America, could be the closest comparable given it is (1) management fee-focused (50-60% of revenue); (2) residential-centric but with some exposure to commercial; (3) serving 1.7 million units (similar to CGS). Despite a much lower margin (3.4% vs. China PMCs' average of 12.6%), the company is trading at a P/E of 29x 2020E P/E (similar to CGS). However, FirstService’s earnings CAGR is 27% for 18-22E (Bloomberg consensus), while our covered names will see a faster CAGR of 37%, by our estimates.

US$200 bn market cap is achievable

As mentioned above, we forecast that in 10 years' time, there could potentially be 100 property management companies listed in Hong Kong, with a total market cap of ~US$200 bn. This can be roughly cross-referenced by the case of FirstService. The company (market cap: US$4.2 bn) currently accounts for 5% market share, and thus the implied market cap of the entire sector (assume all that are listed) is US$84 bn. However, if we adjust the margin to 10%, which we expect to be the normalized margin for China PMCs in the longer term, the market cap would be >US$200 bn already. Given the even larger market size of China, we believe the sector could potentially see a US$200 bn market cap in the long run.

Potential future business model?

While China PMCs are now very much focused on the three major segments, by looking at how global peers have evolved, we believe the following directions are some possible ways that Chinese PMCs could evolve over the long term:

- **Franchise system:** In the case of FirstService, the company has a franchise system with 1,800 franchisees, operating under different brands. While a similar model is already adopted by CMIG (the company recently acquired by A-Living) where the company operates under different brands, we think this could potentially be more widely adopted in China.
- **Less reliance on residential:** We think China PMCs will gradually expand more in the commercial/institutional/public property management space (such as A-Living). Currently, much Grade-A office space in China is still managed by global peers (e.g. JLL). In the long run, we think they could potentially be replaced by China PMCs.
- **Expand in service offerings:** Currently, property management companies are focused on offering services to the community as well as developers. In the long term, we think PMCs could further diversify their service offerings and operate like CBRE/JLL. For example, they could provide property valuation, mortgage servicing or retail/office leasing services.

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Business model

A three-pillar model

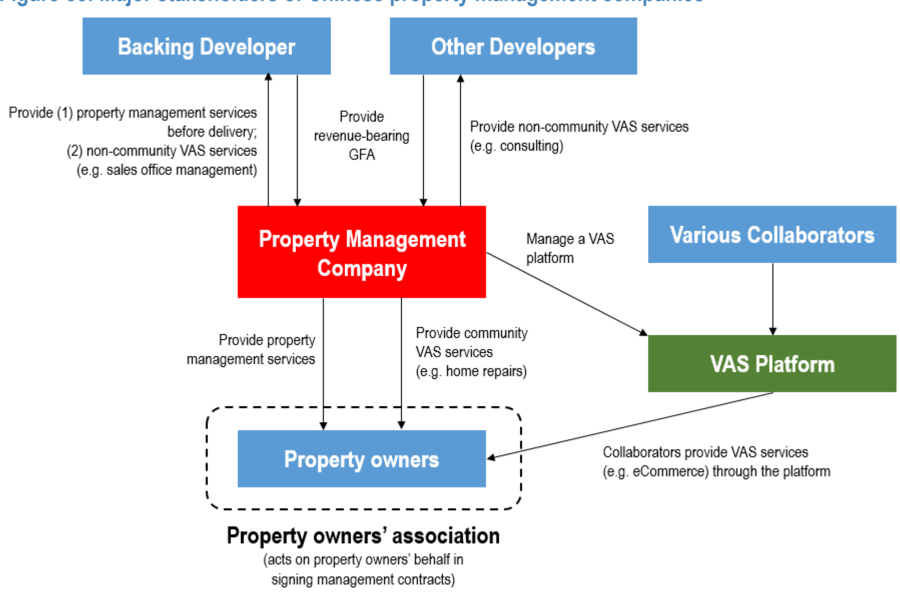
Chinese property management companies typically run on a three-pillar model. The fundamental pillar is the traditional property management business which serves as a base of the eco-system. By accumulating a big network of property owners and expertise in running related functions, property management companies also provide value-added services ("VAS") to both property owners ("community VAS") and other developers ("non-community VAS"). This hybrid business model comprises **B2C** (providing services to property owners), **platform** (engaging other companies to provide related services, such as eCommerce) and **B2B** (providing services to other companies).

Figure 54: Chinese property management - three-pillar business model

Property Management	Community Value-added service (VAS)	Non-community Value-added service (VAS)
• Security • Common area cleaning & landscaping • Building maintenance	• Clubhouse activities • Home living services (e.g. home repairs) • Platform services (e.g. eCommerce, leasing)	• Sales office management • Consultancy • Engineering • Security for construction sites
B2C	B2C & Platform	B2B

Source: J.P. Morgan

Figure 55: Major stakeholders of Chinese property management companies

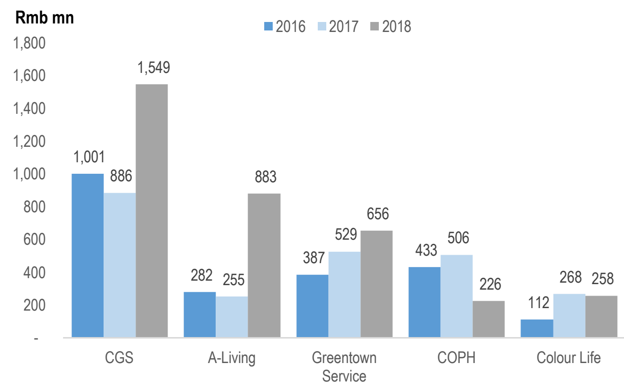


Source: J.P. Morgan

Characteristics (vs. property developers)

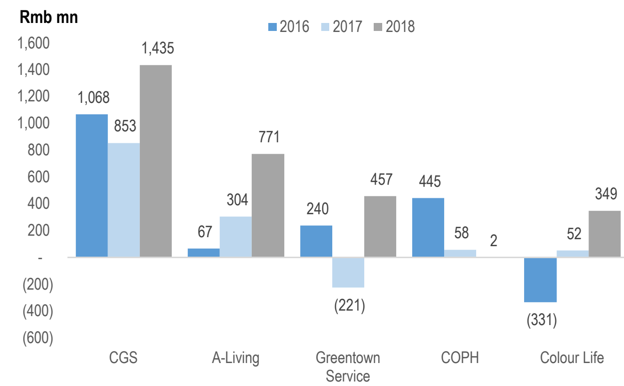
- **Asset-light:** All three sub-segments are essentially services, and thus the business model is asset-light by nature, unlike property developers which are mostly asset-heavy.
- **Low cyclicality:** While property developers are subject to cycles due to policy and macroeconomic factors, property management companies provide essential services to a base of property owners, and are thus less impacted by policy risk or the economic environment. Although one might argue that a recession may lead to lower collection rate, compared to most other sectors, property management clings to a recurring income base and is thus less prone to cyclicality.
- **Positive operating cash flows:** While many developers are consistently running a negative operating cash flow due to constant reinvestment to new lands, property management companies are mostly running on a positive operating cash flow. Among the companies we cover, free cash flows are also mostly positive except in years where there are big acquisitions. Therefore, property management companies usually only have fund-raising needs when they want to engage in more M&As. Most even do not incur any debt and are thus sitting on net cash.

Figure 56: Operating cash flows



Source: Company data
Note: All are on Rmb basis except COPH which is on HKD basis.

Figure 57: Free cash flows

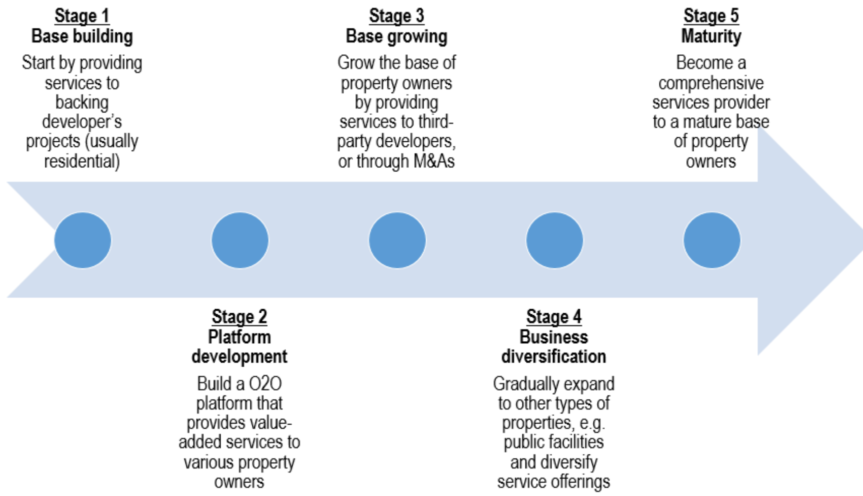


Source: Company data, J.P. Morgan
Note: All are on Rm basis except COPH which is on HKD basis.
Free cash flows are defined as operating cash flows minus investing cash flows.

Roadmap

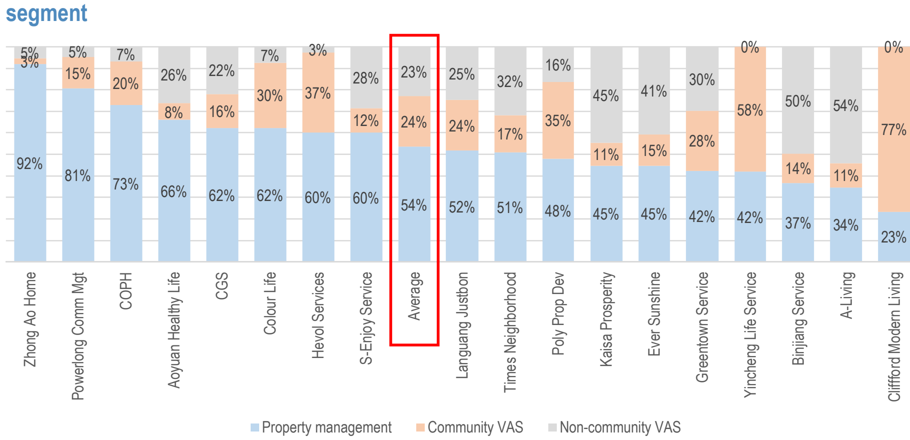
We believe a typical property management company usually goes through a 5-stage process as illustrated in the roadmap below. Most listed companies are currently at Stage 3 or Stage 4 where they are experiencing high growth due to a jump in revenue-bearing GFA and VAS penetration. COPH and Greentown Service are in Stage 3, while Country Garden Services and A-Living (particularly after the acquisition of CMIG) are in Stage 4. Even for Colour Life (the first HK-listed property management company), we think they are still in Stage 4 as their VAS platform is still not yet fully mature.

Figure 58: Growth roadmap of a typical property management company



Source: J.P. Morgan

Figure 59: Listed property management companies - gross profit breakdown by business segment



Source: Company data, HKEx, J.P. Morgan

Geographical exposure

Compared to Chinese developers where we focus more on analyzing the breakdown of land bank by city tiering or region, we are less concerned about this for property management companies, as the recurring income nature is not dependent on where the projects are, and the success of community VAS lies more on PMCs' ability to attract use.

Table 20: Geographical exposure by region in China

	East	Central	South	North	Others
CGS	21%	13%	31%	8%	27%
A-Living	19%	13%	38%	11%	20%
Greentown Service	66%	0%	7%	16%	11%
Colour Life	27%	24%	18%	10%	21%
COPH	17%	11%	13%	47%	12%

Source: Company data, J.P. Morgan estimates.

Property management businesses

The traditional property management services mainly comprise security, cleaning, landscaping, repairs and maintenance etc. Revenue is a simple multiple of (1) average annual management fee per GFA and (2) revenue-bearing GFA.

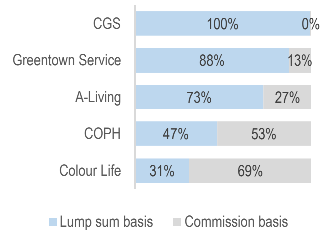
Management fee

Lump sum vs. commission basis

There are two major management fee collection bases:

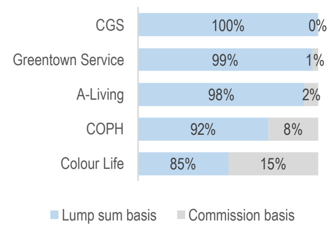
- **Fixed revenue model – Lump sum basis (包干制):** Riskier model. Property management companies receive predetermined fees from the residents. The companies enjoy all the profits but also bear all losses and by law the companies cannot ask residents for extra money even if they run at a loss. Most listed developers opt for this model.
- **Fixed profit model – Commission basis (酬金制):** Low risk model. Property management companies collect a certain percentage (~5%-10%) of fees from the total property management fees under the agreement and recognize them as revenue. All costs are borne by the residents and they also get to retain the surplus or assume the shortage. As the commission is recognized as revenue, gross margin from this model is essentially 100%. Theoretically, companies with an increasing ratio of lump-sum basis will see a decline in margin, and this is best illustrated by Colour Life's declining gross margin trend as the % of commission-basis GFA has declined in the past few years.

Figure 60: Property management GFA breakdown by type (2018)



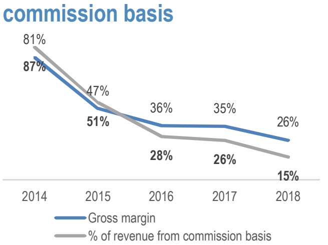
Source: Company data, J.P. Morgan estimates

Figure 61: Property management revenue breakdown by type (2018)



Source: Company data, J.P. Morgan estimates

Figure 62: Colour Life – Gross margin vs. % of revenue from commission basis



Source: Company data, J.P. Morgan estimates

Table 21: Comparisons between two main management fees collection bases

	Lump sum basis 包干制	Commission basis 酬金制
Management fees source	Property owners	Property owners
Riskiness to operator	Higher risk	Lower risk
Revenue recognition	All management fees	Only the commission
Company profit model	Net profits from management fees after assuming all operational costs	Commission (around 5-10%) from the management fees
Entity subjected to P/L	Property management company	Property owners
Advantages	Property owners more sticky to operators; easier to differentiate	Stable profit for the company
Disadvantages	Projects could be loss-making	Need resident management committee; might cause conflicts with residents

Source: Company data, J.P. Morgan.

Average management fee has seen little increment

Among top 100 property management companies, average property management fee has remained largely stable in the past four years at Rmb4.2-4.3 psm/month. Fee also varies among property types: Office and commercial properties see the highest fee at Rmb7.84 and Rmb7.01 psm/month, whereas residential is the lowest at Rmb2.25 psm/month.

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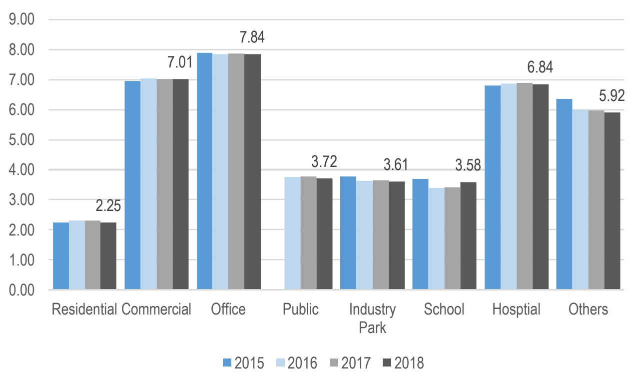
- **Residential:** Management fee is determined at the time of signing the contract which usually lasts for 3-5 years (sometimes, there is an annual increment clause, too). Since the price control on management fee of private residential properties was only abolished in Dec 2014, property management companies have been allowed to freely negotiate property management fees with property owners. However, as raising management fees requires majority approval by home owners, significant increment is harder to achieve.
- **Commercial/office/institutions:** Fee is usually negotiated with a single owner, so raising fees is slightly easier than residential, although the competition is high.
- **Public facilities:** Typically, management fee is determined based on minimum wage and inflation, and thus increment magnitude may be small, but the frequency could be higher than other property types.

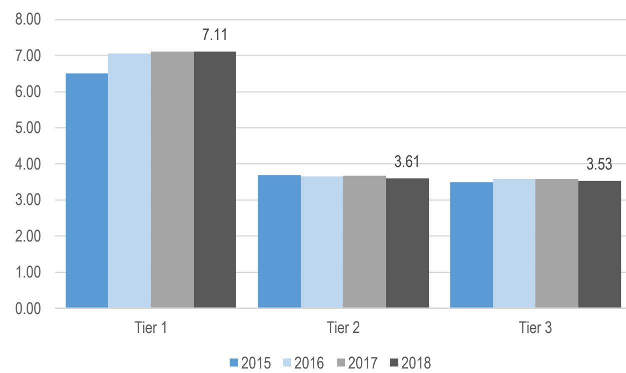
Residential management fee also varies among city tiers. Average fee in tier-1 cities is Rmb7.11 psm/month, while those in tier-2 and tier-3 cities are respectively Rmb3.61/3.51 psm/month.

Figure 63: Average management fee by property type (Rmb psm per month)



Source: CIA

Figure 64: Average management fee by city tier (Rmb psm per month)



Source: CIA

Management fee should be mildly trending up in medium term

If we compare the average residential management fee (assume 100sqm GFA of average flat size) to household disposable income, the ratio is 2.4% (Hong Kong's is around the same level by our estimate). We therefore think home owners should not be overly sensitive to a single-digit change in management fee upon contract expiry, as long as they are satisfied by the service quality. Therefore, despite the flattish fee over the past few years, we think the average fee should be on a mild uptrend in the medium term. Among new renewals, property management companies have reported 10-40% increment in management fee (same concept as "rental reversion" for investment properties), and although the proportion of renewal is not high, this shows the upward momentum.

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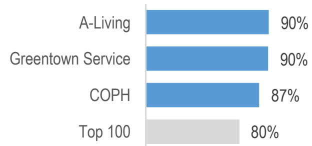
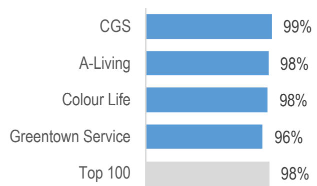
Figure 65: Customer satisfaction rate (2018)



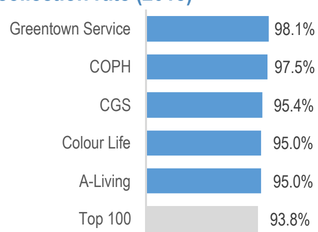
Source: China Index Academy, Company data

Figure 66: Management contract renewal rate (2018)



Source: China Index Academy, Company data, J.P. Morgan estimates.

Figure 67: Management fee collection rate (2018)



Source: China Index Academy, Company data, J.P. Morgan estimates.

Service quality is key

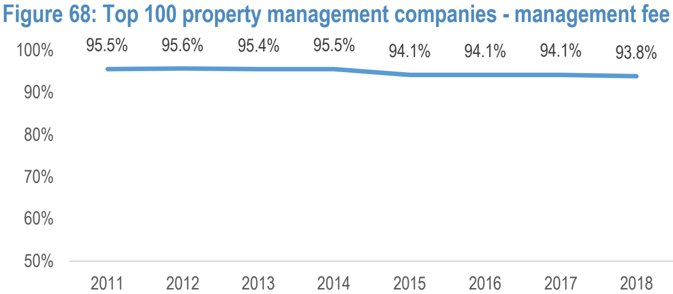
For newly completed residential projects, the property management company is usually the one backed by its own developer. However, after the first contract (3-5 years), home owners are allowed to opt for another property management company if they find the service quality unsatisfactory, as long as a property owners' committee has been formed (note: for projects without a committee, the property management contract is automatically renewed upon expiry).

Unlike home building where developers can leverage on land market cycles and make large margins if the timing is right, property management companies, due to the "passive consumption" nature, have to really understand what property owners want and provide solutions and value-added services during their accommodation. The "end-game" of being a good property management company is to be able to not only encourage renewal and raise management fees, but also establish a good reputation so that the corresponding backing developer can charge a price premium in subsequent projects.

Therefore, service quality is key, and this can be reflected by three major metrics: (1) customer satisfaction rate; (2) renewal rate and (3) fee collection rate.

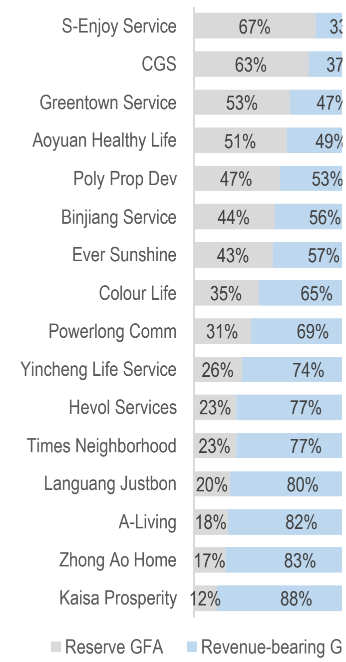
- **Customer satisfaction rate:** China Index Academy (CIA), a third party consultancy, regularly conducts customer satisfaction surveys. The top 100 companies' average satisfaction rate is 80%, while those under our coverage are >85%.
- **Renewal rate:** This reflects the willingness of home owners to stick with the same property management company. The top 100 companies' average renewal rate is 98%, and our covered companies also see a similar rate. However, companies can also voluntarily discontinue certain management contracts (e.g. due to profitability concerns), and thus a slightly lower renewal rate might not be particular concern, unless it is lower than 80%.
- **Fee collection rate:** If service quality is subpar, some property owners may choose not to pay the dues (or delay payments) if they find the quality unsatisfactory. Companies under our coverage have an average 96% collection rate, while that of top 100 companies (defined by CIA) has been steady at 93-95%. For those outside the top 100, collection rates could be as low as 70-80%, reflecting a differential in service satisfaction.

Figure 68: Top 100 property management companies - management fee collection rate



Source: China Index Academy

Figure 69: Listed property management companies' revenue-bearing GFA vs. reserve GFA (1H19)



Source: Company data, HKEx, J.P. Morgan
Note: A-Living's includes CMIG acquisition

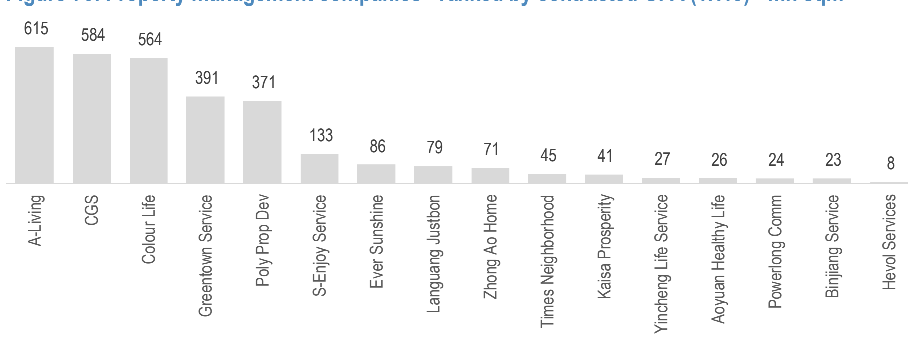
GFA

There are three basic concepts of the gross floor area (GFA) when we refer to property management companies:

- **Revenue-bearing GFA (A):** refers to the GFA that currently contributes to revenue. It refers to those properties that have been delivered, or are ready to be delivered for which property management services have begun.
- **Reserve GFA (B):** refers to the GFA that will contribute to revenue in the future, under a preliminary property management contract, which is usually signed with a developer shortly before the pre-sale permit is obtained from the government.
- **Contracted GFA (A+B):** it is the sum of revenue-bearing GFA and reserve GFA, including all current and future GFA that contributes to revenue.

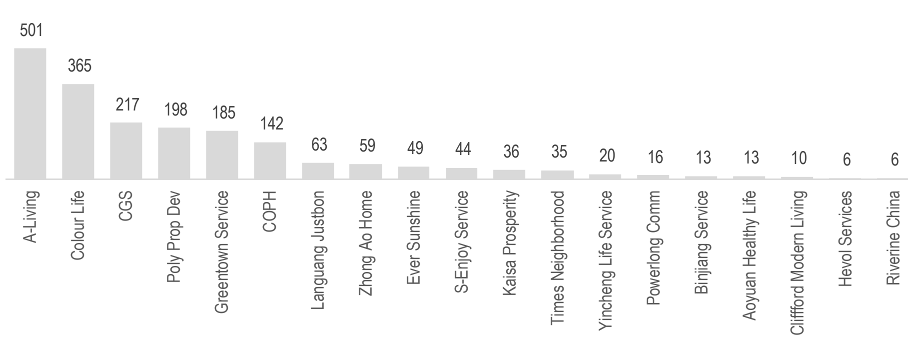
As fee increment is minimal, revenue growth is driven more by the increase in revenue-bearing GFA. To assess a company's potential future revenue growth, we look at the ratio of reserve GFA as a % of contracted GFA. Among major listed property management companies, the average ratio is 36%. The higher the ratio, the more growth potential. S-Enjoy Service, CGS, Greentown Service and Aoyuan Healthy Life have the highest ratios among all (>50%).

