Sunland Group 18/09/2018 **FAT-AUS-891**

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Fat Prophets Take Profits

The property market in Australia is having a challenging time of it currently, with the tightening of credit standards and overall slowing of market activity resulting in fewer buyers, rising inventory levels and compounded by affordability challenges for first time homebuyers. With lending rates also now on the rise we see the headwinds deepening, particularly in hot spots which have experienced robust price gains in recent years. Regions which have lagged may hold up better, but we are nonetheless exercising prudence in taking profits on Sunshine state developer, **Sunland Group** (ASX.SDG).

What's New?

In our last coverage in May (FAT-AUS-875) we focussed on the company's "Grace on Coronation" project located at Lot 30 Coronation Drive, in Toowong, Queensland which is still in legal limbo. We also looked at the company's First Half 2018 results which indicated a very solid start to the financial year.

However, property market concerns were already surfacing as the company provided a conservative FY18 outlook with an NPAT target of between $27 and $30 million. Developments since then don't augur well for the property sector and consequently, Sunland itself.

Over the past 11 months, property prices have been cooling down with Sydney and Melbourne down 5.6% and 3.5% from their respective highs. This weakening market conditions for property are tied to a varied mix of factors led by the introduction of stricter lending criteria by the banks and affecting investor demand.

The table below illustrates the price movements across a mix of time periods and continues to show a weakening market:

