

## Agile (3383.HK)

### China Property Sector

8 Jul 2008

### Special Deal Indicates Assets Are Undervalued

Last Friday, Agile announced the sale of a 30% stake in its Hainan project to a strategic investor (Morgan Stanley). Agile will make a profit of RMB4.2bn (RMB1.12/share) from this deal and is expected to distribute a special dividend. We see this significant special gain as an indication that Morgan Stanley sees the current China property market as heavily undervalued. In our view, this represents a good entry point for the stock.

We have cut our NAV estimate 14% to HK\$15.09 to account for the 30% Hainan project stake sale, improvement in cash position and expected special dividend. The fall factors in the large slice of GFA sold and lower future earnings, as less profit can be booked in future.

Overall, we remain positive on Agile over the long term due to its solid fundamentals, and this strategic investment has also improved Agile's finances significantly (to an estimated 20.6% net gearing in FY08F, from 45% previously). We maintain our Buy rating and target price of HK\$13.13, based on a 13% discount to our new NAV estimate. We have narrowed our target NAV discount to reflect Agile's improved finances and further potential upside from the possible sale of a stake in another project to a strategic investor.

#### Key investment positives

- Strong financial position.** The sale of a 30% stake in the Hainan project will generate a RMB4.2bn profit and significantly improve Agile's financial position to an FY08F net gearing of 20.6%, from 45% previously.
- Economies of scale.** Agile's gross margin improved 7.7 ppts to 50.5% in FY07, one of the highest in the sector, due to better economies of scale. We expect margins to remain high for FY08-10.
- 36% of FY08 sales target secured.** By end-May 2008, Agile had generated presales of RMB5bn, locking in 36% of our revised FY08 sales target. Given the recovering property market, Agile's strong sales execution and its high product quality, we are confident that the company will achieve our conservative sales forecasts.
- Low land costs.** Agile's land-bank cost makes up only 7.7% of our FY08 ASP estimate. This should provide solid downside protection from ASP declines in the event of further credit-tightening measures.

Figure 1: Earnings Summary

Year ending 31 Dec	FY05	FY06	FY07	FY08F	FY09F
Net profit (core) – RMBm	978.7	1,242.5	2,102.8	2,921.8	4,455.9
Net-profit growth - %	330.0	27.0	69.2	38.9	52.5
EPS – RMB fen (core)	38.6	35.5	56.1	78.0	119.0
EPS growth- %	324.2	(8.0)	58.0	39.0	52.5
P/E – X	19.4	21.1	12.5	8.9	5.7
DPS – RMB fen	2.9	12.0	19.0	26.5	40.3
Dividend yield – %	0.4	1.7	2.6	3.7	5.6
BVPS – RMB	1.3	2.0	2.4	3.4	4.1
P/BV – X	5.7	3.8	2.9	2.1	1.6
Net debt per share – RMB fen	(84.3)	4.4	145.2	69.4	113.9
Net debt/price - %	(11.7)	0.6	20.1	9.6	15.8
Issued shares – millions	3,465.3	3,745.7	3,745.7	3,745.7	3,745.7

Sources: Bloomberg and Sun Hung Kai Financial

12-month rating

**Buy**

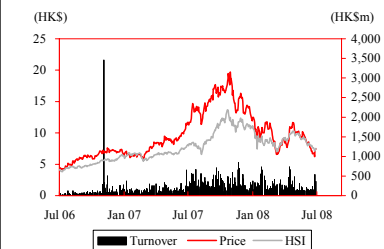
Unchanged

 12m target price  
Price

**HK\$13.13**  
**HK\$7.46**

Performance (%)	1m	3m	12m
Absolute	(20.0)	(17.1)	(33.9)
HSI	(10.2)	(9.9)	(2.7)

Agile – Price vs. HSI, Share Data



Price – HK\$	7.46
HSI	21,913.06
52W high/low (HK\$)	20.15/6.22
Shares in issue – millions	3,745.66
Market cap – HK\$m	27,942.62
3M avg. turnover – HK\$m	218.96
Major shareholders – %	
Chan Cheuk Nam	58.38