Figure 70: Property management companies - ranked by contracted GFA (1H19) - mn sqm



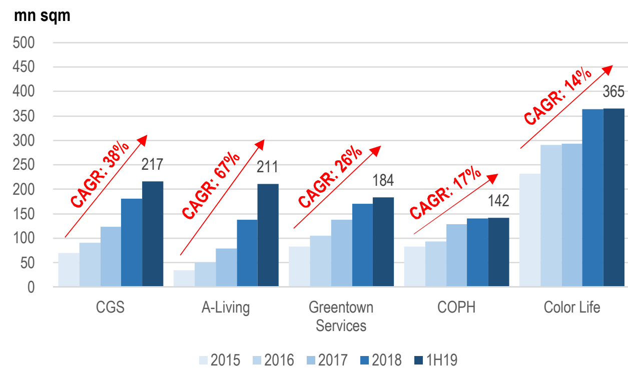
Source: Company data, HKEx, J.P. Morgan
Note: A-Living includes CMIG acquisition.

Figure 71: Property management companies - ranked by revenue-bearing GFA (1H19) – mn sqm



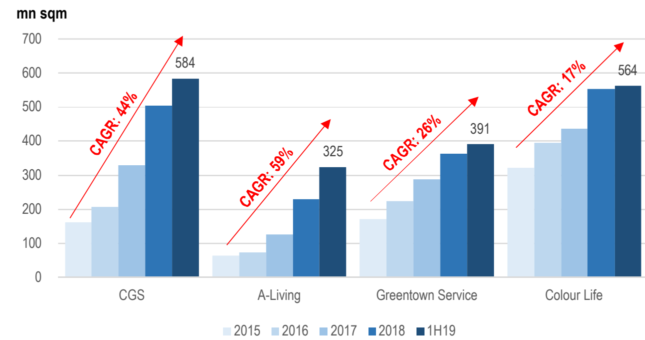
Source: Company data, HKEx, J.P. Morgan
Note: A-Living's includes CMIG acquisition.

Figure 72: Revenue-bearing GFA (2015-1H19)



Source: Company data
Note: A-Living's excludes CMIG acquisitions.

Figure 73: Contracted GFA (2015-1H19)



Source: Company data
Note: A-Living's excludes CMIG acquisitions.

GFA acquisitions

There are three major ways for a company to grow its revenue-bearing GFA:

- **Backing developer:** This is the case for most of the major listed property management companies, which are spun off from a backing developer (or parent company). We don't call them parent companies here because not all property management companies remain consolidated into the listed company, e.g. Country Garden Services (6098 HK), after spin-off, is now a sister company to Country Garden Holdings (2007 HK). On average, 48% of GFA managed by major property management companies comes from their respective backing developers.
- **Third-party:** Property management companies can also acquire more GFA by submitting a bid to third-party developers (usually smaller ones without a property management arm) or existing projects which are looking for a new operator.
- **M&A:** An effective way to significantly expand the scale is through M&A. Some large-scale M&As in the past few years include:
    - **Colour Life's acquisition of Wanxiang**: In Nov 2017, Colour Life announced the acquisition of a 100% stake in Wanxiang (万象美), which comprises mainly assets from Wanda, for Rmb2 bn.
    - **A-Living's acquisition of CMIG:** In Sep 2019, A-Living announced the acquisition of a 60% stake of the 190 mn sqm GFA (and 100 mn sqm GFA at associate level) of CMIG (中民物业).

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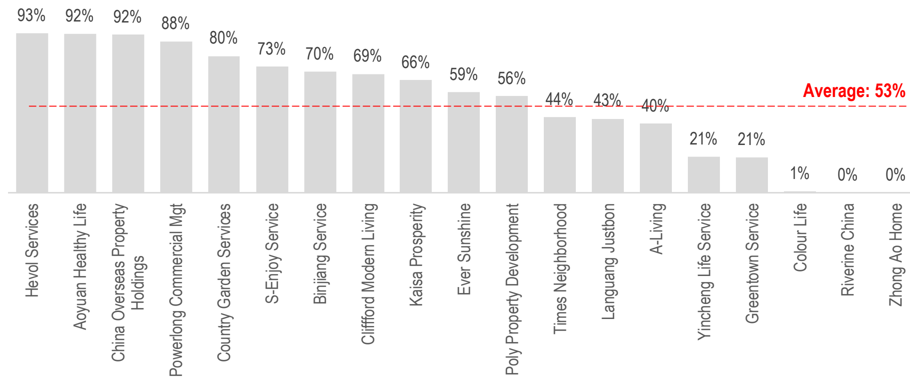
Figure 74: % of revenue-bearing GFA from backing developer (1H19)

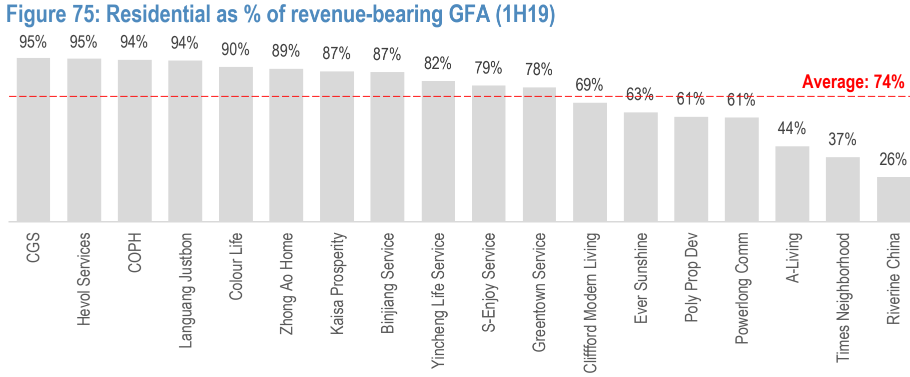


Source: Company data, HKEx, J.P. Morgan estimates. Note: The remaining GFA refers to those acquired through third-party or M&A.

Residential remains the primary driver

Among major companies, 74% of revenue-bearing GFA is residential, which is the major driver of growth.

Figure 75: Residential as % of revenue-bearing GFA (1H19)



Source: Company data, HKEx, J.P. Morgan estimates.

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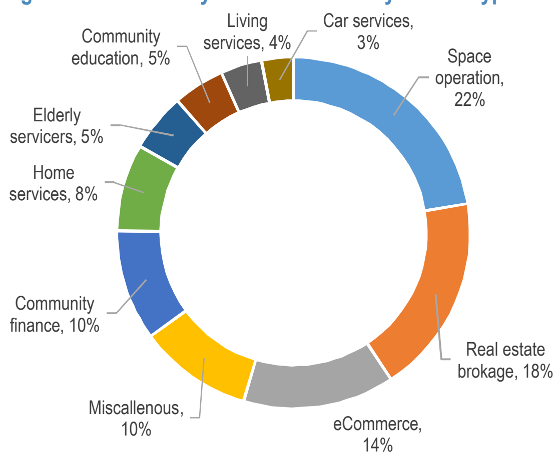
Community VAS

Overview

Community valued-added services (VAS) refer to services provided for property owners. The vast majority of community VAS serves residential communities. Among listed names, community VAS accounts for 24% of companies' gross profit on average, and examples of services include home repairs, furnishing, healthcare, education, nursery services, clubhouse activities, leasing/agency services for secondary units, e-Commerce, community finance and elderly services etc.

Figure 76: Community VAS breakdown by service type

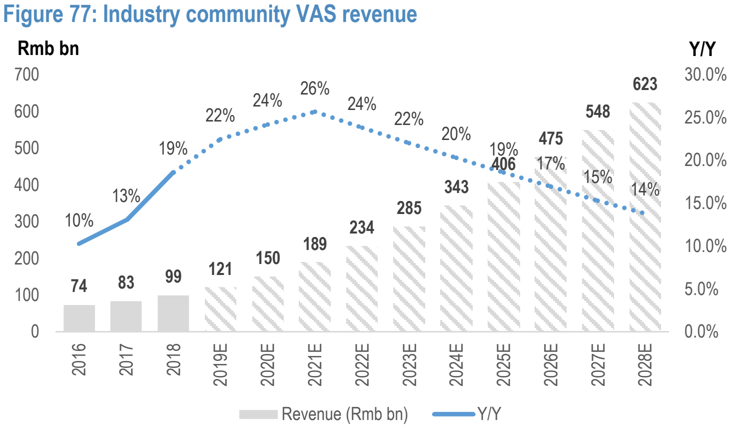


Source: China Index Academy

11% of total addressable market

China Index Academy estimates that the total addressable market for community VAS amounted to Rmb922 bn as of 2018. With an aggregate community VAS revenue of Rmb99 bn, this means Chinese PMCs have only captured 11% of the total addressable market, with a lot of room to grow.

Figure 77: Industry community VAS revenue

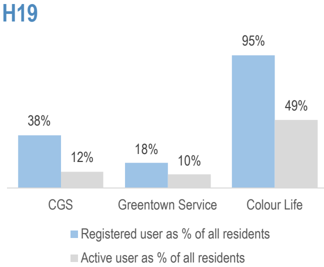


Source: China Index Academy, J.P. Morgan estimates.

Figure 78: Community VAS mobile app developed by Country Garden Services

Source: Country Garden Services

Figure 79: App penetration rate (by registered user & active user) as of 1H19



Source: Company data, J.P. Morgan estimates.

Both B2C & "Platform for B2C"

Community VAS incorporates elements of both B2C (for services provided to residents directly) and *platform* for B2C (for services provided through third parties). For B2C, the PMCs directly provide services (such as home repairs, education and elderly care) with their own staff. For platforms for B2C, PMCs earn a commission (e.g. eCommerce on the community app).

Services are usually facilitated by an O2O mobile platform, most commonly a mobile app, but they are also available in offline platforms such as clubhouse and on-site support booths etc.

In the long run, we believe PMCs are leaning towards the "platform for B2C" direction, i.e. reducing reliance on employing own staff to provide services, and most service offerings should be centralized in a mobile platform. The goal of the platform is to provide a convenient "one-stop shop" for residents to satisfy their various daily needs.

Expanding the community is now the priority

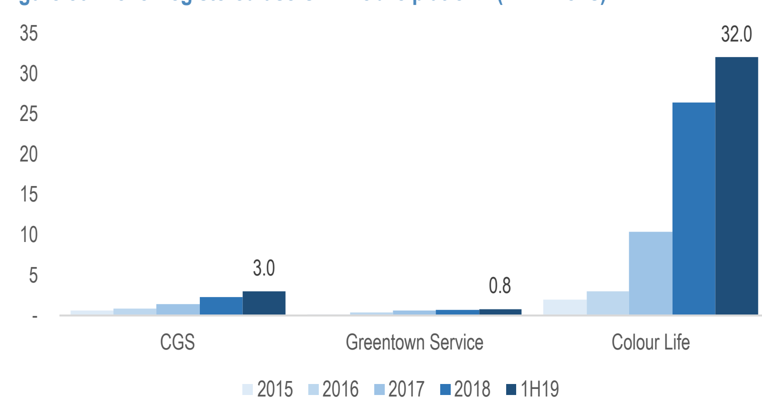
The user base is the direct revenue income source, and thus **(1) expanding the number of residents and (2) enhancing active user rate** drives success in VAS. However, not all service offerings are profitable. In fact, quite a few services are offered to only attract traffic, without much profitability. However, the end goal is to create loyalty and active usage, and finally direct users to the more profitable businesses.

Case study of partnership between JD.com & Colour Life

For example, JD.com, a strategic shareholder of Colour Life, is now offering more SKUs for sale on Colour Life's platform. Usually JD.com would need to pay a distribution cost to a platform collaborator, but for this, JD.com offers a rebate (roughly equal to the amount of their usual distribution cost) that can offset part of property management fees. This way, residents are incentivized to purchase items on Colour Life's platform. Although Colour Life does not really make a profit from this, traffic can be boosted, and it is hoped that some traffic will be diverted to the other profitable services (e.g. home repairs) on the mobile app.

Given currently most companies are still at an early stage of developing their platforms for community VAS, we believe most listed companies now prioritize in expanding the community, and their next step will be to raise the penetration rate.

Figure 80: No. of registered users in mobile platform (in millions)

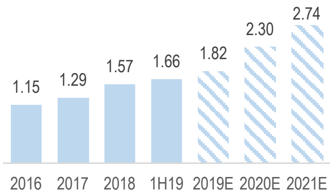


Source: Company data, J.P. Morgan estimates. Note: Colour Life's mobile platform is available in some non-managed projects, too.

Assessing profitability

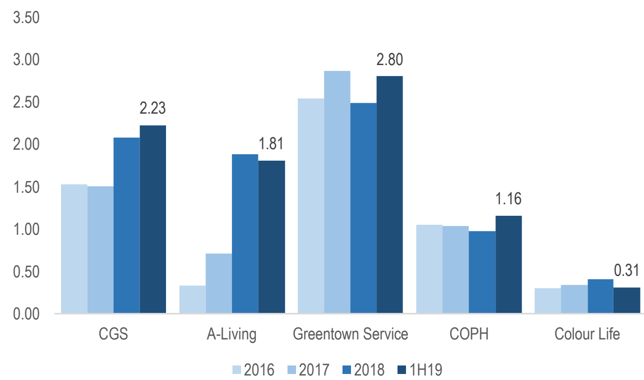
The service offerings vary significantly among PMCs, and therefore the margin differential should not be compared directly as they are not apple-to-apple. For example, commission-based services could see a much higher margin of >70%, while clubhouse services may fetch only <30% margin. Therefore, to assess profitability we look at the EBIT per *residential* revenue-bearing GFA, i.e. how much profit each GFA can generate. The efficiency has been raised from Rmb1.15/year per GFA in 2016 to Rmb1.66/year as of 1H19, and we expect this will continue to go up to Rmb2.74/year in 2021E. Among our covered names, Greentown Service stands out with the highest efficiency, while Colour Life has the lowest.

Figure 81: Community VAS EBIT per residential GFA (Rmb psm)



Source: Company data, J.P. Morgan estimates.

Figure 82: Community VAS EBIT per residential GFA (Rmb psm)



Source: Company data, J.P. Morgan estimates.

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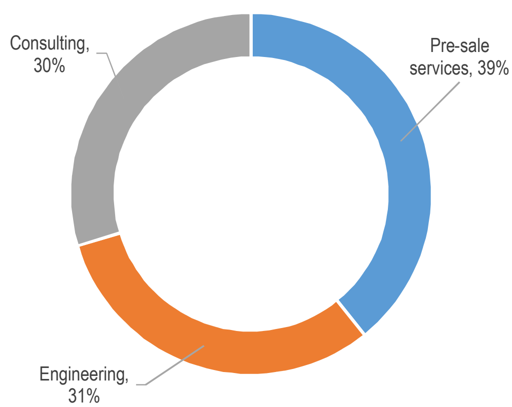
Non-community VAS

Non-community value-added services (VAS) accounts for 23% of PMCs' gross profit on average, and it mainly includes sales office/pre-sales management for developers, engineering services and consulting, etc. For A-Living in particular, real estate agency accounts for roughly half of its non-community VAS profit. Under this model, the PMC employs agents to sell primary units from Agile's projects and earns commission from the backing developer, replacing the functions usually performed by third-party agents such as Centaline.

Figure 83: Non-community VAS breakdown by service type (top 100 property management companies)



Source: China Index Academy

A cyclical business

This business segment, which mainly serves property developers (both the backing developer and others), corresponds to the well-being of the property market. When the market is good, theoretically there should be more demand for sales office management services and consulting etc. Therefore, non-community VAS is essentially a cyclical business. For small/unlisted developers, these VAS services (especially those provided by reputable developers such as Greentown) should be highly sought after as they lack the operating systems and expertise in sales launches (e.g. design of sales office and marketing events). Therefore, we think the big PMCs have an edge in expanding further in this segment.

Lower visibility

As most of these services (except real estate agency where PMC earns commission) are provided on a one-time contractual basis (e.g. a developer signs the contract with a PMC to manage the sales office for a certain period of time), there is low visibility on future earnings trajectory.

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Country Garden Services

Overweight

6098.HK,6098 HK
Price (22 Oct 19): HK$24.85
Price Target (Dec-20): HK$31.00

China
China / Hong Kong Property

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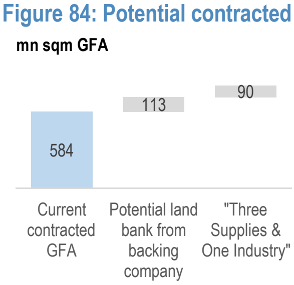
Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top) 6M	1Y	3Y	5Y
Value	97	93	96	98	
Growth	2	4	13		
Momentum	2	39			
Quality	1	4	20		
Low Vol	91	96	99		

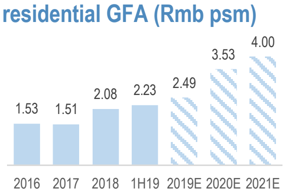
Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Figure 84: Potential contracted GFA



Source: Company data, J.P. Morgan estimates.

Figure 85: CGS – community EBIT per residential GFA (Rmb psm)



Source: Company data, J.P. Morgan estimates.

The high-growth giant that ticks the boxes

We initiate coverage on Country Garden Services (CGS) at Overweight with a Dec-20 price target of HK$31. CGS is trading at the highest 2020E P/E (31x) in the sector, but it is expensive for good reason, given (1) the strong support from backing developer (80% of GFA); (2) visible growth (reserve GFA is 67% of revenue-bearing GFA) and (3) leadership positions in low-tier cities (less competition for third-party projects). However, we think the sustainable growth in community VAS is not yet fully priced in, and more evidence on that will further rerate the stock. Given the strong share price movement lately, we think there could be some near-term profit-taking, and by then we think it will be a good opportunity to accumulate the name, which offers a sustainable long-term growth pipeline (39% core EPS 18-22E CAGR).

The industry leader with visible growth

CGS has the largest *attributable* contracted GFA (577 mn sqm) in the sector, and its reserve GFA is 67% of revenue-bearing GFA, which is the second highest among HK-listed companies, translating into a 39% 18-22E CAGR in core EPS (driven by a 32% CAGR in revenue-bearing GFA and increasing EBIT contribution of community VAS, from 18% in FY18 to 32% in FY22E).

What's not priced in?

We think that, while the market has priced in CGS's strong future growth in revenue-bearing GFA, the following have not been fully accounted for: (1) more potential contracted GFA from "Three Supplies & One Industry" (90 mn sqm GFA) and Country Garden (2007 HK)'s huge potential land bank of 113 mn sqm GFA (primary land & projects with signed MOU); (2) sustainable growth in community VAS due to short track record (CGS' community app only became fully functional in 2017); we expect CGS' community VAS EBIT per GFA to jump from Rmb2.08 in 2018 to Rmb4.00 in 2021E; (3) ability to sustainably expand third-party GFA, which has grown at a 132% CAGR over 2015-18 but from a small base; (4) potential labor cost savings with more implementation of robotics/AI. Also, we like CGS' leadership position in low-tier cities, as there is less competition in terms of: (1) acquiring third-party GFA, and (2) fewer alternatives to service offerings by CGS' VAS.

Too late to catch the train? Not quite.

CGS is trading at a 7x P/E premium to the sector average, which we think is justified due to its strong positioning, as shown by how CGS hits the highest score in almost all criteria in our target P/E scoreboard (see Table 4). CGS is trading at 31x 2020E P/E, which is similar to FirstService's (30x), but CGS' earnings CAGR of 39% will highly outperform FirstService's. If CGS rerates to our target P/E, by end of 2021 (~2 years), the implied potential return would be 124%. Even if CGS trades at the current P/E (i.e. no rerating), the 2-year implied potential return would still be 80%, driven solely by earnings growth. In a more conservative scenario where CGS de-rates to 23x P/E (historical mean), the implied valuation in two years would still be 34% above the current share price. We thus think this is still an attractive buy. We think the next strong rerating will come in early 1Q20 when the market trades on results, and before that, we suggest buying-on-dips when there is profit-taking.

Price Performance

	YTD	1m	3m	12m
Abs	99.8%	10.0%	31.2%	115.0%
Rel	95.8%	8.5%	33.5%	114.7%

Company Data

Shares O/S (mn)	2,669
52-week range (HK$)	25.65-9.54
Market cap ($ mn)	8,456
Exchange rate	7.84
Free float(%)	49.6%
3M - Avg daily vol (mn)	6.79
3M - Avg daily val ($ mn)	18.3
Volatility (90 Day)	36
Index	HSCEI
BBG BUY|HOLD|SELL	18|3|0

Key Metrics (FYE Dec)

Rmb in millions	FY18A	FY19E	FY20E	FY21E
Financial Estimates				
Revenue	4,675	7,686	10,943	14,827
Adj. EBITDA	1,059	1,807	2,556	3,525
Adj. EBIT	1,026	1,760	2,499	3,457
Adj. net income	923	1,490	1,934	2,677
Adj. EPS	0.37	0.56	0.72	1.00
BBG EPS	0.33	0.56	0.73	0.95
Cashflow from operations	1,549	1,053	3,096	3,933
FCFF	1,435	778	2,970	3,805
Margins and Growth				
Revenue growth	49.8%	64.4%	42.4%	35.5%
EBITDA margin	22.6%	23.5%	23.4%	23.8%
EBITDA growth	76.4%	70.7%	41.4%	37.9%
EBIT margin	21.9%	22.9%	22.8%	23.3%
Net margin	19.7%	19.4%	17.7%	18.1%
Adj. EPS growth	-	52.0%	29.1%	38.4%
Ratios				
Adj. tax rate	17.9%	18.0%	25.0%	24.9%
Interest cover	NM	NM	NM	NM
Net debt/Equity	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM
ROCE	45.8%	38.1%	30.8%	32.5%
ROE	50.1%	39.3%	31.7%	33.6%
Valuation				
FCFF yield	2.6%	1.3%	5.0%	6.4%
Dividend yield	0.4%	0.6%	0.8%	1.1%
EV/EBITDA	60.4	34.1	24.1	17.5
Adj. P/E	60.7	39.9	30.9	22.3

Summary Investment Thesis and Valuation

CGS is trading at the highest P/E in the sector, but it is expensive for good reasons, given (1) the strong support from backing developer (80% of GFA); (2) visible growth (reserve GFA is 67% of revenue-bearing GFA) and (3) leadership positions in low-tier cities (less competition for third-party projects). We think the sustainable growth potential from community VAS is not yet priced in, and more evidence on that should further rerate the stock, which offers a sustainable long-term growth pipeline (39% core EPS CAGR from 2018-22E).

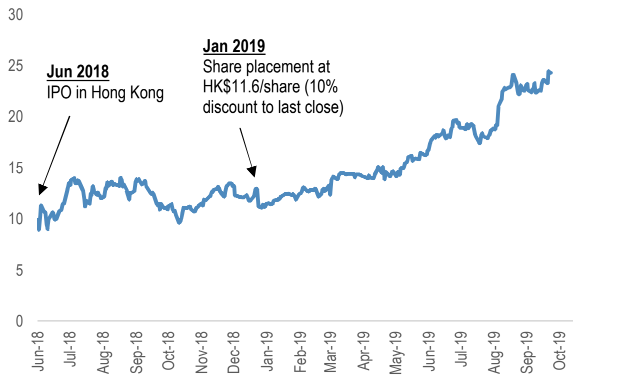
Valuation

Our Dec-20 price target of HK$31 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 39x 2020E P/E.

1. **Property management:** We apply a 26x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 19x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS:** We apply a 15x P/E to one-year forward net profit, with a premium to peers due to CGS' strong branding.

