Sector Report

China Commercial Property
July 25, 2013

Sector rating: Overweight

Key data

Average 13E P/E (x)	7.9
Average 13E P/B (x)	0.7
Average 13E Dividend Yield (%)	4.6

Source(s): Bloomberg, ABCI Securities estimates

Contracted Sales (RMB bn)

Developer	2012	1H13
Franshion	10.5	7.3
SOHO	9.5	NA
China South City *	8.3	**2.2
Shui On Land	5.7	6.4

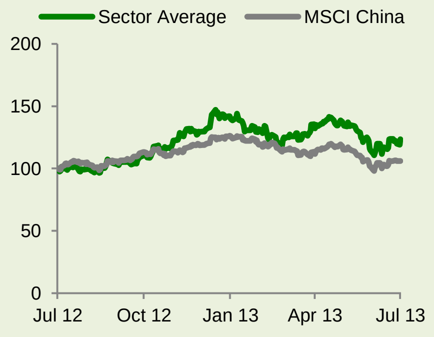
** in HK$*
***1Q figures*
Source(s): Company data

Sector performance (%)

	Absolute	Relative*
1-mth	(6.1)	(2.3)
3-mth	9.5	2.8
6-mth	14.9	(4.4)

**Relative to MSCI China*
Source(s): Bloomberg

1-year price performance



Source(s): Bloomberg

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Niche commercial developers as outperformers

Commercial property stocks outperformed the residential stocks by 14ppt during the period of 2009-13. These developers in general enjoy higher pricing power and margins than residential due to the lack of government intervention. The relatively small number of listed commercial developers also implies that their stock valuations are less likely to be affected by competition from similar peers in the equity market. Based on these reasons, we assign an "Overweight" rating for the commercial property sector. We initiate coverage on China South City (CSC, 1668 HK) and Franshion (817 HK) with a BUY rating. The former's niche development in large-scale trade and logistic parks and the latter's exposure to office market in tier-one cities enable both to generate sustainable and lucrative profits in the long run.

Share price less sensitive to policies. Commercial property stocks largely outperformed residential stocks during 2009-13 when a series of property tightening measures was implemented during the period. As of July 2013, commercial property stocks are on average 201% higher than its Jan-2009 level, outperforming residential stocks (+187%) by 14ppt.

Residential stocks: Too many players, too little differentiation. Over the past few years, a large number of China residential stocks have been listed in the Hong Kong stock market yet many are similar in business nature. As A-share IPOs are suspended, it is likely that more residential players will be listed in Hong Kong, stiffening the competition in the equity market. Given that only four commercial developers were listed since 2009, commercial sector is less likely to be affected by upcoming IPOs.

Higher pricing power and margins. Commercial developers can enjoy higher pricing power than their residential peers because of less government control. Driven by better ASPs, commercial developers' gross margins were in the range of 38%-58% in FY12, higher than most residential players.

China South City (CSC, 1668 HK) and Franshion (817 HK) as Top Picks. CSC enjoyed a low land cost of RMB 269/sqm as local governments encourage development of large-scale trade and logistics parks. FY13 gross margin (53%) and net margin (25%) of CSC were higher than industry leader China Overseas Land International (COLI, 688 HK). We recommend **BUY** for CSC with TP at HK$ 2.40. We recommend **BUY** for Franshion with TP at HK$ 2.90 on its exposure to its high-end office market in tier-1 cities, growing recurrent rental income and its SOE background that allows a favorable funding cost.

Risk factors: (1) Weaker property demand on slowing economy and (2) tightening liquidity in China.

Sector Valuation Summary

Companies	Ticker	Rating	Price (HK$)	Target (HK$)	Upside (%)	13E PER	13E PBV	13E yield
China South City	1668 HK	Buy	1.88	2.40	27.7	6.0	0.7	5.3
Franshion	817 HK	Buy	2.47	2.90	17.4	8.5	0.9	4.0

Source(s): Company, Bloomberg, ABCI Securities estimates

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Advantages of commercial property exposure

Overall, the commercial property counters are more defensive than its residential counterparts due to the following reasons:

1. **Minimal policy headwinds.** So far, commercial property counters have not been subjected to any purchase restrictions, as the government sees rising commercial property price less of a threat to (a) stable economic growth and (b) the development of asset bubbles.

2. **A growing number of residential property stocks.** The number of China residential property stocks has increased dramatically since 2009, while the number of commercial property stocks trading in the Hong Kong stock exchange has only grown by four since 2009.

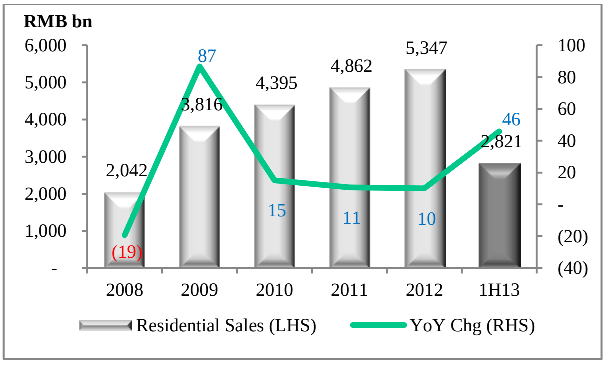
Reason #1 Minimal Policy Headwinds

ASP growth: Commercial beats residential

As a result of Home Purchase Restrictions (HPR) in the residential market, residential sales growth has been lagging behind the commercial . However, as government rolled out favorable mortgage policy for first-time homebuyers (with a 15% discount on PBOC rate), residential market rebounded faster than commercial in 2012 (Residential: +10% YoY; Commercial: +5% YoY) and 1H13 (Residential: +46% YoY; Commercial: +30% YoY).

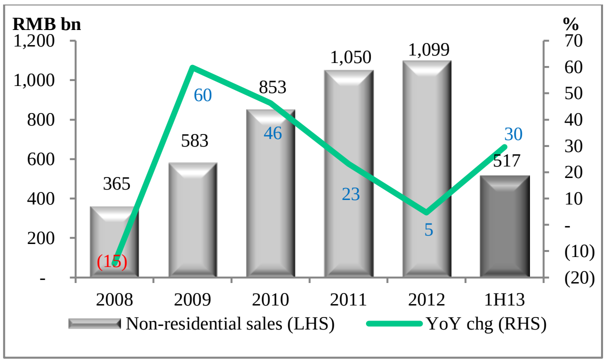
ASP of commercial properties, however, demonstrated stronger growth than residential ASP for most of the period since 2009. This can be attributed to strict residential pricing control implemented by the government. In general, commercial developers can exercise better pricing power than residential players.

Exhibit 1: China's first-hand residential property sales in 2008-1H13



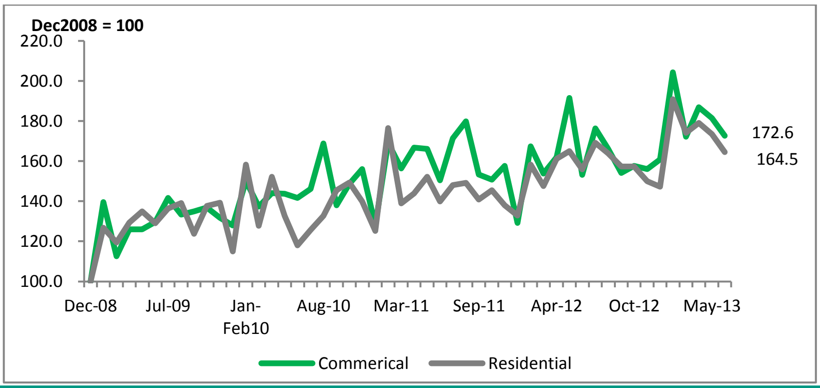
Source(s): NBS, ABCI Securities

Exhibit 2: China's first-hand commercial property sales in 2008-1H13



Source(s): NBS, ABCI Securities

Exhibit 3: Commercial property ASP showed stronger growth than the residential ASP (Dec 2008-Mar 2013)



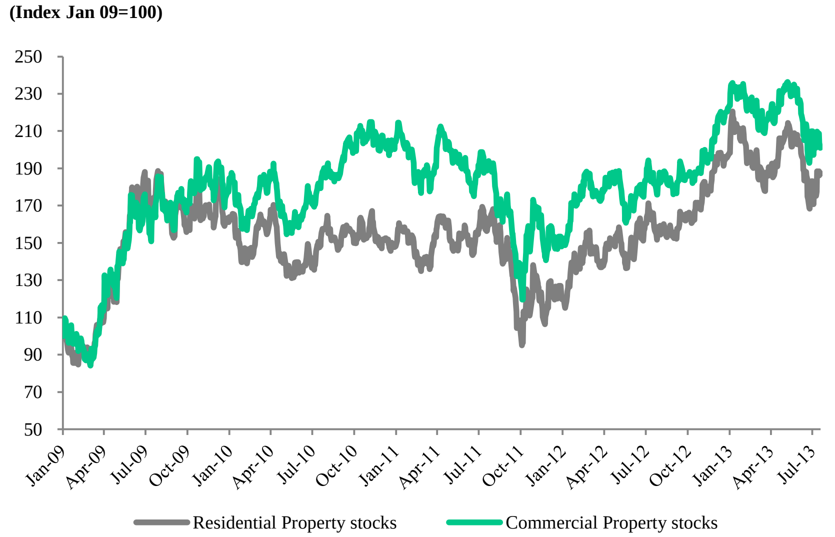
Source(s): NBS; ABCI Securities

Share price growth: Commercial beats residential

On the equity front, commercial property stocks have outperformed residential since 2009. On average, commercial property stocks (as of mid-July 2013) are 201% higher than its Jan-2009 level, outperforming residential stocks (which grew by 187% during the same period) by 14ppt. The performance gap was the widest in 2010 when introduction of HPR in the residential market took place.

In our view, policy risk has a bigger impact on stock market than the physical one- tightening policy rumors came out from time to time, diminishing investors' confidence on the residential stocks.

Exhibit 4: Equity performance of residential stocks vs. commercial stocks (Jan 2009-July 2013)



** Residential Market cap –total market cap of COLI (688 HK)/ Shimao (813 HK)/Country Garden (2007 HK)/ Agile (3383HK)*
***Commercial Market Cap- total market cap of CR Land (1109 HK)/ Hang Lung(101 HK/ Soho China(410 HK)/Franshion (817 HK)*
Source(s): Company; ABCI Securities

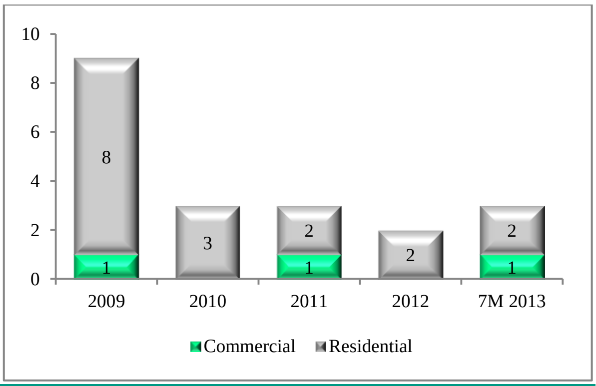
Reason #2 Too many residential plays in the market

Between 2009-1H13, there were 20 China property IPOs in Hong Kong, raising a total of HK$ 45.8bn. Eighty-seven percent of the IPOs were residential developers. Along the years, Hong Kong stock market has accumulated a large number of China residential property stocks, with many sharing a similar business model. Thus, differentiation among the residential stocks was rather limited.

Tight liquidity in China at the moment implies more residential players are likely to raise fund in Hong Kong (as A-share IPOs were suspended). The large number of China residential stocks could stiffen competition for funds in the equity market and drag down the valuations of property peers –the valuations of the IPOs that took place in 2013 may have reflected this possibility. Residential developer Modern Land (1107 HK),was valued at 4.8x FY12 PE and 0.98x FY12 PB, much lower than sector's average valuation of 7.9x FY12 PE while two other developers' IPOs in 2013 were also listed in the range of 5-7x PE. The overcrowding situation is augmented when A-share developers raised funds via asset injection to Hong Kong-listed shell companies (e.g. Vanke Overseas (1036 HK) by Vanke (000002 CH), Gemdale Properties (535 HK) by Gemdale (600383 CH) and Tonic Industries (978 HK) by China Merchants Property (000024 CH).

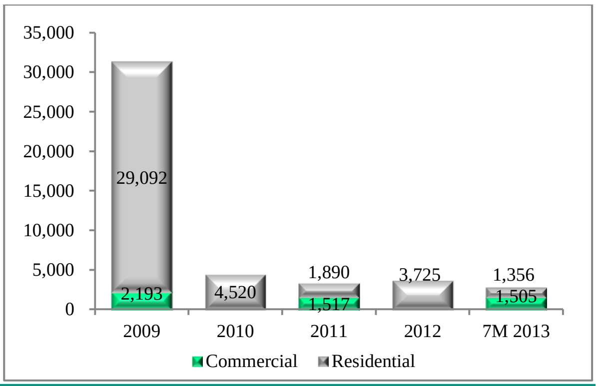
On the other hand, there were only four commercial developer IPOs during 2009-1H13. Moreover, these developers were mostly niche developers specializing in different sub-segments among each other in terms of geographic and strategy. In general, commercials property sector is facing much less competition than residential.

Exhibit 5: Number of IPOs by China developers



Source(s): HKEx, ABCI Securities

Exhibit 6: IPO proceeds raised by China developers (HK$ mn)



Source(s): HKEx, ABCI Securities

Exhibit 7: A list of China property developer IPOs

	Listing date	Company	Stock code	Total IPO proceeds (HK$ mn)	Developer
1	July 12, 2013	Modern Land	1107 HK	596	Residential
2	July 13, 2013	Wuzhou	1369 HK	1,505	Commercial
3	Jan 16, 2013	Golden Wheel	1232 HK	760	Residential
	Jan- July 2013			***2,861***	
1	Nov 29, 2012	Future Land	1030 HK	2,056	Residential
2	Nov 23, 2012	CIFI	884 HK	1,669	Residential
	2012 total			***3,725***	
1	Mar 23, 2011	Top Spring	1623 HK	1,560	Residential
2	July 13, 2011	Zall	2098 HK	1,517	Commercial
3	July 22, 2011	Sino Harbour Property	1663 HK	330	Residential
	2011 total			***3,407***	
1	Feb 5, 2010	China SCE Property	1996 HK	1,560	Residential
2	July 15, 2010	Tian Shan Development	2118 HK	350	Residential
3	Oct 7, 2010	Sunac	1918 HK	2,610	Residential
	2010 total			***4,520***	
1	Sep 30, 2009	China South City	1668 HK	2,193	Commercial
2	Oct 2, 2009	Glorious Property	845 HK	1,035	Residential
3	Oct 14, 2009	Powerlong	1238 HK	2,990	Residential
4	Nov 2, 2009	Yuzhou	1628 HK	1,620	Residential
5	Nov 5, 2009	Evergrande	3333 HK	6,500	Residential
6	Nov 13, 2009	Mingfa	846 HK	2,151	Residential
7	Nov 19, 2009	Longfor	960 HK	8,131	Residential
8	Nov 25, 2009	Fantasia	1777 HK	3,215	Residential
9	Dec 9, 2009	Kaisa	1638 HK	3,450	Residential
	2009 total			***31,285***	

(2009- Jul 2013)	**Number of IPO**		**Proceeds**	
	No.	**As % of total**	**HKDm**	**As % of total**
Commercial	3	15.0%	5,216	11.4%
Residential	17	85.0%	40,583	88.6%
	20	**100.0%**	**45,799**	**100.0%**

Source(s): HKEx, ABCI Securities

Cherry-picking the Commercial Developers

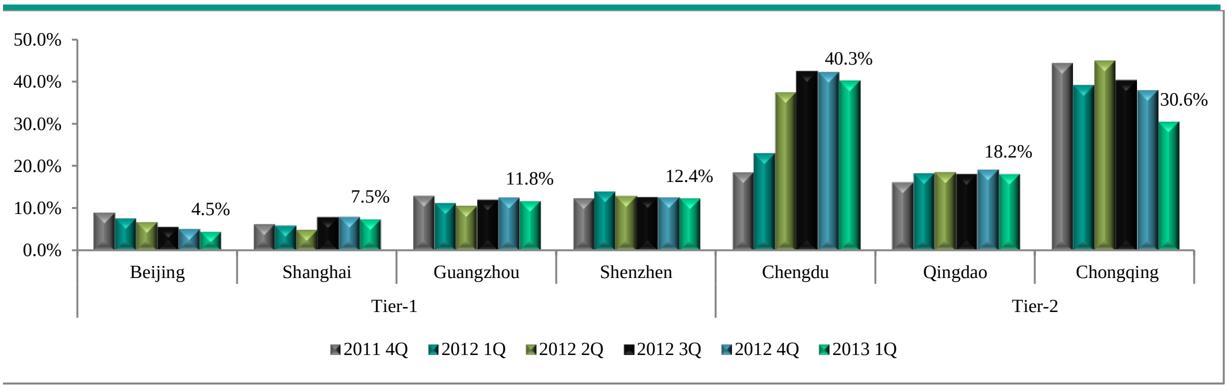
Within the commercial developers, we favor those with businesses operating in the niche sub-segments because of the limited number of competitors. In particular, we recommend commercial developers with exposure to:

- **Trade and logistic parks in lower-tier cities,** where demand is growing quickly due to urbanization. Also, competition is limited**;**
- **Grade A office in tier-1 cities,** due to limited land supply and low vacancy

Office: Vacancy rate remains healthy in tier-1 Office market

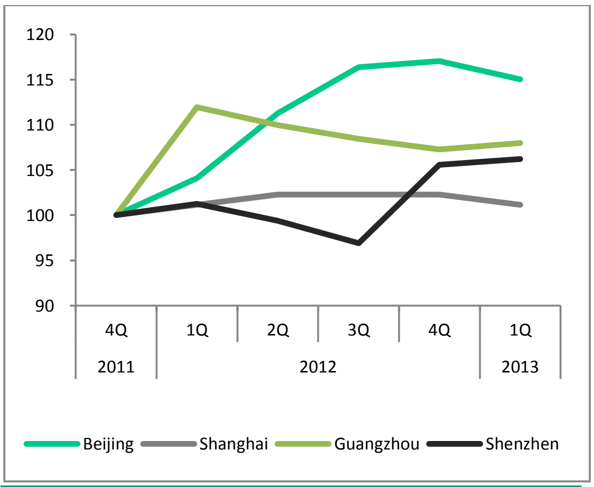
Vacancy rate in 1Q13 remained low at 4.5%-12.4% in tier-1 cities, compared to 18.2%-40.3% in tier-2 cities such as Chengdu, Qingdao and Chongqing. Despite a rental correction took place in most cities in 1Q13 on slowing economy (except in Guangzhou and Shenzhen where rent rose 0.7% QoQ and 0.6% QoQ, respectively), vacancies had dropped by 0.3%-7.5% QoQ across the seven cities in our samples. This indicates end-user demand remains solid though buyers are becoming more price-sensitive.