Sources: Bloomberg and Sun Hung Kai Financial

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## Company update

- Last Friday, Agile announced the sale of a 30% stake in its Hainan project to a strategic investor (Morgan Stanley) for RMB5.28bn. Costs for the project so far total about RMB2.9bn, putting costs for the 30% stake at about RMB0.9bn. Agile is hence expected to recognize a one-off profit of RMB4.2bn from this deal in FY08
- Furthermore, the company plans to distribute a special dividend for 1H08 if time allows, with an ordinary dividend-payout ratio in line with last year's 35%. That means a special dividend of about RMB0.39/share, for a 9.1% dividend yield at the latest closing price.

## Key investment positives

### Strong financial position

- In our latest company report, we estimated Agile would improve its net gearing to 45% in FY08F due to no further land bank expansion in 2008 and strong contract sales.
- However, given this latest deal, we now expect net gearing to further improve to 20.6% in FY08F, about 40 ppts better than FY07. This is much better than peers such as **Greentown (3900.HK, HK\$5.86, Sell)**, which is expected to post about 110% net gearing in FY08, and **Shanghai Forte (2337.HK, HK\$1.80, Neutral)**, which is set for 80% net gearing.
- The stake sale also means the strategic investor will share any future costs for the Hainan project, which indicates its confidence in the China property market and that it believes now is a good time to accumulate a high-quality project with strong potential growth.
- Overall, we believe Agile's low gearing can help it weather any worsening of the economic environment in 2008 and mean less impact from more monetary-tightening measures, such as further interest-rate hikes.

Figure 2: Agile – financial ratios

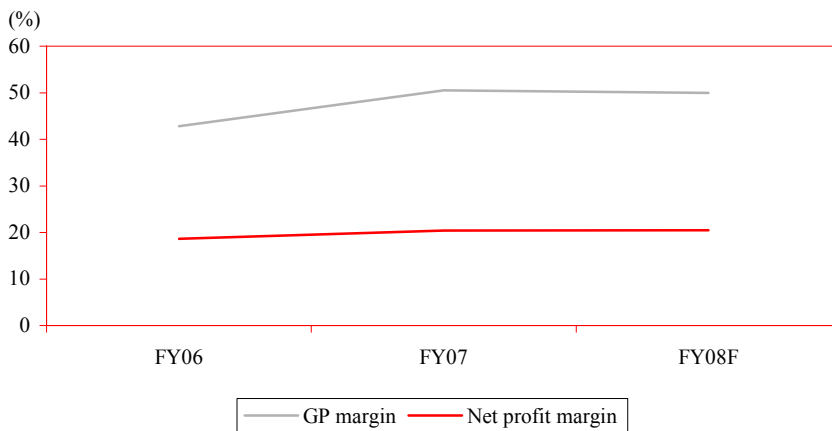
RMBm	FY08F	FY07	FY06
Net assets (after MI)	12,601.7	9,015.0	7,370.0
Cash on hand	6,362.2	2,583.0	5,195.0
Bank loans	8,962.0	8,022.0	5,360.0
Bank loans / total assets (%)	27.5	27.9	30.7
Net gearing (%)	20.6	60.2	2.2

Sources: The Company and Sun Hung Kai Financial

## Economies of scale

- Agile's gross margin improved 7.7 ppts to 50.5% in FY07, one of the highest in the sector (c.f. the sector average of 40%), due to better economies of scale. The net margin accordingly improved 1.8 ppts to 20.4% (c.f. the sector average of 15%). We expect margins to remain high for FY08-10
- The company launched 22 projects in 2007 (up 57% from 2006), expanded into four new cities and completed 1.53 million sq m of GFA. Despite more project launches and GFA completion, selling, marketing and administration expenses stayed at only 5.5% of revenue (c.f. the sector average of 7%). That indicates Agile's economies of scale have helped keep costs under control.