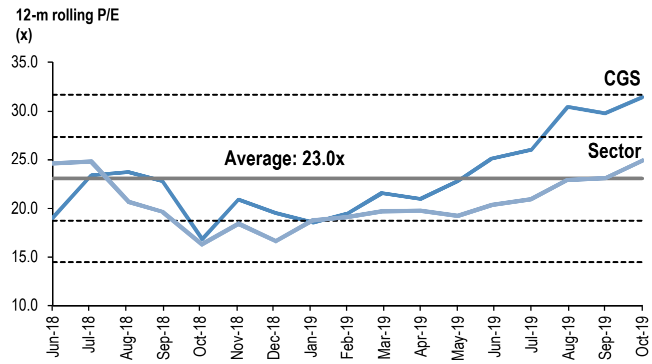
Sources for: Performance Drivers – Bloomberg, J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Figure 86: Country Garden Services – Share price performance (HK$)



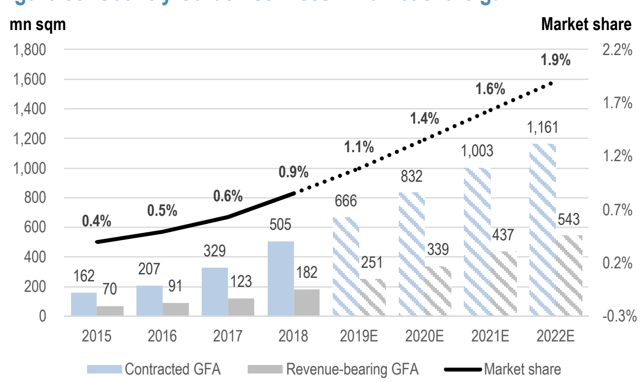
Source: Bloomberg, HKEx, J.P. Morgan

Figure 87: Country Garden Services – P/E time series



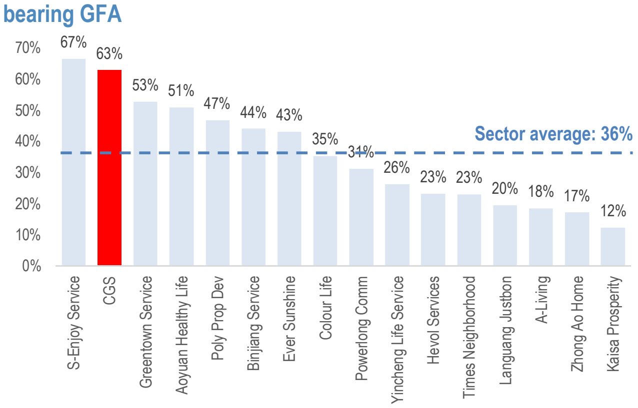
Source: Company data, Bloomberg. J.P. Morgan estimates.

Figure 88: Country Garden services – Market share gain



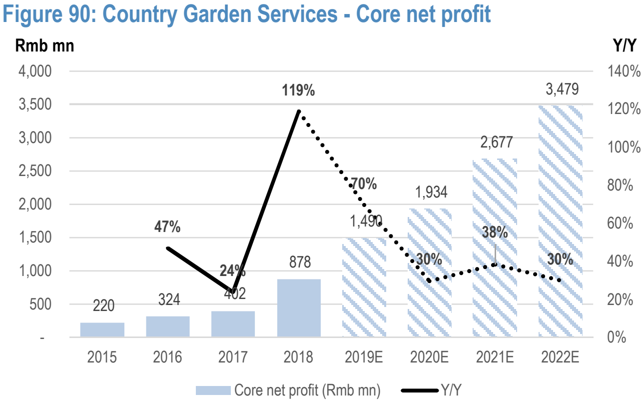
Source: Company data, CIA, J.P. Morgan estimates.

Figure 89: Country Garden Services – Reserve GFA as % of revenue-bearing GFA



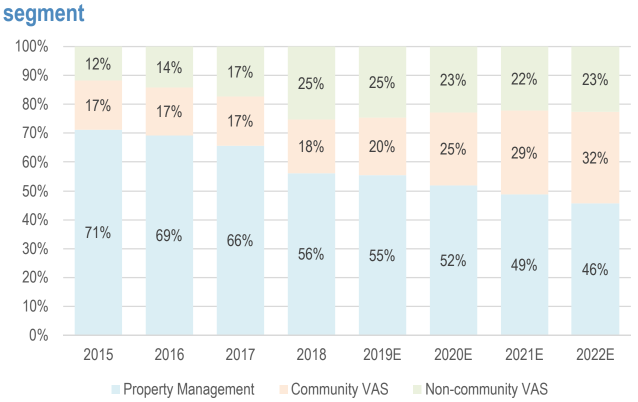
Source: Company data, HKEx, J.P. Morgan.

Figure 90: Country Garden Services - Core net profit



Source: Company data, J.P. Morgan estimates.

Figure 91: Country Garden Services – EBIT breakdown by business segment



Source: Company data, J.P. Morgan estimates.

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Figure 92: Implied return by P/E scenario

Scenario	P/E	1-year	2-year
Target P/E	39x	73%	124%
Current P/E	31x	38%	80%
Average P/E	23x	3%	34%
Trough P/E	17x	-25%	-2%

Source: J.P. Morgan estimates.

Key questions answered

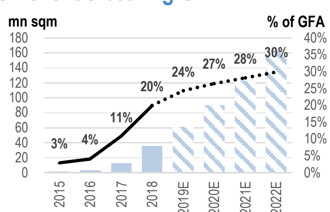
Is it too late to chase?

Our positive view on CGS is over the medium term. That said, CGS is currently trading at a P/E that is two standard deviations above average, and we therefore suggest waiting for a buy-on-dip opportunity to accumulate the name. As shown in the figure on the left, in a bullish scenario, a two-year implied return could be 124%. Even if CGS does not rerate and only trades at the current P/E (31x), in two years' time the implied valuation would still be up by 80%, driven solely by earnings growth. In a conservative scenario where CGS de-rates to its historical average P/E of 23x, this would still imply 34% upside from today's share price. Therefore, we think the risk reward is still attractive for the number 1 company in a structurally growing sector.

What is the key upside risk?

Consensus earnings upgrades is the biggest upside risk, but usually this would only occur around results season when the company gives out more guidance (Feb/Mar 2020). Apart from this, currently we assume that CGS' effective tax rate will be raised from 18% in FY19E back to the typical 25% in FY20E as this preferential tax rate (due to the fact that CGS qualified as a "High & New Technology Enterprise") will expire after FY19, and after that we will only know if CGS will still be eligible for this in late 2020. Should the favorable tax rate continue going forward, earnings would likely be adjusted upward by **9%** in FY20E/21E/22E.

Figure 93: Third-party projects as % of revenue-bearing GFA

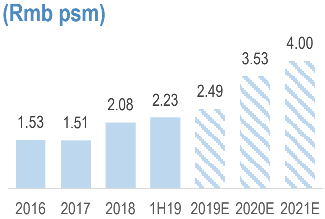


Source: Company data, J.P. Morgan estimates.

Country Garden's contracted sales are already slowing down. Is this a concern?

While it is true that Country Garden (2007 HK)'s contracted sales growth Y/Y has already slowed to single digit in 2019 YTD, one must not ignore its strong sales growth over the past three years (71% 15-18 CAGR) which will be translated into revenue-bearing GFA in the coming 2-3 years. Moreover, we also expect the contribution from third-party developers would climb from 20% in 2018 to 30% in 2022E, and this will be a new growth driver. Therefore, we think that the >30% CAGR in revenue-bearing GFA till 2022E is achievable, with upside risk from potential significant M&A.

Figure 94: Community VAS EBIT per residential GFA (Rmb psm)



Source: Company data, J.P. Morgan estimates.

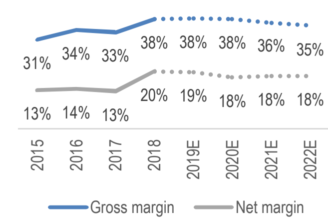
Why the community VAS growth potential has not been fully priced in?

CGS' community app only became fully functional in 2017. The track record has been good (51% EBIT CAGR in community VAS) but short, so we think investors will only be willing to give a higher multiple after more demonstrated growth. We think that there is substantial upside given (1) monthly active app user rate is only 11% of the entire CGS population (8 million residents) as of 1H19; (2) the company has heavily invested in AI and robotics which will differentiate its service offerings from peers. Further penetration, together with more efficiency per resident, will drive strong earnings growth in community VAS, and we expect the contribution to rise from 18% in FY18A to 32% in FY22E.

Is "Three Supplies & One Industry" profitable?

In short, it will only barely break-even given the low management fees. As of now, potential contracted GFA from this new JV initiative amounts to 90 mn sqm GFA, of which a minimal part has already started to contribute revenue in 2019, and the contribution will become higher in FY2020. Although this segment will not be a huge profit contributor, after entering this new field where major competitors are not in, we think CGS will still benefit as (1) after gaining track record, this could attract more similar collaboration, and thus further growth in GFA; (2) more GFA under management implies more growth opportunities for its community VAS.

Figure 95: Margin trend



Source: Company data, J.P. Morgan estimates.

Is margin squeeze a concern?

We currently forecast a slight margin squeeze till 2022, as we think the margin from property management business will see a gradual decline with the % of new projects (which typically see higher margin due to lower occupancy rate) getting smaller (from 24% in 2018, down to 19% in 2022E). However, the downtrend will be offset by the increasing contribution from community VAS (~60% margin). Therefore, we forecast gross margin will only be slightly down from 38% in 2018 to 35% in 2022E, while net margin will also only see a mild squeeze from 19.7% in 2018 to 18.0% in 2022E.

Why we like the exposure to low-tier cities?

Actually, we do not like the exposure to low-tier cities per se. What we like is Country Garden's *leading position* and *strong market share & brand name* in low-tier cities (~70% of GFA), where CGS sees minimal competition when acquiring projects from third-party developers, who typically don't have their own management companies. By bidding success rate, it has been mostly 100% for CGS, due to the fact that it is usually the third-party developers who approach CGS (rather than CGS having to bid around). Moreover, with fewer resources in low-tier cities, there will also be fewer competitors of the services provided by CGS' VAS platform (e.g. home repairs).

Is there share placement risk?

Given the share price is reaching a historical high, we think there is share placement risk. However, we think the company's preference is to introduce a strategic shareholder that can bring synergy, such as a technology company or even an international real estate firm. Placement risk to public shareholders will be higher when the company sees the need to conduct significant M&A.

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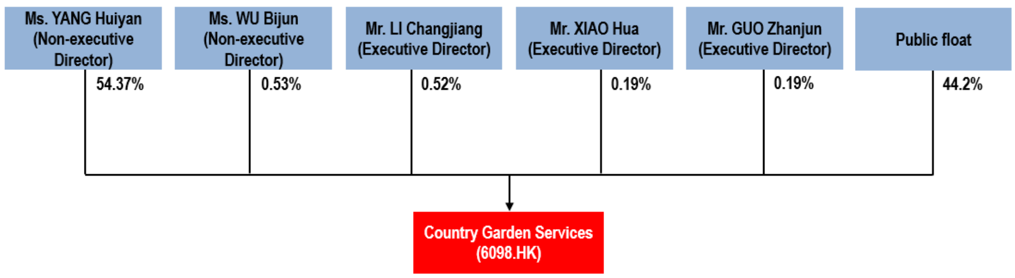
Company background

Country Garden Services was founded in 1992 as a subsidiary under Country Garden Holdings (2007 HK). CGS was listed separately by way of introduction on the HKEx in June 2018, after spinning off and being deconsolidated from parent company Country Garden (2007 HK). As of Jun-2019, it had contracted GFA of 584 mn sqm, covering more than 300 cities across China, with a focus on low-tier cities.

Figure 96: Country Garden Services - shareholding structure



Source: HKEx, Company data, J.P. Morgan

Table 22: Country Garden Services – board of directors

Name	Ms. Yang Huiyan 楊惠妍	Mr. Yang Zhicheng 楊志成	Ms. Wu Bijun 伍碧君	Mr. Li Changjiang 李長江	Mr. Xiao Hua 肖華	Mr. Guo Zhanjun 郭戰軍	Mr. Mei Wenjue 梅文珏	Mr. Rui Meng 芮萌	Mr. Chen Weiru 陳威如
Age	37	45	45	53	41	39	49	51	48
Role	Non-executive Director	Non-executive Director	Non-executive Director	Executive Director	Executive Director	Executive Director	Independent	Independent	Independent
Remarks	Daughter of Yang Guoqiang (chairman of CGH)	Cousin of Ms. Yang Huiyan; joined CGH in 1997	CFO of CGH; joined CGH in 2005	Joined CGS in 2011	Joined CGS in 2004	Joined CGH in 2017	Joined CGH in 2013	Serving as INED in several companies	Serving as INED in several companies

Source: Company data, HKEx, J.P. Morgan

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Table 23: Country Garden Services - detailed earnings model

	2015	2016	2017	2018	2019E	2020E	2021E	2022E
Gross turnover breakdown								
Property management	1,434	1,957	2,545	3,445	5,419	7,572	10,218	13,233
Community value-added-services	122	194	242	417	846	1,511	2,254	3,070
Value-added-services to non property owners	110	200	328	791	1,368	1,796	2,278	2,894
Gross Turnover	**1,672**	**2,358**	**3,122**	**4,675**	**7,686**	**10,943**	**14,827**	**19,289**
Cost of services	-1,161	-1,558	-2,086	-2,914	-4,779	-6,828	-9,418	-12,473
Gross Profit	**511**	**800**	**1,036**	**1,762**	**2,907**	**4,116**	**5,409**	**6,816**
Selling and marketing expenses	0	0	-9	-27	-44	-62	-84	-110
Administrative expenses	-226	-333	-459	-743	-1,158	-1,633	-1,974	-2,369
EBIT breakdown								
Property management	254	406	487	758	1,261	1,670	2,044	2,389
Community value-added-services	61	97	126	248	457	816	1,217	1,658
Value-added-services to non property owners	42	82	128	342	560	735	933	1,187
Other services	5	6	6	7	18	21	25	30
EBIT	**293**	**477**	**581**	**1,026**	**1,760**	**2,499**	**3,457**	**4,475**
Interest income	**2**	**16**	**35**	**54**	**75**	**106**	**148**	**207**
Interest expenses	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Operating profit	**295**	**493**	**616**	**1,079**	**1,835**	**2,604**	**3,604**	**4,682**
Share of associates / JCEs	0	-7	-8	3	3	5	8	11
Profit before tax	**295**	**486**	**608**	**1,083**	**1,839**	**2,609**	**3,612**	**4,693**
Income tax	-74	-134	-168	-193	-330	-651	-901	-1,170
Minority Interest	0	-28	-39	-11	-19	-24	-34	-44
Core net profit	**220**	**324**	**402**	**878**	**1,490**	**1,934**	**2,677**	**3,479**
Exceptional items	0	0	0	45	0	0	0	0
Reported net profit	**220**	**324**	**402**	**923**	**1,490**	**1,934**	**2,677**	**3,479**
Fully diluted EPS (Rmb)	NA	NA	NA	0.37	0.55	0.71	0.99	1.28
Core EPS (Rmb)	NA	0.13	0.16	0.35	0.56	0.72	1.00	1.30
Total DPS (Rmb)	0.00	0.00	0.00	0.08	0.14	0.18	0.25	0.33
Payout ratio	NA	NA	NA	25%	25%	25%	25%	25%
Margin								
Gross margin	**30.6%**	**33.9%**	**33.2%**	**37.7%**	**37.8%**	**37.6%**	**36.5%**	**35.3%**
Property management	27.3%	30.3%	29.4%	31.9%	32.4%	31.3%	29.3%	27.4%
Community value-added-services	55.1%	55.8%	57.7%	66.1%	60.0%	60.0%	60.0%	60.0%
Value-added-services to non property owners	42.6%	45.9%	43.2%	48.1%	45.4%	45.5%	45.5%	45.6%
EBIT margin	**17.5%**	**20.2%**	**18.6%**	**21.9%**	**22.9%**	**22.8%**	**23.3%**	**23.2%**
Operating margin	17.6%	20.9%	19.7%	23.1%	23.9%	23.8%	24.3%	24.3%
Net Margin (before MI)	**13.2%**	**15.2%**	**14.4%**	**19.0%**	**19.6%**	**17.8%**	**18.2%**	**18.2%**
YoY growth (%)								
Gross Turnover	NA	41%	32%	50%	64%	42%	35%	30%
EBIT	NA	63%	22%	76%	72%	42%	38%	29%
Core net profit	**NA**	**47%**	**24%**	**119%**	**70%**	**30%**	**38%**	**30%**
Reported net profit	NA	47%	24%	130%	61%	30%	38%	30%
Property management								
Contracted GFA (Period end) (mn sqm)	**162**	**207**	**329**	**505**	**666**	**832**	**1,003**	**1,161**
Y/Y%		28%	59%	53%	32%	25%	21%	16%
Revenue-bearing GFA (Period end) (mn sqm)	**70**	**91**	**123**	**182**	**251**	**339**	**437**	**543**
Y/Y%		30%	35%	48%	38%	35%	29%	24%

Source: Company data, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Country Garden Services Holdings Co. Ltd. *(Overweight; Price Target: HK$31.00)*

Investment Thesis

CGS is trading at the highest P/E in the sector, but it is expensive for good reasons, given (1) the strong support from backing developer (80% of GFA); (2) visible growth (reserve GFA is 67% of revenue-bearing GFA), and (3) leadership positions in low-tier cities (less competition for third-party projects). We think the sustainable growth potential from community VAS is not yet priced in, and more evidence on that will further rerate the stock, which offers a sustainable long-term growth pipeline (39% core EPS CAGR from 2018-22E).

Valuation

Our Dec-20 price target of HK$31 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 39x 2020E P/E.

1. **Property management:** We apply a 26x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 19x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS:** We apply a 15x P/E to one-year forward net profit, with a premium to peers due to CGS' strong branding.

Risks to Rating and Price Target

Upside risks: (1) value-accretive M&A; (2) accelerating sales growth of Country Garden Holdings; (3) continual preferential tax rate in FY20 and beyond; (4) better-than-expected profitability from "Three Supplies & One Industry".
Downside risks: (1) significant increase in labor costs which hurt margin; (2) value-destructive M&A; (3) worse-than-expected sales/completions of Country Garden Holdings: (4) worse-than-expected profitability from "Three Supplies & One Industry".

Table 24: Country Garden Services (6098 HK) - SOTP valuation

Property Management	Unit		
Adjusted attributable contracted GFA	mn sqm	548	
Stabilized net profit	Rmb mn	1,761	
Target P/E	**x**	**26x**	
Valuation	**Rmb mn**	**45,793**	**(Rmb17.2/sh)**
Community VAS			
Net profit	Rmb mn	1,126	(3-year forward)
Target P/E	**x**	**19x**	
Valuation	**Rmb mn**	**21,387**	**(Rmb8.0/sh)**
Non-community VAS			
Net profit	Rmb mn	427	(1-year forward)
Target P/E	**x**	**15x**	
Valuation	**Rmb mn**	**6,402**	**(Rmb2.4/sh)**
SOTP		**Rmb/sh**	**HK$/sh**
Property Management		17.2	19.3
Community VAS		8.0	9.0
Non-community VAS		2.4	2.7
Valuation		**27.6**	**31.0**

Source: J.P. Morgan estimates.

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Country Garden Services: Summary of Financials

Income Statement	FY18A	FY19E	FY20E	FY21E	FY22E
Revenue	**4,675**	**7,686**	**10,943**	**14,827**	**19,289**
COGS	(2,914)	(4,779)	(6,828)	(9,418)	(12,473)
Gross profit	**1,762**	**2,907**	**4,116**	**5,409**	**6,816**
SG&A	(769)	(1,202)	(1,695)	(2,058)	(2,479)
Adj. EBITDA	**1,059**	**1,807**	**2,556**	**3,525**	**4,475**
D&A	(33)	(47)	(57)	(68)	0
Adj. EBIT	**1,026**	**1,760**	**2,499**	**3,457**	**4,475**
Net Interest	54	75	106	148	207
Adj. PBT	**1,083**	**1,839**	**2,609**	**3,612**	**4,693**
Tax	(193)	(330)	(651)	(901)	(1,170)
Minority Interest	(11)	(19)	(24)	(34)	(44)
Adj. Net Income	**923**	**1,490**	**1,934**	**2,677**	**3,479**
Reported EPS	0.35	0.56	0.72	1.00	1.30
Adj. EPS	**0.37**	**0.56**	**0.72**	**1.00**	**1.30**
DPS	**0.08**	**0.14**	**0.18**	**0.25**	**0.33**
Payout ratio	24.2%	25.0%	25.0%	25.0%	25.0%
Shares outstanding	2,500	2,655	2,669	2,669	2,669

Balance Sheet	FY18A	FY19E	FY20E	FY21E	FY22E
Cash and cash equivalents	3,874	6,219	8,815	12,138	16,101
Accounts receivable	788	1,314	1,577	1,892	2,271
Inventories	8	12	17	23	32
Other current assets	0	1,043	1,043	1,043	1,043
Current assets	**4,671**	**8,587**	**11,452**	**15,096**	**19,447**
PP&E	113	136	163	195	234
LT investments	-	-	-	-	-
Other non current assets	738	1,069	1,279	1,530	1,831
Total assets	**5,522**	**9,792**	**12,893**	**16,822**	**21,513**
Short term borrowings	0	0	0	0	0
Payables	2,060	2,843	3,842	4,959	6,161
Other short term liabilities	1,067	1,474	1,985	2,561	3,188
Current liabilities	**3,127**	**4,317**	**5,827**	**7,520**	**9,349**
Long-term debt	0	0	0	0	0
Other long term liabilities	65	72	79	87	95
Total liabilities	**3,192**	**4,389**	**5,906**	**7,607**	**9,445**
Shareholders' equity	2,261	5,316	6,876	9,069	11,879
Minority interests	69	88	112	146	190
Total liabilities & equity	**5,522**	**9,792**	**12,893**	**16,822**	**21,513**
BVPS	**0.90**	**1.99**	**2.58**	**3.40**	**4.45**
y/y Growth	-	*120.3%*	*29.3%*	*31.9%*	*31.0%*
Net debt/(cash)	(3,874)	(6,219)	(8,815)	(12,138)	(16,101)

Cash Flow Statement	FY18A	FY19E	FY20E	FY21E	FY22E
Cash flow from operating activities	**1,549**	**1,053**	**3,096**	**3,933**	**4,753**
o/w Depreciation & amortization	33	47	57	68	0
o/w Changes in working capital	617	659	1,248	1,378	1,448
Cash flow from investing activities	**(114)**	**(275)**	**(126)**	**(128)**	**(122)**
o/w Capital expenditure	(78)	(366)	(233)	(280)	(336)
as % of sales	*1.7%*	*4.8%*	*2.1%*	*1.9%*	*1.7%*
Cash flow from financing activities	**(200)**	**1,566**	**(374)**	**(483)**	**(669)**
o/w Dividends paid	(96)	(231)	(374)	(483)	(669)
o/w Shares issued/(repurchased)	2	1,796	0	0	0
o/w Net debt issued/(repaid)	0	0	0	0	0
Net change in cash	**1,235**	**2,343**	**2,595**	**3,321**	**3,961**
Adj. Free cash flow to firm	**1,435**	**778**	**2,970**	**3,805**	**4,631**
y/y Growth	*63.4%*	*(45.8%)*	*281.8%*	*28.1%*	*21.7%*

Ratio Analysis	FY18A	FY19E	FY20E	FY21E	FY22E
Gross margin	37.7%	37.8%	37.6%	36.5%	35.3%
EBITDA margin	22.6%	23.5%	23.4%	23.8%	23.2%
EBIT margin	21.9%	22.9%	22.8%	23.3%	23.2%
Net profit margin	19.7%	19.4%	17.7%	18.1%	18.0%
ROE	50.1%	39.3%	31.7%	33.6%	33.2%
ROA	20.5%	19.5%	17.1%	18.0%	18.1%
ROCE	45.8%	38.1%	30.8%	32.5%	32.1%
SG&A/Sales	16.5%	15.6%	15.5%	13.9%	12.9%
Net debt/Equity	NM	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM	NM
Sales/Assets (x)	1.0	1.0	1.0	1.0	1.0
Assets/Equity (x)	2.4	2.0	1.9	1.9	1.8
Interest cover (x)	NM	NM	NM	NM	NM
Operating leverage	153.7%	111.2%	99.1%	108.0%	97.9%
Tax rate	17.9%	18.0%	25.0%	24.9%	24.9%
Revenue y/y Growth	49.8%	64.4%	42.4%	35.5%	30.1%
EBITDA y/y Growth	76.4%	70.7%	41.4%	37.9%	26.9%
EPS y/y Growth	-	52.0%	29.1%	38.4%	29.9%

Valuation	FY18A	FY19E	FY20E	FY21E	FY22E
P/E (x)	60.7	39.9	30.9	22.3	17.2
P/BV (x)	24.8	11.3	8.7	6.6	5.0
EV/EBITDA (x)	60.4	34.1	24.1	17.5	13.8
Dividend Yield	0.4%	0.6%	0.8%	1.1%	1.5%

Source: Company reports and J.P. Morgan estimates.