Exhibit 8: Office vacancies in tier-1 and tier-2 cities in 4Q11 – 1Q13



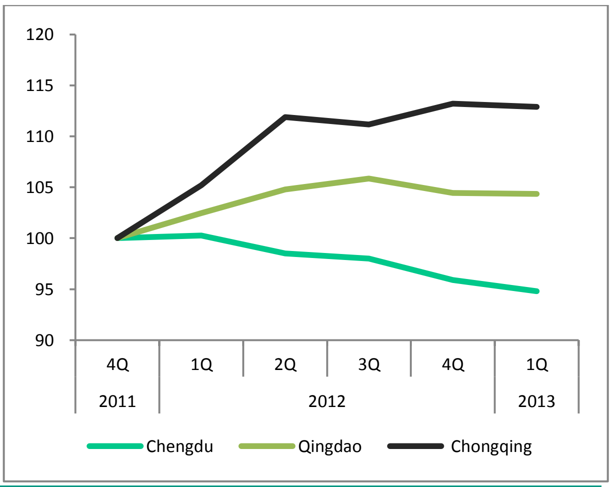
Source(s): Jones Lang LaSalle; ABCI Securities

Exhibit 9: Office rental index in tier-1 cities



Source(s): Jones Lang LaSalle; ABCI Securities

Exhibit 10: Office rental index in tier-2 cities

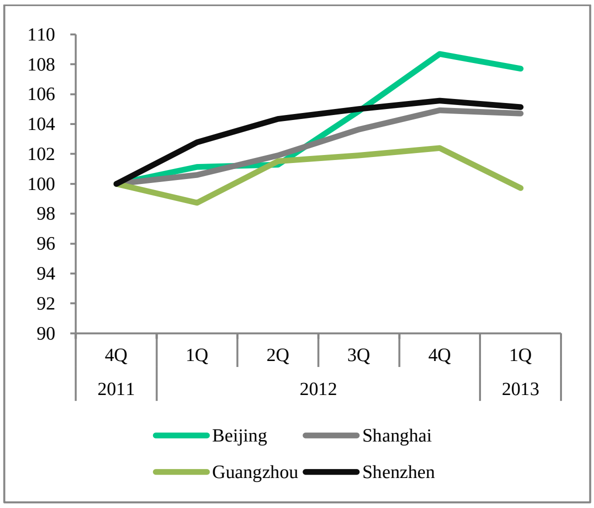


Source(s): Jones Lang LaSalle; ABCI Securities

Retail: Headwinds from luxury spending cut

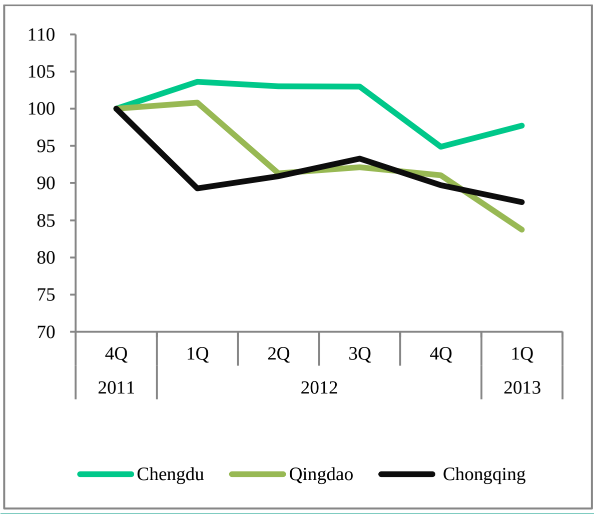
On the retail side, rental index was on a downtrend in tier-1 and tier-2 cities in 1Q13, as the government has aimed to reduce luxury spending since early 2013. As various retailers reported sluggish same-store sales growth in 2Q13 (e.g. Daphnes (210 HK): -13.7%; Belle (1880 HK): +0.5% for footwear & +2.5% for sportswear), retail properties demand is likely to weaken and we are cautious on the near-term prospect of this sector.

Exhibit 11: Retail rental index in tier-1 cities



Source(s): Jones Lang LaSalle, ABCI Securities

Exhibit 12: Retail rental index in tier-2 cities



Source(s): Jones Lang LaSalle, ABCI Securities

Trade & Logistics: a rising star

In contrary to tier-1 cities where finance and retail industries usually represent a large portion of GDP, SMEs engaging in trade & logistics industries represent a larger share of tier-2 and tier-3 cities' economy than first-tier cities. We see two key drivers for trade & logistics park development in China:

1. Government-led Urbanization Process

The large-scale trade centre development is led by local governments as a process to relocate SME-oriented specialized trade centres in prime locations to city outskirts. As urbanization takes place, the local governments prefer to reassign the prime locations for residential and office uses while easing the traffic congestion caused by the transport-intensive trade/logistics industries.

Exhibit 13: Urbanization Rate in China (2006-12)

	2006	2007	2008	2009	2010	2011	2012	2006-12 CAGR (%)
Urban Population (m)	583	606	624	645	670	691	712	**3.4**
Population (m)	1314	1321	1328	1335	1341	1347	1354	**0.5**
Urbanisation rate (%)	***44.4***	***45.9***	***47.0***	***48.3***	***50.0***	***51.3***	***52.6***	

Source(s): NBS

Both the local governments, SMEs and trade/logistics park developers will benefit from the trade/logistics park development. SMEs will be able to enjoy lower rents given the off-centre locations; the large-scale park would also increase buyer traffic after reaching a critical mass and become a one-stop purchasing centre. Moreover, the project developers usually can secure the land at a very low cost upon the support of local governments.

Exhibit 14: Trade/Logistics parks developments offer a winning solution for all

SMEs	Government	Developer
Incentives from government	***Benefit of SME's relocation***	***Incentives from government***
- compensation from government relocation	- Easing traffic in city centre	- Lower Land cost
	- Land sales of prime sites previously occupied by trade/logistic centre	
Benefit from the new trade/logistics parks		
- Lower rent		
- Critical mass to draw traffic		

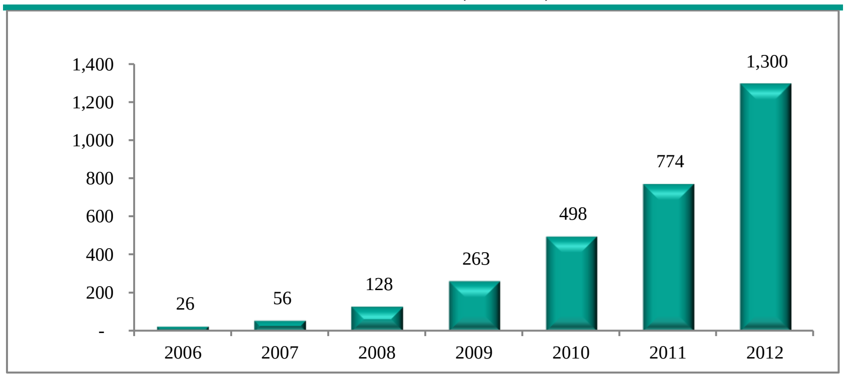
Source(s): China South City, ABCI Securities

2. Rising E-commerce Activities with ample room for growth

Growing online retail sales activities in China has reduced the need for retail stores to be located in prime locations. Relocation of retail shops could be the next key driver for trade and logistics demand in the near future. CSC's trade & logistics parks can offer SME retailers with limited affordability to enjoy efficient storage and logistics services in its off-centre trade & logistics park, often at a lower cost.

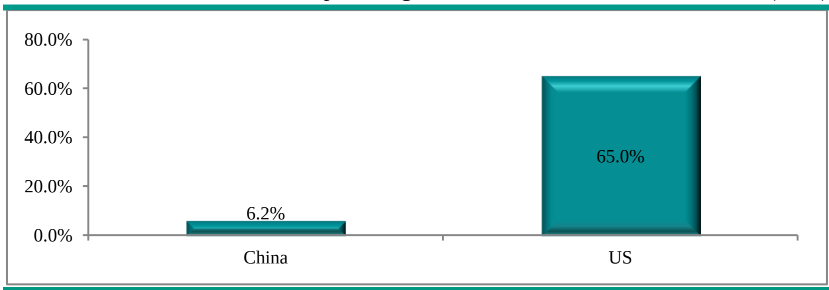
While China's online retail sales have grown almost 50 times from RMB 26bn in 2006 to RMB 1,300bn in 2012, online retail only accounted for 6.2% of total China's retail sales in 2012, according to iResearch Group. The figure was much lower than the 65% in the U.S. Thus, we believe the room for online retail sales growth is still ample - trade and logistic demand driven by expanding online retail sales will experience strong growth in the future.

Exhibit 15: China's online retail sales in 2006-12 (RMB bn)



Source(s): iResearch Consulting Group; Ministry of Commerce

Exhibit 16: Online retail sales as a percentage of total retail sales in China and U.S. (2012)



Source(s): iResearch Consulting Group

Prefer developers over landlords

We can largely classify commercial property players into two categories:

1) **Developers** (e.g. Franshion (817 HK) / China South City (1668 HK))- Developers in commercial properties segment build and pre-sell their projects in the same way as residential players
2) **Landlord** (e.g. Hang Lung Properties (101 HK), CRL (1109 HK))- Develop commercial properties for leasing to earn stable rental income

Exhibit 17: Major Commercial Properties players

	Landlord/ REIT				Developer			
	Hanglung Prop	CRL	Huixian	Yuexiu REIT	SOHO	Franshion	CSC	Shui On Land
Stock Code	101 HK	1109 HK	87001 HK	405 HK	410 HK	817 HK	1668 HK	272 HK
Sales breakdown (FY12)	**HKDm**	**HKDm**	**RMBm**	**RMBm**	**RMBm**	**HKDm**	**HKDm**	**RMBm**
Rental	**6,098**	**2,674**	**1,873**	**643**	**148**	**1,106**	**214**	**979**
- China	*3,082*	*2,674*	*1,873*	*643*	*148*	*1,106*	*214*	*979*
- Outside China	*3,016*	-	-	-	-	-	-	-
Hotel	**-**	**574**	**775**	**69**	**-**	**2,010**	**13**	**193**
Non-residential sales	**-**	**1,504**	**-**	**-**	**15,157**	**6,523**	**5,190**	**2,038**
Residential Sales	**-**	**37,018**	**-**	**-**	**-**	**4,274**	**1,988**	**1,747**
Other revenues	**-**	**2,593**	**-**	**-**	**-**	**3,263**	**82**	**135**
Total	**6,098**	**44,363**	**2,648**	**712**	**15,305**	**17,176**	**7,488**	**5,092**
% of total								
Rental	100%	6%	71%	90%	1%	6%	3%	19%
Hotel	0%	1%	29%	10%	0%	12%	0%	4%
Non-residential sales	0%	3%	0%	0%	99%	38%	69%	40%
Residential Sales	0%	83%	0%	0%	0%	25%	27%	34%
Other revenues	0%	6%	0%	0%	0%	19%	1%	3%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

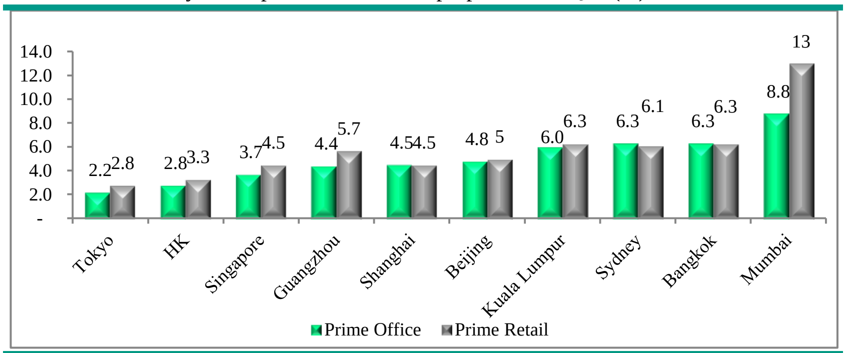
Source(s): Companies data; ABCI Securities

Decreasing asset yield; increasing funding cost

Compared to other regions, major cities in China such as Beijing and Shanghai have lower asset yields than most emerging markets in Asia. In our view, assets yield is low in China mainly due to stronger demand for self-owned than leased office/ shops.

Landlords choose to lease the properties rather than selling based on the rationale that rent would rise in the future, and relatively low borrowing cost would allow them to gain on the spread between the asset yield and funding cost. However, recent rental rate correction in the office/ retail markets in 1Q13 suggested otherwise.

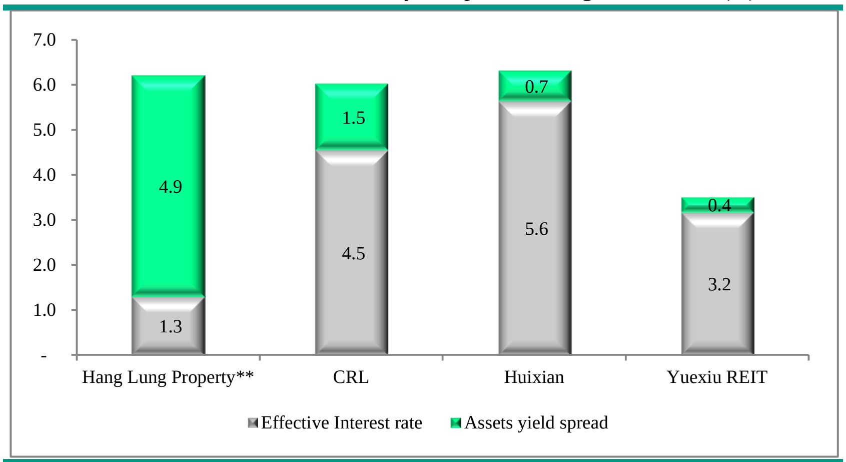
Exhibit 18: Market yield of prime office/ retail properties in 1Q13 (%)



Source(s): CBRE, ABCI Securities

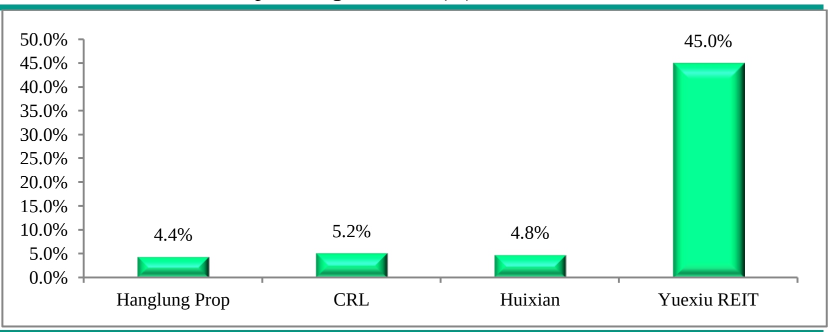
Besides, current borrowing rate for onshore bank loan for property developers is ~6.2%, which is high compared to office/retail market yield in the 4%-6% range. Against the backdrop of tightening liquidity in the Chinese banking system, further hikes in interest rate may erode the already low asset yield spread (gross rental income/ investment properties valuation - effective interest rate) among some players (e.g. 0.4% for Yuexiu REIT and 0.7% for Huixian REIT). As finance cost is not capitalized for landlords, rising finance cost has an immediate impact to their income statements.

Exhibit 19: Effective Interest rate and asset yield spread* among the landlords (%)



** Assets Yield Spread= Gross rental income/ Investment property valuation on balance sheet – effective interest rate*
*** Effective interest rate is low for Hang Lung due to its high proportion of offshore borrowing*
Source(s): Company, ABCI Securities

Exhibit 20: Finance cost as a percentage of EBIT (%)

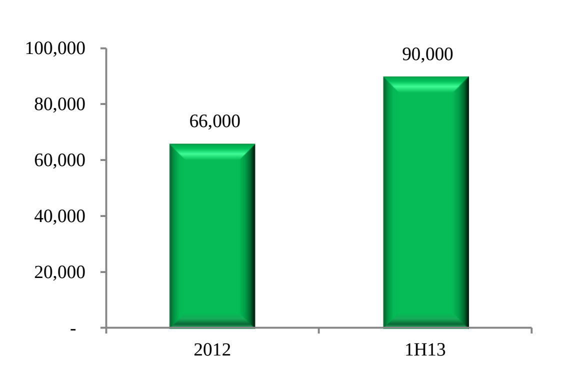


Source(s): Company data, ABCI Securities

Commercial developers demonstrates higher pricing power

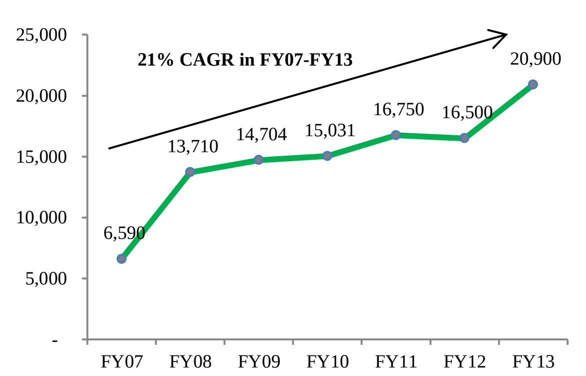
Developers in commercial property segment can enjoy higher pricing power as they are subjected to less government control than the residential peers. For instance, Franshion's Shanghai International Shipping Services Centre, a high-end office development in Shanghai, achieved a 36%ASP growth in 1H13 to RMB 90k/sqm compared to FY12. Besides, commercial players also enjoy higher margins. Commercial developers' gross margins were in the range of 38%-58% in FY12, higher than most residential players.

Exhibit 21: ASP of Franshion's Shanghai International Shipping Services Centre (RMB/sqm)



Source(s): *Franshion, ABCI Securities*

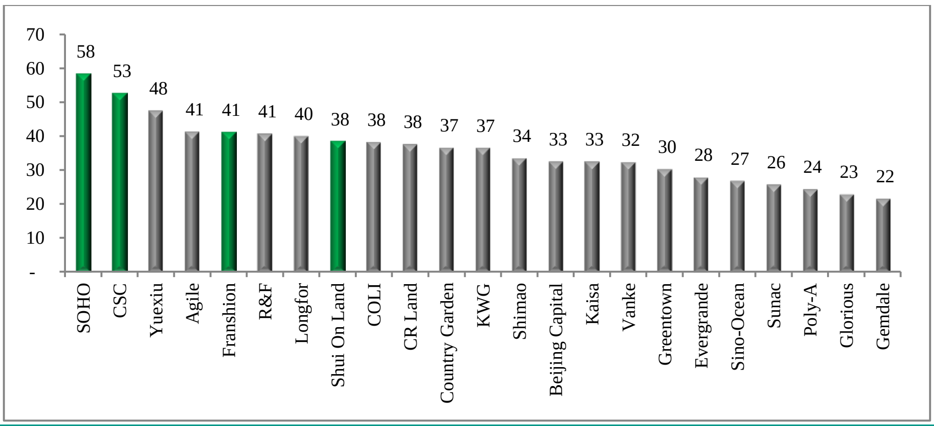
Exhibit 22: ASPs of China South City's Shenzhen project (RMB/sqm)



** China South City's fiscal year ended in Mar*

Source(s): *China South City, ABCI Securities*

Exhibit 23: GP Margin Comparison in FY12 (%)



** Mar-end FY13 and FY12 is used for CSC*

Source(s): *Company reports, ABCI Securities*

Among the major developers in commercial property segment, we are concerned about the changes that have recently taken place in SOHO China (410 HK) and Shui On land (272 HK). SOHO China has recently changed its business model from build-to-sales to build-to-lease model, while Shui On Land's Shanghai urban redevelopment projects have seen difficulties in relocation of local residents.

Stock Picks

We prefer commercial developers with exposure to trade & logistics park development and Grade A office in tier-1 cities. Thus, China South City (1668 HK) and Franshion (817 HK) stands out as our preferred picks.

China South City - Top Pick (BUY; TP HKD2.40)

- **Low land cost.** Weighted average land cost of CSC was only RMB 269/sqm as local governments encourage development of large-scale trade and logistics parks. FY13 gross margin (GP, 53%) and net margin (25%) were higher than the industry leader COLI (GP: 38%; net margin: 21%)

- **Phase development shortens payback period.** Larger projects are developed in multiple phases that allow shorter payback period. For example, a project with a GFA of 10 mn sqm is divided into multiple phases, and the Group will pay for the corresponding land premium based on the area being developed.

- **Disciplined sales strategy to improve ASP.** CSC usually reserves about half of the trade centres (in terms of GFA) as investment properties, while the rest is sold over a period of four to five years to attain better ASPs.