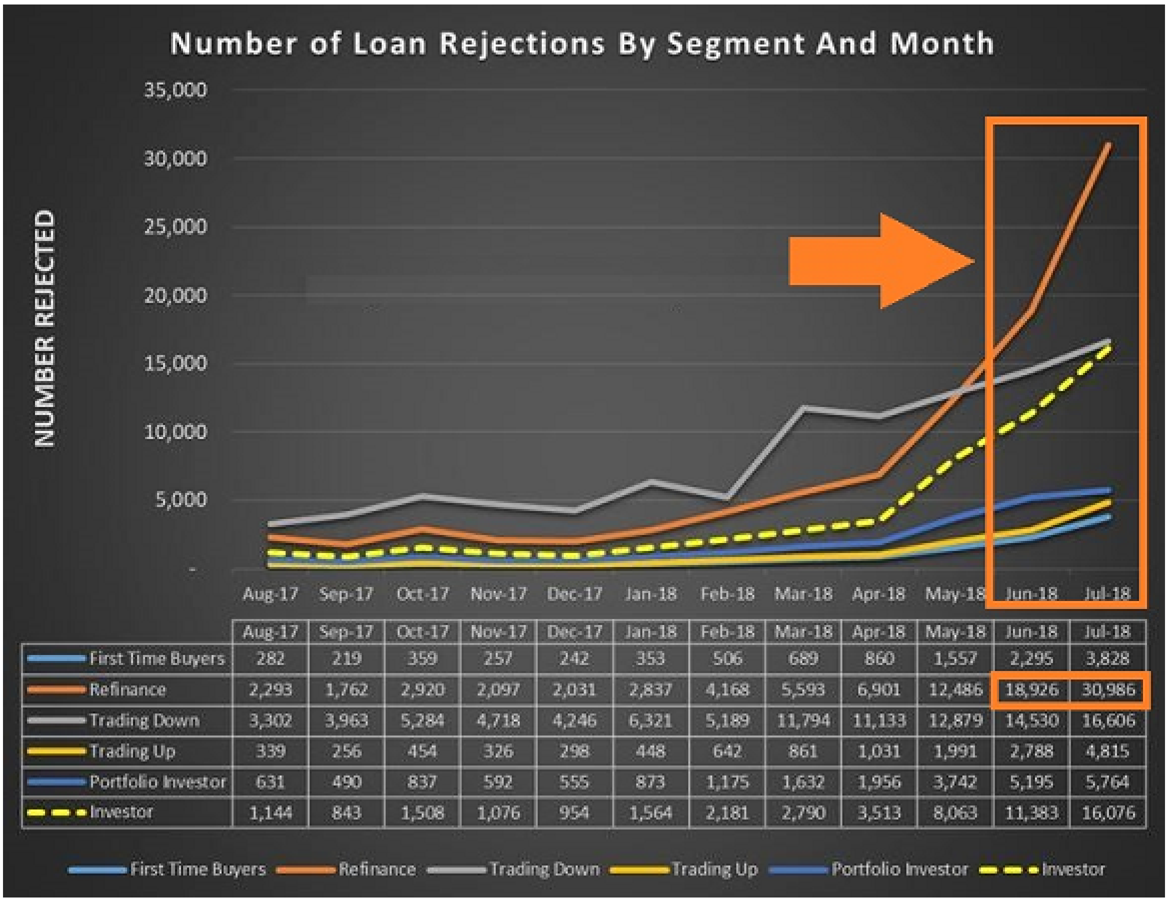
Index results as at August 31, 2018

	Change in dwelling values Month	Quarter	Annual	Total return	Median value
Sydney	-0.3%	-1.2%	-5.6%	-2.7%	$855,287
Melbourne	-0.6%	-2.0%	-1.7%	1.2%	$703,183
Brisbane	-0.2%	0.1%	0.9%	5.0%	$493,922
Adelaide	0.3%	0.5%	1.0%	5.2%	$438,466
Perth	-0.6%	-1.9%	-2.1%	1.8%	$454,007
Hobart	-0.1%	0.1%	10.7%	16.2%	$437,254
Darwin	0.1%	-0.7%	-4.0%	1.5%	$439,718
Canberra	0.5%	0.4%	2.3%	6.9%	$593,886
Combined capitals	-0.4%	-1.2%	-2.9%	0.3%	$646,020
Combined regional	-0.2%	-0.6%	1.6%	6.6%	$368,336
National	-0.3%	-1.1%	-2.0%	1.5%	$552,141

Source: CoreLogic

Conceptually, the introduction of stricter lending criteria by the banks was originally intended to dampen “investor” demand (reduce lending to high loan-to-income borrowers) and reduce some upwards price pressure, but instead it became a double-edged sword and also hurt first homebuyers (i.e. actual consumers).

A concerning statistic with data from Digital Finance Analytics (DFA), a boutique consulting firm, and investment bank UBS, indicate a massive spike in Mortgage rejections with DFA founder Martin North stating that “about 40% of people who tried to refinance were unable to do so” and added that “…if you go back a year it was 5%.” This is a very concerning trend indeed.



	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18
First Time Buyers	282	219	359	257	242	353	506	689	860	1,557	2,295	3,828
Refinance	2,293	1,762	2,920	2,097	2,031	2,837	4,168	5,593	6,901	12,486	18,926	30,986
Trading Down	3,302	3,963	5,284	4,718	4,246	6,321	5,189	11,794	11,133	12,879	14,530	16,606
Trading Up	339	256	454	326	298	448	642	861	1,031	1,991	2,788	4,815
Portfolio Investor	631	490	837	592	555	873	1,175	1,632	1,956	3,742	5,195	5,764
Investor	1,144	843	1,508	1,076	954	1,564	2,181	2,790	3,513	8,063	11,383	16,076

Source: Digital Finance Analytics

Furthermore, a broadening number of Australian homeowners are experiencing mortgage stress. This is defined as a household where 30% of the post-tax income goes to servicing a mortgage, implying a greater degree of financial risk for the system. The concerning factor here is that about 30.5% owner occupied borrowing households are experiencing this.

With fewer buyers and owners experiencing financial distress, no surprise that this would result in a negative feedback loop with sellers trying to exit their "mortgage hand-cuffs".

We see a build-up in supply and as evidenced by research from CoreLogic, a data analytics firm, which noted that inventory levels have been rising due to fewer buyers with advertised "stock" levels 7.6% higher year-on-year. Properties generally are taking much longer to sell with auction clearance rates in the mid- to low- 50% range.

This is supported by data from property site, Domain, showcasing preliminary Auction results:

Source: Domain

The increasing desperation to some vendors to head for the exits has been only fuelled by media anecdotes that there are sellers (of mid-range properties) willing to lop off $250,000 off their initial asking prices just to close a deal.

Despite the increasing 'doom and gloom', Sunland's share price has held quite well and has been trading in a band between $1.67 and the $1.80s levels. We believe this is primarily due to the fact that the company has a larger exposure to Queensland which was lagged, and could potentially hold up better in a national downturn.

However, we believe it prudent to move to a SELL recommendation at current levels, with the company likely to face increasing industry headwinds. While the likes of South-East Queensland may hold up well (and helped by rising tourism and investment), the company has exposure to the Brisbane apartment market (where there is oversupply) as well as south of the border. Borrowing on the aphorism from New England Council's slogan "a rising tide lifts all the boats", the converse is true as well.