Note: Rmb in millions (except per-share data).Fiscal year ends Dec. o/w - out of which

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A-Living Services

Rerating will continue; top pick for the sector

Overweight

3319.HK,3319 HK
Price (22 Oct 19): HK$22.00
Price Target (Dec-20): HK$31.00

China
China / Hong Kong Property

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Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top) 6M	1Y	3Y	5Y
Value	81	55	72	98	
Growth	1	3	3		
Momentum	2	30	25		
Quality	15	25	7	1	
Low Vol	87	84	90		

Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

We initiate coverage on A-Living (3319 HK) at Overweight with a Dec-20 price target of HK$31. After the acquisition of CMIG in Sep 2019, A-Living has outperformed HSCEI by 32%. However, we expect the rerating to continue, as the market should gradually appreciate A-Living's shift from M&A-centric to organic growth-focused. We also argue that A-Living's P/E gap with the sector should further narrow (now still 39% discount) after the scale upgrade, but this has not happened yet. With a 37% 18-22E core EPS CAGR but 14x 2020E P/E, we think risk reward is attractive. Potential inclusion into Southbound Connect in 1Q20 is another share price catalyst. Top pick for the sector.

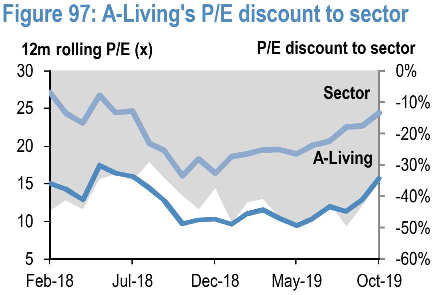
A good mix of growth appetite & defensiveness

We like A-Living's model because it not only has the backing from Agile and Greenland, which are two top 20 developers (38% of revenue-bearing GFA), but it also has demonstrated a strong ability to acquire third-party projects (149% 15-18 CAGR) and conduct M&As. The acquisition of CMIG projects is a particular milestone, raising A-Living's *attributable* contracted GFA to 417 mn sqm, which is the third largest in the HK-listed space, behind CGS and Colour Life (or the largest, if by total GFA of 615 mn sqm). Market share will also jump from 0.6% in 2018 to 2.4% in 2020E. We expect A-Living's attributable revenue-bearing GFA will grow at a 37% CAGR in 18-22E (even without CMIG, we still assume a 25% CAGR), translating to a 37% core EPS CAGR.

More evidence on organic growth will drive a rerating

We think A-Living's long-term discount to sector P/E is mainly because of its (1) M&A-driven growth strategy which does not give the market clear-enough visibility into earnings and (2) more profit contribution from the real estate agency. After this CMIG deal, we expect A-Living will slow down in M&A, and shift its focus to organic growth, thus alleviating the two major concerns. We therefore expect a gradual rerating as and when there is more evidence on solid growth through both backing developers' GFA and third-party projects.

Figure 97: A-Living's P/E discount to sector



Source: Bloomberg, J.P. Morgan estimates.

Market is too bearish on agency business

The market has been cautious on A-Living's agency business (31% of FY18 net profit). While this is a cyclical business, we think the market has been too bearish on it, because (1) compared to developers (average P/E: 5-6x), this business is asset-light; (2) agencies (e.g. Shenzhen World Union) are typically trading at mid-teens P/E; and (3) gross margin is high at ~50% (peers average: 30-40%). Nonetheless, we forecast the agency contribution to profit will be down to 10% in FY22E. Thus, even if the market remains bearish on it, the blended multiple should still expand.

Figure 98: P/E scenario if stripping out the entire agency business in net profit calculations

	Core EPS (Rmb)		P/E	
	19E	20E	19E	20E
Current	0.90	1.38	22x	14x
Ex-Agency	0.70	1.17	28x	17x

Source: Company data, J.P. Morgan estimates.

Attractive risk reward

A-Living is trading at 14x FY2020E P/E. Even if we strip out the entire agency business (15% of net profit) and conservatively assume zero value, A-Living would still be trading at just 17x P/E, below the sector average of 24x. For a company with the second strongest earnings CAGR of 37% in the sector, risk reward is very attractive, in our view.

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Price Performance

	YTD	1m	3m	12m
Abs	107.2%	33.3%	40.7%	116.1%
Rel	103.2%	31.8%	43.0%	115.8%

Company Data

Shares O/S (mn)	1,333
52-week range (HK$)	23.30-8.84
Market cap ($ mn)	3,740
Exchange rate	7.84
Free float(%)	95.3%
3M - Avg daily vol (mn)	5.33
3M - Avg daily val ($ mn)	12.7
Volatility (90 Day)	50
Index	HSCEI
BBG BUY|HOLD|SELL	17|0|0

Key Metrics (FYE Dec)

Rmb in millions	FY18A	FY19E	FY20E	FY21E
Financial Estimates				
Revenue	3,377	5,399	11,586	13,301
Adj. EBITDA	982	1,584	2,742	3,434
Adj. EBIT	949	1,546	2,697	3,380
Adj. net income	767	1,181	1,843	2,345
Adj. EPS	0.59	0.89	1.38	1.76
BBG EPS	0.52	0.84	1.16	1.52
Cashflow from operations	883	2,027	2,282	2,873
FCFF	771	(58)	1,667	2,126
Margins and Growth				
Revenue growth	91.8%	59.9%	114.6%	14.8%
EBITDA margin	29.1%	29.3%	23.7%	25.8%
EBITDA growth	139.6%	61.2%	73.1%	25.2%
EBIT margin	28.1%	28.6%	23.3%	25.4%
Net margin	22.7%	21.9%	15.9%	17.6%
Adj. EPS growth	70.6%	49.8%	56.0%	27.2%
Ratios				
Adj. tax rate	25.4%	25.0%	24.5%	24.5%
Interest cover	NM	NM	NM	NM
Net debt/Equity	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM
ROCE	11.3%	10.9%	16.7%	17.2%
ROE	22.2%	20.0%	26.1%	27.7%
Valuation				
FCFF yield	3.0%	(0.2%)	6.3%	8.0%
Dividend yield	1.5%	2.0%	3.1%	4.0%
EV/EBITDA	27.6	17.2	10.1	8.1
Adj. P/E	33.5	22.4	14.4	11.3

Summary Investment Thesis and Valuation

Investment Thesis

After the acquisition of CMIG in Sep 2019, A-Living has outperformed HSCEI, but we think rerating will still continue, as the market should gradually appreciate A-Living's shift from M&A-centric to organic growth-focused. We also argue that A-Living's P/E gap with the sector should further narrow after the scale upgrade, but this has not happened yet. With a 37% 18-22E core EPS CAGR but 14x FY20E P/E, we think risk reward is attractive. Potential inclusion into Southbound Connect in 1Q20 is another share price catalyst. Top pick for the sector.

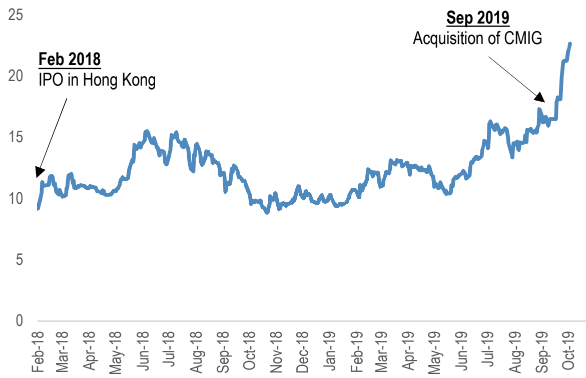
Valuation

Our Dec-20 price target of HK$31 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 20x 2020E P/E.

1. **Property management:** We apply a 24x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 18x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS (non-agency):** We apply a 15x P/E to one-year forward net profit.
4. **Non-community VAS (agency):** We apply an 8x P/E to one-year forward net profit, given the cyclicality, but at a slight premium over developers' P/E.

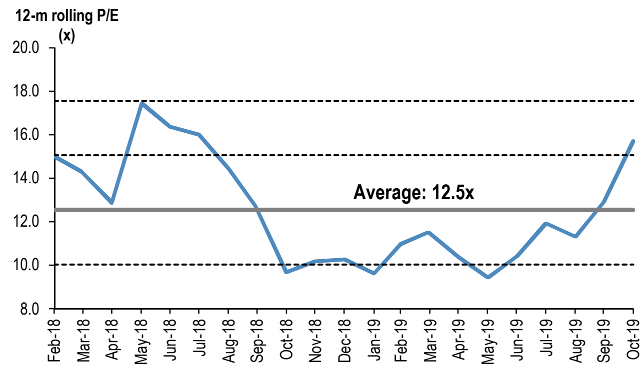
Sources for: Performance Drivers – Bloomberg, J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Figure 99: A-Living – Share price performance



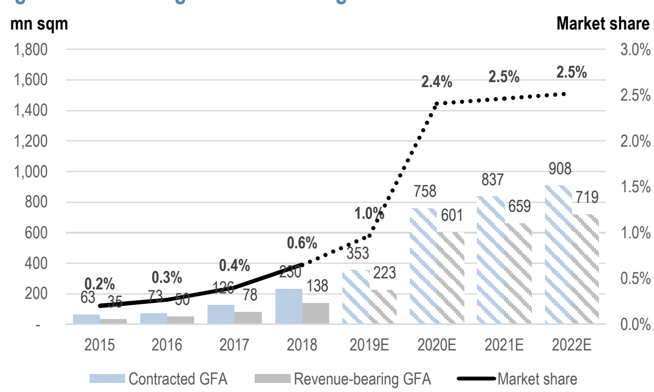
Source: Bloomberg, HKEx, J.P. Morgan

Figure 100: A-Living – P/E time series



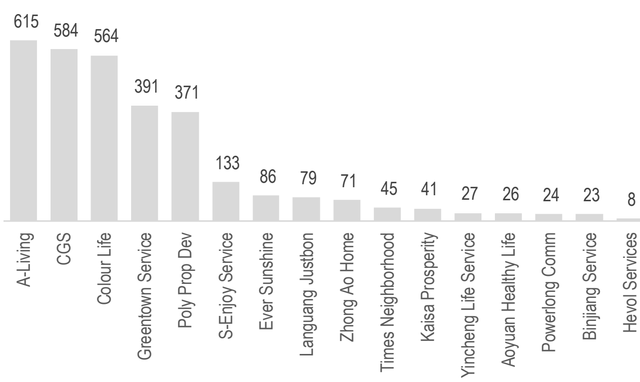
Source: Company data, Bloomberg. J.P. Morgan estimates.

Figure 101: A-Living – Market share gain



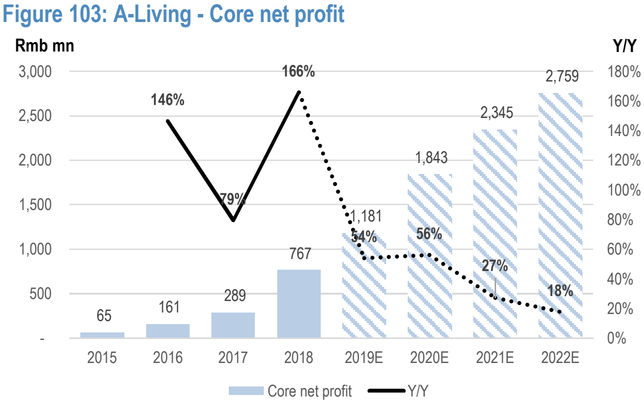
Source: Company data, CIA, J.P. Morgan estimates. Note: Based on total GFA

Figure 102: A-Living – total contracted GFA vs. peers (1H19)



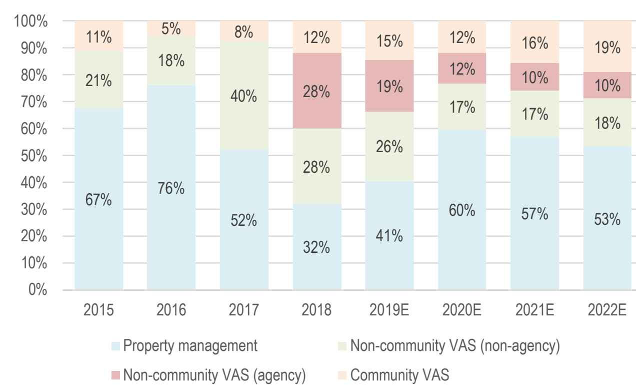
Source: Company data, HKEx, J.P. Morgan.

Figure 103: A-Living - Core net profit



Source: Company data, J.P. Morgan estimates.

Figure 104: A-Living – EBIT breakdown by business segment



Source: Company data, J.P. Morgan estimates.

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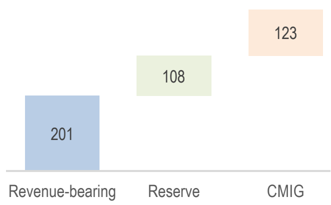
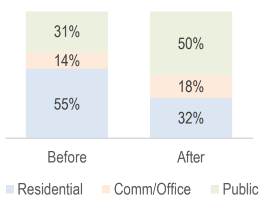
Figure 105: Attributable GFA under management



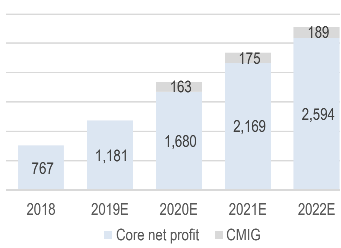
Source: Company data J.P. Morgan estimates. Note: Revenue-bearing & reserve GFA is as of 1H19.

Figure 106: Revenue-bearing GFA breakdown before and after CMIG acquisition



Source: Company data J.P. Morgan estimates

Figure 107: Core net profit, breakdown by pre- and post-CMIG contribution



Source: Company data J.P. Morgan estimates.

Key questions answered

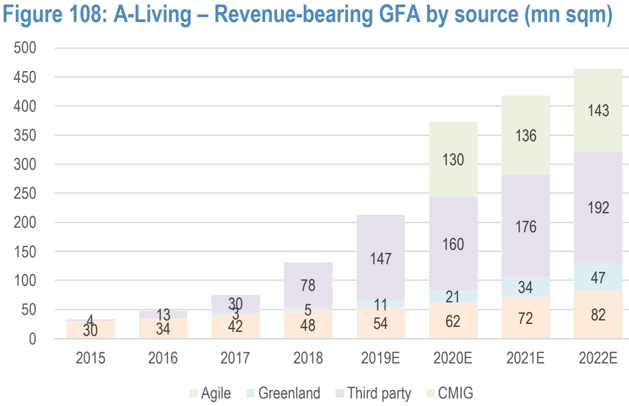
Is the acquisition of CMIG positive?

We think it is overall positive due to (1) upgrade in scale & showcase of M&A ability should drive a valuation premium; (2) expansion into more property types and geographical regions diversifies business risk; (3) although the effective stake in revenue-bearing GFA is only 38%, we think the community VAS eco-system can capture the entire residential GFA (61 mn sqm); and (4) experience in management for all types of properties helps A-Living prepare itself to transform into a full-service provider in the long run, and this is an edge in future acquisitions which may require relevant experience. While the P/E of 12.5x is more expensive than the average acquisition cost of ~10x P/E, we think this is a long-term strategic move, and the merit is that A-Living can pay by its own cash, which still amounts to Rmb2.3 bn after acquisition. We expect CMIG will start to contribute profit in FY2020E.

Recap of CMIG acquisitions (simplified)

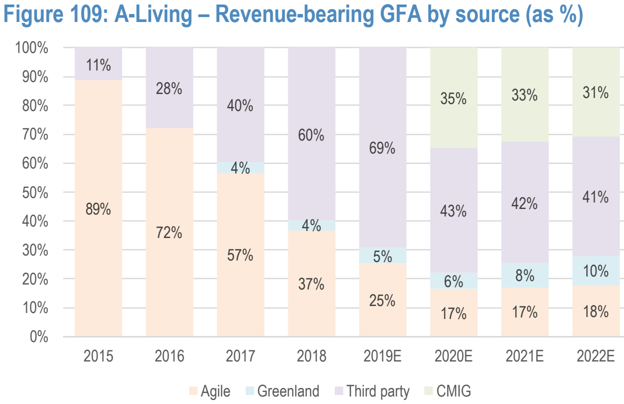
- **Consideration:** In Sep 2019, Agile announced it would acquire a 60% stake in CMIG Property Management, which operates several different brands of management companies, for a total maximum consideration of Rmb2.06 bn (47% of cash balance as of 1H19), with an implied P/E of 12.5x.
- **Effective stake:** Given CMIG is a holding platform with a revenue-bearing GFA of 190 mn sqm (on consolidated level) and 100 mn sqm (on associate level), we estimate the attributable ratio to CMIG is 63%. Since A-Living owns a 60% stake in CMIG, it translates into an effective stake of **38%**.
- **Net profit contribution:** We estimate the net profit contribution (attributable to A-Living) will be Rmb163 mn/Rmb175 mn/Rmb189 mn, raising the original earnings by 10%/8%/7%.

Figure 108: A-Living – Revenue-bearing GFA by source (mn sqm)



Source: Company data, J.P. Morgan estimates. Note: On attributable basis.

Figure 109: A-Living – Revenue-bearing GFA by source (as %)



Source: Company data, J.P. Morgan estimates. Note: On attributable basis.

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Why has A-Living's multiple been at a discount?

A-Living has consistently been trading at a 41% discount to sector average P/E since listing, and we believe there are two main reasons: (1) A-Living has been active in M&A and the average P/E it paid was ~10x P/E; the market would give a premium to those who could prove strong organic growth without too much reliance on M&A; and (2) 31% of core net profit in FY18 comes from the real estate agency business, which the market believes should be trading at a lower P/E.

However, we think this is set to change as (1) after the CMIG acquisition, we believe A-Living will slow down M&A, and re-focus on organic growth; and (2) the proportion of real estate agency business will gradually come down (31% in FY18A to 12% in FY22E, see Figure 104) and thus even if we separately value it at a lower P/E, the impact on the overall P/E should become smaller.

How is A-Living's real estate agency business?

The market has been cautious on this business, where A-Living acts as the property agent for mostly Agile and Greenland (90%; the remaining are third-party projects). While this is a cyclical business, we think when valuing this sub-segment, we should at least apply a higher P/E because (1) compared to developers (average P/E: 5-6x), this business segment is asset-light; (2) agencies (e.g. Shenzhen World Union) are typically trading at mid-teens P/E; and (3) gross margin is high at ~50% (peers average: 30-40%).

Figure 110: P/E scenario if stripping out agency business in net profit calculations

	Core EPS (Rmb)		P/E	
	19E	20E	19E	20E
Current	0.90	1.38	22x	14x
Ex-Agency	0.70	1.17	28x	17x

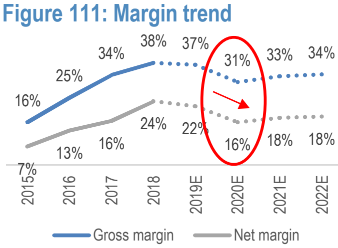
Source: Company data, J.P. Morgan estimates.

Most importantly, even if we entirely strip out the agency business in our net profit estimates (i.e. assume zero value), A-Living would still be trading at a lower P/E (18x) than peers. We currently apply a conservative 8x P/E to this sub-segment.

Will margin squeeze be significant after CMIG acquisition?

CMIG's FY18 margins are lower than A-Living's. For gross margin, CMIG's is 18% vs. A-Living's 37%. Although this is due more to the higher margins from A-Living's VAS segment while CMIG solely relies on traditional property management, even if we just compare the gross margin from property management, A-Living's 27% margin is still more competitive. On net margin (before MI), CMIG's 9% margin is also lower than A-Living's 23%.

Figure 111: Margin trend



Source: Company data, J.P. Morgan estimates.

Therefore, we think A-Living's overall gross/net margin will decline by ~6ppts in 2020E when CMIG is consolidated. However, we think margin could pick up again when contribution from VAS increases again.

Is Greenland's recent partial stake disposal a negative?

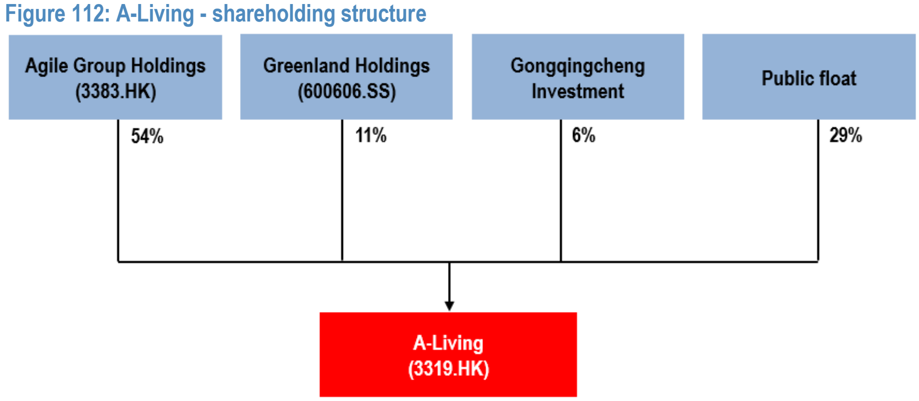
On 15 Oct 2019, Greenland disposed of a 3.75% stake in A-Living for the company's own funding needs. Currently Greenland still holds an 11.25% stake, of which 7.5% stake is domestic share (the remaining 3.75% is H-share). We think Greenland will not dispose of a further stake in the near future, and even if they intend to, they will likely retain the 7.5% stake through domestic shares. We are not too concerned about the stake disposal as the agreement for Greenland to supply revenue-bearing GFA is still valid (50 mn sqm GFA in five years since 2018, of which 7 mn sqm GFA p.a. is compulsory and A-Living has priority for another 3 mn sqm GFA p.a.).

Company background

As a subsidiary of Agile (3383 HK), A-Living Service Co. Ltd was established in 1997 in Zhongshan and introduced a Hong Kong-style property management model. The company then expanded the business nationwide from 2005. In 2017, the company acquired Greenland Property Services, where its parent company, Greenland Holdings (600606.SS) agreed to offer up to 10mn sqm GFA of properties to be managed by A-Living between 2018 and 2022. A-Living was spun off from Agile in 2018 and is now separately listed on HKEx, but it remains a subsidiary of Agile.

In Sep 2019, A-Living acquired a 60% stake in CMIG PM. After the acquisition, the company's attributable revenue-bearing GFA totals 417 mn sqm GFA.

Figure 112: A-Living - shareholding structure



Source: HKEx, Company data, J.P. Morgan
Note: (1) Greenland Holdings' stake was reduced from 15% to 11% in Oct 2019.