Overall, we forecast CSC's contracted sales and net profit to grow at a CAGR of 34% and 45%, respectively, in FY14E-16E.

Franshion Properties (BUY; TP HK$ 2.90)

- **Strong pricing power.** Leverage on its Jinmao brand, Franshion is able to register significant ASP improvement for its office projects. ASP of Shanghai International Shipping Services Centre (SISSC) rose by 36% from RMB 60k/sqm in 2012 to RMB 90k/sqm in 1H2013.

- **Rental income keeps growing.** Franshion generated HK$ 1.1bn of recurring rental income in 2012 from three major properties with a total GFA of 372k sqm in Beijing and Shanghai (Beijing Chemsunny, Jin Mao Tower, and Sinochem Tower). Due to the limited Grade A office supply in tier-1 cities, spot rent of these properties is 50-100% above passing rent in 2012.

- **Primary land development in Meixi Lake represents enormous earning potential.** Land transaction price in Meixi Lake jumped 23% to RMB 2,700/sqm in 1H13 vs. RMB 2,200/sqm in 2012, implying a 97% appreciation over the original cost of RMB1,300/sqm.

- **SOE advantage:** Backed by its SOE parent (Sinochem Group), Franshion can obtain a 5% discount to PBOC rate on 3-year loans in most Chinese banks.

Overall, we forecast Franshion's contracted sales and net profit to grow at 44% and 37% CAGR, respectively, in FY13E-15E.

Sector deserves higher valuation

Despite commercial developers trades higher valuation (7.9x 2013E PE) over residential (6.1x 2013 PE), we believe they deserve higher valuations given their lower exposure to policy risks. Valuation of CSC is the most attractive among commercial developers at 6.0x FY14E P/E, while shares of Franshion (8.5x FY13E P/E) also deserve premium given its high earning power and favorable funding cost made possible by its SOE background.

Exhibit 24: Peer valuation

	China Property	Ticker	Rating	Mkt cap	Share Price	Performance 1M	YTD	2012	Discount to NAV	2013E NAV	P/E 2012A	2013E	2014E	Yield (%) 2012A	2013E	2014E	P/B 2012A	2013E	2014E
				(HK$ bn)	(local ccy)	% Chg	% Chg	% Chg	(%)	(HK$)									
	Residential :																		
1	COLI	688 HK	BUY	179.0	21.90	15.4	(5.2)	76.1	(15.9)	26.05	11.2	9.2	7.3	1.9	2.2	2.7	2.1	1.7	1.5
2	CR Land	1109 HK	NR	121.2	20.80	9.8	(1.4)	70.4	(25.5)	27.93	16.0	13.1	10.4	1.6	1.9	2.4	1.8	1.5	1.3
3	Country Garden	2007 HK	NR	77.7	4.21	12.3	3.7	38.6	(31.0)	6.10	9.0	7.6	6.5	4.1	4.8	5.5	1.6	1.4	1.2
4	Longfor	960 HK	NR	62.4	11.46	(7.1)	(24.5)	76.5	(45.3)	20.95	9.1	7.8	6.7	2.2	2.5	3.0	1.6	1.4	1.2
5	Shimao	813 HK	NR	57.2	16.48	17.2	12.7	121.9	(44.3)	29.57	8.0	7.4	6.1	3.3	4.1	4.8	1.3	1.1	1.0
6	Evergrande	3333 HK	NR	51.0	3.18	13.2	(25.2)	31.6	(62.6)	8.50	4.2	4.7	4.0	-	5.3	6.0	1.0	0.8	0.7
7	Guangzhou R&F	2777 HK	NR	36.7	11.40	(1.4)	(11.6)	109.4	(55.5)	25.60	6.0	5.2	4.6	6.6	7.2	8.1	1.1	1.0	0.8
8	Agile	3383 HK	NR	28.0	8.13	(0.5)	(25.4)	55.9	(64.2)	22.73	4.5	4.5	4.0	4.7	5.3	5.9	0.9	0.7	0.6
9	Greentown	3900 HK	BUY	31.5	14.64	13.3	3.1	320.1	(54.5)	32.16	5.5	4.6	3.5	4.3	4.7	5.1	1.2	1.0	0.8
10	Sino Ocean	3377 HK	NR	23.7	4.04	(0.5)	(30.2)	64.0	(53.8)	8.75	6.8	6.8	5.6	5.8	5.9	6.7	0.5	0.5	0.5
11	COGO	81 HK	NR	21.3	9.35	(5.5)	0.3	47.2	(32.6)	13.87	8.9	7.4	5.9	1.2	1.6	1.9	2.7	1.9	1.5
12	Yuexiu Properties	123 HK	NR	18.5	1.99	4.7	(18.8)	122.7	(62.4)	5.29	14.1	7.3	6.1	3.3	4.6	5.6	0.7	0.6	0.6
13	Sunac	1918 HK	BUY	17.9	5.38	4.3	(10.3)	277.4	(66.0)	15.81	5.4	3.8	3.5	2.0	2.6	2.8	1.4	1.0	0.8
14	KWG	1813 HK	NR	12.7	4.38	4.0	(24.7)	121.3	(66.3)	13.00	5.3	4.3	3.7	4.3	5.6	6.4	0.7	0.6	0.5
15	Glorious	845 HK	NR	8.9	1.14	(6.6)	(21.9)	15.9	(67.4)	3.50	10.3	5.1	4.1	-	1.8	2.6	0.4	0.4	0.3
16	Kaisa	1638 HK	BUY	8.5	1.72	(7.0)	(28.3)	77.8	(65.6)	4.99	5.1	3.5	2.3	-	-	-	0.5	0.5	0.4
17	CIFI	884 HK	NR	7.9	1.37	0.7	(2.1)	5.3	(67.1)	4.17	6.8	4.4	3.3	3.6	4.7	6.3	1.0	0.8	0.6
18	BJ Capital Land	2868 HK	NR	5.8	2.80	(4.1)	(13.0)	109.1	(67.3)	8.56	5.4	3.5	2.6	8.4	9.3	12.4	0.8	0.5	0.4
	HK Listed Avg					**3.5**	**(12.4)**	**96.7**	**(52.6)**		**7.9**	**6.1**	**5.0**	**3.2**	**4.1**	**4.9**	**1.2**	**1.0**	**0.8**
	- Large cap (>HKD30b) avg					***10.1***	***(6.6)***	***69.2***	***(41.8)***		***9.6***	***8.3***	***6.8***	***2.2***	***3.5***	***4.1***	***1.6***	***1.3***	***1.1***
	- Small-mid cap (<HKD30b) avg					***0.1***	***(15.3)***	***110.5***	***(61.3)***		***7.0***	***5.0***	***4.1***	***3.7***	***4.4***	***5.3***	***1.0***	***0.8***	***0.7***
1	Vanke	000002 CH	NR	135.1	10.28	(3.1)	0.4	30.3	(32.4)	15.20	8.4	6.9	5.6	1.9	2.0	2.3	1.7	1.4	1.1
2	Poly-A	600048 CH	NR	90.4	10.66	(5.4)	(26.3)	39.6	(42.6)	18.57	8.5	6.6	5.2	2.3	2.9	3.8	1.7	1.4	1.1
3	China Merchants Property	000024 CH	NR	53.3	26.80	7.2	(12.1)	68.9	na	na	13.6	10.4	8.2	1.1	1.4	1.7	1.9	1.6	1.4
4	Gemdale	600383 CH	NR	38.2	7.20	1.4	(3.8)	46.3	(12.1)	8.19	8.9	8.1	6.7	1.2	2.3	2.6	1.3	1.2	1.0
	A-share Listed Avg					**0.0**	**(10.5)**	**46.3**	**(29.0)**		**9.8**	**8.0**	**6.4**	**1.6**	**2.1**	**2.6**	**1.6**	**1.4**	**1.2**
	Commercial:																		
1	SOHO China	410 HK	NR	30.9	6.40	6.1	2.9	21.5	na	na	8.0	7.8	11.1	4.9	5.0	4.7	0.8	0.8	0.7
2	Hui Xian REIT	87001 HK	NR	25.9	4.00	4.4	(3.6)	19.6	na	na	16.7	20.0	13.9	6.0	6.2	6.4	0.7	0.7	0.7
3	**Franshion**	**817 HK**	**BUY**	**22.6**	**2.47**	**2.5**	**(11.5)**	**103.6**	**(49.0)**	**4.85**	**12.4**	**8.5**	**6.6**	**2.8**	**4.0**	**4.9**	**1.0**	**0.9**	**0.8**
4	Shui On Land	272 HK	NR	18.6	2.32	2.7	(38.1)	55.6	na	na	55.7	9.4	7.9	2.6	3.9	4.1	0.3	0.4	0.4
5	Yuexiu REIT	405 HK	NR	11.3	4.12	1.0	12.0	7.3	na	na	11.8	34.3	25.1	6.5	7.1	7.3	0.7	0.7	0.7
6	**China South City**	**1668 HK**	**BUY**	**11.5**	**1.88**	**16.8**	**60.7**	**19.4**	**(68.2)**	**5.91**	**6.4**	**6.0**	**3.4**	**5.3**	**5.3**	**8.0**	**0.7**	**0.7**	**0.6**
7	Zall	2098 HK	NR	10.5	2.99	6.0	(3.9)	(5.2)	na	na	13.4	na	na	2.0	na	na	1.7	na	na
	Commercial Avg					**5.6**	**2.6**	**31.7**			**17.7**	**14.3**	**11.3**	**4.3**	**5.2**	**5.9**	**0.9**	**0.7**	**0.7**
	- Developers avg					***7.0***	***3.5***	***50.0***			***20.6***	***7.9***	***7.2***	***3.9***	***4.6***	***5.4***	***0.7***	***0.7***	***0.6***
	- Landlords/REIT avg					***2.7***	***4.2***	***13.4***			***14.2***	***27.1***	***19.5***	***6.2***	***6.6***	***6.9***	***0.7***	***0.7***	***0.7***

** The data in table is as at 24 July 2013*
Source(s): *Bloomberg, ABCI Securities estimates*

Company Report

China South City (1668 HK)

July 25, 2013

Rating: BUY

TP: HK$ 2.40

Initiation

Previous Rating & TP: NA
Previous Report: NA

Key Data

H-Share price (HK$)	1.88
Upside potential (%)	27.66
52Wk H/L(HK$)	1.93/ 1.05
Issued shares (mn)	6,054
Market cap (HK$ mn)	11,458
3-mth avg daily turnover (HK$ mn)	12.74
Major shareholder(s) (%):	
Cheng Chung Hing	40.35

Source(s): Company, Bloomberg, ABCI Securities

FY12 Revenue breakdown (%)

Property development	95.87
Property Investment	2.86
Property management	0.58
Hotels	0.18
Others	0.51

Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	15.5	6.8
3-mth	45.3	47.1
6-mth	48.8	60.6

**Relative to HSI*
Source(s): Bloomberg, ABCI Securities

1-Year price performance (HK$)

Source(s): Bloomberg, ABCI Securities

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Top developer in the Trade and Logistics niche

CSC's business model has not been fully understood by the market since its listing in 2009. Focusing on developing large-scale trade and logistics centres, the Group is able to secure land at a low cost and develop projects in phase to shorten payback cycle. Combined with its strategy of reserving half of the project as investment properties, CSC has been able to triple its underlying net profit from HK$0.4bn in FY10 to HK$1.8bn in FY13. Despite a good track record, its current share price is below its IPO level at HK$ 2.10. Strong earning potential and below-peer valuations at 6.0x FY14E P/E or 0.7x FY14E P/B prompt us to recommend BUY with TP at HK$2.40.

Lucrative business model. CSC's business model stands out among the average developers because of: (1) the low land cost. Weighted average land cost of CSC was only RMB 269/sqm, as local governments encourage development of large-scale trade and logistics parks; (2) larger projects are developed in multiple phases which allow shorter payback period.

Three earnings engines. We expect CSC's contracted sales to grow at a CAGR of 34% in FY14E-16E; rental revenue and ancillary services income will grow at a CAGR of 12% and 10%, respectively, for the same period.

Disciplined sales strategy. CSC usually reserves ~50% of each trade centre's GFA as investment properties, while the rest is sold over a period of four to five years to attain better ASPs.

Initiate CSC with BUY. We apply the DCF- model with a WACC of 13.5% to valuate the Group's property projects. Property development represents 96% of its Gross Assets Value (GAV), with investment property and hotels accounting for the rest (based on a 6% cap rate on net rental income and 5x EBITDA for hotels' valuation). We apply a 60% discount (in line with historical average since listing) to our NAV forecast to derive a TP of HK$ 2.40, which implies 7.2x FY14E P/E or 0.8x FY14E P/B (lower than peer average of 14.3x). We recommend BUY on CSC strong earning potential and below-peer valuation.

Risk factors: (1) Shares dilution by convertible bonds and (2) high volume of unsold units/vacancy may lead to slower cash in-flow.

FY ended Mar 31	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue (HK$ mn)	3,671	7,488	10,263	14,547	17,551
Chg (%,YoY)	*64.3*	*104.0*	*37.1*	*41.7*	*20.6*
Underlying Net Profit* (HK$ mn)	923	1,776	2,020	3,662	4,224
Chg (%,YoY)	*70.1*	*92.5*	*13.7*	*81.3*	*15.4*
Underlying EPS (HK$)	0.15	0.29	0.31	0.56	0.64
Chg (%,YoY)	*69.8*	*91.6*	*6.3*	*78.8*	*15.1*
BVPS (HK$)	2.16	2.63	2.86	3.31	3.80
Chg (%,YoY)	*22.7*	*21.7*	*8.6*	*15.7*	*14.9*
P/E (x)	12.2	6.4	6.0	3.4	2.9
P/B (x)	0.87	0.71	0.66	0.57	0.49
DPS(HK$)	0.08	0.10	0.10	0.15	0.20
Yield (%)	4.0	5.3	5.3	8.0	10.6
ROE (%)	7.1	11.2	11.7	18.4	18.5
ROA (%)	3.0	4.2	4.0	6.4	6.8

Source(s): Company, Bloomberg, ABCI Securities estimates (Rmb1.0=HK$1.26)
**Underlying net profit is calculated by deducting revaluation gain and one-time disposal gain from the Group's reported net profit*

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A Niche Developer

CSC is China's market leader in development of trade and logistics centres. CSC started its first project in Shenzhen back in 2002. Its current landbank exceeds 20mn sqm, with seven projects locating across China. CSC's projects are different from other developers in the following aspects:

(1) Bigger sizes, ranging from 2.6mn sqm in Shenzhen to 17.5mn sqm in Xi'an;

(2) Expertise required. Experiences in large-scale trade and logistics centre development projects are key prerequisites for the local governments to enter into master agreements with the developer prior to land acquisitions. This selection criterion weeds out numerous inexperienced developers.

Exhibit 25: CSC's landbank as of Mar 2013 (mn sqm)

Project	Completed Properties		Under Development	For Future Development	Total planned GFA	GFA for Land acquired	
(mn sqm)	*Sold*	*Unsold*		*Estimated*	*Estimated*		%
Shenzhen	0.6	1.2	-	0.8	**2.6**	**2.6**	100%
Nanchang	0.6	0.2	0.3	3.2	**4.3**	**4.3**	100%
Nanning	0.1	0.3	1.0	3.5	**4.9**	**2.5**	51%
Xi'an	0.2	0.4	0.3	16.6	**17.5**	**2.0**	12%
Harbin	0.0	0.0	0.7	11.3	**12.0**	**2.2**	19%
Zhengzhou	0.0	0.0	1.5	10.5	**12.0**	**4.2**	35%
Hefei	0.0	0.0	-	12.0	**12.0**	**3.9**	33%
Total	**1.4**	**2.1**	**3.8**	**57.9**	**65.3**	**21.8**	**33%**

Source(s): China South City; ABCI Securities

Exhibit 26: CSC Shenzhen

Source(s): China South City

Exhibit 27: CSC Nanchang

Source(s): China South City

Exhibit 28: CSC Harbin

Source(s): China South City

Exhibit 29: CSC Xi'an

Source(s): China South City

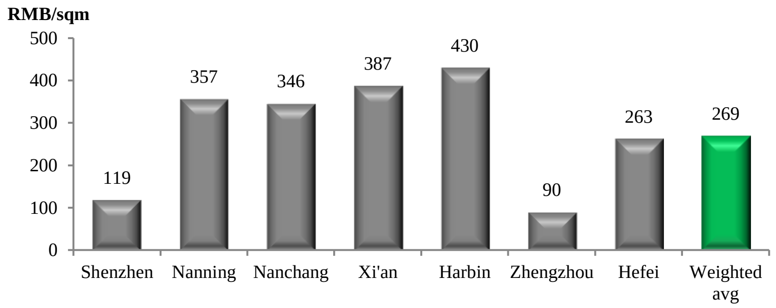
Lucrative business model

CSC's business model that specializes in the development of trade and logistics centres is highly lucrative in our view because of:

1. Low land cost. Owing to local governments' strong initiatives to develop large-scale trade & logistics parks, CSC has been able to secure projects at a very low land cost. Weighted average land cost of CSC's landbank is only RMB 269/sqm, representing only 3% of ASP (vs. industry average of 10%-20%). As a result, CSC has a gross and net margin of 53% and 25%, respectively, even higher than the property industry leader COLI (688 HK)

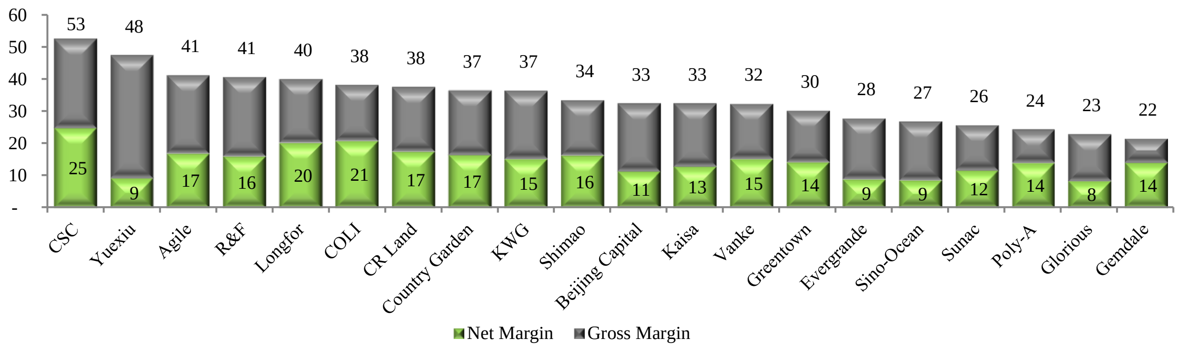
2. Phase development shortens payback period. Larger projects are developed in multiple phases. For example, a project with a GFA of 10 mn sqm is divided into multiple phases, and the Group will acquire and develop the area accordingly. CSC can sell the properties under development in one phase before investing in other phases of the project, thus the payback period is much shortened. For example, the RMB 1bn and RMB 3.7bn land and construction costs in FY04 (Phase 1) and FY10 (Phase 2) in its Shenzhen projects were fully recovered by FY07 and FY12, respectively.

