新鴻基金融集團
SUN HUNG KAI FINANCIAL

Sector Report

Company and Industry Analysis

China Property Sector

11 Jun 2008

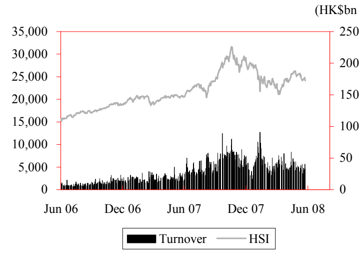
Uncertain Outlook

Last month's earthquake – which may further delay a slowdown in the CPI – has increased concerns that tightening measures would continue until 4Q08. In addition to the already tighter credit situation in the property sector and further unexpected interest-rate increases, this would have a major impact on buyers' appetites. The result may be lower sales volumes and a possible price war in the near future. So what are our recommendations if there is a further hike in interest rates? Our top property-stock picks remain developers with strong financial positions (even net cash), we also prefer high presales ratios and excellent land-bank locations.

HSI	**23,376**
HSCEI	**12,790**

Performance (%)	1m	3m	12m
HSI	(6.7)	3.9	14.0
HSCEI	(6.4)	1.5	18.1

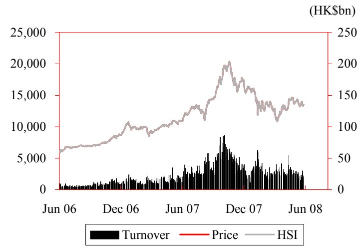
HSI Performance



Closing	23,376
52W high/low	31,958/19,387

Source: Bloomberg and Sun Hung Kai Financial

HSCEI Performance



Closing	12,790
52W high/low	20,609/10,253

Source: Bloomberg and Sun Hung Kai Financial

Property stocks have performed in line with the market

- Most China property stocks have performed in line with the equities market in the past few months, rebounding 20% after bottoming out in March. This was mainly driven by the FY07 results for most developers meeting or outperforming market expectations. The current market concern is that property prices and sales volumes might drop.

Current property market

- The latest property-market figures show varying performances across different cities and locations.

Implications: uncertain outlook

- We expected signs of a property-market recovery, following a few months of consolidation at the start of the year, and these were borne out in March and April. However, last month's earthquake – which may further delay a slowdown in the CPI – has increased concerns that tightening measures would continue until 4Q08.
- In addition to the already tighter credit situation in the property sector and further unexpected interest-rate increases, this would have a major impact on buyers' appetites. The result may be lower sales volumes and a possible price war in the near future.
- As such, we believe China property stocks as a whole face downgrade pressure and remain cautious toward the sector. We are especially wary of developers with weak financial positions, which we believe are at greater downside risk than those with strong finances and high presales ratios.

Worst-case scenario: select China property stocks with strong fundamentals

- So what are our recommendations if there is a further hike in interest rates? Our top property-stock picks remain developers with strong financial positions (even net cash), as they are less likely to suffer from cash-flow issues stemming from increases in interest rates and the RRR. We also prefer high presales ratios (as this limits the possibility of price drops) and excellent land-bank locations (which mean less price competition and as demand remains strong for central locations).

Christina Ngai
+ (852) 3761 1340
christina.ngai@shkf.com

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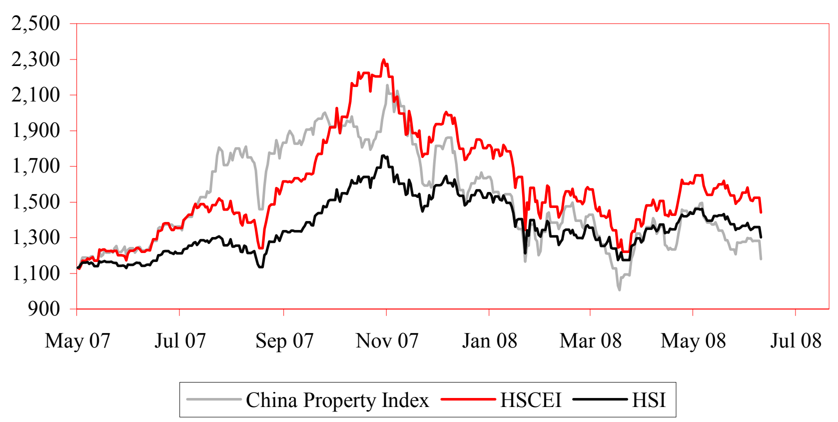
Latest Developments in the China Property Market

Property stocks have performed in line with the market

- Most China property stocks have performed in line with the equities market in the past few months, rebounding 20% after bottoming out in March. This was mainly driven by the FY07 results for most developers meeting or outperforming market expectations.