Figure 3: Agile – profit-margin comparison

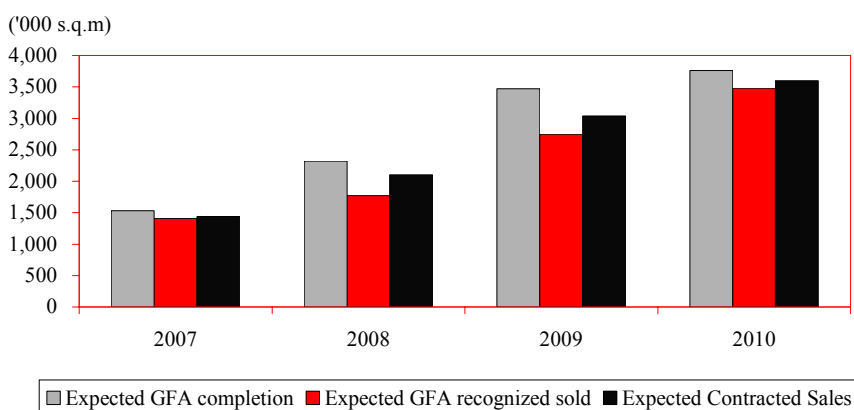


Source: The Company and Sun Hung Kai Financial

**36% of FY08 sales target locked in**

- By end-May 2008, Agile had generated presales of RMB5bn, locking in 36% of our revised FY08 sales target. That was similar to its peers' 30-40% of sales locked in for the first five months of 2008.
- Given the recovering property market, Agile's strong sales execution and its high product quality, we are confident that the company will achieve our conservative sales forecasts.

Figure 4: Agile – contract-sales target

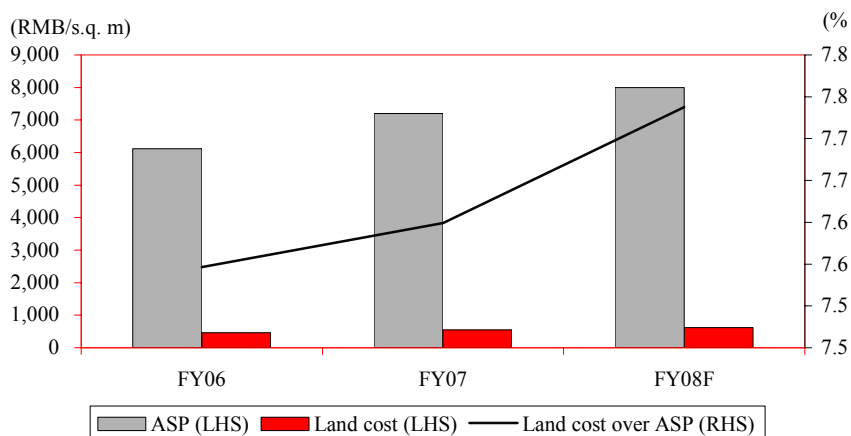


Source: The Company and Sun Hung Kai Financial

**Low land costs, only 7.7% of property sales price, offers downside protection**

- The other reason for Agile’s improving margins was its low land costs. These made up 7.5% of its ASP in 2006, and stayed steady at 7.6% in 2007. We expect land costs to remain low against ASPs for the next 4-5 years.
- Currently, Agile’s land-bank cost is as low as RMB619/sq m, or only 7.7% of our FY08 ASP estimate. Such low land costs should provide solid downside protection for its profit growth.

Figure 5: Agile – Land Cost over ASP



Source: The Company and Sun Hung Kai Financial

**Sufficient and diverse land bank**

- Agile has one of the largest and most diverse land banks among the top five property developers. It has about 25 million sq m of GFA over 20 cities, sufficient for the next eight years of development. That should help dilute its policy risk from any single market.