Exhibit 30: Low-cost Landbank (as of Mar 2013)



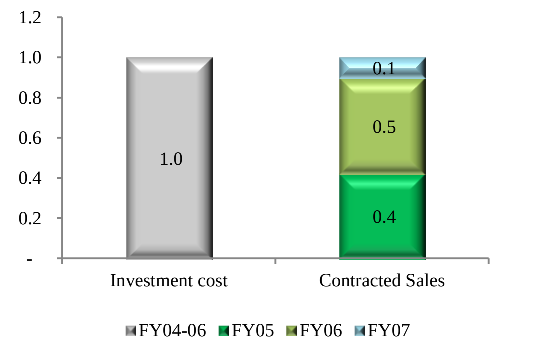
Source(s): China South City; ABCI Securities

Exhibit 31: Above-sector average gross & net margins in FY12 (%)



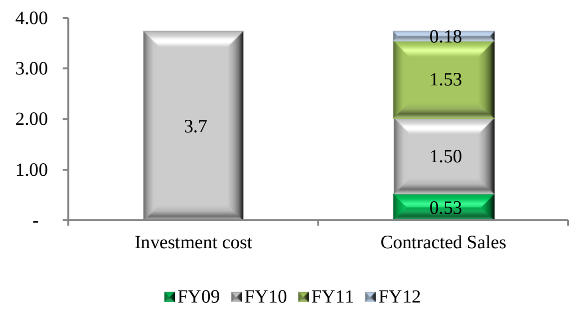
**Revenue adjusted for business tax for CSC*
*** Gross/Net Margin as at FY13 for CSC; Rest as at FY12*
Source(s): Company data, ABCI Securities

Exhibit 32: CSC Shenzhen Phase I- cost recovery in 4 years (HK$ bn)



Source(s): China South City, ABCI Securities

Exhibit 33: CSC Shenzhen Phase II- cost recovery in 4 years (HK$ bn)



Source(s): China South City, ABCI Securities

Two Key drivers for Trade and Logistics centre demand

1. Government-led Urbanization Process

The large-scale trade centre development is led by the local governments as a process to relocate SME-oriented trade centre in prime locations to city outskirts. As urbanization takes place, the governments prefer to free up land resources in prime locations for residential and office development while easing traffic congestion caused by the transport-intensive trade and logistics industry.

Exhibit 34: Urbanization rate in 2006-12

	2006	2007	2008	2009	2010	2011	2012	2006-12 CAGR (%)
Urban Population (m)	583	606	624	645	670	691	712	**3.4**
Population (m)	1314	1321	1328	1335	1341	1347	1354	**0.5**
Urbanization rate (%)	***44.4***	***45.9***	***47.0***	***48.3***	***50.0***	***51.3***	***52.6***	

Source(s): NBS

Both the governments, SMEs and trade & logistics developers will benefit from such development. SMEs will be able to enjoy lower rent and more visitations from potential buyers, given the large-scale park reach a critical mass and become a one-stop purchasing location to draw traffic. Given its expertise in trade/logistics centre development, CSC will be able to secure sites at a low cost from government.

Exhibit 35: A winning solution for all

SMEs	**Government**	**CSC**
Incentives from government - Relocation compensation from government ***Benefit from large-scale trade & logistics centres*** - Lower rent - Critical mass to attract traffic	***Benefit of SME's relocation*** - Easing traffic in city centres - Land sales from prime sites previously occupied by trade/logistics centre	***Incentives from government*** - Lower Land cost

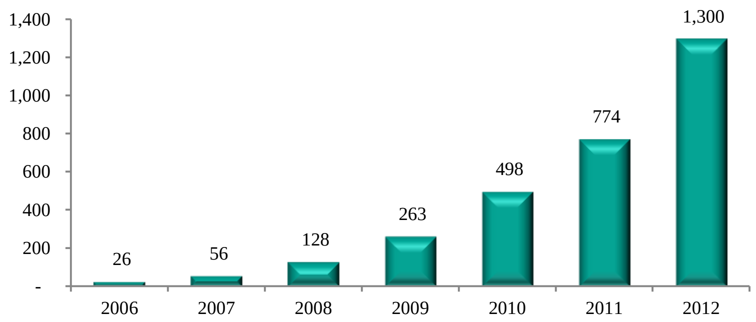
Source(s): China South City, ABCI Securities

2. Rising E-commerce Activities

Growing online retail sales activities in China has reduced the need for retail store to locate at prime locations. Relocation of retail stores could be the next key demand driver for trade and logistics centres. SME retailers that are unable to afford high rent in the city centres can enjoy lower rents and efficient storage and logistics costs in CSC's trade & logistics parks.

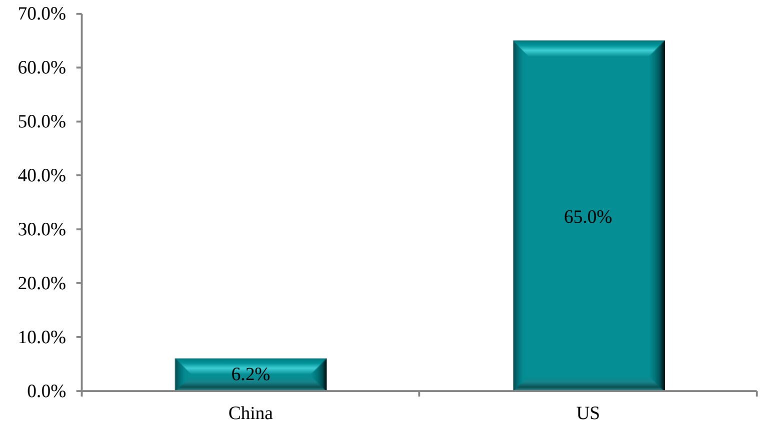
China's online retail revenue has grown almost 50 times from RMB 26bn in 2006 to RMB 1,300bn in 2012. According to iResearch Group, online retail sales only account for 6.2% of total China's retail sales in 2012, much lower than the 65% in the U.S. Thus, we see huge demand potential for trade and logistics centres and services driven by the fast-growing online retailers.

Exhibit 36: China's online retail sales in 2006-12 (RMB bn)



Source(s): iResearch Consulting Group, Ministry of Commerce

Exhibit 37: China and US online retail sales as a percentage of total retail sales in 2012



Source(s): iResearch Consulting Group

In fact, CSC has been able to capture such demand via its logistics services operation. Currently logistics services are only available in CSC Shenzhen, which provides services such as warehousing, freight forwarding, on-site third-party delivery, etc. Logistics services should extend to Nanning, Nanchang, Xi'an and Zhengzhou in 2014.

Strong relocation demand- CSC Zhengzhou as an example

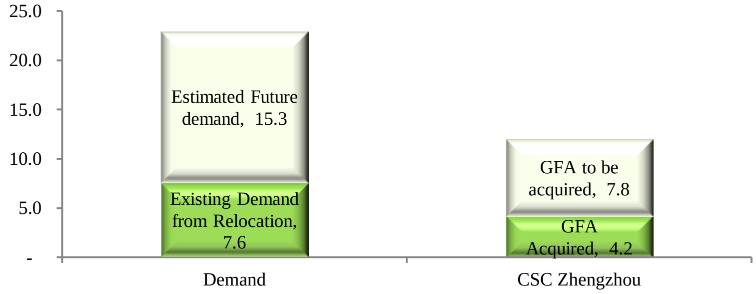
Take CSC Zhengzhou as an example- existing relocation demand (7.6m sqm) should more than satisfy the 4.2m sqm GFA acquired by CSC. The estimated future demand of 15.3mn sqm GFA over the longer term will be accommodated by 7.8mn sqm GFA under further land tendering.

Exhibit 38: Key metrics of CSC Zhengzhou

Demographics*		**Relocation Demand**	**Location and Quality of Site**
Population (m)	9.031	**Zhengzhou municipal government relocation plan:** 2012-2015	**Zhengzhou:**
Urban Population (m)	5.986		Capital city of Henan Province
GDP (RMB bn)	554.7	**Target:** Relocate 177 wholesales markets out of 3rd ring of city	2nd Eurasian Continental Bridge- China Section
YoY %	*12%*		One of 7 major highway hubs in China
GDP per Capita (RMB)	63,328	**GFA to be dismantled:** 7.63m sqm	
YoY %	*19.6%*		**CSC Zhengzhou:**
			30-min drive to international airport
			Adjacent to Beijing Guangzhou Railway Freight Station
			A few km away from Beijing-HK-Macau Highway

** Figures as at 2012*
Source(s): China South City

Exhibit 39:Relocation Demand vs. Supply from CSC Zhengzhou in 2012 (sqm,mn)



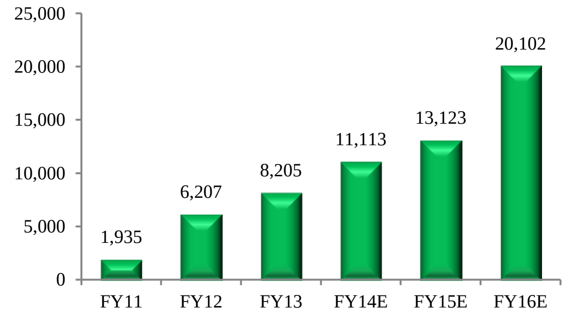
Source(s): China South City, ABCI Securities

Three earnings engines

For the past few years, CSC has successfully replicated its one-body-two-wings (一体两翼) strategy (50% of GFA as trade centre, 25% as residential 25% as commercial facilities) in Shenzhen to other cities. We expect revenue growth in the three segments to accelerate because of:

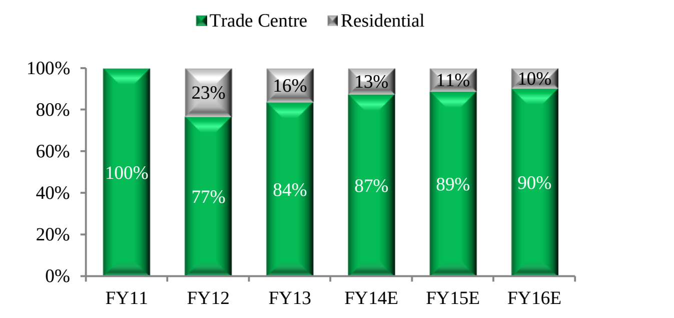
1. Rising contracted sales at 34% CAGR in FY14E-16E
CSC's contracted sales have been impressive, growing at a CAGR of 106% in FY11-13. Sales in 1Q14 remained strong and grew 162% YoY to HK$ 2.2bn. We expect CSC's contracted sales to grow 32% YoY to HK$ 11.1bn in FY14E, in line with its target of HK$ 11bn. With the upcoming Hefei project (Total GFA: 3.9mn sqm; estimated ASP: RMB 8k/sqm), acquired in May 2013, presale should start as soon as 2014, and we forecast contracted sales to be boosted further.

Exhibit 40: Contracted Sales Forecast (HK$, mn)



Source(s): China South City, ABCI Securities estimates

Exhibit 41: Contracted sales- residential vs. trade Centre

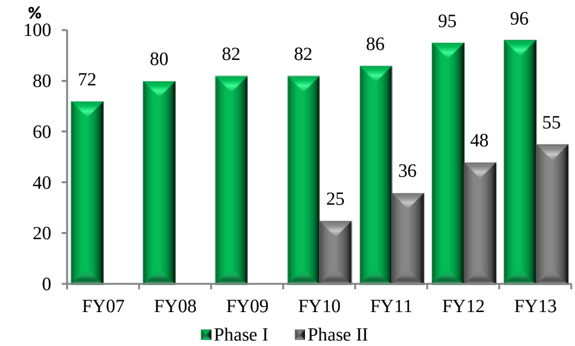


Source(s): China South City, ABCI Securities estimates

2. Expanding Rental portfolio
CSC currently holds a rental portfolio of 0.6mn sqm GFA in Shenzhen for leasing. Phase 1 has reached the mature stage with a 96% occupancy rate and a rising rent rate (FY13: RMB 40/sqm/mth, +14% YoY), while Phase 2 has an occupancy rate of 55%.

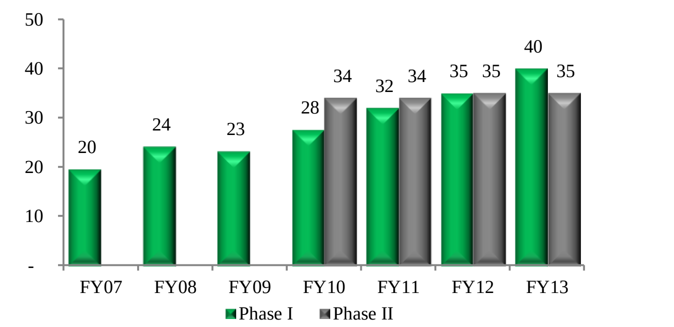
Going forward, as GFA of rental portfolio will increase upon completion of new projects (CSC tends to retain 50% of trade centres for lease). We expect rental revenue to grow at 12% CAGR in FY14E-16E

Exhibit 42: Occupancy rate of CSC Shenzhen (%)



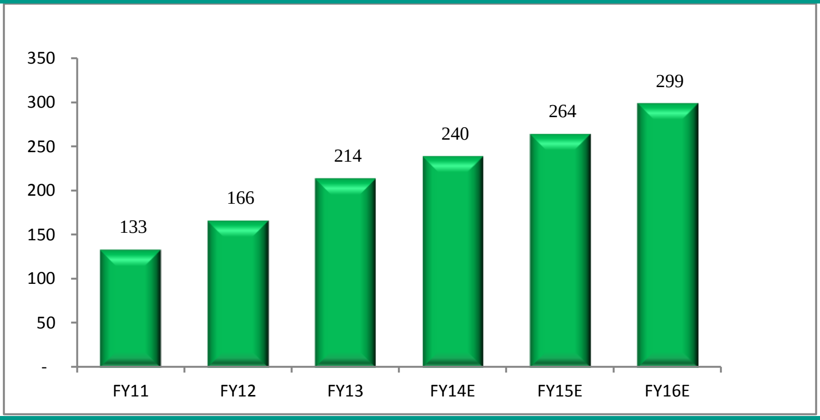
Source(s): China South City, ABCI Securities

Exhibit 43: Rent Rate of CSC Shenzhen (RMB/sqm)



Source(s): China South City, ABCI Securities

Exhibit 44: CSC's rental income in FY11-16E (HKD mn)



Source(s): China South City , ABCI Securities estimates

3. Other Ancillary Services

Apart from property sales and rental, CSC also provides five major ancillary services, including (1) outlet operation and management, (2) e-commerce, (3) logistics, (4) property management, and (5) convention & exhibition services. Of which e-commerce and logistics services should benefit most from rising online retail activities and may serve as key drivers of CSC's ancillary services in our view.

Exhibit 45: Five Major Ancillary Services

	Operations	Details
1	Outlet Operation and Management	CSC Shenzhen - Began operation in Apr 2011 - Located in Phase II trade centre Other projects: - Trial operation in Nanning, Nanchang and Xi'an in FY14 - Offering over 100 brands
2	E-Commerce	- B2C/ B2B platform with 195k registered users
3	Logistics	- Available in CSC Shenzhen currently - provides warehousing, freight forwarding, on-site third party delivery etc. - Logistics services should extend to Nanning, Nanchang, Xi'an and Zhengzhou in FY14E
4	Property management	- Committed to differentiating CSC projects from old wholesale markets
5	Convention & Exhibition	- A special team to outreach in major trade fair across China

Source(s): China South City, ABCI Securities

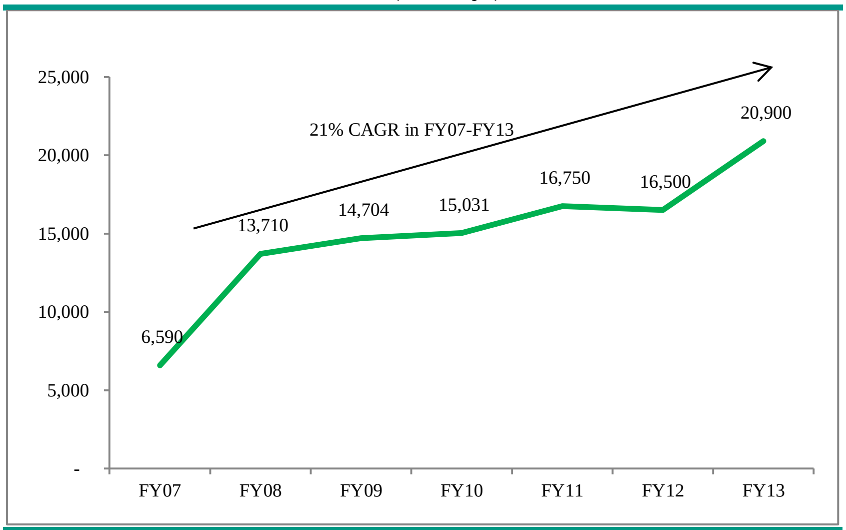
Success replicable in Tier-2 cities?

CSC has demonstrated an impressive contracted sales record over the past few years. However, market has concerns over the sustainability of such large-scale development model in tier-2 cities, as sales in later phases could diminish on declined purchase enthusiasm.

Disciplined sales strategy generated good returns for buyers

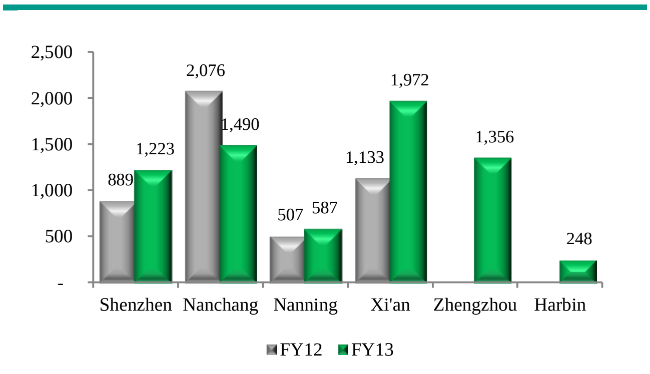
CSC reserves about 50% GFA of trade centres as investment properties, while launching the rest for sales over a period of four to five years to enjoy better ASP. The above measures avoid oversupply in the market to support ASP, as demonstrated by CSC Shenzhen. Good investment returns in early phases could reassure potential buyers and generate sales momentum in subsequent phases.

Exhibit 46: ASP Trend for CSC Shenzhen (RMB/sqm)



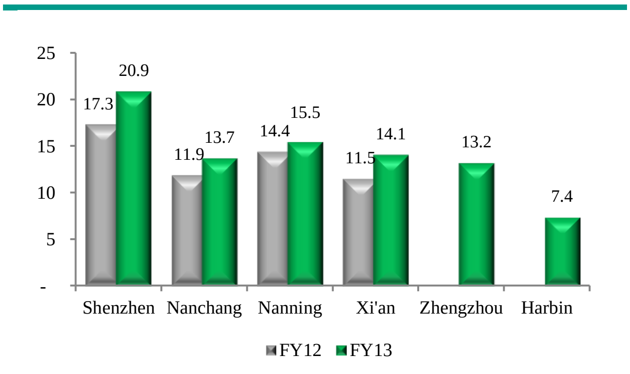
Source(s): China South City, ABCI Securities

Exhibit 47: Contracted Sales of trade centre by location (RMB mn)



Source(s): China South City , ABCI Securities

Exhibit 48: Contracted ASP of trade centre by location (RMB k/sqm)



Source(s): China South City, ABCI Securities

Replicable model in Tier-2 cities

While CSC's existing landbank of ~20m sqm is sufficient for development in the next 15 years, the Group will be able to secure new projects to drive future growth. The number of projects for sales increased from only two in FY11 to six in FY13. As CSC secured the Hefei projects and acquired the first batch on land in May 2013, the number of projects on sales will increase further to seven in FY14E.