Indeed, the company's FY 18 results were something of a disappointment and reflective of a slowdown in the broader market. In the 2H18 it seems that the actual performance slowed significantly and ended with an unfavourable year-on-year comparison and only slightly beating guidance estimates between $27 and $30 million. Results are summarised below:

KEY FINANCIAL HIGHLIGHTS

$M	FY18	FY17	% CHANGE
TOTAL REVENUE	298.7	405.5	-26%
REVENUE – SALE OF PROPERTY	290.4	394.3	-26%
STATUTORY NET PROFIT BEFORE TAX	43.3	50.0	-13%
LESS: TAX EXPENSE	12.1	14.7	-18%
STATUTORY NET PROFIT AFTER TAX	31.3	35.3	-11%
EBIT	51.9	63.8	-19%
INTEREST COVER (TIMES)	6.3	4.7	30%
FINAL DIVIDEND (CENTS)	6.0	4.0	50%
INTERIM DIVIDEND (CENTS)	5.0	4.0	25%
SPECIAL DIVIDEND (CENTS)	-	2.0	-
TOTAL DIVIDENDS	11.0	10.0	10%

Source: 22 August 2018 Company Presentation

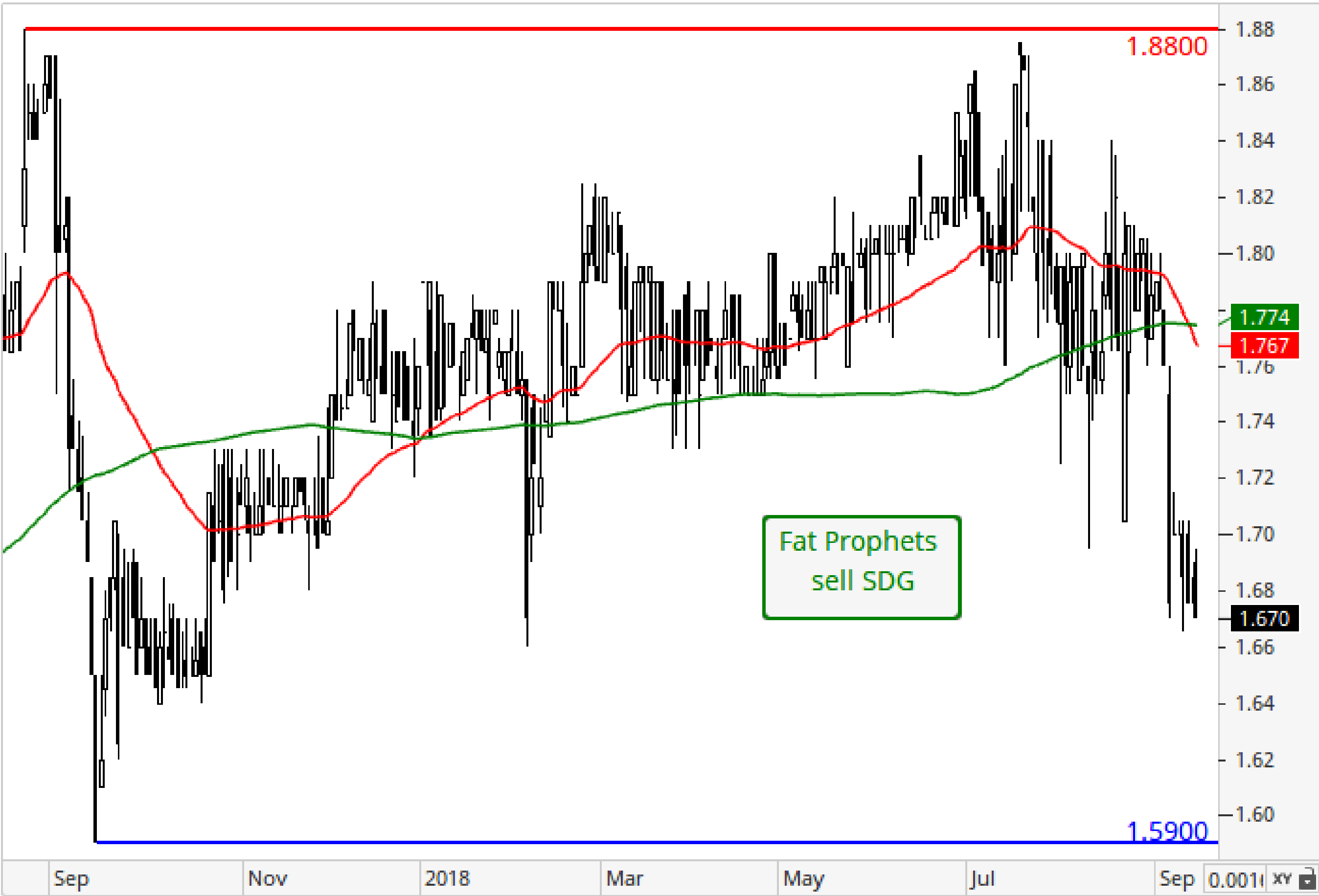
Going forward, the company's outlook isn't entirely positive. Note that many CEOs and management are usually "bullish" in order to rally investors and internal morale. However, Managing Director, Sahba Abedian, has provided a more muted and, in our view, realistic portrayal of next year's outlook, quote:

"Following a nine-year period of expansion, the Australian property market has entered an inevitable phase of consolidation and adjustment," and further added that "…this is the natural consequence of the cyclical nature of our industry and evidenced by a reduction in the volume of property sales, a reduction in foreign investment, a tightening of the lending environment, and softening economic conditions."

If an industry expert such as himself would urge caution, we believe it is most prudent to listen and act accordingly. He also added that Sunland management are now “focussed on establishing the Company for the next phase of the cycle” instead of attempting to “ease” concerns and offer glib remarks about a better near term. **This thus supports our view to move to a SELL.**

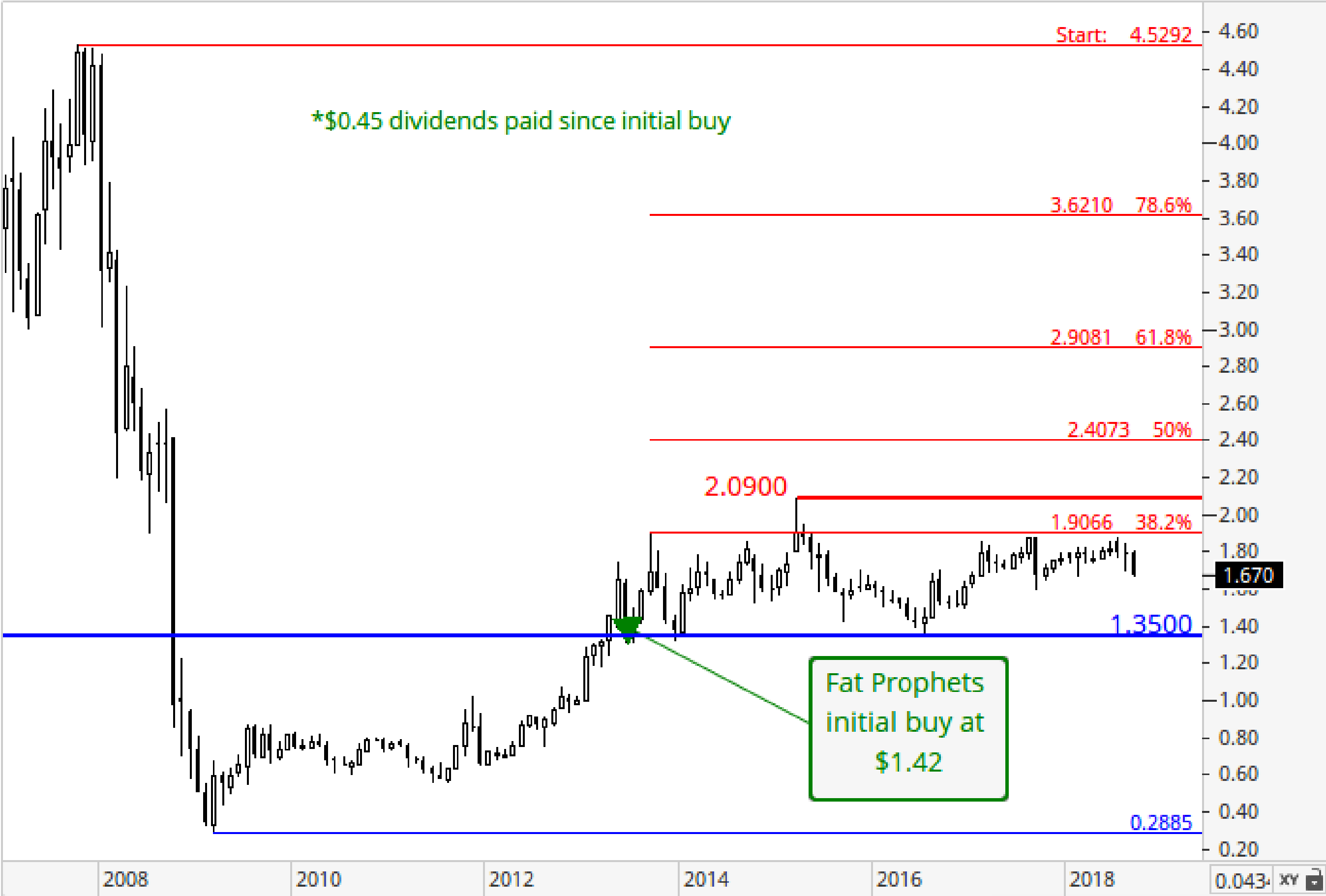
Turning to the daily chart, prices have breached support at the 50-day moving average (red line) of \$1.77. As such, downside support at the mid-September low of \$1.59 as marked by the horizontal blue line, is now potentially in for a test. In order for the short-term technical outlook to improve, a sustained break above dynamic resistance indicated at the 200-day moving average (green line) of \$1.76 is required. A bearish crossover (where the 50 day moving average crosses below the 200 day moving average) does little to instil confidence this will occur.