Figure 113: A-Living – board of directors

Name	Mr. Chan Cheuk Hung 陳卓雄	Mr. Huang Fengchao 黃奉潮	Mr. Feng Xin 馮欣	Mr. Wei Xianzhong 魏憲忠	Ms. Yue Yuan 岳元	Mr. Wan Kam To 尹錦滔	Mr. Joseph Wan 溫世昌	Mr. Wang Peng 王鵬
Age	61	56	47	55	43	66	65	43
Role	Executive Director (Co-chairman)	Executive Director (Co-chairman, CEO and GM)	Executive Director (Vice President)	Non-executive	Non-executive	Independent	Independent	Independent
Remarks	Brother of Agile's Chairman	Joined Agile in 1999	Joined Agile in 2002	Joined Greenland in 2003	Joined Agile in 2006	Former PWC Partner now serving as INED in 10+ companies	Retired	Vice president at China Property Management Institute

Source: HKEx, Company data, J.P. Morgan

Table 25: A-Living - detailed earnings model

Rmb mn	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E
Revenue breakdown									
Property management	595	691	978	1,206	1,625	2,998	8,583	9,363	10,187
Extended Value Added Services	189	186	212	453	1,463	1,834	2,152	2,556	3,027
Community Value Added Services	42	58	55	102	289	568	851	1,381	1,939
Gross Turnover	**826**	**934**	**1,245**	**1,761**	**3,377**	**5,399**	**11,586**	**13,301**	**15,153**
Cost of services	(727)	(786)	(933)	(1,170)	(2,087)	(3,384)	(8,004)	(8,903)	(10,043)
Gross Profit	**99**	**149**	**312**	**591**	**1,290**	**2,015**	**3,582**	**4,397**	**5,110**
Selling and marketing expenses	(7)	(9)	(19)	(33)	(46)	(66)	(128)	(147)	(167)
Administrative expenses	(32)	(52)	(79)	(171)	(302)	(410)	(765)	(878)	(1,000)
EBIT breakdown									
Property management	52	83	195	260	356	726	1,967	2,309	2,506
Extended Value Added Services	20	26	47	201	628	801	938	1,110	1,306
Community Value Added Services	10	14	14	38	132	260	389	632	887
Corporate expenses	(19)	(35)	(39)	(108)	(167)	(240)	(598)	(670)	(749)
EBIT	**63**	**88**	**217**	**391**	**949**	**1,546**	**2,697**	**3,380**	**3,951**
Interest income	**80**	**67**	**86**	**59**	**93**	**111**	**134**	**160**	**192**
Interest expenses	**(79)**	**(55)**	**(71)**	**(49)**	**(1)**	**-**	**-**	**-**	**-**
Operating profit									
Share of associates / JCEs	-	-	-	-	-	-	62	65	68
Profit before tax	**64**	**100**	**232**	**402**	**1,041**	**1,658**	**2,893**	**3,606**	**4,212**
Income tax	(17)	(27)	(63)	(102)	(264)	(414)	(708)	(885)	(1,036)
Minority Interest	(5)	(7)	(8)	(10)	(10)	(62)	(342)	(376)	(416)
Core net profit	**42**	**65**	**161**	**289**	**767**	**1,181**	**1,843**	**2,345**	**2,759**
Exceptional items	(0)	(0)	(0)	1	34	-	-	-	-
Reported net profit	**42**	**65**	**161**	**290**	**801**	**1,181**	**1,843**	**2,345**	**2,759**
Fully diluted EPS (Rmb)				0.35	0.62	0.89	1.38	1.76	2.07
Core EPS (Rmb)				0.35	0.59	0.90	1.38	1.76	2.07
Total DPS (Rmb)				0.00	0.30	0.40	0.62	0.79	0.93
Payout ratio				0%	50%	45%	45%	45%	45%
Margin									
Gross margin	**12.0%**	**15.9%**	**25.0%**	**33.5%**	**38.2%**	**37.3%**	**30.9%**	**33.1%**	**33.7%**
Property management	11.0%	15.1%	24.9%	27.0%	27.4%	27.9%	24.5%	26.3%	26.2%
Community Value Added Services	25.3%	26.8%	28.1%	41.2%	50.9%	50.9%	50.8%	50.8%	50.8%
Extended Value Added Services	12.0%	15.7%	24.8%	49.3%	47.7%	48.5%	48.5%	48.2%	47.9%
EBIT margin	**7.6%**	**9.4%**	**17.5%**	**22.2%**	**28.1%**	**28.6%**	**23.3%**	**25.4%**	**26.1%**
Operating margin	7.8%	10.7%	18.6%	22.8%	30.8%	30.7%	24.4%	26.6%	27.3%
Net Margin (before MI)	**5.7%**	**7.7%**	**13.6%**	**17.0%**	**23.0%**	**23.0%**	**18.3%**	**20.0%**	**20.5%**
YoY growth (%)									
Gross Turnover	NA	13.1%	33.2%	41.5%	91.8%	59.9%	114.6%	14.8%	13.9%
EBIT	NA	39.7%	146.6%	79.9%	142.8%	62.9%	74.4%	25.3%	16.9%
Core net profit	NA	**56.0%**	**146.4%**	**79.4%**	**165.7%**	**54.0%**	**56.0%**	**27.2%**	**17.7%**
Reported net profit	NA	56.2%	147.3%	80.3%	176.5%	47.4%	56.0%	27.2%	17.7%
Development properties									
Contracted GFA (Period end) (mn sqm)	**45**	**63**	**73**	**126**	**230**	**353**	**758**	**837**	**908**
Y/Y%		41%	16%	72%	82%	54%	114%	10%	9%
Revenue-bearing GFA (Period end) (mn sqm)	**24**	**35**	**50**	**78**	**138**	**223**	**601**	**659**	**719**
Y/Y%		43%	43%	56%	76%	62%	169%	10%	9%

Source: Company data, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

A-Living Services Co., Ltd. *(Overweight; Price Target: HK$31.00)*

Investment Thesis

After the acquisition of CMIG in Sep 2019, A-Living has outperformed the HSCEI. However, we expect rerating to continue, as we think market will gradually appreciate A-Living's shift from M&A-centric to organic growth-focused. We also argue that A-Living's P/E gap with the sector should further narrow after the scale upgrade, but this has not happened yet. With a 37% 18-22E core EPS CAGR but 14x FY20E P/E, we think risk reward is attractive. Potential inclusion into Southbound Connect in 1Q20 could be another share price catalyst. Top pick for the sector.

Valuation

Our Dec-20 price target of HK$31 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 20x 2020E P/E.

1. **Property management:** We apply a 24x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply an 18x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS (non-agency):** We apply a 15x P/E to one-year forward net profit.
4. **Non-community VAS (agency):** We apply an 8x P/E to one-year forward net profit, given the cyclicality, but at a slight premium over developers' P/E.

Risks to Rating and Price Target

Upside risks: (1) value-accretive M&A; (2) accelerating sales growth of Agile & Greenland; (3) better-than-expected profitability from CMIG; (4) better-than-expected margin & earnings growth; (5) more-than-expected GFA contribution from Greenland

Downside risks: (1) significant increase in labor costs which hurt margin; (2) value-destructive M&A; (3) worse-than-expected profitability/margin from CMIG: (4) failed acquisition of CMIG.

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Table 26: A-Living (3319 HK) - SOTP valuation

Property Management	**Unit**		
Adjusted attributable contracted GFA	mn sqm	402	
Stabilized net profit	Rmb mn	865	
Target P/E	**x**	**24x**	
Valuation	**Rmb mn**	**20,761**	**(Rmb15.6/sh)**
Community VAS			
Net profit	Rmb mn	505	(3-year forward)
Target P/E	**x**	**18x**	
Valuation	**Rmb mn**	**9,098**	**(Rmb6.8/sh)**
Non-community VAS (Non-agency)			
Net profit	Rmb mn	335	(1-year forward)
Target P/E	**x**	**15x**	
Valuation	**Rmb mn**	**5,019**	**(Rmb3.8/sh)**
Non-community VAS (Real estate agency)			
Net profit	Rmb mn	285	(1-year forward)
Target P/E	**x**	**8x**	
Valuation	**Rmb mn**	**2,277**	**(Rmb1.7/sh)**
SOTP		**Rmb/sh**	**HK$/sh**
Property Management		15.6	17.3
Community VAS		6.8	7.6
Non-community VAS (Non-agency)		3.8	4.2
Non-community VAS (Agency)		1.7	1.9
Valuation		**27.9**	**31.0**

Source: J.P. Morgan estimates.

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A-Living Services: Summary of Financials

Income Statement	FY18A	FY19E	FY20E	FY21E	FY22E
Revenue	**3,377**	**5,399**	**11,586**	**13,301**	**15,153**
COGS	(2,087)	(3,384)	(8,004)	(8,903)	(10,043)
Gross profit	**1,290**	**2,015**	**3,582**	**4,397**	**5,110**
SG&A	(348)	(476)	(892)	(1,024)	(1,167)
Adj. EBITDA	**982**	**1,584**	**2,742**	**3,434**	**4,015**
D&A	(33)	(37)	(45)	(54)	(64)
Adj. EBIT	**949**	**1,546**	**2,697**	**3,380**	**3,951**
Net Interest	92	111	134	160	192
Adj. PBT	**1,041**	**1,658**	**2,893**	**3,606**	**4,212**
Tax	(264)	(414)	(708)	(885)	(1,036)
Minority Interest	(10)	(62)	(342)	(376)	(416)
Adj. Net Income	**767**	**1,181**	**1,843**	**2,345**	**2,759**
Reported EPS	0.62	0.89	1.38	1.76	2.07
Adj. EPS	**0.59**	**0.89**	**1.38**	**1.76**	**2.07**
DPS	**0.30**	**0.40**	**0.62**	**0.79**	**0.93**
Payout ratio	48.6%	45.0%	45.0%	45.0%	45.0%
Shares outstanding	1,297	1,333	1,333	1,333	1,333

Balance Sheet	FY18A	FY19E	FY20E	FY21E	FY22E
Cash and cash equivalents	4,809	4,551	5,687	6,983	8,310
Accounts receivable	1,165	1,398	1,677	2,013	2,416
Inventories	15	21	30	42	58
Other current assets	0	0	0	0	0
Current assets	**5,989**	**5,970**	**7,394**	**9,038**	**10,784**
PP&E	80	96	115	138	166
LT investments	-	-	-	-	-
Other non current assets	1,228	3,297	3,955	4,744	5,692
Total assets	**7,297**	**9,363**	**11,464**	**13,921**	**16,642**
Short term borrowings	0	0	0	0	0
Payables	1,193	1,929	2,211	2,566	2,925
Other short term liabilities	557	841	1,002	1,208	1,444
Current liabilities	**1,750**	**2,769**	**3,213**	**3,774**	**4,369**
Long-term debt	0	0	0	0	0
Other long term liabilities	37	40	44	49	54
Total liabilities	**1,787**	**2,810**	**3,257**	**3,822**	**4,423**
Shareholders' equity	5,422	6,404	7,715	9,230	10,935
Minority interests	88	150	492	868	1,285
Total liabilities & equity	**7,297**	**9,363**	**11,464**	**13,921**	**16,642**
BVPS	**4.07**	**4.80**	**5.79**	**6.92**	**8.20**
y/y Growth	*176.3%*	*18.1%*	*20.5%*	*19.6%*	*18.5%*
Net debt/(cash)	(1)	(1)	(1)	(1)	(1)

Cash Flow Statement	FY18A	FY19E	FY20E	FY21E	FY22E
Cash flow from operating activities	**883**	**2,027**	**2,282**	**2,873**	**3,289**
o/w Depreciation & amortization	33	0	0	0	0
o/w Changes in working capital	(51)	780	155	213	176
Cash flow from investing activities	**(112)**	**(2,085)**	**(615)**	**(748)**	**(907)**
o/w Capital expenditure	(19)	(16)	(19)	(23)	(28)
as % of sales	*0.6%*	*0.3%*	*0.2%*	*0.2%*	*0.2%*
Cash flow from financing activities	**3,143**	**(200)**	**(531)**	**(829)**	**(1,055)**
o/w Dividends paid	(50)	(200)	(531)	(829)	(1,055)
o/w Shares issued/(repurchased)	3,313	0	0	0	0
o/w Net debt issued/(repaid)	(12)	0	0	0	0
Net change in cash	**3,913**	**(257)**	**1,135**	**1,296**	**1,327**
Adj. Free cash flow to firm	**771**	**(58)**	**1,667**	**2,126**	**2,382**
y/y Growth	*153.6%*	*(107.5%)*	*(2995.8%)*	*27.5%*	*12.0%*

Ratio Analysis	FY18A	FY19E	FY20E	FY21E	FY22E
Gross margin	38.2%	37.3%	30.9%	33.1%	33.7%
EBITDA margin	29.1%	29.3%	23.7%	25.8%	26.5%
EBIT margin	28.1%	28.6%	23.3%	25.4%	26.1%
Net profit margin	22.7%	21.9%	15.9%	17.6%	18.2%
ROE	22.2%	20.0%	26.1%	27.7%	27.4%
ROA	15.6%	14.2%	17.7%	18.5%	18.1%
ROCE	11.3%	10.9%	16.7%	17.2%	16.8%
SG&A/Sales	10.3%	8.8%	7.7%	7.7%	7.7%
Net debt/Equity	NM	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM	NM
Sales/Assets (x)	0.7	0.6	1.1	1.0	1.0
Assets/Equity (x)	1.4	1.4	1.5	1.5	1.5
Interest cover (x)	NM	NM	NM	NM	NM
Operating leverage	155.6%	105.0%	64.9%	171.1%	121.2%
Tax rate	25.4%	25.0%	24.5%	24.5%	24.6%
Revenue y/y Growth	91.8%	59.9%	114.6%	14.8%	13.9%
EBITDA y/y Growth	139.6%	61.2%	73.1%	25.2%	16.9%
EPS y/y Growth	70.6%	49.8%	56.0%	27.2%	17.7%

Valuation	FY18A	FY19E	FY20E	FY21E	FY22E
P/E (x)	33.5	22.4	14.4	11.3	9.6
P/BV (x)	4.9	4.1	3.4	2.9	2.4
EV/EBITDA (x)	27.6	17.2	10.1	8.1	7.1
Dividend Yield	1.5%	2.0%	3.1%	4.0%	4.7%

Source: Company reports and J.P. Morgan estimates.
Note: Rmb in millions (except per-share data).Fiscal year ends Dec. o/w - out of which

Greentown Service

Growth to reaccelerate but valuation is fair

Neutral

2869.HK,2869 HK

Price (22 Oct 19): HK$8.21

Price Target (Dec-20): HK$8.80

China

China / Hong Kong Property

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Bloomberg JPMA KCHAN <GO>

J.P. Morgan Securities (Asia Pacific) Limited

We initiate coverage on Greentown Service (2869 HK) at Neutral with a Dec-20 price target of HK$8.8. After two sets of disappointing results, we think Greentown Service should be on track to see accelerated earnings growth (36% CAGR in 18-22E, slightly higher than peers' average of 31%). However, given the track record of consensus earnings miss and worsening efficiency in community VAS (EBIT per residential GFA has stayed within the range of Rmb2.5-2.9 with no significant improvement), we believe the current valuation of 27x forward P/E already appears fair with limited potential for upside. We could turn more positive if there is a significant turnaround in the community VAS segment.

The more mature community VAS operator

Greentown Service has a relatively more mature community VAS business among major peers (28% of EBIT, vs. average 21%), and it also has the highest EBIT per GFA under management among our covered companies (Rmb2.8 psm vs. average of Rmb1.7 psm). This explains the consistently higher P/E as the market would assign a higher P/E to its community VAS segment. However, Greentown Service has not yet been able to improve efficiency since 2016, as the EBIT per residential GFA has remained sluggish within the range of Rmb2.5 to Rmb2.9.

Track record doesn't deserve a premium

The past two results were disappointing. For FY18, core net profit (excluding disposal gains) came down 1% Y/Y. For 1H19, single digit Y/Y growth in the bottom line was also weak compared to peers. For both, the weakness could be attributed to more SG&A (share option expenses) and losses in some sub-sectors under community VAS (e.g. education). However, even if we compare revenue and gross profit Y/Y growth, it still underperformed. While we think those were one-off events and thus the growth in community VAS should be back on track, we think this track record will lead to some valuation discount, particularly with the lower earnings visibility of smaller community VAS businesses such as education.

Valuation looks fair

Greentown Service trades at 27x forward P/E, which is still 11% higher than the sector average, although the gap has already narrowed from the peak 87% premium. With an ongoing trend of consensus earnings downgrades and mediocre track record in community VAS growth, we think the current valuation is already fair.

Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top) 6M	1Y	3Y	5Y
Value	94	88	89	74	99
Growth	15	11	23	8	16
Momentum	22	55	36		
Quality	17	13	23	1	
Low Vol	62	68	73	27	

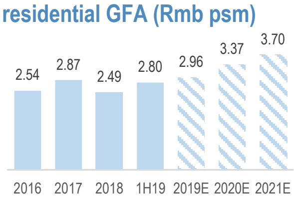
Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Figure 114: Greentown Service's Y/Y growth vs. peers

	FY18	1H19
Revenue Y/Y		
Greentown Service	31%	25%
Peers Average	63%	38%
Gross Profit Y/Y		
Greentown Service	27%	28%
Peers Average	59%	31%
Net Profit Y/Y		
Greentown Service	-1%	7%
Peers Average	78%	37%

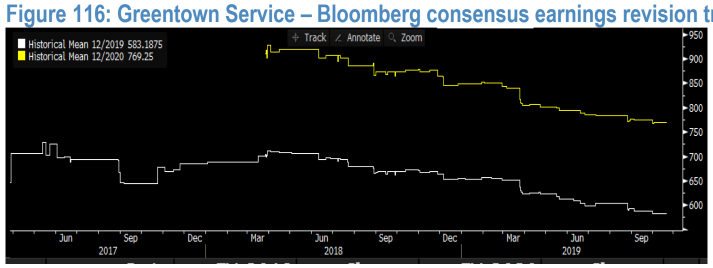
Source: Company data, J.P. Morgan.

Figure 115: Greentown Service's community VAS EBIT per residential GFA (Rmb psm)



Source: Company data, J.P. Morgan.

Figure 116: Greentown Service – Bloomberg consensus earnings revision trend



Source: Bloomberg

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Price Performance

	YTD	1m	3m	12m
Abs	36.8%	5.9%	23.1%	42.5%
Rel	32.8%	4.4%	25.4%	42.2%

Company Data

Shares O/S (mn)	2,778
52-week range (HK$)	8.40-4.75
Market cap ($ mn)	2,908
Exchange rate	7.84
Free float(%)	37.2%
3M - Avg daily vol (mn)	5.07
3M - Avg daily val ($ mn)	4.7
Volatility (90 Day)	33
Index	HSCEI
BBG BUY|HOLD|SELL	17|4|0

Key Metrics (FYE Dec)

Rmb in millions	FY18A	FY19E	FY20E	FY21E
Financial Estimates				
Revenue	6,710	8,664	11,211	14,266
Adj. EBITDA	694	1,019	1,353	1,751
Adj. EBIT	498	779	1,065	1,406
Adj. net income	379	555	760	1,003
Adj. EPS	0.14	0.20	0.27	0.36
BBG EPS	0.18	0.21	0.28	0.36
Cashflow from operations	656	1,564	1,178	1,448
FCFF	466	1,474	1,072	1,322
Margins and Growth				
Revenue growth	30.5%	29.1%	29.4%	27.3%
EBITDA margin	10.3%	11.8%	12.1%	12.3%
EBITDA growth	18.2%	46.8%	32.8%	29.4%
EBIT margin	7.4%	9.0%	9.5%	9.9%
Net margin	5.6%	6.4%	6.8%	7.0%
Adj. EPS growth	(1.5%)	46.3%	36.9%	31.9%
Ratios				
Adj. tax rate	27.1%	25.0%	24.9%	24.8%
Interest cover	NM	NM	NM	NM
Net debt/Equity	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM
ROCE	17.0%	23.2%	26.8%	29.0%
ROE	17.8%	22.1%	25.4%	27.5%
Valuation				
FCFF yield	2.3%	7.1%	5.2%	6.4%
Dividend yield	0.9%	0.9%	1.3%	1.7%
EV/EBITDA	29.8	19.0	14.3	11.1
Adj. P/E	54.3	37.1	27.1	20.6

Summary Investment Thesis and Valuation

Investment Thesis

After two sets of disappointing results, we think Greentown Service should be on track to see accelerated earnings growth (36% CAGR in 18-22E), which will be stronger than peers' average of 31%. However, given the track record of consensus earnings miss and worsening efficiency in community VAS, we believe the current valuation already appears fair. We could turn positive if there is a significant turnaround in the community VAS segment.

Valuation

Our Dec-20 price target of HK$8.8 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 29x 2020E P/E.

1. **Property management:** We apply a 14x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 19x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS:** We apply a 14x P/E to one-year forward net profit, with a premium to peers due to Greentown's strong branding.

Sources for: Performance Drivers – Bloomberg, J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

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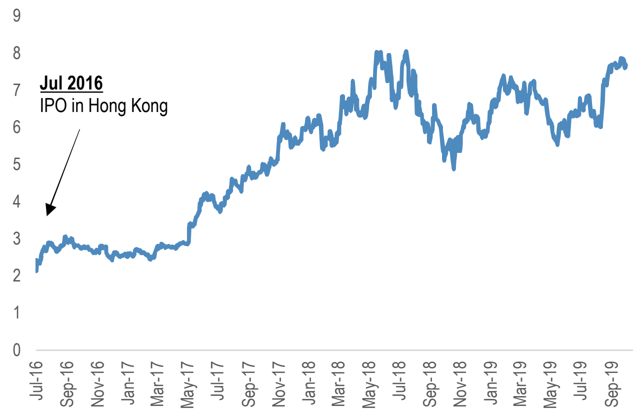
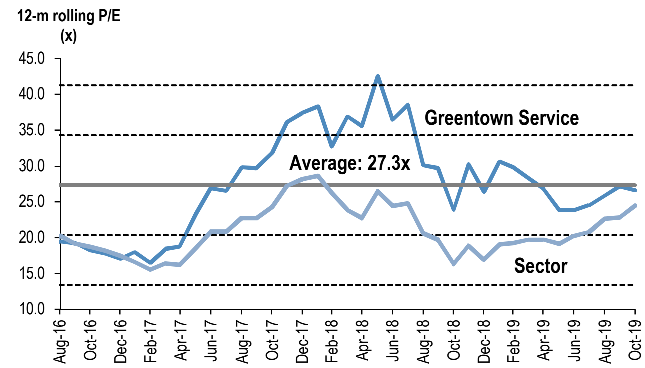
Figure 117: Greentown Service – Share price performance (HK$)



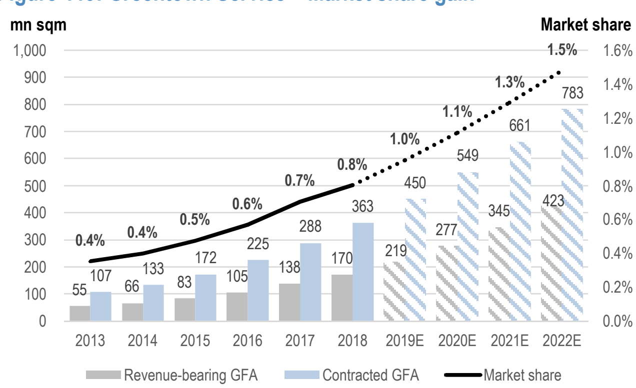
Source: Bloomberg, HKEx, J.P. Morgan

Figure 118: Greentown Service – P/E time series



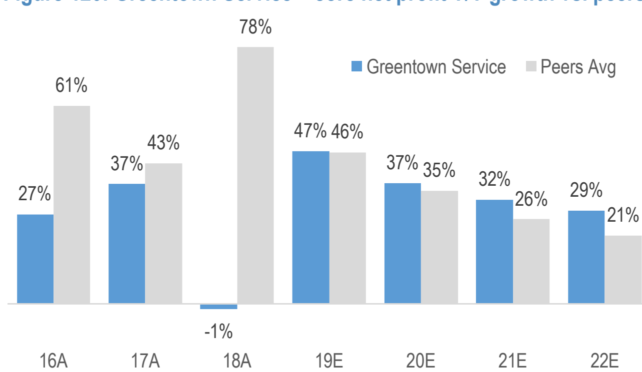
Source: Company data, Bloomberg. J.P. Morgan estimates.

Figure 119: Greentown Service – Market share gain



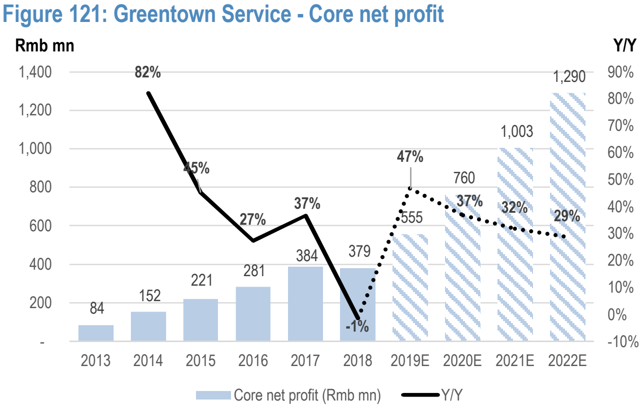
Source: Company data, CIA, J.P. Morgan estimates. Note: Based on total GFA

Figure 120: Greentown Service – core net profit Y/Y growth vs. peers



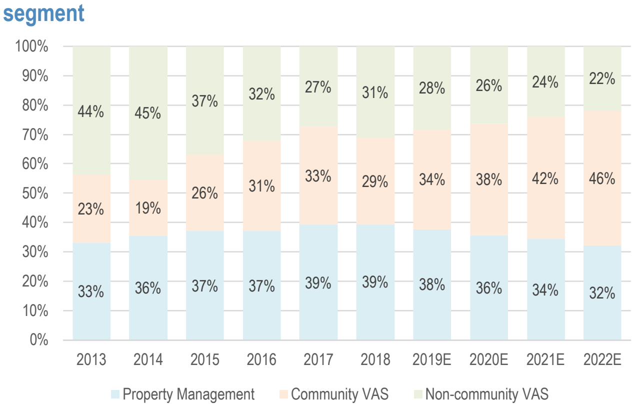
Source: Company data, J.P. Morgan estimates.

Figure 121: Greentown Service - Core net profit



Source: Company data, J.P. Morgan estimates.

Figure 122: Greentown Service – EBIT breakdown by business segment



Source: Company data, J.P. Morgan estimates.