Exhibit 49: CSC's projects for sales

Year	Projects for Sales						Total
FY11	Shenzhen	Heiyuen					2
FY12	Shenzhen	Heiyuen	Nanchang	Nanning	Xi'an		5
FY13	Shenzhen	Nanchang	Nanning	Xi'an	Zhengzhou	Harbin	6

Source(s): China South City, ABCI Securities

Strengths over peers on project acquisition and scale

We have seen CSC's stronger financial performance as compared to peers for past few years:

Zall (2098 HK) is a developer and operator of large-scale, consumer product-focused wholesale shopping malls and commercial properties in China. Zall's booked sales dropped by 39% YoY (CSC: up 104% YoY) in FY12 to RMB 1.5bn. Despite the Group has a higher gross margin of 73% (due to exceptionally low land cost of their North Hankou project), sales momentum gradually declined as Zall failed to secure new projects for sales in other cities. The North Hankou project and the No. 1 Enterprise Community in Wuhan are only selling projects since IPO in FY11 (CSC's number of projects increased from two in FY11 in to five in FY12). In our view, slow geographic expansion is the major reason for Zall's fallen sales.

Wuzhou (1369 HK) is a property developer engaging in the development and operation of multi-functional commercial complexes. Despite registering a healthy topline growth, the Group only achieved a net margin of 13-14% (CSC: 22-26%) in FY11-12 mainly due to the lack of economies of scale. Wuzhou's SG&A expenses represented 22.4% of its total revenue (~RMB 500m), higher than the 11% for CSC.

In comparison, CSC is able to maintain sustainable sales growth with high margin due to 1) fast geographic expansion & 2) economies of scale, in which both Zall and Wuzhou are lacking of.

Exhibit 50: Peer Comparison

	CSC			Zall			Wuzhou		
Ticker		**1668 HK**			**2098 HK**			**1369 HK**	
Year eneded		**Mar**			**Dec**			**Dec**	
	FY11	**FY12**	**FY13**	**FY10**	**FY11**	**FY12**	**FY10**	**FY11**	**FY12**
	HKDm	HK$ mn	HK$ mn	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn	RMB mn
Revenue	**2,234**	**3,671**	**7,488**	**770**	**2,454**	**1,490**	**876**	**1,516**	**2,253**
YoY Chg %		*64%*	*104%*		*219%*	*(39%)*		*73%*	*49%*
Gross Profit	**1,333**	**2,236**	**4,177**	**357**	**1,739**	**1,083**	**390**	**739**	**1,201**
YoY Chg %		*68%*	*87%*		*388%*	*-38%*		*90%*	*62%*
Gross margin	*59.7%*	*60.9%*	*55.8%*	*46.3%*	*70.9%*	*72.7%*	*44.5%*	*48.8%*	*53.3%*
EBIT	**1,013**	**1,698**	**3,351**	**292**	**1,586**	**858**	**160**	**436**	**722**
YoY Chg %		*68%*	*97%*		*444%*	*-46%*		*172%*	*66%*
EBIT margin	*45.4%*	*46.3%*	*44.8%*	*37.9%*	*64.6%*	*57.6%*	*18.3%*	*28.8%*	*32.0%*
Underlying Net profit	**542**	**923**	**1,776**	**165**	**1,003**	**628**	**71**	**203**	**321**
YoY Chg %		*70%*	*93%*		*507%*	*-37%*		*185%*	*58%*
Core net margin	*20.4%*	*22.2%*	*26.2%*	*21.5%*	*40.9%*	*42.1%*	*8.2%*	*13.4%*	*14.2%*

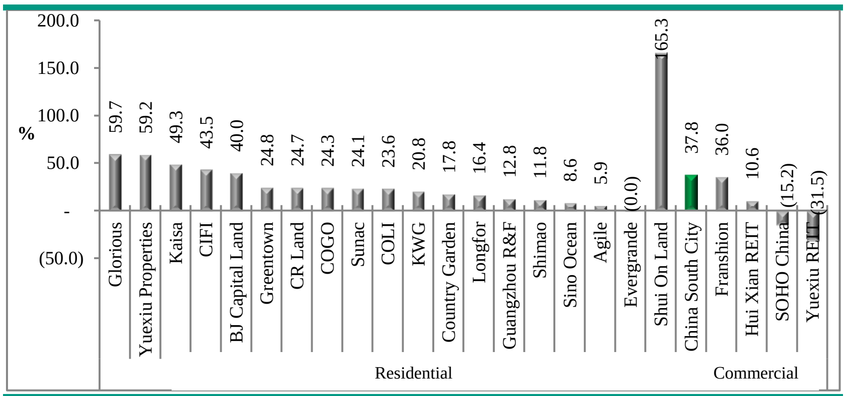
Source(s): Company data

Attractive Valuation

Deserves higher valuation than residential plays

Commercial developers (excluding landlords) are now trading at an average of 7.9x FY13E P/E, which is 30% higher than the residential developers (6.1x FY13E P/E), mainly on lower policy risks. CSC, however, has the lowest valuation of 6.0x FY14E P/E within the commercial property sector, which is comparable to mid-to-small-cap residential peers. Furthermore, we expect CSC's EPS will grow at 37.8% in FY13-15E, which is higher than most commercial peers albeit its lower valuation at present. Hence, we believe the counter is undervalued.

Exhibit 51: EPS CAGR FY13-15E



Source(s): Company data, ABCI Securities estimates

Exhibit 52: Peer valuation

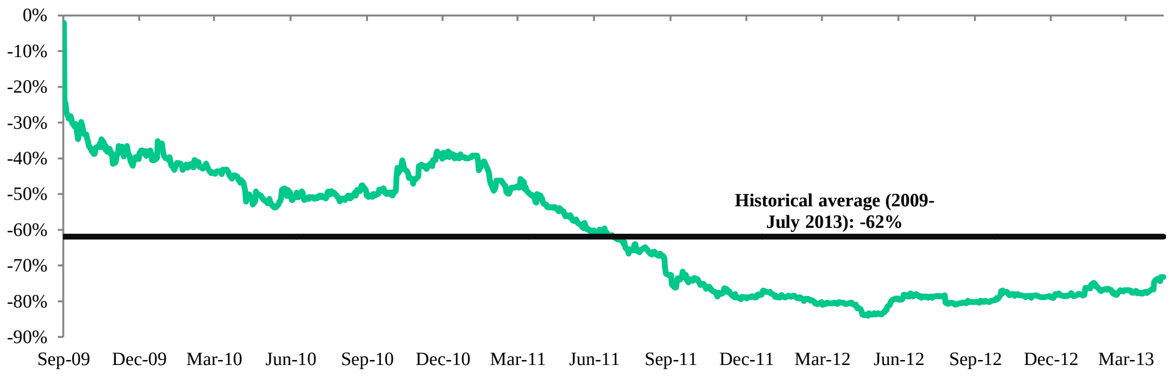
	China Property	Ticker	Rating	Mkt cap	Share Price	Performance 1M	YTD	2012	Discount to NAV	2013E NAV	P/E			Yield (%)			P/B		
				(HK$ bn)	(local ccy)	% Chg	% Chg	% Chg	(%)	(HK$)	2012A	2013E	2014E	2012A	2013E	2014E	2012A	2013E	2014E
	Residential :																		
1	COLI	688 HK	BUY	179.0	21.90	15.4	(5.2)	76.1	(15.9)	26.05	11.2	9.2	7.3	1.9	2.2	2.7	2.1	1.7	1.5
2	CR Land	1109 HK	NR	121.2	20.80	9.8	(1.4)	70.4	(25.5)	27.93	16.0	13.1	10.4	1.6	1.9	2.4	1.8	1.5	1.3
3	Country Garden	2007 HK	NR	77.7	4.21	12.3	3.7	38.6	(31.0)	6.10	9.0	7.6	6.5	4.1	4.8	5.5	1.6	1.4	1.2
4	Longfor	960 HK	NR	62.4	11.46	(7.1)	(24.5)	76.5	(45.3)	20.95	9.1	7.8	6.7	2.2	2.5	3.0	1.6	1.4	1.2
5	Shimao	813 HK	NR	57.2	16.48	17.2	12.7	121.9	(44.3)	29.57	8.0	7.4	6.1	3.3	4.1	4.8	1.3	1.1	1.0
6	Evergrande	3333 HK	NR	51.0	3.18	13.2	(25.2)	31.6	(62.6)	8.50	4.2	4.7	4.0	-	5.3	6.0	1.0	0.8	0.7
7	Guangzhou R&F	2777 HK	NR	36.7	11.40	(1.4)	(11.6)	109.4	(55.5)	25.60	6.0	5.2	4.6	6.6	7.2	8.1	1.1	1.0	0.8
8	Agile	3383 HK	NR	28.0	8.13	(0.5)	(25.4)	55.9	(64.2)	22.73	4.5	4.5	4.0	4.7	5.3	5.9	0.9	0.7	0.6
9	Greentown	3900 HK	BUY	31.5	14.64	13.3	3.1	320.1	(54.5)	32.16	5.5	4.6	3.5	4.3	4.7	5.1	1.2	1.0	0.8
10	Sino Ocean	3377 HK	NR	23.7	4.04	(0.5)	(30.2)	64.0	(53.8)	8.75	6.8	6.8	5.6	5.8	5.9	6.7	0.5	0.5	0.5
11	COGO	81 HK	NR	21.3	9.35	(5.5)	0.3	47.2	(32.6)	13.87	8.9	7.4	5.9	1.2	1.6	1.9	2.7	1.9	1.5
12	Yuexiu Properties	123 HK	NR	18.5	1.99	4.7	(18.8)	122.7	(62.4)	5.29	14.1	7.3	6.1	3.3	4.6	5.6	0.7	0.6	0.6
13	Sunac	1918 HK	BUY	17.9	5.38	4.3	(10.3)	277.4	(66.0)	15.81	5.4	3.8	3.5	2.0	2.6	2.8	1.4	1.0	0.8
14	KWG	1813 HK	NR	12.7	4.38	4.0	(24.7)	121.3	(66.3)	13.00	5.3	4.3	3.7	4.3	5.6	6.4	0.7	0.6	0.5
15	Glorious	845 HK	NR	8.9	1.14	(6.6)	(21.9)	15.9	(67.4)	3.50	10.3	5.1	4.1	-	1.8	2.6	0.4	0.4	0.3
16	Kaisa	1638 HK	BUY	8.5	1.72	(7.0)	(28.3)	77.8	(65.6)	4.99	5.1	3.5	2.3	-	-	-	0.5	0.5	0.4
17	CIFI	884 HK	NR	7.9	1.37	0.7	(2.1)	5.3	(67.1)	4.17	6.8	4.4	3.3	3.6	4.7	6.3	1.0	0.8	0.6
18	BJ Capital Land	2868 HK	NR	5.8	2.80	(4.1)	(13.0)	109.1	(67.3)	8.56	5.4	3.5	2.6	8.4	9.3	12.4	0.8	0.5	0.4
	HK Listed Avg					**3.5**	**(12.4)**	**96.7**	**(52.6)**		**7.9**	**6.1**	**5.0**	**3.2**	**4.1**	**4.9**	**1.2**	**1.0**	**0.8**
	- Large cap (>HKD30b) avg					***10.1***	***(6.6)***	***69.2***	***(41.8)***		***9.6***	***8.3***	***6.8***	***2.2***	***3.5***	***4.1***	***1.6***	***1.3***	***1.1***
	- Small-mid cap (<HKD30b) avg					***0.1***	***(15.3)***	***110.5***	***(61.3)***		***7.0***	***5.0***	***4.1***	***3.7***	***4.4***	***5.3***	***1.0***	***0.8***	***0.7***
1	Vanke	000002 CH	NR	135.1	10.28	(3.1)	0.4	30.3	(32.4)	15.20	8.4	6.9	5.6	1.9	2.0	2.3	1.7	1.4	1.1
2	Poly-A	600048 CH	NR	90.4	10.66	(5.4)	(26.3)	39.6	(42.6)	18.57	8.5	6.6	5.2	2.3	2.9	3.8	1.7	1.4	1.1
3	China Merchants Property	000024 CH	NR	53.3	26.80	7.2	(12.1)	68.9	na	na	13.6	10.4	8.2	1.1	1.4	1.7	1.9	1.6	1.4
4	Gemdale	600383 CH	NR	38.2	7.20	1.4	(3.8)	46.3	(12.1)	8.19	8.9	8.1	6.7	1.2	2.3	2.6	1.3	1.2	1.0
	A-share Listed Avg					**0.0**	**(10.5)**	**46.3**	**(29.0)**		**9.8**	**8.0**	**6.4**	**1.6**	**2.1**	**2.6**	**1.6**	**1.4**	**1.2**
	Commercial:																		
1	SOHO China	410 HK	NR	30.9	6.40	6.1	2.9	21.5	na	na	8.0	7.8	11.1	4.9	5.0	4.7	0.8	0.8	0.7
2	Hui Xian REIT	87001 HK	NR	25.9	4.00	4.4	(3.6)	19.6	na	na	16.7	20.0	13.9	6.0	6.2	6.4	0.7	0.7	0.7
3	**Franshion**	**817 HK**	**BUY**	**22.6**	**2.47**	**2.5**	**(11.5)**	**103.6**	**(49.0)**	**4.85**	**12.4**	**8.5**	**6.6**	**2.8**	**4.0**	**4.9**	**1.0**	**0.9**	**0.8**
4	Shui On Land	272 HK	NR	18.6	2.32	2.7	(38.1)	55.6	na	na	55.7	9.4	7.9	2.6	3.9	4.1	0.3	0.4	0.4
5	Yuexiu REIT	405 HK	NR	11.3	4.12	1.0	12.0	7.3	na	na	11.8	34.3	25.1	6.5	7.1	7.3	0.7	0.7	0.7
6	**China South City**	**1668 HK**	**BUY**	**11.5**	**1.88**	**16.8**	**60.7**	**19.4**	**(68.2)**	**5.91**	**6.4**	**6.0**	**3.4**	**5.3**	**5.3**	**8.0**	**0.7**	**0.7**	**0.6**
7	Zall	2098 HK	NR	10.5	2.99	6.0	(3.9)	(5.2)	na	na	13.4	na	na	2.0	na	na	1.7	na	na
	Commercial Avg					**5.6**	**2.6**	**31.7**			**17.7**	**14.3**	**11.3**	**4.3**	**5.2**	**5.9**	**0.9**	**0.7**	**0.7**
	- Developers					***7.0***	***3.5***	***50.0***			***20.6***	***7.9***	***7.2***	***3.9***	***4.6***	***5.4***	***0.7***	***0.7***	***0.6***
	- Landlords/REIT					***2.7***	***4.2***	***13.4***			***14.2***	***27.1***	***19.5***	***6.2***	***6.6***	***6.9***	***0.7***	***0.7***	***0.7***

** The data in table is as at 24 July 2013*
Source(s): Bloomberg; ABCI Securities estimates

Initiate CSC with a BUY with at TP HK$ 2.40

We adopt the DCF-model and apply a 13.5% WACC to gauge the value of the Group's property development projects. Property development represents 96% of the group's GAV, while investment properties account for the rest (assuming a 6% cap rate on net rental income). Based on a 60% discount to its NAV (historical average since listing), we derive CSC's TP of HKD2.40, which translates into 7.2x FY14E PE or 0.8x FY14E PB (lower than peers average of 14.3x). We recommend BUY on CSC on its fast profit growth, strong pricing power, high margins, and below-peer valuation.

Exhibit 53: CSC's discount to NAV



Source(s): Bloomberg, ABCI Securities

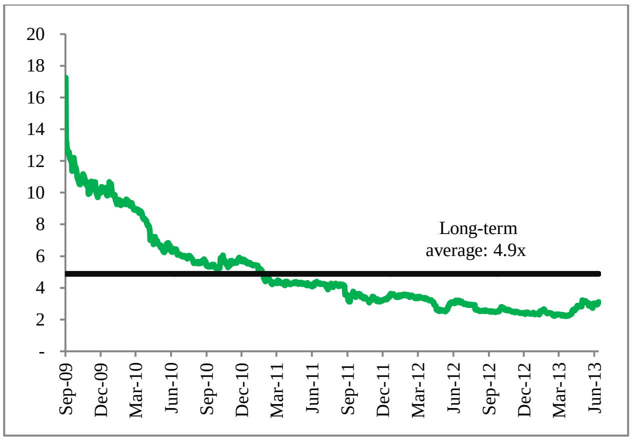
Exhibit 54: CSC's FY14E NAV breakdown

	Attr. GFA (mn sqm)	Net assets value (HK$ mn)	% of total	Valuation Methodology	Implied value per sqm (HK$)
Property development					
Shenzhen	2.2	9,094	20%	DCF at WACC of 13.5%	4,223
Nanning	2.7	6,326	14%		2,362
Nanchang	3.7	7,765	17%		2,125
Xi'an	1.1	3,162	7%		2,931
Harbin	2.2	3,267	7%		1,464
Others	8.16	14,073	31%		1,726
Subtotal	**20.0**	**43,687**	**96%**		**2,189**
Investment Properties		1,946	4%	6% cap rate on net rental income	
Hotels		27	0%	5x EBITDA mutiple	
Total FY14E GAV		**45,660**	**100%**		
FY14E Net debt		(10,048)	-22%		
Total FY14E NAV		**35,613**	**78%**		
No. of share outstanding		6,027			
NAV per share (HK$)		**5.91**			
Target discount (%)		60%			
Target Price (HK$)		**2.40**			
Current price (HK$)		1.88			
Upside		**27.7%**			

WACC	**13.5%**
Cost of debt	10.0%
Cost of Equity	20.0%
Debt/ (Debt + Equity)	**52%**

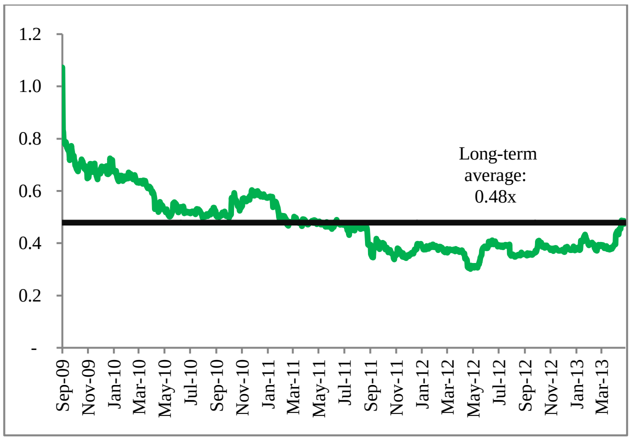
** Figures as at Jul 24, 2013*
Source(s): China South City, ABCI Securities estimates

Exhibit 55: CSC's historical forward P/E



Source(s): Bloomberg, ABCI Securities

Exhibit 56: CSC's historical forward P/B



Source(s): Bloomberg; ABCI Securities

What are the risks?

- **Convertible bonds (CB) dilution.** In Apr 2013, CSC issued HK$ 975mn of convertible bonds to PAG, a private equity investor. The CB will mature in 2018 and have a coupon rate of 6.5% and exercise price of HKD1.56/share. As current share price is already above exercise price, the CB will lead to a 10% dilution impact on CSC if exercised.

- **High inventory.** Properties held for sales increased by 21% YoY from HK$ 7.8bn in FY12 to HK$ 9.4bn in FY13. CSC is cautious about launching further sales in other to avoid oversupply that may affect ASP of later phases. This may lead to a higher balance and higher net gearing.

- **ASP growing too fast:** Despite growing ASP may benefit CSC's margins in the short term, it may deter SMEs from moving into CSC's properties. If occupancy has not reached a reasonably level (no less than 70%), this would affect sales in subsequent phases. In our view, a stable and gradual growth in ASP is the key to sustainable business development.