Figure 6: Agile – Land bank



Source: The Company and Sun Hung Kai Financial

### Downside risks

- **Any unexpected rapid slowdown in sales.** Government tightening measures have caused sales to slow since December 2007, compared with 2Q07-3Q07. A further slowdown in 2Q08 might cause a rapid deceleration in contract sales or a price war. Either scenario could eventually hit property developers' top lines for 2008/09. However, we think this is highly unlikely, as the competitive pricing strategy adopted by developers has so far resulted in strong contract sales. This has also had little impact on ASPs, with most companies keeping prices flat and in some cases even raising ASPs.
- **Poor sales in 2Q08.** As mentioned previously, Agile had no new projects for sale in 1Q08, and is expected to start sales of new projects in 2Q-3Q08. If sales are poor for these new projects, this could hit the bottom line and trigger a de-rating.

## Valuation

- We see the latest deal as a special gain, and maintain our core earnings expectation. However, we see the stake sale as an indication that the strategic investor sees the current China property market as heavily undervalued. In our view, this indicates a good time to accumulate the stock on weakness.
- We have cut our NAV estimate 14% to HK\$15.09 to account for the 30% Hainan project stake sale, improvement in cash position and expected special dividend. The fall factors in the large slice of GFA sold and lower future earnings, as less profit can be booked in future.
- Overall, we remain positive on Agile over the long term due to its solid fundamentals, and this strategic investment has also improved Agile's finances significantly (to an estimated 20.6% net gearing in FY08F, from 45% previously). We maintain our Buy rating and target price of HK\$13.13, based on a 13% discount to our new NAV estimate. We have narrowed our target NAV discount to reflect Agile's improved finances and further potential upside from the possible sale of a stake in another project to a strategic investor.
- We see the current valuation as undemanding. The stock trades at 8.9X FY08F and 5.7X FY09F earnings and a 52.1% discount to NAV, still a huge discount compared with its peers. For example, COLI trades at only a 24.2% discount to NAV and 16.7X FY08F earnings. Our target price implies 15.7X FY08F and 10.0X FY09F earnings. We therefore maintain our Buy rating, and recommend investors accumulate the stock on any weakness.

Figure 7: Investment Highlights for Agile



 Key investment positives	 Key investment negatives
<ul style="list-style-type: none"> <li>■ Economies of scales: Agile launched 22 projects in 2007, up 57% from 2006. It expanded into four new cities, and completed 1.53 million sq m of GFA. Despite more project launches and GFA completion, selling, marketing and administration expenses stayed at only 5.5% of revenue. That suggests Agile's economies of scale helped it keep costs under control.</li> <li>■ Greater economies of scale also boosted margins, with the gross margin surging 7.7 ppts to 50.5% in FY07, one of the highest in the sector. The net margin also increased 1.8 ppts to 20.4%. We expected high margins to continue over FY08-10.</li> <li>■ 36% of our FY08 sales estimate has already been locked in: by end-1Q08, Agile had pre-sold RMB5.0bn revenue, which represents about 36% of our FY08 sales target has been locked-in.</li> <li>■ Agile's current land-bank cost is as little as RMB619/sq m, only 7.7% of its estimated FY08 ASP. This should provide solid downside protection for profit growth.</li> <li>■ Large land bank: Agile has one of the largest and most diverse land banks among the top five developers. It has 28.4 million sq m of GFA across 20 cities, sufficient for eight years of development. That should help dilute policy risk from any single market.</li> <li>■ Solid earnings growth: net income forecast to rise at a 46% three-year CAGR to about RMB3bn by FY08.</li> <li>■ Development completion accelerating: GFA of 1.6 million, 2.5 million and 3.1 million sq m will be completed in 2007-09 (vs. 1.1 million in 2006), representing a 41% three-year CAGR.</li> <li>■ Strong financial position: after the latest deal, we expected Agile will improve its net gearing to 20.6% in FY08F, about 40 ppts better than FY07. Overall, we believe Agile's low gearing can help it weather any worsening of the economic environment in 2008 and mean less impact from more monetary-tightening measures, such as further interest-rate hikes.</li> <li>■ Operational strengths: 1) strong execution, 2) expertise in the Guangzhou property market, and 3) high-quality products (large-scale community projects).</li> <li>■ Benefits from accelerating industry consolidation: recent austerity measures (including credit tightening, restricted land supply and the 70%, 90 sq m requirement) may accelerate industry consolidation. Large property developers would benefit.</li> <li>■ Expansion to other markets: Agile has expanded to other provinces, helping it increase brand awareness.</li> <li>■ Strong brand image: Agile has firmly established its brand name as a master community developer and is also well recognized by the market for its high-quality products and related property-management services.</li> <li>■ Expansion into non-residential property: Agile has started to expand its product range. It is building a five-star hotel in Shanghai and complex buildings, which will generate sustainable long-term profit.</li> </ul>	<ul style="list-style-type: none"> <li>■ Policy risks: More unexpected tightening policies targeting the property sector (e.g. faster-than-expected rate hikes, policies to curb presales, implementation of LAT), may dampen sentiment and slow property sales.</li> <li>■ The gross margin normalizing after 2009: the gross margin is set to fall to about 25% after 2009 (vs. 30% in 2007-09) as low-cost land bank (acquired pre-2007) gradually runs out.</li> <li>■ Potential oversupply: as cheap land bank runs out, developers need to roll out projects more aggressively to maintain profit growth. This plus the 70%, 90 sq m rule (effectively increasing the number of property units supplied) could lead to property oversupply after 2009.</li> <li>■ Expansion into unfamiliar markets: more time is required to understand new markets, which could slow property sales and increase operating risk.</li> <li>■ The possibility of increased competition in Guangdong.</li> <li>■ A potential slowdown in Guangdong: the Guangdong property market is more mature than other provinces, and demand for residential property may rise slower.</li> </ul>