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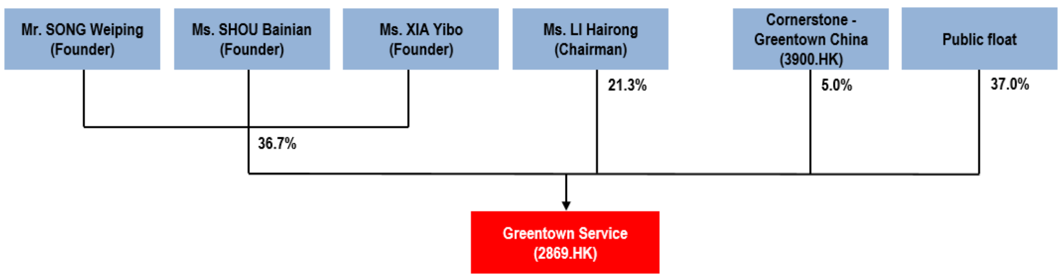
Company background

Founded in 1988, Greentown Service Group is a leading real estate management service provider in China. The company focuses on high-end residential property management. Greentown Service is not part of Greentown China (3900.HK), but a sister company that shares the same founders. The company listed on HKEx in July 2016.

As of Jun-2019, the company has total contracted GFA and revenue-bearing GFA of 391mn sqm and 158mn sqm respectively, covering 137 cities across China.

Figure 123: Greentown Service - shareholding structure



Source: HKEx, Company data, J.P. Morgan

Figure 124: Greentown Service - shareholding structure

Name	Ms. Li Hairong 李海榮	Mr. Yang Zhangfa 楊掌法	Mr. Wu Zhihua 吳志華	Mr. Chen Hao 陳浩	Mr. Shou Bainian 壽柏年	Ms. Xia Yibo 夏一波	Mr. Poon Chiu 潘昭國	Mr. Wong Ka Yi 黃嘉宜	Mr. Li Feng 李風
Age	61	47	40	49	65	56	57	44	60
Role	Executive Director (Chairman)	Executive Director (Vice Chairman)	Executive Director (CFO)	Executive Director	Non-executive Director	Non-executive Director	Independent Non-executive Director	Independent Non-executive Director	Independent Non-executive Director
Remarks	Joined Greentown Property Group in 1997	Joined Greentown Property Management in 2002	Joined Greentown Property Management in 2003	Joined Greentown Property Management in 2015	Joined Greentown Property Group in 1998	Joined Greentown Property Group in 1996	Serving as INED in several companies	INED since 2016	VP of China Property Management Association

Source: HKEx, Company data, J.P. Morgan

Table 27: Greentown Service - detailed earnings model

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E
Gross turnover breakdown										
Property management	1,224	1,624	2,091	2,620	3,560	4,461	5,601	7,210	9,127	11,373
Consulting services (external)	330	439	551	618	680	939	1,238	1,443	1,611	1,801
Community Value Added Services (internal)	117	142	277	484	900	1,310	1,825	2,558	3,527	4,787
Gross Turnover	**1,671**	**2,205**	**2,919**	**3,722**	**5,140**	**6,710**	**8,664**	**11,211**	**14,266**	**17,961**
Cost of services	-1,429	-1,842	-2,388	-3,006	-4,194	-5,512	-7,071	-9,192	-11,739	-14,827
Gross Profit	**242**	**363**	**531**	**716**	**946**	**1,198**	**1,593**	**2,019**	**2,527**	**3,134**
Selling and marketing expenses	-1	-1	-6	-10	-23	-59	-76	-98	-124	-156
Administrative expenses	-125	-146	-214	-275	-416	-597	-677	-772	-886	-1,023
EBIT breakdown										
Property management	69	111	170	229	319	405	520	622	742	860
Consulting services	92	142	168	197	221	321	390	459	519	587
Community Value Added Services	48	60	118	189	271	301	468	656	905	1,228
Corporate expenses	-99	-110	-155	-203	-333	-529	-599	-673	-761	-865
EBIT	**110**	**203**	**302**	**413**	**479**	**498**	**779**	**1,065**	**1,406**	**1,810**
Interest income	**1**	**2**	**2**	**5**	**19**	**18**	**20**	**22**	**24**	**27**
Interest expenses	**-3**	**-3**	**-9**	**-7**	**0**	**0**	**0**	**0**	**0**	**0**
Operating profit	**108**	**202**	**295**	**411**	**498**	**516**	**799**	**1,087**	**1,430**	**1,836**
Share of associates / JCEs	1	-1	2	3	8	-21	0	5	10	15
Profit before tax	**109**	**201**	**296**	**414**	**506**	**495**	**799**	**1,092**	**1,440**	**1,851**
Income tax	-26	-49	-76	-124	-117	-134	-200	-272	-357	-459
Minority Interest	0	0	0	-9	-5	18	-44	-60	-80	-102
Core net profit	**84**	**152**	**221**	**281**	**384**	**379**	**555**	**760**	**1,003**	**1,290**
Exceptional items	-1	-2	-18	4	4	105	0	0	0	0
Reported net profit	**83**	**150**	**203**	**286**	**388**	**483**	**555**	**760**	**1,003**	**1,290**
Fully diluted EPS (Rmb)	NA	NA	NA	0.12	0.14	0.17	0.20	0.27	0.36	0.46
Core EPS (Rmb)	NA	NA	NA	0.12	0.14	0.14	0.20	0.27	0.36	0.46
Total DPS (Rmb)	0.00	0.00	0.00	0.04	0.05	0.06	0.07	0.10	0.13	0.16
Payout ratio	0%	0%	0%	35%	35%	37%	35%	35%	35%	35%
Margin										
Gross margin	**14.5%**	**16.5%**	**18.2%**	**19.2%**	**18.4%**	**17.8%**	**18.4%**	**18.0%**	**17.7%**	**17.4%**
Property management	7.1%	8.6%	10.2%	10.9%	11.2%	11.4%	11.4%	10.8%	10.3%	9.8%
Community Value Added Services	45.8%	46.7%	47.5%	43.5%	33.5%	25.5%	28.5%	28.5%	28.5%	28.5%
Consulting services	30.9%	35.9%	33.9%	35.5%	36.1%	38.0%	35.0%	35.4%	35.8%	36.2%
EBIT margin	**6.6%**	**9.2%**	**10.3%**	**11.1%**	**9.3%**	**7.4%**	**9.0%**	**9.5%**	**9.9%**	**10.1%**
Operating margin	6.5%	9.1%	10.1%	11.0%	9.7%	7.7%	9.2%	9.7%	10.0%	10.2%
Net Margin (before MI)	**4.9%**	**6.9%**	**7.5%**	**7.7%**	**7.4%**	**5.7%**	**6.9%**	**7.3%**	**7.5%**	**7.7%**
YoY growth (%)										
Gross Turnover	NA	32%	32%	28%	38%	31%	29%	29%	27%	26%
EBIT	NA	85%	49%	37%	16%	4%	56%	37%	32%	29%
Core net profit	**NA**	**82%**	**45%**	**27%**	**37%**	**-1%**	**47%**	**37%**	**32%**	**29%**
Reported net profit	NA	81%	35%	41%	36%	25%	15%	37%	32%	29%
Property management										
Contracted GFA (Period end) (mn sqm)	**107**	**133**	**172**	**225**	**288**	**363**	**450**	**549**	**661**	**783**
Y/Y%		24%	29%	31%	28%	26%	24%	22%	20%	18%
Revenue-bearing GFA (Period end) (mn sqm)	**55**	**66**	**83**	**105**	**138**	**170**	**219**	**277**	**345**	**423**
Y/Y%		20%	26%	27%	31%	24%	29%	26%	24%	23%

Source: Company data, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Greentown Service Group Co. Ltd. *(Neutral; Price Target: HK$8.80)*

Investment Thesis

After two sets of disappointing results, we think Greentown Service should be on track to see accelerated earnings growth (36% CAGR in 18-22E), which will outperform its peers' average of 31%. However, given the track record of consensus earnings miss and worsening efficiency in community VAS, we believe the current valuation already appears fair. We could turn more positive if there is a significant turnaround in the community VAS segment.

Valuation

Our Dec-20 price target of HK$8.8 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 29x 2020E P/E.

1. **Property management:** We apply a 14x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 19x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS:** We apply a 14x P/E to one-year forward net profit, with a premium to peers due to Greentown's strong branding.

Risks to Rating and Price Target

Upside risks: (1) value-accretive M&A; (2) better-than-expected growth in revenue-bearing GFA; (3) better-than-expected ramp-up of community VAS; (4) better-than-expected margin

Downside risks: (1) significant increase in labor costs which hurt margin; (2) value-destructive M&A; (3) worse-than-expected growth in revenue-bearing GFA; (4) worse-than-expected margin

Table 28: Greentown Service (2669 HK) - SOTP valuation

Property Management	**Unit**		
Adjusted attributable contracted GFA	mn sqm	344	
Stabilized net profit	Rmb mn	397	
Target P/E	**x**	**14x**	
Valuation	**Rmb mn**	**5,553**	**(Rmb2.0/sh)**
Community VAS			
Net profit	Rmb mn	750	(3-year forward)
Target P/E	**x**	**19x**	
Valuation	**Rmb mn**	**14,245**	**(Rmb5.1/sh)**
Non-community VAS			
Net profit	Rmb mn	154	(1-year forward)
Target P/E	**x**	**14x**	
Valuation	**Rmb mn**	**2,157**	**(Rmb0.8/sh)**
SOTP		**Rmb/sh**	**HK$/sh**
Property Management		2.0	2.2
Community VAS		5.1	5.7
Non-community VAS		0.8	0.9
Valuation		**7.9**	**8.8**

Source: J.P. Morgan estimates.

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Greentown Service: Summary of Financials

Income Statement	FY18A	FY19E	FY20E	FY21E	FY22E
Revenue	**6,710**	**8,664**	**11,211**	**14,266**	**17,961**
COGS	(5,512)	(7,071)	(9,192)	(11,739)	(14,827)
Gross profit	**1,198**	**1,593**	**2,019**	**2,527**	**3,134**
SG&A	(657)	(753)	(870)	(1,010)	(1,179)
Adj. EBITDA	**694**	**1,019**	**1,353**	**1,751**	**1,810**
D&A	(196)	(240)	(288)	(345)	0
Adj. EBIT	**498**	**779**	**1,065**	**1,406**	**1,810**
Net Interest	18	20	22	24	27
Adj. PBT	**495**	**799**	**1,092**	**1,440**	**1,851**
Tax	(134)	(200)	(272)	(357)	(459)
Minority Interest	18	(44)	(60)	(80)	(102)
Adj. Net Income	**379**	**555**	**760**	**1,003**	**1,290**
Reported EPS	0.14	0.20	0.27	0.36	0.46
Adj. EPS	**0.14**	**0.20**	**0.27**	**0.36**	**0.46**
DPS	**0.06**	**0.07**	**0.10**	**0.13**	**0.16**
Payout ratio	47.0%	35.1%	35.1%	35.1%	35.1%
Shares outstanding	2,778	2,786	2,786	2,786	2,786

Balance Sheet	FY18A	FY19E	FY20E	FY21E	FY22E
Cash and cash equivalents	2,329	3,712	4,718	5,942	7,386
Accounts receivable	1,202	1,443	1,731	2,077	2,493
Inventories	291	408	571	799	1,119
Other current assets	16	16	16	16	16
Current assets	**3,838**	**5,579**	**7,036**	**8,834**	**11,014**
PP&E	372	446	536	643	771
LT investments	-	-	-	-	-
Other non current assets	1,134	574	664	769	892
Total assets	**5,344**	**6,599**	**8,235**	**10,246**	**12,677**
Short term borrowings	1	0	0	0	0
Payables	1,892	2,435	3,080	3,833	4,696
Other short term liabilities	1,029	1,328	1,693	2,133	2,659
Current liabilities	**2,922**	**3,763**	**4,773**	**5,966**	**7,355**
Long-term debt	9	0	0	0	0
Other long term liabilities	8	9	10	11	12
Total liabilities	**2,939**	**3,772**	**4,783**	**5,977**	**7,367**
Shareholders' equity	2,329	2,706	3,272	4,009	4,948
Minority interests	76	120	180	260	362
Total liabilities & equity	**5,344**	**6,599**	**8,235**	**10,246**	**12,677**
BVPS	**0.84**	**0.97**	**1.18**	**1.44**	**1.78**
y/y Growth	*21.4%*	*16.2%*	*20.9%*	*22.5%*	*23.4%*
Net debt/(cash)	(2,319)	(3,712)	(4,718)	(5,942)	(7,386)

Cash Flow Statement	FY18A	FY19E	FY20E	FY21E	FY22E
Cash flow from operating activities	**656**	**1,564**	**1,178**	**1,448**	**1,728**
o/w Depreciation & amortization	196	0	0	0	0
o/w Changes in working capital	116	371	413	433	417
Cash flow from investing activities	**(199)**	**(23)**	**(13)**	**(1)**	**16**
o/w Capital expenditure	(177)	(74)	(89)	(107)	(129)
as % of sales	*2.6%*	*0.9%*	*0.8%*	*0.8%*	*0.7%*
Cash flow from financing activities	**(120)**	**(188)**	**(194)**	**(266)**	**(351)**
o/w Dividends paid	(134)	(178)	(194)	(266)	(351)
o/w Shares issued/(repurchased)	0	0	0	0	0
o/w Net debt issued/(repaid)	1	(10)	0	0	0
Net change in cash	**337**	**1,354**	**970**	**1,180**	**1,393**
Adj. Free cash flow to firm	**466**	**1,474**	**1,072**	**1,322**	**1,579**
y/y Growth	*17.9%*	*216.2%*	*(27.3%)*	*23.3%*	*19.4%*

Ratio Analysis	FY18A	FY19E	FY20E	FY21E	FY22E
Gross margin	17.8%	18.4%	18.0%	17.7%	17.4%
EBITDA margin	10.3%	11.8%	12.1%	12.3%	10.1%
EBIT margin	7.4%	9.0%	9.5%	9.9%	10.1%
Net profit margin	5.6%	6.4%	6.8%	7.0%	7.2%
ROE	17.8%	22.1%	25.4%	27.5%	28.8%
ROA	8.0%	9.3%	10.2%	10.9%	11.3%
ROCE	17.0%	23.2%	26.8%	29.0%	30.4%
SG&A/Sales	9.8%	8.7%	7.8%	7.1%	6.6%
Net debt/Equity	NM	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM	NM
Sales/Assets (x)	1.4	1.5	1.5	1.5	1.6
Assets/Equity (x)	2.2	2.4	2.5	2.5	2.6
Interest cover (x)	NM	NM	NM	NM	NM
Operating leverage	13.0%	193.8%	124.8%	117.2%	111.0%
Tax rate	27.1%	25.0%	24.9%	24.8%	24.8%
Revenue y/y Growth	30.5%	29.1%	29.4%	27.3%	25.9%
EBITDA y/y Growth	18.2%	46.8%	32.8%	29.4%	3.4%
EPS y/y Growth	(1.5%)	46.3%	36.9%	31.9%	28.6%

Valuation	FY18A	FY19E	FY20E	FY21E	FY22E
P/E (x)	54.3	37.1	27.1	20.6	16.0
P/BV (x)	8.8	7.6	6.3	5.1	4.2
EV/EBITDA (x)	29.8	19.0	14.3	11.1	10.7
Dividend Yield	0.9%	0.9%	1.3%	1.7%	2.2%

Source: Company reports and J.P. Morgan estimates.

Note: Rmb in millions (except per-share data).Fiscal year ends Dec. o/w - out of which

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China Overseas Property Holdings

Neutral

2669.HK,2669 HK
Price (22 Oct 19): HK$4.50

Price Target (Dec-20): HK$4.60

Hong Kong
China / Hong Kong Property

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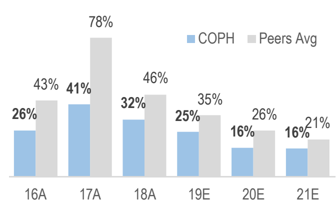
Bloomberg JPMA KCHAN <GO>
J.P. Morgan Securities (Asia Pacific) Limited

Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top) 6M	1Y	3Y	5Y
Value	95	90	74	76	87
Growth	5	6	15	22	6
Momentum	3	2	35	1	
Quality	1	1	8	6	16
Low Vol	85	94	95	98	

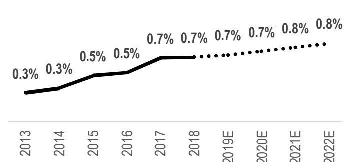
Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Figure 125: Net profit Y/Y growth – COPH vs. peers



Source: Company data, J.P. Morgan estimates.

Figure 126: COPH market share



Source: Company data, CIA, J.P. Morgan estimates.

Lack of growth appetite

We initiate coverage on China Overseas Property Holdings (COPH) at Neutral with a Dec-20 price target of HK$4.6. In a structurally expanding sector that values growth, we think COPH is yet to demonstrate a strong growth appetite, has an unproven ability to expand through third-party GFA (still only 10% of GFA), lacks a solid growth roadmap and has a passive approach to VAS. Currently trading at 23x FY2020E P/E (2 s.d. above mean) without visible catalysts, we think COPH is fairly valued for its underperforming growth (22% 18-22E CAGR vs. peers average of 31%) yet a unique SOE in the space. We could turn more positive if COPH becomes more aggressive in acquiring third-party GFA, or even M&A.

Too stable against a market consolidation backdrop

After a 33% CAGR over FY16-18, we forecast COPH's net profit will grow at a 22% CAGR in FY18-22E, which is below its peers' average of 31%. The increase will be driven mostly by the delivery from COLI (688 HK), contracted sales of which has seen mid-teens growth in the past two years. Although we also forecast an increasing GFA contribution from third-party developers (ratio up from 8% in FY18 to 14% in FY22E), COPH will remain overly reliant on COLI (we like the strong backing from a developer, but inability to expand through third-party GFA could in turn lead the market to question sustainable growth). We think the coming 2-3 years will be the best time for big players to gain market share under the market consolidation backdrop. However, COPH does not show sufficient growth appetite and thus may miss the golden timing to expand. We expect its market share will remain sluggish at 0.8% in 2022E, only slightly up from 0.7% in 2018.

SOE uniqueness is fading out

COPH is currently the only listed property management company with an SOE background that may deserve a premium, but we think this uniqueness may fade with the potential upcoming listing of Poly Property Development backed by another SOE Poly Developments (600048 CH), while peers such as Vanke and CR Land may also consider potential spin-offs of their property management arms in the coming few years.

Too expensive for a name with underperforming growth

COPH is trading at 23x P/E, which is at a 5% discount to the sector P/E (trough discount: 40% to sector). In fact, most of the time, COPH has been trading at a discount to the sector P/E (average: 16% discount), and the recent outperformance is more attributed to investors chasing laggards. Despite strong backing by COLI, we don't see clear catalysts ahead. We would turn more positive if COPH becomes more aggressive in acquiring third-party GFA (or through M&A) and improving VAS profitability.

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Price Performance

	YTD	1m	3m	12m
Abs	96.5%	13.9%	6.4%	116.3%
Rel	92.5%	12.4%	8.7%	116.0%

Company Data

Shares O/S (mn)	3,287
52-week range (HK$)	4.63-1.69
Market cap ($ mn)	1,886
Exchange rate	7.84
Free float(%)	38.8%
3M - Avg daily vol (mn)	9.38
3M - Avg daily val ($ mn)	4.8
Volatility (90 Day)	39
Index	HSCEI
BBG BUY|HOLD|SELL	10|4|2

Key Metrics (FYE Dec)

HK$ in millions	FY18A	FY19E	FY20E	FY21E
Financial Estimates				
Revenue	4,155	5,052	5,983	6,980
Adj. EBITDA	532	681	837	974
Adj. EBIT	514	660	812	944
Adj. net income	402	515	632	736
Adj. EPS	0.12	0.16	0.19	0.22
BBG EPS	0.12	0.15	0.20	0.24
Cashflow from operations	226	686	824	945
FCFF	175	645	775	887
Margins and Growth				
Revenue growth	23.7%	21.6%	18.4%	16.7%
EBITDA margin	12.8%	13.5%	14.0%	14.0%
EBITDA growth	37.5%	27.9%	22.9%	16.4%
EBIT margin	12.4%	13.1%	13.6%	13.5%
Net margin	9.7%	10.2%	10.6%	10.5%
Adj. EPS growth	31.1%	28.1%	22.8%	16.3%
Ratios				
Adj. tax rate	27.0%	25.0%	25.0%	25.0%
Interest cover	NM	NM	NM	NM
Net debt/Equity	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM
ROCE	33.5%	37.8%	35.2%	31.8%
ROE	40.7%	39.4%	36.6%	33.1%
Valuation				
FCFF yield	1.2%	4.4%	5.2%	6.0%
Dividend yield	0.9%	1.0%	1.3%	1.5%
EV/EBITDA	23.1	17.3	14.1	12.1
Adj. P/E	36.8	28.7	23.4	20.1

Summary Investment Thesis and Valuation

Investment Thesis

In a structurally expanding sector that values growth, we think COPH is yet to demonstrate a strong growth appetite, has an unproven ability to expand through third-party GFA (still only 10% of GFA), lacks a solid growth roadmap and has a passive approach to VAS. Currently trading at 23x P/E (2 s.d. above mean) without visible catalysts, we think COPH is fairly valued for its underperforming growth (22% 18-22E CAGR vs. peers average of 31%) yet a unique SOE in the space. We could turn more positive if COPH becomes more aggressive in acquiring third-party GFA, or even M&A.

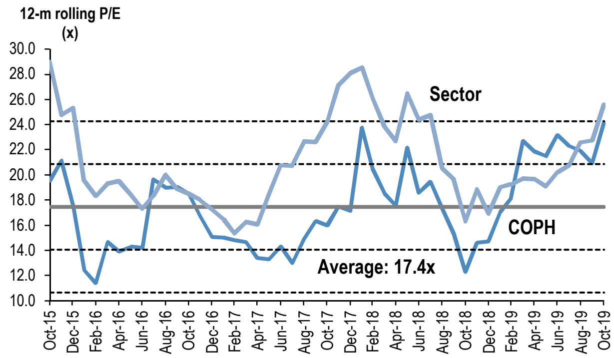
Valuation

Our Dec-20 price target of HK$4.6 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 24x 2020E P/E.

1. **Property management:** We apply an 18x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 14x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS:** We apply a 15x P/E to one-year forward net profit, with a slight premium to peers due to COPH's strong branding.

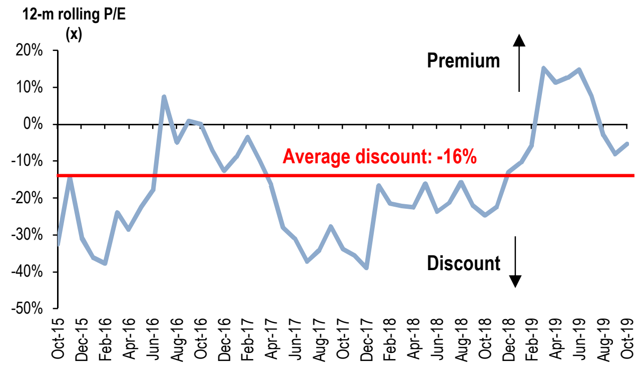
Sources for: Performance Drivers – Bloomberg, J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Figure 127: COPH – P/E time series



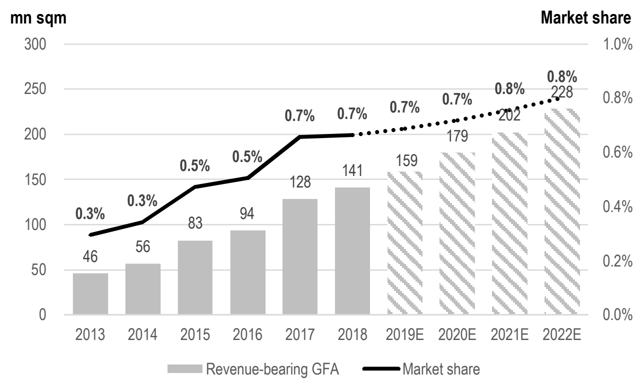
Source: Company data, Bloomberg. J.P. Morgan estimates.

Figure 128: COPH – P/E premium/discount to sector average



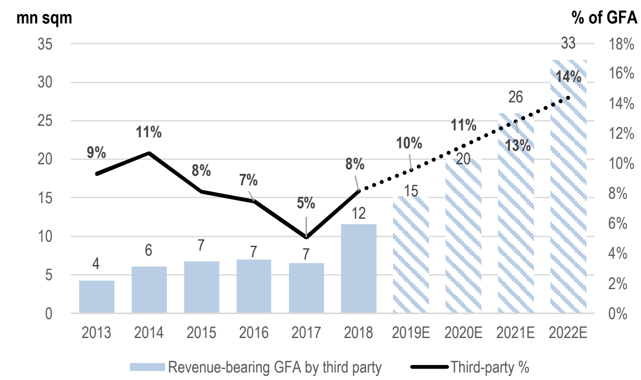
Source: Company data, Bloomberg. J.P. Morgan estimates.