Consolidated income statement (FY12A-FY16E)

Mar-end (HK$ mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Revenue	**3,671**	**7,488**	**10,263**	**14,547**	**17,551**
Cost of sales	(1,435)	(3,311)	(4,884)	(5,839)	(7,474)
Gross Profit	**2,236**	**4,177**	**5,379**	**8,708**	**10,077**
SG&A expenses	(538)	(826)	(974)	(1,159)	(1,445)
EBIT	**1,698**	**3,351**	**4,405**	**7,548**	**8,632**
Finance cost	(59)	(133)	(211)	(262)	(262)
Share of profit of assocaites	1	1	-	-	-
Other income/ (expenses)	22	52	109	128	168
Fair value gain of investment properties	1,118	1,251	-	-	-
Disposal/one-off items	525	(48)	-	-	-
Profit before tax	**2,188**	**3,223**	**4,304**	**7,414**	**8,539**
Tax	(1,258)	(1,606)	(1,975)	(3,466)	(3,923)
Profit after tax	**930**	**1,616**	**2,328**	**3,948**	**4,616**
Minority interest	23	(117)	(308)	(287)	(392)
Reported net profit	**2,071**	**2,750**	**2,020**	**3,662**	**4,224**
Less: exceptional items	(1,148)	(973)	-	-	-
Underlying net profit	**923**	**1,776**	**2,020**	**3,662**	**4,224**
Per share					
Underlying EPS (HK$)	0.15	0.29	0.31	0.56	0.64
DPS (HK$)	0.08	0.10	0.10	0.15	0.20
Payout ratio (%)	49%	34%	32%	27%	31%
BVPS (HK$)	2.16	2.63	2.86	3.31	3.80
Growth %					
Revenue	64.3%	104.0%	37.1%	41.7%	20.6%
Gross Profit	67.7%	86.8%	28.8%	61.9%	15.7%
EBIT	67.6%	97.4%	31.4%	71.4%	14.4%
Underlying net profit	70.1%	92.5%	13.7%	81.3%	15.4%
Margin %					
Gross margin	60.9%	55.8%	52.4%	59.9%	57.4%
Gross margin (post-LAT)	51.4%	48.2%	41.4%	46.0%	45.0%
EBIT margin	46.3%	44.8%	42.9%	51.9%	49.2%
Core net margin	22.2%	26.2%	22.7%	27.1%	26.3%
Key assumptions					
Contracted Sales (HK$ mn)	6,207	8,205	11,113	13,123	20,102
GFA sold (m sqm)	0.59	0.71	1.04	1.11	1.84
ASP (HK$/sqm)	10,487	11,573	10,684	11,807	10,940
Booked Sales (HK$)	3,011	6,899	9,916	14,164	17,120
GFA delivered (m sqm)	0.25	0.66	0.98	1.18	1.53
Booked ASP (HK$/sqm)	11,986	10,409	10,079	12,023	11,201

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (FY12A-FY16E)

As of Mar 31 (HK$ mn)	FY12A	FY13A	FY14E	FY15E	FY16E
Current assets	**13,245**	**18,428**	**19,430**	**20,873**	**24,842**
Bank balances and cash	3,832	6,778	7,781	9,224	13,192
Trade receivables	526	937	937	937	937
Properties held for sale	7,908	9,953	9,953	9,953	9,953
Other current assets	979	760	760	760	760
Non-current assets	**17,421**	**23,917**	**30,985**	**36,335**	**37,524**
Properties under development	2,878	2,382	9,469	14,842	16,057
Property, plant and equipment	196	601	581	558	532
Investment properties	13,637	19,426	19,426	19,426	19,426
Investment in Associate and JCE	1	6	6	6	6
Other non-current assets	709	1,502	1,502	1,502	1,502
Total Assets	**30,666**	**42,345**	**50,415**	**57,208**	**62,365**
Current Liabilities	**10,895**	**15,374**	**20,845**	**24,696**	**26,544**
Short term borrowings	2,740	4,418	9,418	14,418	14,418
Trade and other payables	3,067	4,373	4,373	4,373	4,373
Pre-sale deposits	3,463	3,793	4,264	3,114	4,962
Other current liabilities	1,624	2,790	2,790	2,790	2,790
Non-current liabilities	**6,777**	**10,928**	**11,903**	**11,903**	**11,903**
Long term borrowings	3,878	7,435	8,410	8,410	8,410
Other payables	53	-	-	-	-
Other non-current liabilities	2,845	3,493	3,493	3,493	3,493
Total Liabilities	**17,671**	**26,302**	**32,748**	**36,599**	**38,447**
Net Assets	**12,995**	**16,043**	**17,667**	**20,610**	**23,919**
Shareholders Equity	**12,939**	**15,853**	**17,219**	**19,925**	**22,892**
Minority Interest	57	190	448	685	1,026
Total Equity	**12,995**	**16,043**	**17,667**	**20,610**	**23,919**
Key ratio:					
Gross debt (HK$ mn)	6,618	11,853	17,828	22,828	22,828
Net debt (HK$ mn)	2,786	5,076	10,048	13,605	9,637
Net gearing (%)	22%	32%	58%	68%	42%
Contracted sales/ Total assets (x)	0.20	0.19	0.22	0.23	0.32

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (FY12A-FY16E)

FY ended Mar 31 (HK$ MN)	FY12A	FY13A	FY14E	FY15E	FY16E
EBITDA	1,721	3,378	4,435	7,581	8,669
Change in Working Capital	(2,468)	(554)	(5,423)	(5,040)	2,116
Tax payment	(160)	(200)	(1,975)	(3,466)	(3,923)
Operating CF	**(907)**	**2,624**	**(2,964)**	**(925)**	**6,861**
Purchase of PP&E	(11)	(10)	(10)	(10)	(10)
Addition of Investment Properties	0	0	0	0	0
Investment in Associate/ JCE	11	0	0	0	0
Proceeds from Disposals	286	0	0	0	0
Others	(20)	0	109	128	168
Investing CF	**265**	**(10)**	**99**	**118**	**158**
Debt raised	2,172	2,000	10,000	10,000	10,000
Debt repaid	(1,588)	(500)	(5,000)	(5,000)	(10,000)
Interest expenses	(522)	(719)	(1,403)	(1,744)	(1,744)
Equity raised	0	0	0	0	0
Convertible securities raised	0	0	975	0	0
Dividend to shareholders	(150)	(449)	(654)	(956)	(1,257)
Others	7	0	(50)	(50)	(50)
Financing CF	**(81)**	**332**	**3,867**	**2,250**	**(3,051)**
Net cash inflow/ (outflow)	**(722)**	**2,946**	**1,003**	**1,443**	**3,968**
Cash- beginning	4,554	3,832	6,778	7,781	9,224
Cash- year-end	**3,832**	**6,778**	**7,781**	**9,224**	**13,192**

Source(s): Company, ABCI Securities estimates

ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Company Report

Franshion (817 HK)

July 25, 2013

Rating: BUY

TP: HK$ 2.90

Initiation

Key Data

H-Share price (HK$)	2.47
Upside potential (%)	17.41
52Wk H/L(HK$)	3.02/ 2.19
Issued shares (mn)	9,161
Market cap (HK$ mn)	22,629
3-mth avg daily turnover (HK$ mn)	14.59
Major shareholder(s) (%):	
Sinochem Group	62.90

Source(s): Company, Bloomberg, ABCI Securities

FY12 Revenue breakdown (%)

Property Development	62.9
Property Leasing	6.4
Hotels	11.7
Land Development	15.4
Others	3.6

Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	6.0	(4.4)
3-mth	(6.4)	(4.6)
6-mth	(13.3)	(6.8)

**Relative to HSI*
Source(s): Bloomberg, ABCI Securities

1-Year price performance (HK$)

Source(s): Bloomberg, ABCI Securities

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An undervalued prime office developer

Listed in 2007, Franshion is the real estate platform of Sinochem Group. Franshion enjoys growing ASP and margins on (1) high demand for Grade A office in tier-1 cities; (2) primary land development in Meixi Lake whose land value appreciated by more than 23% in 1H13. Its rental income is expected to undergo further increase with the expiry of lease 2013-14. Its current valuation with a 49% discount to NAV is low compared to other SOE peers. Based on its growing earning power and the counter's cheap valuation, we recommend BUY with TP at HK$2.90.

Strong pricing power. Leverage on its Jinmao brand, Franshion is able to register significant ASP hike for its office projects. ASP of Shanghai International Shipping Services Centre (SISSC) rose by 36% from RMB 60k/sqm in 2012 to RMB 90k/sqm in 2013. Owing to strong demand for Grade A offices, we expect Franshion's contracted sales to exceed its original target of RMB13bn to RMB 14bn (+34% YoY) By end-June, ~54% of the target was achieved.

Recurrent rental income keeps growing. Franshion generated HK$ 1.1 bn in recurring rental income in FY12 from two major property in Beijing (Beijing Chemsunny and Sinochem Tower) and one property in Shanghai (Jin Mao Tower). Total GFA of investment properties was 372 k sqm. Due to limited Grade A office supply in tier-1 cities, spot rent of these properties is 50%-100% above passing rent in 2012.

Primary land development in Meixi Lake starts to bears fruit. Land transaction price in Meixi Lake jumped 23% to RMB 2,700/sqm in 1H13 from RMB 2,200/sqm in FY12, representing a 97% appreciation over the original cost of RMB 1,300/sqm. We expect maturing complementary infrastructure in the region (e.g. the metro station to be completed by Oct 2013) will enhance the land value further.

Initiate Franshion with BUY. We valuate Franshion's property projects by using the DCF-model with a WACC of 8.3%. A 40% discount rate (which is the historical average in 2009-current) is applied to our NAV forecast to derive the TP of HK$ 2.90. Current valuation that implies a 49% discount to its NAV is low compared to other SOE players such as COLI (688 HK, 16%) and CR Land (1109 HK, 26%). Initiate with **BUY** .
Risk factors: 1) Potential dilution by convertible bonds and 2) difficulties in replenishing high-quality commercial land bank due to short supply.

FY ended Dec 31	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue (HK$ mn)	6,592	17,176	19,170	28,538	35,764
Chg (%,YoY)	3.8	160.6	11.6	48.9	25.3
Underlying Net Profit (HK$ mn)*	1,455	2,154	2,841	3,715	5,308
Chg (%,YoY)	45.9	48.0	31.9	30.8	42.9
Underlying EPS (HK$)	0.13	0.20	0.29	0.37	0.52
Chg (%,YoY)	45.9	48.0	46.4	27.7	39.6
BVPS (HK$)	2.32	2.58	2.79	3.08	3.52
Chg (%,YoY)	14.5	11.5	8.1	10.2	14.3
P/E (x)	18.3	12.4	8.5	6.6	4.7
P/B (x)	1.1	1.0	0.9	0.8	0.7
DPS(HK$)	0.04	0.07	0.10	0.12	0.14
Yield (%)	1.6	2.8	4.0	4.9	5.7
ROE (%)	6.7	8.9	10.8	12.9	16.2
ROA (%)	2.1	2.6	3.0	3.5	4.7

Source(s): Company, Bloomberg, ABCI Securities estimates (Rmb1.0=HK$1.26)
**Underlying net profit is calculated by deducting revaluation gain and one-time disposal gain from the Group's reported net profit*

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High-end commercial SOE developer

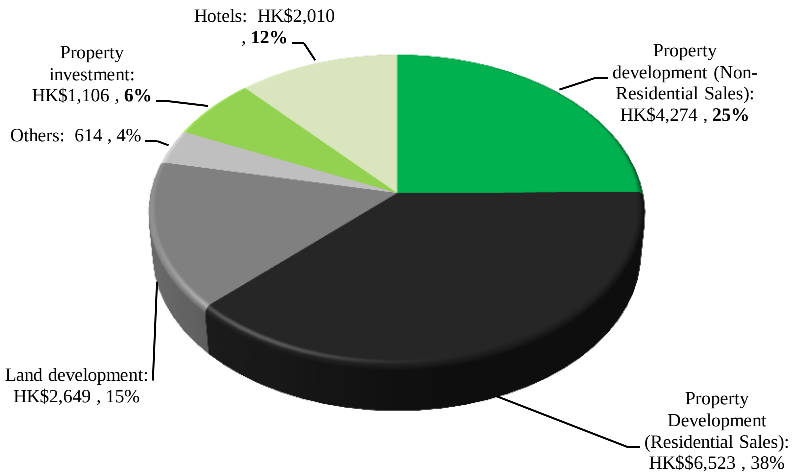
Listed in 2007, Franshion is the listed real estate platform of state-owned enterprise Sinochem Group. Franshion positions itself in the high-end segment. Jinmao Tower, once the tallest building in Shanghai, is one of its flagship properties.

Franshion has four main businesses :

1. **Property development -** Grade A office and luxury residential.
2. **Property leasing -** Beijing Chemsunny, Jinmao and Sinochem Tower as core portfolio.
3. **Hotels -** International branded hotels such as Ritz Carlton Sanya, Grant Hyatt Shanghai, and Westin Beijing etc.
4. **Primary land development -** mainly land sales in Meixi Lake.

Commercial properties (including non-residential sales, property investment, and hotels) accounted for 43% of Franshion's revenue in FY12. The high proportion of commercial properties in its revenue portfolio suggests a limited policy headwind.

Exhibit 57: Franshion's 2012 revenue mix (HK$ mn)



Source(s): Franshion, ABCI Securities

Exhibit 58: Franshion's Projects

Jinmao Tower

Beijing Chemsunny World Trade Centre

Beijing Jinmao Palace Guangqu

Ritz Carlton Hotel, Sanya

Source(s): Soufun

Strong pricing power on commercial property sales

Shanghai Office Empire

Replicating its success in the Shanghai Port International Cruise Terminal, Franshion still has two high-end offices in the pipeline at the Shanghai International Shipping Services Centre (SISSC) and Shanghai Haimen Road.

Key differentiating features of Franshion's two Shanghai office projects are:

- **En-bloc sales strategy:** As opposed to the skyscrapers (e.g. Jinmao and Shanghai IFC etc), Franshion's SISSC consists of multiple low-rise blocks. Each block is usually sold to one sizeable corporate along with the building's naming right.

- **River view offices:** The two projects are close to each other with a view of the Huangpu River. Given the lack of the river view offices at the site, Franshion could command a higher ASP for these in the area.

Exhibit 59: Franshion's Shanghai commercial portfolio

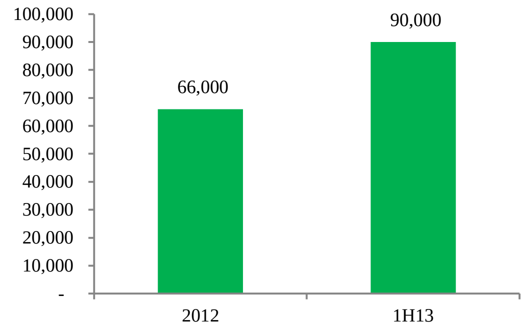
Source(s): Franshion

Strong pricing power

Leverage on its Jinmao brand, Franshion is able to register significant ASP improvement for its SISSC project. Selling price rose by 36% from RMB 60k/sqm in 2012 to RMB 90k/sqm in 1H13.

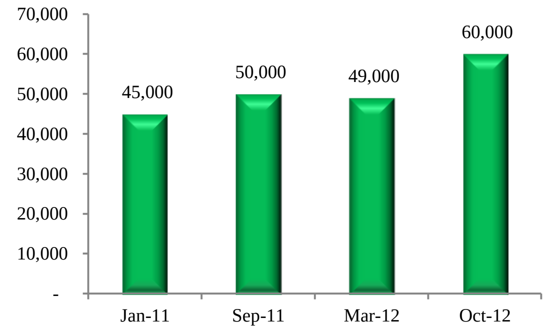
Despite severe tightening measure in the residential market, ASP of Jinmao Residence Guangqu, Franshion's high-end residential projects in Beijing, has been rising in subsequent launches since 2011. For example, ASP of Phase 3 lin Oct 2012 was RMB 60k/sqm, 33% higher than ASPs of Phase 1 & 2 launched in Jan 2011. This demonstrated the Group's strong pricing power for its products.

Exhibit 60: ASP of SISSC (RMB/sqm)



Source(s): Franshion; ABCI Securities

Exhibit 61:ASP of Beijing Jinmao Residence(RMB/sqm)



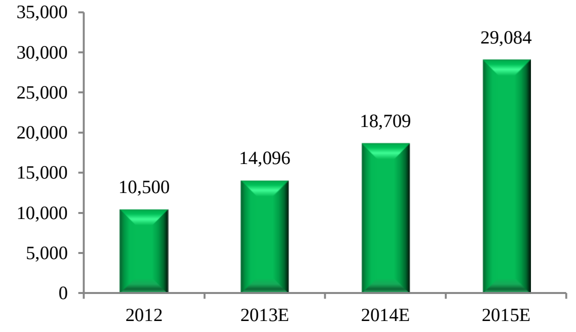
Source(s): Franshion; ABCI Securities

Expect 44% YoY growth for 2013 contracted sales

Apart from ASP improvement, we expect contracted sales amount will also grow along with increasing saleable property. Franshion's FY13 contracted sales target was RMB 13bn (2012 actual contracted sales: RMB10.5bn), implying a 76% sell-through rate on RMB 17bn saleable property in 2013.

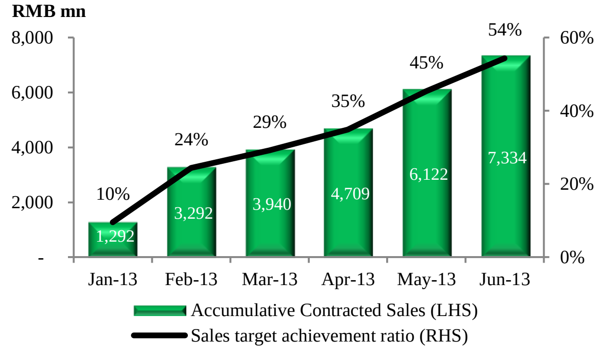
We expect Franshion's contracted sales in FY13 to reach RMB14b (+34% YoY), given that 54% of the target was achieved by end-June. As new projects in Suzhou, Changsha and Lijiang in the pipeline, we forecast contracted sales to reach RMB 29bn in 2015E, implying a 44% CAGR in 2013E-15E.

Exhibit 62: Contracted sales (RMB mn)



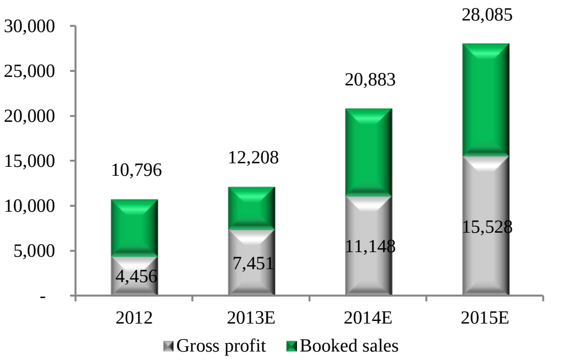
Source(s): Franshion, ABCI Securities estimates

Exhibit 63:Monthly contracted sales and achievement Ratio



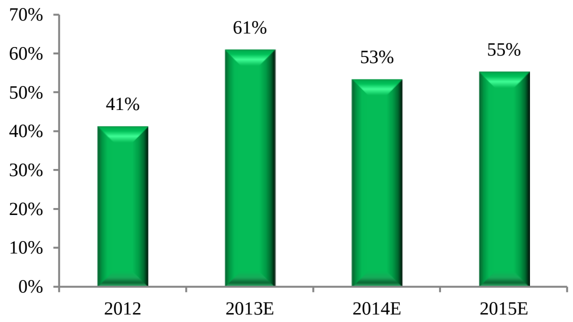
Source(s): Franshion, ABCI Securities

Exhibit 64: Property development-booked sales & gross profit (HK$ mn)



Source(s): Franshion, ABCI Securities estimates

Exhibit 65: Property development- GP Margin (%)



Source(s): Franshion, ABCI Securities estimates

Investment Properties: Ample room for rent hike

Spot 50-100% above passing rent

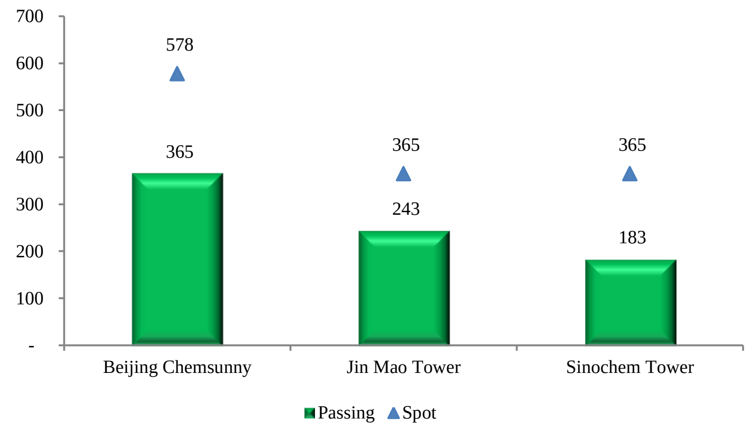
Franshion generated about HK$ 1.1bn in 2012 from three major properties in Beijing and Shanghai, namely the Bejing Chemsunny, Sinochem Tower in Beijing, and Jin Mao Tower in Shanghai. Due to limited supply of high-quality Grade A office at prime locations, spot rent of these commercial properties is 50%-100% above passing rent in 2012. We expect strong upward rental revisions upon the expiry of leases in 2013 (~33% of GFA) and 2014 (~50% of GFA).