SUNLAND GROUP LTD - SDG (ASX) - 1 Day CandleStick Chart - AUD



With reference to the monthly chart, overhead resistance is situated at the 38.2% Fibonacci retracement of \$1.91. A sustained break above this level would bolster upward momentum and strengthen the long-term technical landscape. On the flip side an ongoing rotation south could see the \$1.35 level threatened.

SUNLAND GROUP LTD - SDG (ASX) - 1 Month CandleStick Chart - AUD



Summary

The property market in Australia is having a challenging time of it currently, with the tightening of credit standards and overall slowing of market activity resulting in fewer buyers, rising inventory levels and compounded by affordability challenges for first time homebuyers. With lending rates also now on the rise we see the headwinds deepening, particularly in hot spots which have experienced robust price gains in recent years.

These difficulties have bled into Sunland's Fiscal 2018 results, showcasing a significant slowdown. Management has likewise expressed muted expectations of the future instead of glib remarks. **We recommend Members SELL all their holdings in Sunland Group (ASX.SDG) around current levels.**

Energy, BG Group, BOLSAS Y MERCADOS ESPANOLES,SOCIEDAD, Bovis Homes, BP, Braemar Shipping Group, British American Tobacco, BT Group, Cairn Energy, Centamin Egypt, China Life Insurance, China Mobile, China Overseas, China Taiping, China Vanke, Country Garden, Daejan Holdings, Development Securities, Dragon, Enquest, Esure, Euronext, FedEx, Fresnillo, Ibiden, Infosys, Glaxosmithkline, Glencore International, Goldbridges Global Resources, Google (Alphabet), Grainger, Gulf Keystone Petroleum, Highland Gold Mining, HSBC,ICICI Bank, Ironveld, iShares Physical Metals, J Sainsbury, JKX Oil & Gas, John Wood Group, Kazakhmys, Legal & General, Lloyds, Low and Bonar, Market Vectors Junior Gold Miners, Market Vectors Oil Services, Market Vectors Vietnam, Marstons, Medusa Mining, Mitchells & Butlers, Mitsubishi Tokyo Financial, Mitsubishi UFJ, National Grid, Nippon Telegraph and Telephone, Panasonic, Paragon Group of Companies, Petra Diamonds, Petrofac, Petropavlovsk, PICC Property & Casualty, PPHE Hotel Group, Randgold Resources, Rank Group, Reckitt Benckiser, Royal Dutch Shell, Solgold, Sony Corporation, Standard Chartered, STV Group, Sylvania Platinum, Tata Motors, Tencent, Tertiary Minerals, Teva Pharamaceutical, Toyota Motor, Tullow Oil, Unilever, Vedanta Resources, Vodafone, Walt Disney, Zillow.

Snapshot SDG

Sunland Group

Latest Closing Price: $1.69

Sunland Group Limited is engaged in property development and construction together with project services and hotel investments and operations. The Company operates in five segments: land and housing, multistorey Australia, multistorey International, hotel investments and operations, and project services. Land and housing includes development and sale of land and medium density housing products within Australia. Multistorey Australia includes development and sale of high rise products within Australia. Hotel investments and operations include hotel ownership and management. Project services include project management and design services to development properties within Australia.

Market Capitalisation:$255.56m

	FY1	FY2
Price to Earnings	8.8	7.9
Dividend Yield (%)	6.1	6.6
Price to Book	0.74	0.65
Return on Equity (%)	8.5	8.4
EV/EBITDA	11.4	7.5