- In our previous sector report, *China Property Developers' Prospects in 2008,* published on 28 March, we noted that most developers would focus on completing presales in 2Q-3Q08. However, the current market concern is that property prices and sales volumes might drop. We see this as the main reason for property stocks recently performing in line with the HSI, compared with last year's outperformance.

Figure 1: Property-stock performances vs. the market



Source: Bloomberg and Sun Hung Kai Financial

Current property market

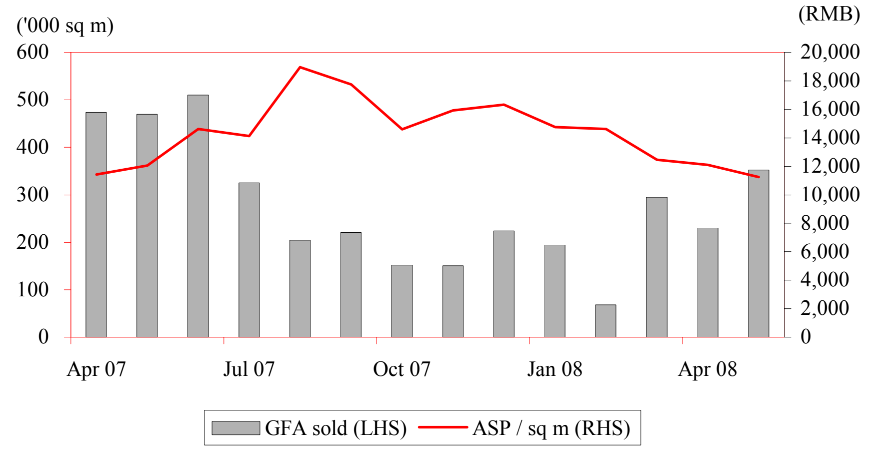
- The latest property-market figures show varying performances across different cities and locations.

- For example, prices have dropped 30-40% in Shenzhen since the peak last September. The property market seemed to stabilize in April and May, with sales volumes and ASPs returning to similar levels to April-May 2007.

- The Guangzhou ASP rebounded to more than RMB10,000/sq m in April after dropping below that level for three months. However, sales volume remains lower than for the same period last year.

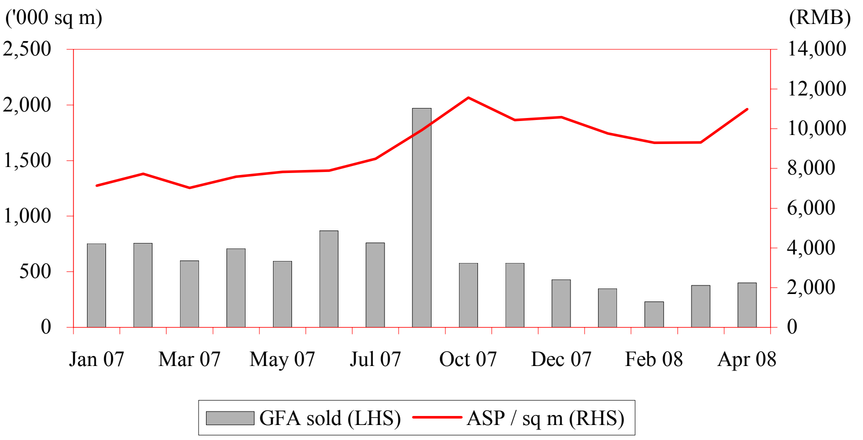
- Performances were also mixed among second-tier cities. Chongqing's March and April figures indicated a recovery, but this market was the worst hit by the Sichuan earthquake. That cut sales volume to a record low of 901 units in May, with a slight 1.3% fall in ASP (from sales volume of 10,003 units and a record-high ASP of RMB4,090/sq m in April).