Figure 8: Agile – Profit and Loss Statement

Year ended 31 Dec, RMBm	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR (%)
Revenue	5,370.6	6,675.2	10,312.3	14,282.1	22,184.0	42.6
COGS	(3,631.9)	(4,375.3)	(5,105.3)	(7,141.0)	(11,092.0)	32.2
Gross Profit	1,738.7	2,299.9	5,207.0	7,141.0	11,092.0	58.9
Operating expense	(267.4)	(376.7)	(617.0)	(912.1)	(1,613.6)	56.7
Other operating income	8.4	24.6	40.0	44.0	48.4	54.9
Operating profit	1,422.6	2,372.1	4,417.7	6,273.0	9,526.9	60.9
Finance expense	(9.9)	(48.5)	(63.2)	(98.5)	(101.4)	79.0
PBT	1,458.1	2,423.9	4,454.5	6,111.4	9,320.4	59.0
Tax	475.1	1,173.4	2,343.7	3,178.0	4,846.6	78.7
Net profit (core)	978.7	1,242.5	2,102.8	2,921.8	4,455.9	46.1
EPS –RMB fen (core)	38.6	35.5	56.1	78.0	119.0	32.5

Source: The Company and Sun Hung Kai Financial

Figure 9: Agile - Balance Sheet

Year ended 31 Dec, RMBm	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR (%)
Cash and securities	4,205.2	5,194.5	2,582.5	6,362.2	5,800.2	8.4
Accounts receivable	278.9	591.3	1,056.9	1,571.0	2,662.1	75.8
Inventory	2,971.3	3,619.3	6,401.7	9,283.3	13,754.1	46.7
Other current assets	1,275.0	4,584.2	13,116.3	8,454.6	12,203.8	75.9
Total current assets	8,730.4	13,989.3	23,157.4	25,671.1	34,420.2	40.9
Net fixed assets	871.8	3,462.4	5,384.4	6,730.5	7,403.6	70.7
Other long-term assets	18.2	32.1	164.1	180.1	194.2	80.8
Total assets	9,620.3	17,483.8	28,705.9	32,581.7	42,018.0	44.6
Short-term debt	507.5	651.2	1,375.1	1,650.1	1,732.6	35.9
Accounts payable	1,751.5	2,089.6	3,647.6	4,298.9	6,211.5	37.2
Other current liabilities	1,761.4	2,070.9	7,168.9	5,412.9	8,208.1	46.9
Total current liabilities	4,020.4	4,811.6	12,191.6	11,361.9	16,152.2	41.6
Long-term debt	778.2	4,708.4	6,647.3	7,312.0	8,335.7	80.9
Other long-term liabilities	311.6	579.5	833.3	1,285.4	1,996.6	59.1
Total liabilities	5,110.2	10,099.6	19,672.2	19,959.3	26,484.5	50.9
Shareholders equity	4,510.1	7,384.2	9,033.7	12,601.7	15,509.6	36.2
Minorities	5.9	14.7	18.8	20.7	23.8	41.6
Total equity and liabilities	9,620.3	17,483.8	28,705.9	32,561.0	41,994.1	44.5