Exhibit 66: Existing Investment properties Portfolio

Project	Opening Year	GFA	Stake	2012 Revenue
		('000 sqm)	(%)	(HK$ mn)
Beijing Chemsunny World Trade Centre	2006	111	100	537
Jin Mao Tower (office + retail)	1999	189	100	471
Sinochem tower	1995	49	100	87
Nanjing International Centre*	2011	140	51	NA
		489		**1,095**

** Acquired in Feb 2013*
Source(s): Franshion; ABCI Securities

Exhibit 67: Spot vs Passing Rent (RMB/sqm/mth)



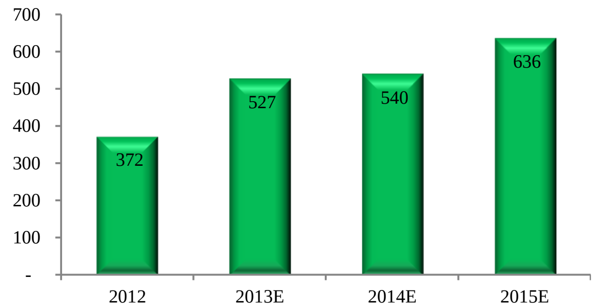
Source(s): Franshion; ABCI Securities

Rising GFA on M&A and existing pipeline

Besides its healthy organic growth, the Group's strong balance sheet and low funding cost allowed it to complete an M&A deal in Feb 2013 to acquire 51% stake of Nanjing International Centre at RMB 1.1bn. The project has ~ 140k sqm of developed office/retail rental properties (Phase 1) and 196k sqm of raw land (Phase 2) for future development. We estimate the newly acquired Nanjing International square will generate an addition rental income of HK$ 139mn in 2013E.

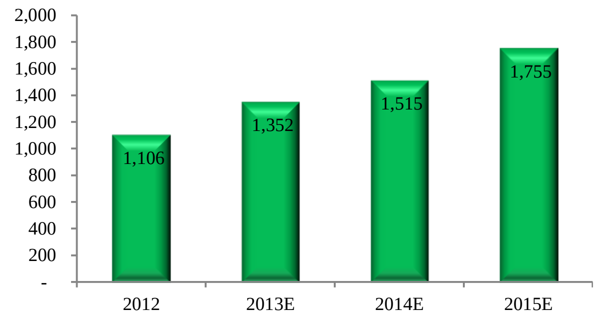
Furthermore, as Franshion planned to reserve part of the office/retail spaces in its Changsha R&D Centre (~15k sqm), Lijiang Whisper (~13k sqm) and Shanghai International Shipping Service Centre (~96k sqm), we expect the GFA of investment properties will increase to 636k by 2015E, 71% higher than 2012.

Exhibit 68: GFA of Franshion's investment properties portfolio (k sqm)



Source(s): Franshion; ABCI Securities estimates

Exhibit 69: Franshion's rental revenue (HK$ mn)



Source(s): Franshion; ABCI Securities estimates

Hotel portfolio dragged down by Sanya, Hainan

As at Dec 2012, Franshion has a hotel portfolio with 6 properties and 2,872 rooms. Business performance in FY12 was dragged down by hotels in Sanya (Revenue of Ritz Carlton, Sanya:-9.4% YoY; Hilton, Sanya: -16.3% YoY) due to numerous hotel openings in the area.

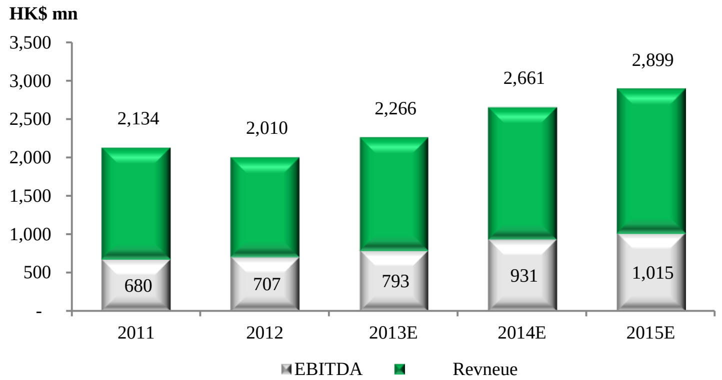
Despite hotel operation in Sanya may still be under pressure in the near term, with the acquisition of Westin Nanjing (231 rooms), completion of renovation in the Wangfujing Grand Hotels (405 rooms) and other hotel projects in the pipeline such as Chongming Hyatt (231 rooms) and Lijiang Grand Hyatt (381 rooms), we expect revenue from the hotel operation to grow at a CAGR of 13% in 2013E-15E.

Exhibit 70: Hotel portfolio as at Dec 2012

Project	Location	No. of rooms	2012			YoY Chg (%)		
			Revenue	Occupancy	Avg. Room rate	Revenue	Occupancy	Avg. Room rate
			(HKDm)	(%)	(RMB)			
Grand Hyatt Shanghai	Shanghai	555	**552**	60	1,676	**(2.2)**	1.0	(5.4)
Hilton Sanya Resort & Spa	Sanya	501	**313**	59.2	1,858	**(16.3)**	(8.3)	(8.1)
The Ritz-Carlton, Sanya	Sanya	450	**500**	62.1	3,081	**(9.4)**	(15.3)	10.7
Westin Beijing, Chaoyang	Beijing	550	**443**	76.5	1,540	**9.1**	(2.1)	13.5
Wangfujing Grand Hotel	Beijing	405	**NA**	NA	NA	**NA**	NA	NA
JW Marriott Shenzhen	Shenzhen	411	**202**	71.5	1,025	**4.7**	(2.8)	6.4
Total		**2,872**	**2,010**					

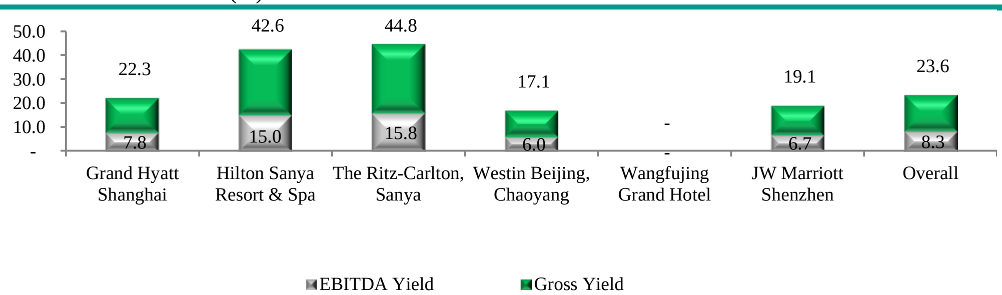
Source(s): Franshion, ABCI Securities

Exhibit 71:Hotel revenue and EBITDA



Source(s): Franshion; ABCI Securities estimate

Exhibit 72: Gross/EBITDA Yield (%) on Cost



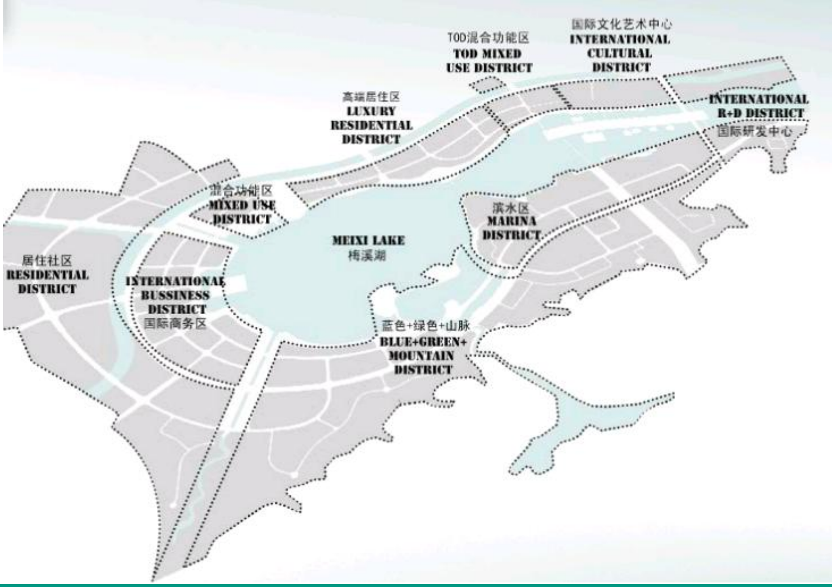
** Wangfunjing Grand Hotel under renovation*
Source(s): Franshion; ABCI Securities

Meixi Lake: Enjoying the land appreciation

In 2011, Franshion (80%) and China State Construction (20%) jointly acquired Meixi Lake primary land development at RMB 12.8bn. Total project has a GFA of 9.45mn sqm, implying a land cost of ~RMB1,300/sqm. Key project terms include:

- Franshion can collect 92% of land premium while remaining 8% will be entitled by local government.
- No LAT will be applied on primary land development.

Exhibit 73:Meixi Lake development plan in Changsha

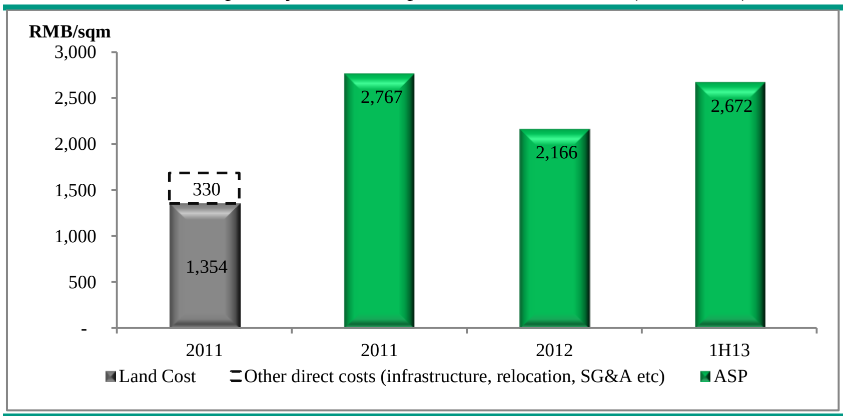


Source(s): Franshion

Land price on fire

Despite the huge initial upfront investment, Meixi Lake starts to bear fruit in 2013. Land transaction price in Meixi Lake jumped 23% to RMB 2,700/sqm in 1H13 vs. RMB 2,200/sqm in 2012, implying a 97% appreciation over the original cost of RMB 1,300/sqm. We expect with the increases in (1) complementary infrastructure (e.g. metro station to be completed by Oct 2013) and (2) surrounding population upon completion of more residential projects will further enhance the land value.

Exhibit 74: Meixi Lake primary land development- Contracted ASP (2011-1H13)



Source(s): Franshion, Changsha Land & Resources Bureau

Currently, pre-sale price of the residential projects near Meixi Lake is at RMB 7.5k-8k/sqm. Based on the land price of RMB 3k /sqm, we estimate gross margin to be in the satisfactory range of 20-25% even if we assume ASP remain constant in the future.

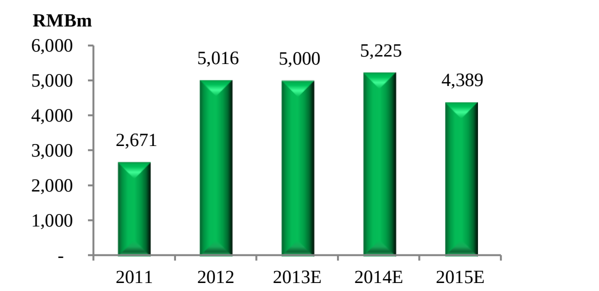
Exhibit 75: Residential projects on pre-sale in Meixi Lake

Source(s): Soufun, ABCI Securities

High margin business without LAT

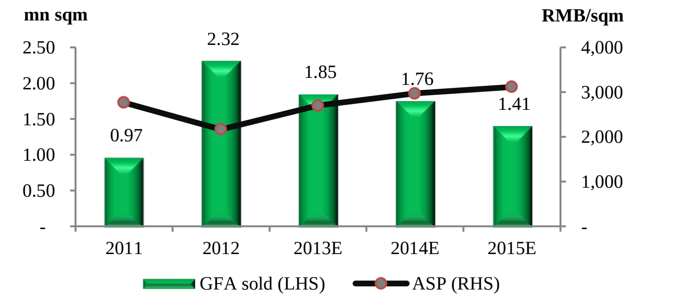
Franshion targets to generate RMB 5bn of sales revenue from Meixi Lake development in 2013E. We believe this is achievable given Franshion has already secured RMB 2.7bn from land sales in 1H13. As LAT is not applicable to primary land development, we expect Franshion to achieve a high net margin in the range of 20.4%-28.0% for 2013E-15E.

Exhibit 76: Franshion's primary land development- contracted sales



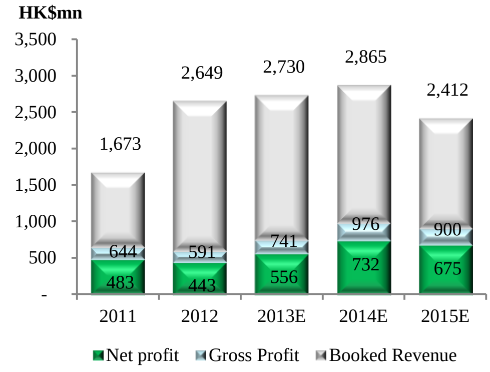
Source(s): *Franshion. Changsha Land & Resources Bureau*

Exhibit 77: Franshion's primary land development- GFA vs ASP



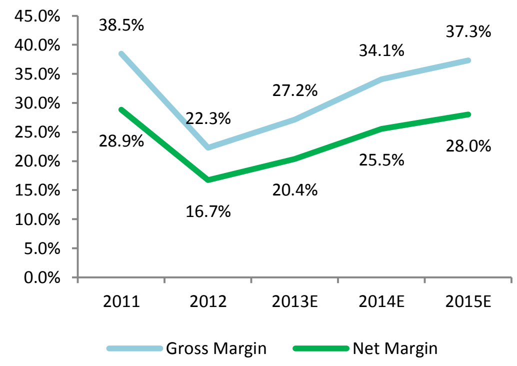
Source(s): *Franshion, Changsha Land & Resources Bureau*

Exhibit 78: Land development- booked revenue, gross and net profit



Source(s): Franshion; ABCI Securities Estimates

Exhibit 79: Land development- gross / net margin (%)

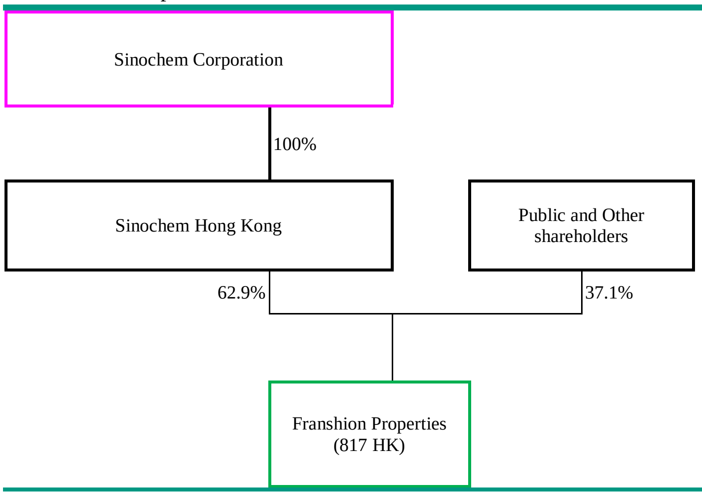


Source(s): Franshion; ABCI Securities Estimates

SOE background enables favorable funding cost

Franshion is currently 62.87% owned by Sinochem, a key state-owned conglomerate engaging in energy, chemical, financial, and real estate business via Franshion. Backed by its SOE parent, Franshion can borrow 3-year loans at 5% discount to PBOC rate in most Chinese banks.

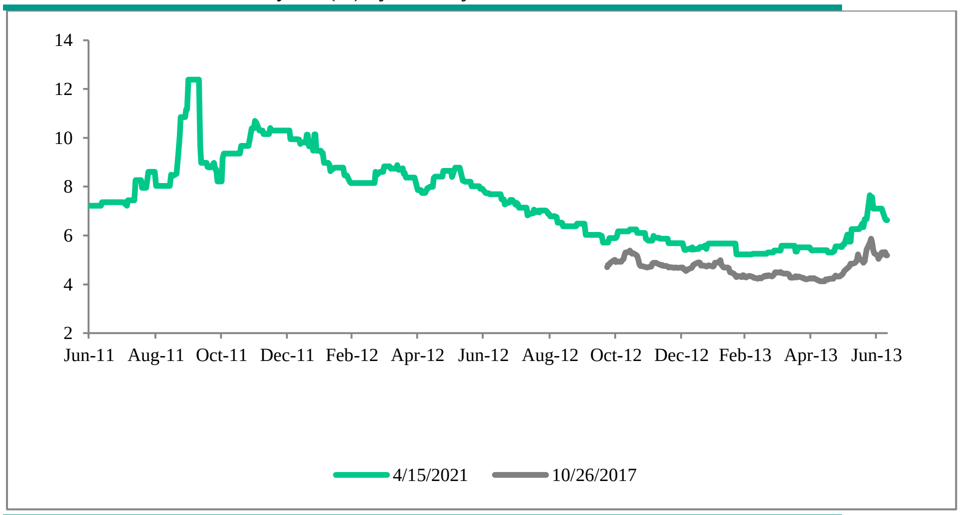
Exhibit 80: Group structure



Source(s): Franshion, ABCI Securities

Further, Franshion has also been active in off-shore financing by leveraging on its SOE background. In Oct 2012, Franshion raised US$ 500mn via bonds (due in 2017) at 4.7% coupon rate (lower than mid-cap non-SOE peers at 6-8%) to extend overall debt maturity. For off-shore loan, Franshion can borrow at a rate of LIBOR+200bps - a more favorable rate than its non-SOE peers (e.g. Longfor secured a HK$ $7.6bn 4-year loan at HIBOR+310bps in July 2013; Sunac raised USD400m 3-year term facilities at LIBOR+388bps in July 2013).