Figure 129: COPH – Market share gain



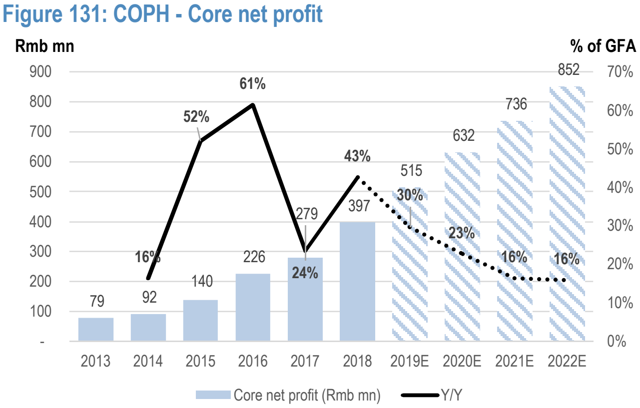
Source: Company data, CIA, J.P. Morgan estimates. Note: Based on total GFA

Figure 130: COPH – third-party as % of GFA



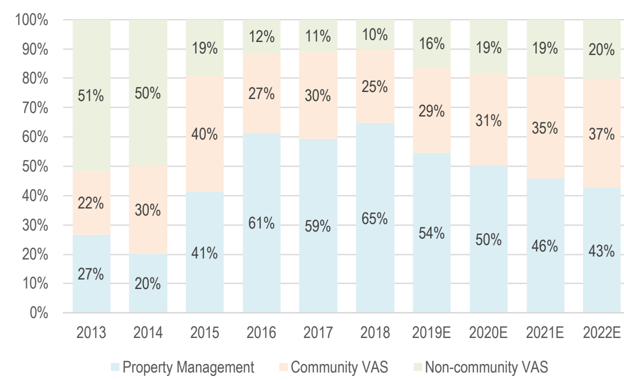
Source: Company data, HKEx, J.P. Morgan.

Figure 131: COPH - Core net profit



Source: Company data, J.P. Morgan estimates.

Figure 132: COPH – EBIT breakdown by business segment



Source: Company data, J.P. Morgan estimates.

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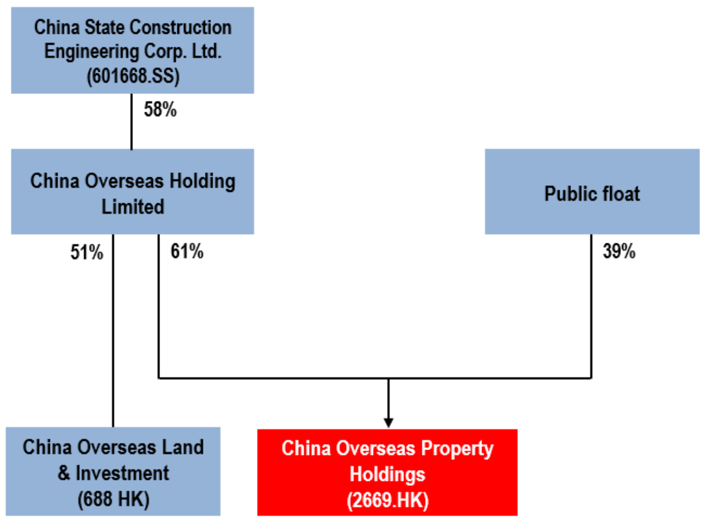
Company background

China Overseas Property Holdings (2669.HK) started its property management business in 1986, and it was wholly-owned by China Overseas Land and Investment (688.HK) before the spin-off. It was listed separately by way of introduction on the HKEx in October 2015. The company expanded across 70+ cities in PRC as well as Hong Kong and Macau, with an aggregate GFA under management of approximately 142mn sqm as of June 2019.

Figure 133: COPH - shareholding structure



Source: HKEx, Company data, J.P. Morgan

Figure 134: COPH - shareholding structure

Name	Mr. Yan Jianguo 顏建國	Dr. Yang Ou 楊鷗	Mr. Pang Jinying 龐金營	Mr. Kam Yuk Fai 甘沃輝	Mr. Bernard Lim 林雲峯	Mr. Gregory Leung 蘇錦樑	Mr. Samuel Yung 容永祺
Age	52	41	51	55	61	60	60
Role	Non-executive Director (Chairman)	Executive Director (CEO)	Executive Director (Vice President)	Executive Director (CFO)	Independent	Independent	Independent
Remarks	Chairman of COLI since 2017	Joined COPH since 2002	Joined COHL in 2004	Joined COGO in 2010	Committee of CPPCC	Ex-Hong Kong government official	INED of COLI since 2014

Source: HKEx, Company data, J.P. Morgan

Table 29: COPH - detailed earnings model (HK$)

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E
Gross turnover breakdown										
Property management	1,584	1,847	2,136	2,143	2,890	3,434	3,959	4,508	5,143	5,865
Value Added Services (external)	158	188	211	191	204	311	560	783	940	1,128
Community Value Added Services (internal)	103	128	197	229	263	410	524	680	883	1,097
Car parking spaces trading	0	0	0	0	0	0	10	12	14	17
Gross Turnover	**1,844**	**2,164**	**2,544**	**2,563**	**3,358**	**4,155**	**5,052**	**5,983**	**6,980**	**8,107**
Cost of services	-1,501	-1,751	-2,020	-1,927	-2,555	-3,306	-4,041	-4,765	-5,562	-6,460
Gross Profit	**343**	**413**	**525**	**636**	**802**	**849**	**1,006**	**1,212**	**1,409**	**1,637**
Selling and Admin expenses	-247	-304	-385	-330	-403	-337	-350	-407	-475	-556
Othe expenses	0	0	0	0	-38	-7	-7	-7	-7	-7
EBIT breakdown										
Property management	28	23	82	230	245	365	382	430	453	487
Value Added Services (external)	53	58	38	43	45	57	114	160	192	230
Community Value Added Services (internal)	23	35	79	101	123	142	205	266	345	429
Car parking spaces trading	0	0	0	0	0	0	4	5	6	7
Corporate expenses	0	0	-26	-58	-43	-50	-46	-49	-53	-61
EBIT	**104**	**117**	**174**	**316**	**371**	**514**	**660**	**812**	**944**	**1,093**
Interest income	**9**	**11**	**11**	**16**	**39**	**39**	**47**	**56**	**65**	**76**
Interest expenses	**0**	**0**	**-2**	**-7**	**-9**	**-3**	**-3**	**-3**	**-3**	**-3**
Operating profit	**112**	**127**	**184**	**325**	**400**	**550**	**704**	**864**	**1,006**	**1,165**
Share of associates / JCEs	0	0	0	0	0	0	0	0	0	0
Profit before tax	**112**	**127**	**184**	**326**	**401**	**550**	**704**	**864**	**1,006**	**1,165**
Income tax	-33	-35	-44	-100	-122	-149	-176	-216	-251	-291
Minority Interest	0	0	0	0	0	-4	-13	-16	-19	-22
Core net profit	**79**	**92**	**140**	**226**	**279**	**397**	**515**	**632**	**736**	**852**
Exceptional items	7	5	-23	1	28	5	0	0	0	0
Reported net profit	**86**	**97**	**117**	**226**	**307**	**402**	**515**	**632**	**736**	**852**
Fully diluted EPS (HK$)	0.03	0.03	0.04	0.07	0.09	0.12	0.16	0.19	0.22	0.26
Core EPS (HK$)	0.02	0.03	0.04	0.07	0.08	0.12	0.16	0.19	0.22	0.26
Total DPS (HK$)	0.00	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08
Payout ratio	0%	0%	34%	32%	32%	33%	30%	30%	30%	30%
Margin										
Gross margin	**18.6%**	**19.1%**	**20.6%**	**24.8%**	**23.9%**	**20.4%**	**19.9%**	**20.3%**	**20.2%**	**20.2%**
Property management	15.4%	16.6%	18.5%	22.1%	21.3%	18.0%	16.7%	16.7%	16.1%	15.7%
Value Added Services (external)	33.9%	30.8%	18.1%	22.5%	22.0%	18.4%	20.4%	20.4%	20.4%	20.4%
Community Value Added Services (internal)	44.3%	37.4%	46.4%	52.3%	53.9%	42.3%	43.5%	43.5%	43.5%	43.5%
EBIT margin	**5.6%**	**5.4%**	**6.8%**	**12.3%**	**11.0%**	**12.4%**	**13.1%**	**13.6%**	**13.5%**	**13.5%**
Operating margin	6.1%	5.9%	7.2%	12.7%	11.9%	13.2%	13.9%	14.4%	14.4%	14.4%
Net Margin (before MI)	**4.3%**	**4.2%**	**5.5%**	**8.8%**	**8.3%**	**9.7%**	**10.4%**	**10.8%**	**10.8%**	**10.8%**
YoY growth (%)										
Gross Turnover	NA	17%	18%	1%	31%	24%	22%	18%	17%	16%
EBIT	NA	12%	49%	82%	17%	39%	28%	23%	16%	16%
Core net profit	**NA**	**16%**	**52%**	**61%**	**24%**	**43%**	**30%**	**23%**	**16%**	**16%**
Reported net profit	NA	14%	21%	93%	36%	31%	28%	23%	16%	16%
Property management										
Revenue-bearing GFA (Period end) (mn sqm)	**46**	**56**	**83**	**94**	**128**	**141**	**159**	**179**	**202**	**228**
Y/Y%		23%	46%	13%	37%	10%	13%	13%	13%	13%

Source: Company data, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

China Overseas Property Holdings Limited *(Neutral; Price Target: HK$4.60)*

Investment Thesis

In a structurally expanding sector that values growth, we think COPH is yet to demonstrate a strong growth appetite, has an unproven ability to expand through third-party GFA (still only 10% of GFA), lacks a solid growth roadmap and has a passive approach to VAS. Currently trading at 23x P/E (2 s.d. above mean) without visible catalysts, we think COPH is fairly valued for its underperforming growth (22% 18-22E CAGR vs. peers average of 31%) yet a unique SOE in the space. We could turn more positive if COPH becomes more aggressive in acquiring third-party GFA, or even M&A.

Valuation

Our Dec-20 price target of HK$4.6 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 24x 2020E P/E.

1. **Property management:** We apply an 18x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 14x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS:** We apply a 15x P/E to one-year forward net profit, with a slight premium to peers due to COPH's strong branding.

Risks to Rating and Price Target

Upside risks: (1) value-accretive M&A; (2) faster-than-expected sales growth from COLI; (3) better-than-expected growth in VAS: (4) better-than-expected growth in revenue-bearing GFA; (5) Grant of share options

Downside risks: (1) value-destructive M&A; (2) lower-than-expected sales growth from COLI; (3) worse-than-expected profitability in VAS; (4) worse-than-expected margins.

Table 30: COPH (2669 HK) - SOTP valuation

Property Management	Unit		
Adjusted attributable contracted GFA	mn sqm	191	
Stabilized net profit	HK$ mn	364	
Target P/E	**x**	**18x**	
Valuation	**HK$ mn**	**6,555**	**(HK$2.4/sh)**
Community VAS			
Net profit	HK$ mn	322	(3-year forward)
Target P/E	**x**	**14x**	
Valuation	**HK$ mn**	**4,503**	**(HK$1.6/sh)**
Non-community VAS			
Net profit	HK$ mn	124	(1-year forward)
Target P/E	**x**	**15x**	
Valuation	**HK$ mn**	**1,855**	**(HK$0.7/sh)**

SOTP	HK$/sh
Property Management	2.4
Community VAS	1.6
Non-community VAS	0.7
Valuation	**4.6**

Source: J.P. Morgan estimates.

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China Overseas Property Holdings: Summary of Financials

Income Statement	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	**3,358**	**4,155**	**5,052**	**5,983**	**6,980**
COGS	(2,555)	(3,306)	(4,041)	(4,765)	(5,562)
Gross profit	**802**	**849**	**1,006**	**1,212**	**1,409**
SG&A	(403)	(337)	(350)	(407)	(475)
Adj. EBITDA	**387**	**532**	**681**	**837**	**974**
D&A	(16)	(18)	(21)	(25)	(30)
Adj. EBIT	**371**	**514**	**660**	**812**	**944**
Net Interest	30	35	44	53	62
Adj. PBT	**401**	**550**	**704**	**864**	**1,006**
Tax	(122)	(149)	(176)	(216)	(251)
Minority Interest	(0)	(4)	(13)	(16)	(19)
Adj. Net Income	**307**	**402**	**515**	**632**	**736**
Reported EPS	0.08	0.12	0.16	0.19	0.22
Adj. EPS	**0.09**	**0.12**	**0.16**	**0.19**	**0.22**
DPS	**0.03**	**0.04**	**0.05**	**0.06**	**0.07**
Payout ratio	35.4%	33.1%	30.0%	30.0%	30.0%
Shares outstanding	3,287	3,287	3,287	3,287	3,287

Cash Flow Statement	FY17A	FY18A	FY19E	FY20E	FY21E
Cash flow from operating activities	**506**	**226**	**686**	**824**	**945**
o/w Depreciation & amortization	16	18	0	0	0
o/w Changes in working capital	229	(180)	120	128	128
Cash flow from investing activities	**(448)**	**(224)**	**(28)**	**(27)**	**(31)**
o/w Capital expenditure	(11)	(25)	(8)	(10)	(12)
as % of sales	*0.3%*	*0.6%*	*0.2%*	*0.2%*	*0.2%*
Cash flow from financing activities	**(197)**	**(380)**	**(138)**	**(171)**	**(204)**
o/w Dividends paid	(85)	(115)	(138)	(171)	(204)
o/w Shares issued/(repurchased)	0	0	0	0	0
o/w Net debt issued/(repaid)	(45)	(265)	0	0	0
Net change in cash	**294**	**(54)**	**520**	**626**	**709**
Adj. Free cash flow to firm	**474**	**175**	**645**	**775**	**887**
y/y Growth	*13.1%*	*(63.0%)*	*267.7%*	*20.2%*	*14.4%*

Balance Sheet	FY17A	FY18A	FY19E	FY20E	FY21E
Cash and cash equivalents	2,711	2,398	2,918	3,545	4,254
Accounts receivable	528	766	919	1,103	1,323
Inventories	0	0	0	0	0
Other current assets	50	99	114	135	164
Current assets	**3,289**	**3,263**	**3,951**	**4,782**	**5,741**
PP&E	141	174	182	192	203
LT investments	-	-	-	-	-
Other non current assets	128	121	140	158	177
Total assets	**3,558**	**3,557**	**4,273**	**5,131**	**6,121**
Short term borrowings	0	0	0	0	0
Payables	1,655	1,617	1,821	2,056	2,323
Other short term liabilities	760	789	908	1,052	1,222
Current liabilities	**2,415**	**2,406**	**2,730**	**3,108**	**3,545**
Long-term debt	265	0	0	0	0
Other long term liabilities	16	22	24	27	30
Total liabilities	**2,696**	**2,428**	**2,754**	**3,135**	**3,575**
Shareholders' equity	856	1,120	1,497	1,958	2,489
Minority interests	5	9	22	39	57
Total liabilities & equity	**3,558**	**3,557**	**4,273**	**5,131**	**6,121**
BVPS	**-**	**0.34**	**0.46**	**0.60**	**0.76**
y/y Growth	-	-	*33.7%*	*30.8%*	*27.1%*
RNAV/Share	-	-	-	-	-
Net debt/(cash)	(2,446)	(2,398)	(2,918)	(3,545)	(4,254)

Ratio Analysis	FY17A	FY18A	FY19E	FY20E	FY21E
Gross margin	23.9%	20.4%	19.9%	20.3%	20.2%
EBITDA margin	11.5%	12.8%	13.5%	14.0%	14.0%
EBIT margin	11.0%	12.4%	13.1%	13.6%	13.5%
Net profit margin	9.1%	9.7%	10.2%	10.6%	10.5%
ROE	38.7%	40.7%	39.4%	36.6%	33.1%
ROA	10.0%	11.3%	13.2%	13.4%	13.1%
ROCE	23.9%	33.5%	37.8%	35.2%	31.8%
SG&A/Sales	12.0%	8.1%	6.9%	6.8%	6.8%
Net debt/Equity	NM	NM	NM	NM	NM
Net debt/EBITDA	NM	NM	NM	NM	NM
Sales/Assets (x)	1.1	1.2	1.3	1.3	1.2
Assets/Equity (x)	3.9	3.6	3.0	2.7	2.5
Interest cover (x)	NM	NM	NM	NM	NM
Operating leverage	55.4%	163.1%	130.9%	124.8%	97.7%
Tax rate	30.3%	27.0%	25.0%	25.0%	25.0%
Revenue y/y Growth	31.0%	23.7%	21.6%	18.4%	16.7%
EBITDA y/y Growth	18.3%	37.5%	27.9%	22.9%	16.4%
EPS y/y Growth	35.5%	31.1%	28.1%	22.8%	16.3%

Valuation	FY17A	FY18A	FY19E	FY20E	FY21E
P/E (x)	48.2	36.8	28.7	23.4	20.1
P/BV (x)	-	13.2	9.9	7.6	5.9
EV/EBITDA (x)	31.6	23.1	17.3	14.1	12.1
Dividend Yield	0.7%	0.9%	1.0%	1.3%	1.5%

Source: Company reports and J.P. Morgan estimates.

Note: HK$ in millions (except per-share data).Fiscal year ends Dec. o/w - out of which

Colour Life Services

Current expectation is too low; attractive valuation

Overweight

1778.HK,1778 HK
Price (22 Oct 19): HK$4.00
Price Target (Dec-20): HK$8.00

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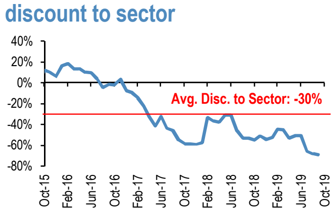
Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top) 6M	1Y	3Y	5Y
Value	68	63	69	90	100
Growth	49	35	39	14	1
Momentum	78	38	70	80	
Quality	28	27	28	47	16
Low Vol	90	89	85	70	99

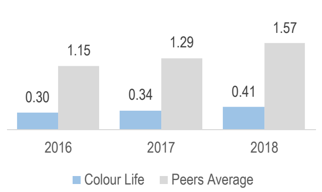
Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Figure 135: Colour Life – P/E discount to sector



Source: Bloomberg, J.P. Morgan estimates.

Figure 136: Colour Life's community VAS EBIT per GFA (vs. peers average) - Rmb psm



Source: Company data, J.P. Morgan

We initiate coverage on Colour Life (1778 HK) at Overweight with a Dec-20 price target of HK$8.0. The company has seen a significant derating since IPO due to lower growth expectation. While we agree that Colour Life deserves to trade at a discount to peers, due to slower growth and lack of support from a strong backing developer, we think it is significantly under-valued, given (1) 20% earnings CAGR in 18-22E is on par with COPH, which is trading at 23x P/E; (2) cash flows & leverage will improve as Colour Life is slowing down M&As; (3) VAS still has a lot of growth potential, particularly with its large community (32 million registered users on its community app, which is way above CGS's 3 million, as of 1H19) and collaboration with JD.com & 360.com. Colour Life is trading at a trough P/E of 7x, which we think is too low for a company with a stably growing recurring income.

Active M&A stage has passed; entering maturity

Since listing, Colour Life has gone through a rigorous stage of active M&As (e.g. Wanda). It has been the company's strategy to prioritize in expanding the community, as developing a sizeable platform for community VAS has been the long-term vision. Currently, Colour Life already has a contracted GFA of >564 mn sqm (one of the largest in the space), or 1.2 bn sqm if including cooperation area. We believe the company is now entering a mature stage where its focus will be on (1) expanding recurring income; and (2) improving profitability of VAS.

Rerating will come from improvement in community VAS & balance sheet

Colour Life has significantly derated from the peak of 36x P/E (excluding 2Q15) to the current 7x P/E, due to the gradual drop in earnings growth expectation. We think the current P/E has already priced in the lower-than-average growth. Colour Life still sees a low efficiency in its community VAS EBIT per GFA (Rmb0.4 psm vs. peers' average of Rmb1.6 psm) due to its previous priority in expanding the platform size rather than profitability. With its proactive approach in building the VAS ecosystem, we think there is still a huge room for the company to improve its community VAS profitability. This, together with an improvement in balance sheet due to fewer M&A activities, should drive a rerating, although we believe that Colour Life should still trade at a discount to peers due to (1) lack of support from a backing developer; (2) slower-than-average earnings growth (20% CAGR in 18-22E vs. peers average of 31%); and (3) unproven strong profitability efficiency in community VAS (though, because of the small base, there is also much more room for Colour Life to improve).

Very attractive valuation

Colour Life trades at 7x P/E, which is both the sector-lowest valuation and its own trough P/E. We don't think it is a value trap given the company should still see stable growth (20% earnings CAGR for 18-22E) and a >90% renewal rate. If we strip out our target valuation on community & non-community VAS, current market price only implies a 1x P/E on Colour Life's property management segment, which is way too low for a recurring income-based business that will see a 12% EBIT CAGR from 18 to 22E, by our estimate.

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Price Performance

	YTD	1m	3m	12m
Abs	-4.5%	-3.6%	-29.8%	0.3%
Rel	-8.5%	-5.1%	-27.5%	0.0%

Company Data

Shares O/S (mn)	1,423
52-week range (HK$)	6.20-3.43
Market cap ($ mn)	726
Exchange rate	7.84
Free float(%)	32.8%
3M - Avg daily vol (mn)	3.55
3M - Avg daily val ($ mn)	2.1
Volatility (90 Day)	44
Index	HSCEI
BBG BUY|HOLD|SELL	11|2|0

Key Metrics (FYE Dec)

Rmb in millions	FY18A	FY19E	FY20E	FY21E
Financial Estimates				
Revenue	3,614	4,200	4,790	5,415
Adj. EBITDA	1,089	1,257	1,481	1,672
Adj. EBIT	883	1,018	1,194	1,327
Adj. net income	447	556	701	815
Adj. EPS	0.35	0.41	0.49	0.57
BBG EPS	0.39	0.43	0.50	0.59
Cashflow from operations	258	(301)	316	386
FCFF	391	(197)	383	412
Margins and Growth				
Revenue growth	121.9%	16.2%	14.0%	13.0%
EBITDA margin	30.1%	29.9%	30.9%	30.9%
EBITDA growth	108.6%	15.5%	17.8%	12.9%
EBIT margin	24.4%	24.2%	24.9%	24.5%
Net margin	12.4%	13.2%	14.6%	15.1%
Adj. EPS growth	31.4%	17.1%	20.5%	16.3%
Ratios				
Adj. tax rate	24.0%	24.1%	24.1%	24.1%
Interest cover	4.2	5.4	7.4	9.7
Net debt/Equity	0.2	0.2	0.1	0.1
Net debt/EBITDA	0.6	0.5	0.3	0.2
ROCE	10.3%	11.3%	12.3%	12.0%
ROE	13.7%	15.7%	16.8%	17.4%
Valuation				
FCFF yield	8.5%	(4.0%)	7.5%	8.0%
Dividend yield	4.3%	4.3%	5.5%	6.4%
EV/EBITDA	6.3	5.5	4.7	4.1
Adj. P/E	10.3	8.8	7.3	6.3

Summary Investment Thesis and Valuation

Investment Thesis

Colour Life has seen a big derating since IPO due to lower growth expectation. While we agree that Colour Life deserves to trade at a discount to peers, due to slower growth and lack of support from a strong backing developer, we think it is significantly under-valued, given (1) 20% earnings CAGR in 18-22E is on par with COPH's which is trading at 23x P/E; (2) cash flows & leverage will improve as Colour Life is slowing down M&As; and (3) VAS still has a lot of growth potential, particularly with its large community (32 million registered users on its community app, which is way above CGS's 3 million, as of 1H19) and collaboration with JD.com & 360.com. Colour Life is trading at a trough P/E of 7x, which we think is too low for a company with a stably growing recurring income.

Valuation

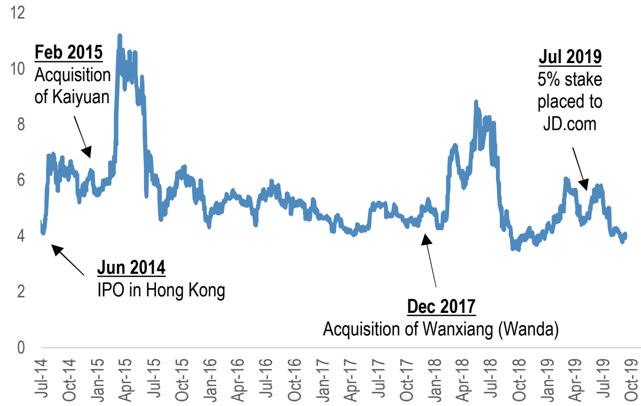
Our Dec-20 price target of HK$8.0 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 14x 2020E P/E.