Source: Bloomberg and Sun Hung Kai Financial

Figure 10: Agile - Key Ratios

Year ended 31 Dec	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR/ average (%)
<b>Growth ratios</b>						
Revenue growth – %	110.7	24.3	54.5	38.5	55.3	54.1
EBIT growth – %	288.7	66.8	86.2	42.0	51.9	91.9
Net-profit growth – %	330.0	27.0	69.2	38.9	52.5	81.3
EPS growth – %	324.2	(8.0)	58.0	39.0	52.5	67.2
<b>Profitability ratios</b>						
Gross margin – %	32.4	34.5	50.5	50.0	50.0	43.5
Operating margin – %	26.5	35.5	42.8	43.9	42.9	38.3
Net margin – %	18.2	18.6	20.4	20.5	20.1	19.6
ROAA – %	12.4	9.2	9.1	9.5	11.9	10.4
ROAE – %	37.4	20.9	25.6	27.0	31.7	28.5
<b>Other ratios</b>						
Operating exp/sales – %	5.0	5.6	6.0	6.4	7.3	6.1
Net debt/equity (net cash) – %	(64.7)	2.2	60.2	20.6	27.5	9.2
Inventory/sales – %	55.3	54.2	62.1	65.0	62.0	59.7
Effective tax rate – %	32.6	48.4	52.6	52.0	52.0	47.5
<b>ROAA component analysis</b>						
Revenue/average assets – %	68.2	49.3	44.7	46.6	59.5	53.6
COGS/average assets – %	(46.1)	(32.3)	(22.1)	(23.3)	(29.7)	(30.7)
Gross profit/average assets – %	22.1	17.0	22.5	23.3	29.7	22.9
Operating expenses/average assets – %	(3.4)	(2.8)	(2.7)	(3.0)	(4.3)	(3.2)
Other operating income/average assets – %	0.1	0.2	0.2	0.1	0.1	0.1
Operating profit/average assets – %	18.1	17.5	19.1	20.5	25.5	20.1
Finance expenses/average assets – %	(0.1)	(0.4)	(0.3)	(0.3)	(0.3)	(0.3)
PBT/average assets – %	18.5	17.9	19.3	19.9	25.0	20.1
Tax/average assets – %	6.0	8.7	10.1	10.4	13.0	9.6
Net profit/average assets – %	12.4	9.2	9.1	9.5	11.9	10.4
<b>ROAE component analysis</b>						
Revenue/average equity – %	205.0	112.2	125.6	132.0	157.8	146.6
COGS/average equity – %	(138.7)	(73.6)	(62.2)	(66.0)	(78.9)	(83.9)
Gross profit/average equity – %	66.4	38.7	63.4	66.0	78.9	62.7
Operating expenses/average equity – %	(10.2)	(6.3)	(7.5)	(8.4)	(11.5)	(8.8)
Other operating income/average equity – %	0.3	0.4	0.5	0.4	0.3	0.4
Operating profit/average equity – %	54.3	39.9	53.8	58.0	67.8	54.8
Finance expenses/average equity – %	(0.4)	(0.8)	(0.8)	(0.9)	(0.7)	(0.7)
PBT/average equity – %	55.7	40.8	54.3	56.5	66.3	54.7
Tax/average equity – %	18.1	19.7	28.6	29.4	34.5	26.1
Net profit/average equity – %	37.4	20.9	25.6	27.0	31.7	28.5

Source: Bloomberg and Sun Hung Kai Financial

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