Figure 2: Shanzhan Property Market



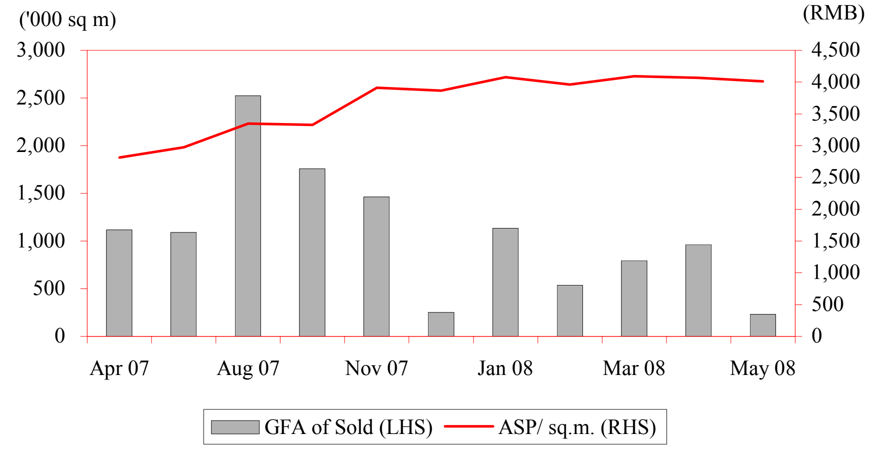
Source: Bloomberg and Sun Hung Kai Financial

Figure 3: Guangzhou Property Market



Source: Bloomberg and Sun Hung Kai Financial

Figure 4: Chongqing Property Market



Source: Bloomberg and Sun Hung Kai Financial

Implications: uncertain outlook

- We expected signs of a property-market recovery, following a few months of consolidation at the start of the year, and these were borne out in March and April. However, last month's earthquake – which may further delay a slowdown in the CPI – has increased concerns that tightening measures would continue until 4Q08. We expect CPI growth to slow from 3Q08, with tightening measures to ease from 4Q08.

- In our view, the surprise announcement of two hikes in the required-reserves ratio (RRR) for financial institutions in June (for a total 1-ppt rise), underlines the central government's priority is to cool the CPI this year. We expect further hikes to be much less frequent. But if CPI growth remains high, what would be the next tightening measure to contain inflation? That would be interest-rate hikes.

- In addition to the already tighter credit situation in the property sector and further unexpected interest-rate increases, this would have a major impact on buyers' appetites. The result may be lower sales volumes and a possible price war in the near future.

- As such, we believe China property stocks as a whole face downgrade pressure and remain cautious toward the sector. We are especially wary of developers with weak financial positions, which we believe are at greater downside risk than those with strong finances and high presales ratios.

Worst-case scenario: select China property stocks with strong fundamentals

- So what are our recommendations if there is a further hike in interest rates? Our top property-stock picks remain developers with strong financial positions (even net cash), as they are less likely to suffer from cash-flow issues stemming from increases in interest rates and the RRR. We also prefer high presales ratios (as this limits the possibility of price drops) and excellent land-bank locations (which mean less price competition and as demand remains strong for central locations).

- **COLI (688.HK, HK$13.58, Buy)** has pre-sold more than 50% of its FY08 sales target, and its gearing remains relatively low at about 30%. It also has a diverse range of projects in first- and second-tier locations. We hence see less impact on earnings from further interest-rate hikes and maintain our target price at HK$16.50, at par with our FY08F NAV estimate.

- **KWG (1813.HK, HK$6.89, Buy)** has strong finances, with net gearing set to stay low at about 1% for FY08. Presales have so far reached about 40% of its FY08 sales target, with many of its high-quality projects in CBDs. We estimate further interest-rate hikes would only lower its FY08F earnings about 6%. We have cut our target price 12.3% to HK$9.90, based on the worst-case scenario of rate hikes weakening market sentiment and cutting sales volume. Our new target price is based on a 25% discount to our FY08F NAV estimate and represents 12.5X FY08F earnings.