1. **Property management:** We apply a 14x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 15x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS:** We apply an 8x P/E to one-year forward net profit, with a discount to peers due to its weaker branding.

Separately, we further apply a 30% discount on Colour Life due to its net debt position.

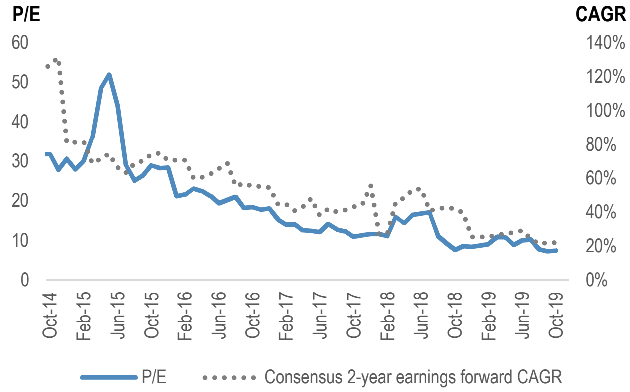
Sources for: Performance Drivers – Bloomberg, J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

Figure 137: Colour Life – Share price performance (HK$)



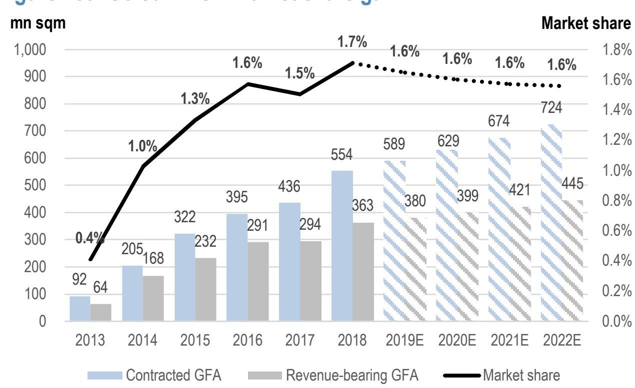
Source: Bloomberg, HKEx, J.P. Morgan

Figure 138: Colour Life – P/E time series vs. consensus 2-year earnings forward CAGR



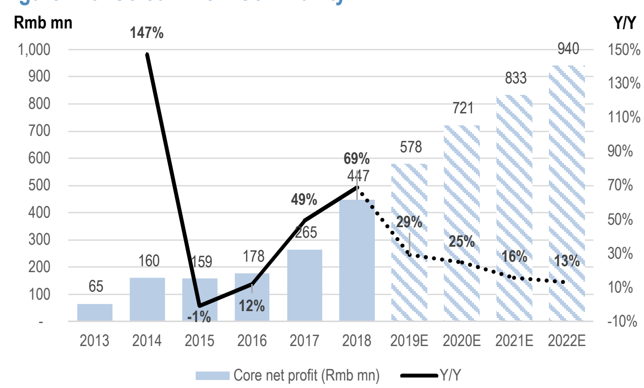
Source: Company data, Bloomberg. J.P. Morgan estimates.

Figure 139: Colour Life – Market share gain



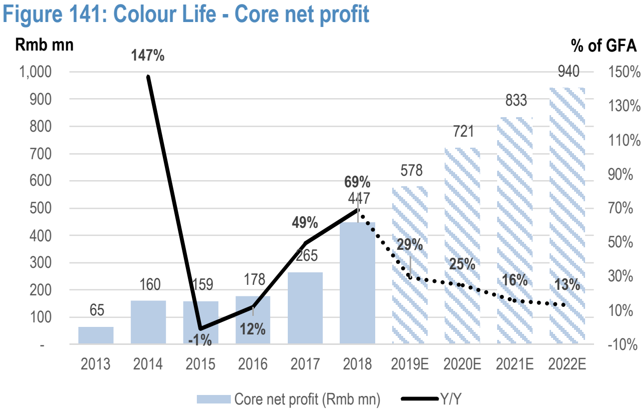
Source: Company data, CIA, J.P. Morgan estimates. Note: Based on total GFA

Figure 140: Colour Life – Community EBIT



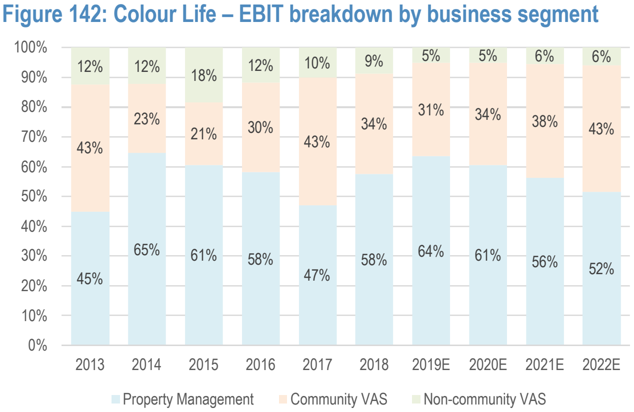
Source: Company data, HKEx, J.P. Morgan.

Figure 141: Colour Life - Core net profit



Source: Company data, J.P. Morgan estimates.

Figure 142: Colour Life – EBIT breakdown by business segment

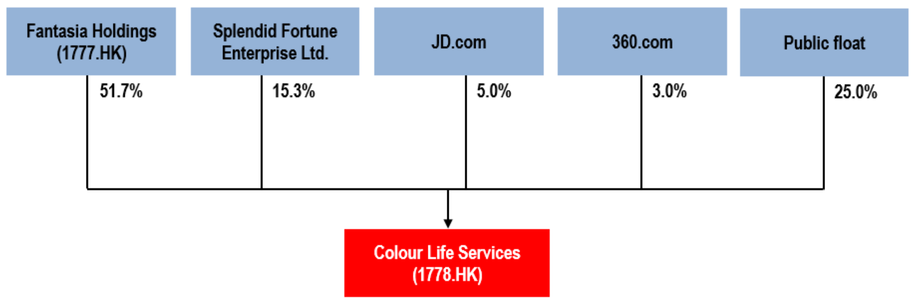


Source: Company data, J.P. Morgan estimates.

Company background

Colour Life (1778.HK) was established in 2002, and listed on the HKEx in June 2014 as the first HK-listed Chinese real estate management service provider. Unlike most peers where most of their area under management is from a backing company, Colour Life's parent company, Fantasia (1777.HK), accounts for only a small portion of Colour Life's area under management. As of Jun-2019, the company had total contracted GFA of 564mn sqm and a total revenue-bearing GFA of 365mn sqm, covering 277 cities across China.

Figure 143: Colour Life - shareholding structure



Source: HKEx, Company data, J.P. Morgan

Figure 144: Colour Life - shareholding structure

Name	Mr. Pan Jun 潘軍	Mr. Tang Xuebin 唐學斌	Mr. Huang Wei 黃瑋	Mr. Chen Xinyu 陳新禹	Mr. Zhou Hongyi 周鴻禕	Mr. Anthony Tam 譚振雄	Dr. Liao Jianwen 廖建文	Mr. Xu Xinmin 許新民
Age	48	51	48	51	48	68	51	67
Role	Chairman	Executive Director (CEO)	Executive Director (Executive President)	Executive Director	Non-executive	Independent	Independent	Independent
Remarks	Joined Fantasia Group in 1999	Joined Colour Life in 2002	Joined Colour LIfe in 2015	Joined Fantasia in 2019, Executive director and CFO	Chairman of Qihoo360	Tax Partner of Mazars	Serving as INED in multiple companies	Real estate economist

Source: HKEx, Company data, J.P. Morgan

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Table 31: Colour Life - detailed earnings model (Rmb mn)

	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E	2022E
Gross turnover breakdown										
Property management	137	236	586	1,059	1,231	3,064	3,446	3,840	4,241	4,692
Community Value Added Services (internal)	45	65	106	157	277	408	542	696	868	1,068
Engineering (external)	52	88	135	126	121	141	212	254	305	366
Gross Turnover	**233**	**389**	**828**	**1,342**	**1,629**	**3,614**	**4,200**	**4,790**	**5,415**	**6,126**
Cost of services	-89	-79	-373	-756	-898	-2,331	-2,725	-3,075	-3,490	-3,982
Gross Profit	**144**	**310**	**454**	**586**	**731**	**1,282**	**1,475**	**1,715**	**1,925**	**2,144**
Selling and marketing expenses	-2	-2	-16	-14	-26	-60	-69	-74	-80	-86
Administrative expenses	-58	-93	-217	-298	-277	-376	-428	-492	-567	-658
EBIT breakdown										
Property management	42	168	206	234	239	529	695	776	806	819
Community Value Added Services (internal)	40	60	71	122	218	309	343	440	549	676
Engineering (external)	12	32	63	47	51	81	55	66	79	95
Corporate expenses	-2	-3	-5	-4	-8	-20	-58	-71	-91	-118
EBIT	**91**	**226**	**247**	**319**	**455**	**883**	**1,018**	**1,194**	**1,327**	**1,455**
Interest income	**1**	**1**	**5**	**6**	**34**	**38**	**42**	**46**	**50**	**55**
Interest expenses	**-1**	**-2**	**-11**	**-38**	**-90**	**-299**	**-242**	**-218**	**-196**	**-177**
Operating profit	**91**	**226**	**241**	**287**	**399**	**621**	**817**	**1,022**	**1,181**	**1,333**
Share of associates / JCEs (mainly AGC)	0	0	1	1	2	11	12	13	14	16
Profit before tax	**91**	**226**	**242**	**288**	**401**	**632**	**829**	**1,034**	**1,195**	**1,349**
Tax expenses	-26	-61	-69	-82	-106	-152	-200	-250	-289	-326
Minority Interest	-1	-5	-14	-28	-30	-33	-51	-64	-73	-83
Core net profit	**65**	**160**	**159**	**178**	**265**	**447**	**578**	**721**	**833**	**940**
Exceptional items	-20	-14	10	10	56	38	0	0	0	0
Reported net profit	**44**	**146**	**168**	**188**	**321**	**485**	**578**	**721**	**833**	**940**
Fully diluted EPS (Rmb)	NA	0.17	0.17	0.19	0.32	0.38	0.43	0.51	0.59	0.66
Core EPS (Rmb)	NA	0.18	0.16	0.18	0.27	0.35	0.43	0.51	0.59	0.66
Total DPS (Rmb)	0.00	0.07	0.08	0.09	0.13	0.15	0.16	0.20	0.23	0.26
Payout ratio	0%	49%	50%	46%	52%	42%	40%	40%	40%	40%
Margin										
Gross margin	**61.6%**	**79.6%**	**54.9%**	**43.6%**	**44.9%**	**35.5%**	**35.1%**	**35.8%**	**35.5%**	**35.0%**
Property management	58.2%	80.5%	46.8%	35.6%	35.2%	26.1%	28.4%	28.2%	26.8%	25.1%
Engineering (external)	38.8%	62.8%	55.9%	51.1%	58.5%	66.0%	30.0%	30.0%	30.0%	30.0%
Community Value Added Services (internal)	98.4%	98.9%	98.3%	91.8%	82.0%	95.7%	80.0%	80.0%	80.0%	80.0%
EBIT margin	**39.0%**	**58.1%**	**29.9%**	**23.8%**	**27.9%**	**24.4%**	**24.2%**	**24.9%**	**24.5%**	**23.7%**
Operating margin	39.0%	58.0%	29.2%	21.4%	24.5%	17.2%	19.5%	21.3%	21.8%	21.8%
Net Margin (before MI)	**28.1%**	**42.2%**	**20.8%**	**15.3%**	**18.0%**	**13.0%**	**14.7%**	**16.1%**	**16.5%**	**16.4%**
YoY growth (%)										
Gross Turnover	NA	67%	113%	62%	21%	122%	16%	14%	13%	13%
EBIT	NA	149%	9%	29%	42%	94%	15%	17%	11%	10%
Core net profit	**NA**	**147%**	**-1%**	**12%**	**49%**	**69%**	**29%**	**25%**	**16%**	**13%**
Reported net profit	NA	228%	16%	12%	71%	51%	19%	25%	16%	13%
Property management										
Contracted GFA (Period end) (mn sqm)	**92**	**205**	**322**	**395**	**436**	**554**	**589**	**629**	**674**	**724**
Y/Y%		124%	57%	23%	10%	27%	6%	7%	7%	7%
Revenue-bearing GFA (Period end) (mn sqm)	**64**	**168**	**232**	**291**	**294**	**363**	**380**	**399**	**421**	**445**
Y/Y%		164%	38%	25%	1%	24%	5%	5%	5%	6%

Source: Company data, J.P. Morgan estimates.

Investment Thesis, Valuation and Risks

Colour Life Services Group Co., Limited *(Overweight; Price Target: HK$8.00)*

Investment Thesis

Colour Life has seen a big derating since IPO due to lower growth expectation. While we agree that Colour Life deserves to trade at a discount to peers, due to slower growth and lack of support from a strong backing developer, we think it is significantly under-valued, given (1) 20% earnings CAGR in 18-22E is on par with COPH's which is trading at 23x P/E; (2) cash flows & leverage should improve as Colour Life is slowing down M&As; and (3) VAS still has a lot of growth potential, particularly with its large community (32 million registered users on its community app, which is way above CGS's 3 million, as of 1H19) and collaboration with JD.com & 360.com. Colour Life is trading at a trough P/E of 7x, which we think is too low for a company with a stably growing recurring income.

Valuation

Our Dec-20 price target of HK$8.0 is based on a SOTP approach due to the different natures of its three major business segments. Our overall price target implies a 14x 2020E P/E.

1. **Property management:** We apply a 14x P/E to the stabilized net profit based on current attributable contracted GFA.
2. **Community VAS:** We apply a 15x P/E to the three-year forward net profit, benchmarking the low-frequency services segment of tech companies, with premium due to positive cash flow nature and stickier user base.
3. **Non-community VAS:** We apply an 8x P/E to one-year forward net profit, with a discount to peers due to its weaker branding.

Separately, we further apply a 30% discount on Colour Life due to its net debt position.

Risks to Rating and Price Target

Upside risks: (1) value-accretive M&A; (2) faster-than-expected growth in revenue-bearing GFA; (3) better-than-expected margin; (4) better-than-expected growth in community VAS.
Downside risks: (1) significant increase in labor costs which hurt margin; (2) value-destructive M&A; (3) worse-than-expected growth in revenue-bearing GFA; (4) worse-than-expected margin.

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Table 32: Colour Life (1778 HK) - SOTP valuation

Property Management	**Unit**		
Adjusted attributable contracted GFA	mn sqm	466	
Stabilized net profit	Rmb mn	525	
Target P/E	**x**	**14x**	
Valuation	**Rmb mn**	**7,347**	**(Rmb5.4/sh)**
Community VAS			
Net profit	Rmb mn	426	(3-year forward)
Target P/E	**x**	**15x**	
Valuation	**Rmb mn**	**6,397**	**(Rmb4.7/sh)**
Non-community VAS			
Net profit	Rmb mn	38	(1-year forward)
Target P/E	**x**	**8x**	
Valuation	**Rmb mn**	**301**	**(Rmb0.2/sh)**
SOTP		**Rmb/sh**	**HK$/sh**
Property Management		5.4	6.0
Community VAS		4.7	5.2
Non-community VAS		0.2	0.2
Valuation		**10.3**	**11.4**
Discount for net debt			30%
Adjusted Price Target (HK$)			**8.0**

Source: J.P. Morgan estimates.

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Colour Life Services: Summary of Financials

Income Statement	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	**1,629**	**3,614**	**4,200**	**4,790**	**5,415**
COGS	(898)	(2,331)	(2,725)	(3,075)	(3,490)
Gross profit	**731**	**1,282**	**1,475**	**1,715**	**1,925**
SG&A	(303)	(436)	(498)	(566)	(647)
Adj. EBITDA	**522**	**1,089**	**1,257**	**1,481**	**1,672**
D&A	(67)	(206)	(239)	(287)	(344)
Adj. EBIT	**455**	**883**	**1,018**	**1,194**	**1,327**
Net Interest	(56)	(261)	(233)	(201)	(172)
Adj. PBT	**401**	**632**	**797**	**1,006**	**1,170**
Tax	(106)	(152)	(192)	(243)	(282)
Minority Interest	(30)	(33)	(49)	(62)	(72)
Adj. Net Income	**265**	**447**	**556**	**701**	**815**
Reported EPS	0.27	0.35	0.41	0.49	0.57
Adj. EPS	**0.27**	**0.35**	**0.41**	**0.49**	**0.57**
DPS	**0.13**	**0.15**	**0.16**	**0.20**	**0.23**
Payout ratio	47.1%	44.1%	38.2%	40.0%	40.0%
Shares outstanding	996	1,280	1,360	1,423	1,423

Balance Sheet	FY17A	FY18A	FY19E	FY20E	FY21E
Cash and cash equivalents	2,225	3,013	2,341	2,935	3,635
Accounts receivable	538	1,904	3,046	3,350	3,685
Inventories	7	5	6	9	13
Other current assets	1,878	862	1,010	1,210	1,451
Current assets	**4,648**	**5,784**	**6,403**	**7,504**	**8,784**
PP&E	310	360	432	519	623
LT investments	-	-	-	-	-
Other non current assets	3,854	3,922	3,586	3,611	3,640
Total assets	**8,812**	**10,066**	**10,422**	**11,635**	**13,047**
Short term borrowings	733	1,753	698	698	698
Payables	1,556	2,001	2,093	2,198	2,317
Other short term liabilities	561	840	927	1,037	1,174
Current liabilities	**2,850**	**4,594**	**3,718**	**3,932**	**4,189**
Long-term debt	2,117	1,907	2,288	2,746	3,295
Other long term liabilities	340	310	310	310	310
Total liabilities	**5,307**	**6,810**	**6,316**	**6,988**	**7,794**
Shareholders' equity	3,399	3,135	3,936	4,415	4,950
Minority interests	106	121	170	232	303
Total liabilities & equity	**8,812**	**10,066**	**10,422**	**11,635**	**13,047**
BVPS	**2.56**	**2.36**	**2.77**	**3.10**	**3.48**
y/y Growth	*75.4%*	*(7.8%)*	*17.2%*	*12.2%*	*12.1%*
RNAV/Share	-	-	-	-	-
Net debt/(cash)	625	647	645	509	357

Cash Flow Statement	FY17A	FY18A	FY19E	FY20E	FY21E
Cash flow from operating activities	**268**	**258**	**(301)**	**316**	**386**
o/w Depreciation & amortization	67	206	0	0	0
o/w Changes in working capital	(51)	(463)	(1,092)	(251)	(280)
Cash flow from investing activities	**(216)**	**91**	**(11)**	**(41)**	**(54)**
o/w Capital expenditure	(100)	(66)	(72)	(86)	(104)
as % of sales	*6.2%*	*1.8%*	*1.7%*	*1.8%*	*1.9%*
Cash flow from financing activities	**1,040**	**462**	**(429)**	**235**	**269**
o/w Dividends paid	(87)	(166)	(205)	(222)	(281)
o/w Shares issued/(repurchased)	(19)	428	449	0	0
o/w Net debt issued/(repaid)	209	757	(674)	458	549
Net change in cash	**1,093**	**819**	**(741)**	**511**	**601**
Adj. Free cash flow to firm	**209**	**391**	**(197)**	**383**	**412**
y/y Growth	*195.9%*	*87.4%*	*(150.3%)*	*(294.5%)*	*7.8%*

Ratio Analysis	FY17A	FY18A	FY19E	FY20E	FY21E
Gross margin	44.9%	35.5%	35.1%	35.8%	35.5%
EBITDA margin	32.0%	30.1%	29.9%	30.9%	30.9%
EBIT margin	27.9%	24.4%	24.2%	24.9%	24.5%
Net profit margin	16.3%	12.4%	13.2%	14.6%	15.1%
ROE	10.9%	13.7%	15.7%	16.8%	17.4%
ROA	4.1%	4.7%	5.4%	6.4%	6.6%
ROCE	7.4%	10.3%	11.3%	12.3%	12.0%
SG&A/Sales	18.6%	12.1%	11.9%	11.8%	11.9%
Net debt/Equity	0.2	0.2	0.2	0.1	0.1
Net debt/EBITDA	1.2	0.6	0.5	0.3	0.2
Sales/Assets (x)	0.3	0.4	0.4	0.4	0.4
Assets/Equity (x)	2.6	2.9	2.9	2.6	2.6
Interest cover (x)	9.4	4.2	5.4	7.4	9.7
Operating leverage	198.9%	77.1%	94.6%	123.0%	85.5%
Tax rate	26.4%	24.0%	24.1%	24.1%	24.1%
Revenue y/y Growth	21.4%	121.9%	16.2%	14.0%	13.0%
EBITDA y/y Growth	41.0%	108.6%	15.5%	17.8%	12.9%
EPS y/y Growth	49.8%	31.4%	17.1%	20.5%	16.3%

Valuation	FY17A	FY18A	FY19E	FY20E	FY21E
P/E (x)	13.6	10.3	8.8	7.3	6.3
P/BV (x)	1.4	1.5	1.3	1.2	1.0
EV/EBITDA (x)	13.1	6.3	5.5	4.7	4.1
Dividend Yield	3.5%	4.3%	4.3%	5.5%	6.4%

Source: Company reports and J.P. Morgan estimates.
Note: Rmb in millions (except per-share data).Fiscal year ends Dec. o/w - out of which

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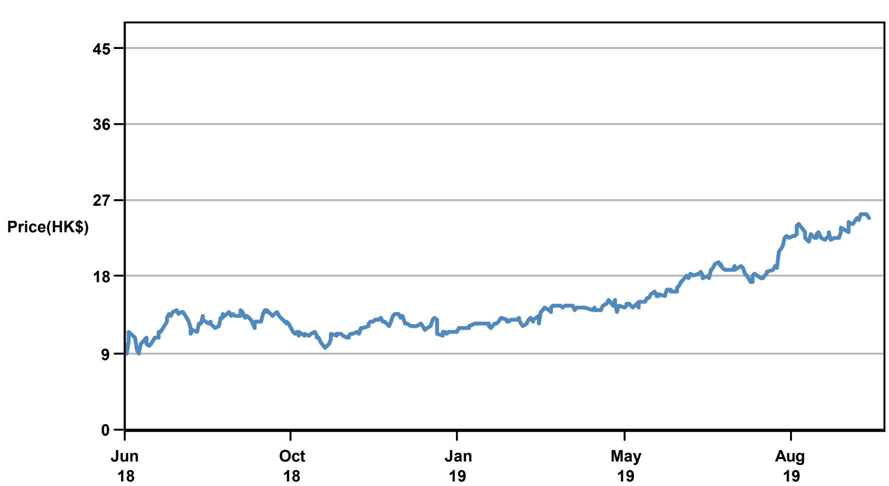
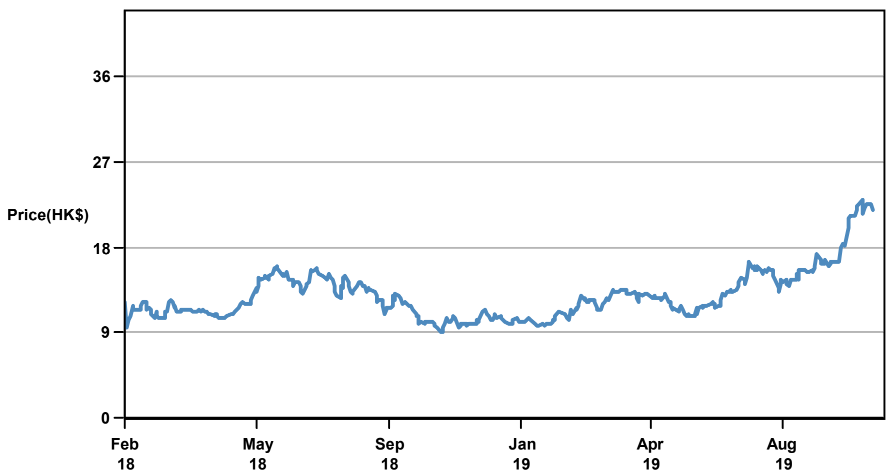


Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.

A-Living Services (3319.HK, 3319 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.

Greentown Service (2869.HK, 2869 HK) Price Chart

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.

China Overseas Property Holdings (2669.HK, 2669 HK) Price Chart

Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.

Colour Life Services (1778.HK, 1778 HK) Price Chart

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