- **Shimao (813.HK, HK$11.70, Buy)** has strong finances in line with COLI, but relatively low presales at about 20% of our previous sales target. We have hence cut our top-line growth estimate 10% and our bottom-line forecast 9.6%. We now value the stock at a 30% discount to our FY08F NAV estimate to reflect the weakening market and further possibility of interest-rate hikes in 2008. This gives a new target price of HK$17.04 and represents 17.2X FY08F and 10.2X FY09F earnings.

- **Agile (3383.HK, HK$8.55, Buy)** has a solid financial position, with net gearing at 40-45%. Given its strong presales at about 45% of our sales target, we maintain our top-line growth estimate. We have cut our target price 6% to HK$12.26, as Agile's net gearing is higher than our top three picks. Our valuation is based on a 30% discount to FY08F NAV and represents 14.7X FY08F and 12.3X FY09F earnings.

Figure 5: Stock Performance

Stock Name	Stock Code	52-weeks high (HK$)	Last price (HK$)	Changes from 52-weeks high (%)	YTD changes (%)	FY08F PE (X)	FY09F PE (X)	NAV (HK$)	Premium/ (Discount) to NAV (%)	SHK Rating
National Developers										
China Overseas	688.HK	21.00	13.62	(35.1)	(15.5)	18.3	13.6	16.5	(17.5)	Buy *
Guangzhou R&F -H	2777.HK	45.60	17.90	(60.7)	(35.6)	10.9	8.5	23.5	(24.0)	Neutral
Shimao Property	813.HK	29.90	11.78	(60.6)	(40.8)	9.6	6.9	24.3	(51.6)	Buy *
China Res Land	1109.HK	22.40	13.00	(42.0)	(24.6)	23.8	14.3	20.0	(35.0)	Not Rated
China Vanke Co-A	000002.CH	40.78	17.70	(56.6)	(38.6)	14.7	9.8			
China Vanke Co-B	200002.CH	25.14	15.44	(38.6)	(23.8)	13.8	9.9			
Poly Real Esta-A	600048.CH	49.25	15.94	(67.6)	(50.8)	13.3	8.1			
China Merchants	200024.CH	31.00	13.96	(55.0)	(28.3)	9.9	6.4			
Regional - National Developers										
Agile Property	3383.HK	20.15	8.71	(56.8)	(38.7)	11.2	8.4	17.5	(50.2)	Buy *
Country Garden	2007.HK	14.18	5.43	(61.7)	(39.8)	12.3	9.4	12.0	(54.8)	Buy
Greentown China	3900.HK	19.72	8.00	(59.4)	(34.3)	8.3	5.9	15.0	(46.7)	Sell
Regional Developers										
Kwg Property	1813.HK	16.50	6.87	(58.4)	(40.3)	8.2	5.7	13.2	(48.0)	Buy *
Shanghai Forte L	2337.HK	7.00	2.69	(61.6)	(37.0)	9.6	7.2	5.5	(51.1)	Neutral
Shenzhen Invest	604.HK	8.00	3.28	(59.0)	(41.2)	7.3	4.9	8.0	(59.0)	Buy
Guangzhou Invest	123.HK	3.49	1.44	(58.7)	(37.1)	7.2	6.5	4.5	(68.0)	Neutral
Beijing North St	588.HK	8.10	2.72	(66.4)	(43.2)	19.7	12.7			Not Rated
Beijing Capital	2868.HK	7.80	2.45	(68.6)	(48.3)	9.5	5.3	7.5	(67.3)	Not Rated
Soho China Ltd	410.HK	11.98	4.62	(61.4)	(42.6)	9.7	8.5			Not Rated
Sino Ocean Land	3377.HK	15.60	6.12	(60.8)	(36.6)	11.4	8.9	9.8	(37.6)	Not Rated

* Our top picks
Source: Bloomberg and Sun Hung Kai Financial

Address:	1201 CITIC Tower, 1 Tim Mei Avenue, Central, Hong Kong
Phone :	(852) 3920 2888
Fax :	(852) 3920 2789
Web :	http://www.SHKFG.com

Head of Research		Alvin Chong
Equities Research Team	Analysts:	Desmond Chan
		Vivien Chan
		Jeff Kwan
		Christina Ngai
		Steven Wang
		Fiona Wong
		Eva Yip
		Michael Yuk

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