Exhibit 81: Franshion's bond yield (%) by maturity



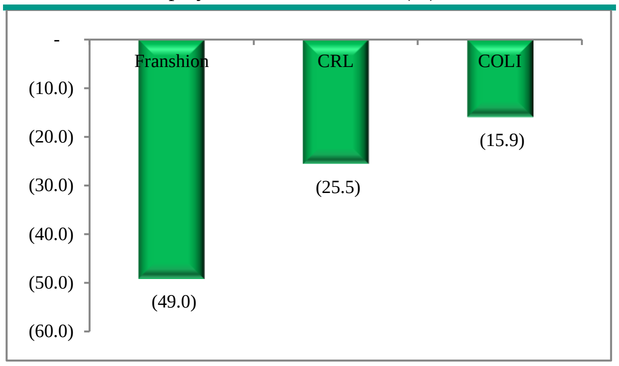
Source(s): Bloomberg, ABCI Securities

SOE player at a bargain

Cheapest SOE developer despite highest rental income

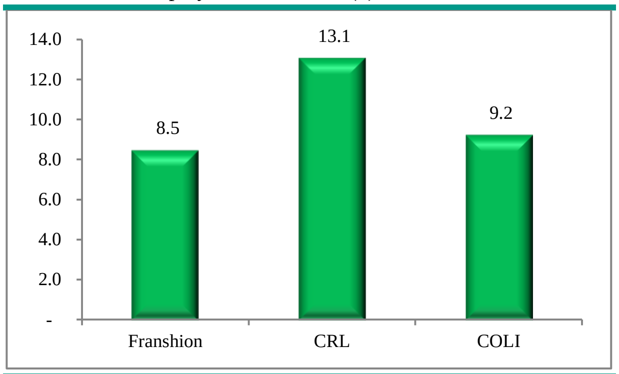
As a SOE player, Franshion has not enjoyed premium valuation that COLI and CR Land have. Franshion now trades at a 49% discount to FY13E NAV, vs. 22-26% for CR Land and COLI.

Exhibit 82: SOE players' discount to NAV (%)



Source(s): Company data, ABCI Securities estimates

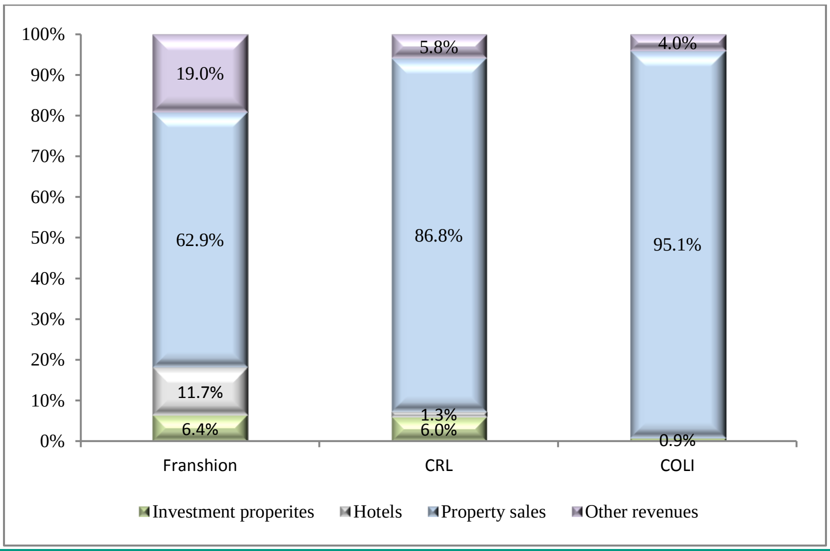
Exhibit 83: SOE players' 2013E P/E (x)



Source(s): Company data, ABCI Securities estimates

In terms of percentage, contribution of rental revenue is highest (6.4%) in Franshion among the SOE players (CR Land: 6.0%; COLI: 0.9%). The market normally gives a premium valuation to companies with a heavy focus on property rental business due to its secure nature. We therefore believe that Franshion is deeply undervalued.

Exhibit 84: Rental revenue as % of Total revenue



Source(s): Company data, ABCI Securities

Exhibit 85: Peer valuations

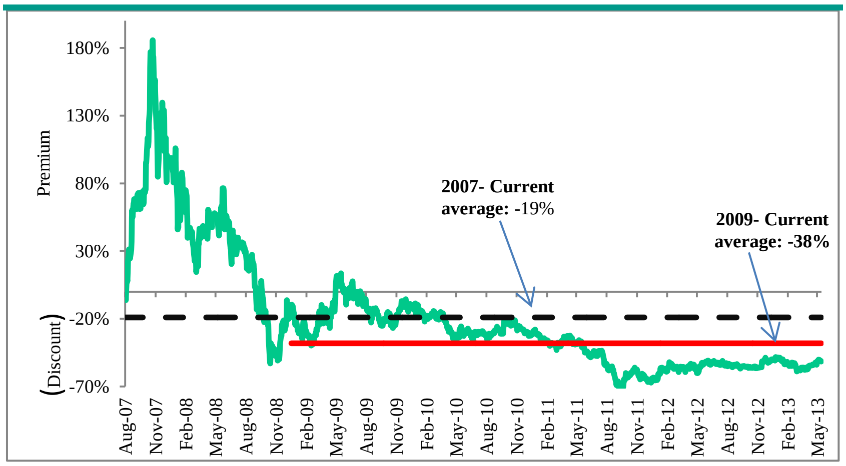
	China Property	**Ticker**	**Rating**	**Mkt cap**	**Share Price**	**Performance** 1M	YTD	2012	**Discount to NAV**	**2013E NAV**	**P/E**			**Yield (%)**			**P/B**		
				(HK$ bn)	(local ccy)	% Chg	% Chg	% Chg	(%)	(HK$)	2012A	2013E	2014E	2012A	2013E	2014E	2012A	2013E	2014E
	Residential :																		
1	COLI	688 HK	BUY	179.0	21.90	15.4	(5.2)	76.1	(15.9)	26.05	11.2	9.2	7.3	1.9	2.2	2.7	2.1	1.7	1.5
2	CR Land	1109 HK	NR	121.2	20.80	9.8	(1.4)	70.4	(25.5)	27.93	16.0	13.1	10.4	1.6	1.9	2.4	1.8	1.5	1.3
3	Country Garden	2007 HK	NR	77.7	4.21	12.3	3.7	38.6	(31.0)	6.10	9.0	7.6	6.5	4.1	4.8	5.5	1.6	1.4	1.2
4	Longfor	960 HK	NR	62.4	11.46	(7.1)	(24.5)	76.5	(45.3)	20.95	9.1	7.8	6.7	2.2	2.5	3.0	1.6	1.4	1.2
5	Shimao	813 HK	NR	57.2	16.48	17.2	12.7	121.9	(44.3)	29.57	8.0	7.4	6.1	3.3	4.1	4.8	1.3	1.1	1.0
6	Evergrande	3333 HK	NR	51.0	3.18	13.2	(25.2)	31.6	(62.6)	8.50	4.2	4.7	4.0	-	5.3	6.0	1.0	0.8	0.7
7	Guangzhou R&F	2777 HK	NR	36.7	11.40	(1.4)	(11.6)	109.4	(55.5)	25.60	6.0	5.2	4.6	6.6	7.2	8.1	1.1	1.0	0.8
8	Agile	3383 HK	NR	28.0	8.13	(0.5)	(25.4)	55.9	(64.2)	22.73	4.5	4.5	4.0	4.7	5.3	5.9	0.9	0.7	0.6
9	Greentown	3900 HK	BUY	31.5	14.64	13.3	3.1	320.1	(54.5)	32.16	5.5	4.6	3.5	4.3	4.7	5.1	1.2	1.0	0.8
10	Sino Ocean	3377 HK	NR	23.7	4.04	(0.5)	(30.2)	64.0	(53.8)	8.75	6.8	6.8	5.6	5.8	5.9	6.7	0.5	0.5	0.5
11	COGO	81 HK	NR	21.3	9.35	(5.5)	0.3	47.2	(32.6)	13.87	8.9	7.4	5.9	1.2	1.6	1.9	2.7	1.9	1.5
12	Yuexiu Properties	123 HK	NR	18.5	1.99	4.7	(18.8)	122.7	(62.4)	5.29	14.1	7.3	6.1	3.3	4.6	5.6	0.7	0.6	0.6
13	Sunac	1918 HK	BUY	17.9	5.38	4.3	(10.3)	277.4	(66.0)	15.81	5.4	3.8	3.5	2.0	2.6	2.8	1.4	1.0	0.8
14	KWG	1813 HK	NR	12.7	4.38	4.0	(24.7)	121.3	(66.3)	13.00	5.3	4.3	3.7	4.3	5.6	6.4	0.7	0.6	0.5
15	Glorious	845 HK	NR	8.9	1.14	(6.6)	(21.9)	15.9	(67.4)	3.50	10.3	5.1	4.1	-	1.8	2.6	0.4	0.4	0.3
16	Kaisa	1638 HK	BUY	8.5	1.72	(7.0)	(28.3)	77.8	(65.6)	4.99	5.1	3.5	2.3	-	-	-	0.5	0.5	0.4
17	CIFI	884 HK	NR	7.9	1.37	0.7	(2.1)	5.3	(67.1)	4.17	6.8	4.4	3.3	3.6	4.7	6.3	1.0	0.8	0.6
18	BJ Capital Land	2868 HK	NR	5.8	2.80	(4.1)	(13.0)	109.1	(67.3)	8.56	5.4	3.5	2.6	8.4	9.3	12.4	0.8	0.5	0.4
	HK Listed Avg					**3.5**	**(12.4)**	**96.7**	**(52.6)**		**7.9**	**6.1**	**5.0**	**3.2**	**4.1**	**4.9**	**1.2**	**1.0**	**0.8**
	- Large cap (>HKD30b) avg					***10.1***	***(6.6)***	***69.2***	***(41.8)***		***9.6***	***8.3***	***6.8***	***2.2***	***3.5***	***4.1***	***1.6***	***1.3***	***1.1***
	- Small-mid cap (<HKD30b) avg					***0.1***	***(15.3)***	***110.5***	***(61.3)***		***7.0***	***5.0***	***4.1***	***3.7***	***4.4***	***5.3***	***1.0***	***0.8***	***0.7***
1	Vanke	000002 CH	NR	135.1	10.28	(3.1)	0.4	30.3	(32.4)	15.20	8.4	6.9	5.6	1.9	2.0	2.3	1.7	1.4	1.1
2	Poly-A	600048 CH	NR	90.4	10.66	(5.4)	(26.3)	39.6	(42.6)	18.57	8.5	6.6	5.2	2.3	2.9	3.8	1.7	1.4	1.1
3	China Merchants Property	000024 CH	NR	53.3	26.80	7.2	(12.1)	68.9	na	na	13.6	10.4	8.2	1.1	1.4	1.7	1.9	1.6	1.4
4	Gemdale	600383 CH	NR	38.2	7.20	1.4	(3.8)	46.3	(12.1)	8.19	8.9	8.1	6.7	1.2	2.3	2.6	1.3	1.2	1.0
	A-share Listed Avg					**0.0**	**(10.5)**	**46.3**	**(29.0)**		**9.8**	**8.0**	**6.4**	**1.6**	**2.1**	**2.6**	**1.6**	**1.4**	**1.2**
	Commercial:																		
1	SOHO China	410 HK	NR	30.9	6.40	6.1	2.9	21.5	na	na	8.0	7.8	11.1	4.9	5.0	4.7	0.8	0.8	0.7
2	Hui Xian REIT	87001 HK	NR	25.9	4.00	4.4	(3.6)	19.6	na	na	16.7	20.0	13.9	6.0	6.2	6.4	0.7	0.7	0.7
3	**Franshion**	**817 HK**	**BUY**	**22.6**	**2.47**	**2.5**	**(11.5)**	**103.6**	**(49.0)**	**4.85**	**12.4**	**8.5**	**6.6**	**2.8**	**4.0**	**4.9**	**1.0**	**0.9**	**0.8**
4	Shui On Land	272 HK	NR	18.6	2.32	2.7	(38.1)	55.6	na	na	55.7	9.4	7.9	2.6	3.9	4.1	0.3	0.4	0.4
5	Yuexiu REIT	405 HK	NR	11.3	4.12	1.0	12.0	7.3	na	na	11.8	34.3	25.1	6.5	7.1	7.3	0.7	0.7	0.7
6	**China South City**	**1668 HK**	**BUY**	**11.5**	**1.88**	**16.8**	**60.7**	**19.4**	**(68.2)**	**5.91**	**6.4**	**6.0**	**3.4**	**5.3**	**5.3**	**8.0**	**0.7**	**0.7**	**0.6**
7	Zall	2098 HK	NR	10.5	2.99	6.0	(3.9)	(5.2)	na	na	13.4	na	na	2.0	na	na	1.7	na	na
	Commercial Avg					**5.6**	**2.6**	**31.7**			**17.7**	**14.3**	**11.3**	**4.3**	**5.2**	**5.9**	**0.9**	**0.7**	**0.7**
	- Developers					***7.0***	***3.5***	***50.0***			***20.6***	***7.9***	***7.2***	***3.9***	***4.6***	***5.4***	***0.7***	***0.7***	***0.6***
	- Landlords/REIT					***2.7***	***4.2***	***13.4***			***14.2***	***27.1***	***19.5***	***6.2***	***6.6***	***6.9***	***0.7***	***0.7***	***0.7***

** Dated as at 24 July 2013*
Source(s): Bloomberg; ABCI Securities estimates

Initiate Franshion with BUY with TP at HK$2.90

To valuate the Group's property development projects, we use a DCF-model and apply a WACC of 8.3%. We assess the value of the primary land projects at the market value of RMB 2,700/sqm (HK$ 3,276/sqm) by referring to the latest transaction price in 1H13. For investment properties, we apply a 6% cap rate on net rental income, while using a 5x EV/EBITDA multiple to assess its hotel business. We derive the Franshion's TP of HKD2.90 based on a 40% discount (in line with historical average in 2009-current) to its NAV to derive the TP of HKD2.90, implying a valuation of 9.8x 2013E P/E and 1.0x 2013E P/B , which is lower than its SOE peers such as CR land and COLI.

Exhibit 86: Franshion's discount to NAV



Source(s): Franshion, ABCI Securities

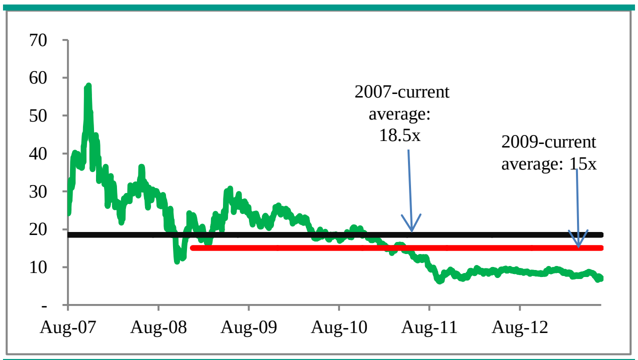
Exhibit 87: Franshion's 2013E NAV breakdown

	Attr. GFA (M sqm)	Net assets value (HK$ m)	% of total	Valuation Methodology	Implied value per sqm (HK$)
Property development					
Beijjng	0.8	14,366	21%	DCF at WACC of 8.3%	17,055
Shanghai	0.4	8,860	13%		25,198
Changsha	1.5	5,321	8%		3,623
Suzhou	0.3	3,592	5%		10,490
Chongqing	0.5	2,370	3%		4,734
Others	1.2	2,806	4%		2,371
Subtotal	**4.2**	**37,315**	**54%**		**8,909**
Primary Land Development	**4.3**	**14,627**	**21%**	**Mkt value**	**3,402**
Investment Properties	**0.5**	**13,521**	**19%**	**6% cap rate on net rental income**	
Hotels		**3,966**	**6%**	**5x EBITDA mutiple**	
Total 2013E GAV		**69,429**	**100%**		
2013E Net debt (including Perpetual convertible securities)		(25,017)	-36%		
Total 2013E NAV		**44,412**	**64%**		
No. of share outstanding		9,161			
NAV per share (HK$)		**4.85**			
Target discount (%)		40%			
Target Price (HK$)		**2.90**			
Current price (HK$)		2.47			
Upside		**17%**			

WACC	**8.3%**
Cost of debt	6.5%
Cost of Equity	12.0%
Debt/ (Debt + Equity)	**52%**

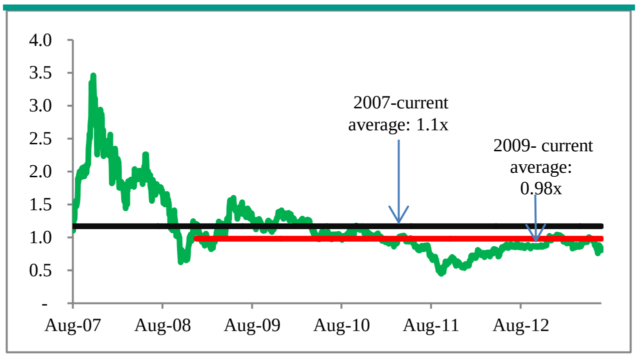
** Share price as at July 24, 2013*
Source(s): Franshion, ABCI Securities estimates

Exhibit 88: Franshion's historical forward P/E



Source(s): Franshion, ABCI Securities

Exhibit 89: Franshion's historical forward P/B



Source(s): Franshion, ABCI Securities

What are the risks?

Potential convertible bonds (CB) dilution: In 2010, Franshion issued an US$ 600m perpetual CB with a 6.8% coupon rate and an exercise price of HK$ 2.83. If its share price exceeds the exercise price from the current level of HK$ 2.47, the CB will result in a 18% dilution upon new share conversion. If the CB is not converted until 2015, Franshion has an option to redeem the bond at 110% of principal amount.

Difficulties in replenishing high-quality commercial land bank: Acquiring prime office land site has become increasingly difficult. For instance, out of the seven land acquisitions in 2012, Franshion only secured one office development site. Upon tightening liquidity in China, Franshion may secure more office/retail projects and M&A opportunities (similar to its acquisition in Nanjing International Plaza in early 2013) going forward.

Consolidated income statement (FY11A-FY15E)

Dec-end (HKDm)	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue	**6,592**	**17,176**	**19,170**	**28,538**	**35,764**
Cost of sales	(3,017)	(9,977)	(8,560)	(13,621)	(16,224)
Gross Profit	**3,575**	**7,199**	**10,609**	**14,917**	**19,540**
SG&A expenses	(1,158)	(1,407)	(1,675)	(2,129)	(2,791)
EBIT	**2,417**	**5,792**	**8,934**	**12,787**	**16,749**
Finance cost	(859)	(986)	(1,100)	(1,279)	(1,368)
Share of profit of assocaites	4	2	-	-	-
Other income/ (expenses)	213	284	197	303	523
Fair value gain of investment properties	931	1,626	-	-	-
Disposal/one-off items	1,392	5	-	-	-
Profit before tax	**4,097**	**6,723**	**8,031**	**11,811**	**15,903**
Tax	(1,187)	(2,783)	(4,046)	(5,656)	(7,985)
Profit after tax	**2,911**	**3,940**	**3,986**	**6,155**	**7,919**
Minority interest	(566)	(563)	(1,145)	(2,440)	(2,610)
Reported net profit	**2,344**	**3,378**	**2,841**	**3,715**	**5,308**
Less: exceptional items	(889)	(1,223)	-	-	-
Underlying net profit	**1,455**	**2,154**	**2,841**	**3,715**	**5,308**
Per share					
Underlying EPS (HK$)	0.13	0.20	0.29	0.37	0.52
DPS (HK$)	0.04	0.07	0.10	0.12	0.14
Payout ratio (%)	30%	35%	34%	32%	27%
BVPS (HK$)	2.32	2.58	2.79	3.08	3.52
Growth %					
Revenue	3.8%	160.6%	11.6%	48.9%	25.3%
Gross Profit	8.2%	101.4%	47.4%	40.6%	31.0%
EBIT	0.9%	139.7%	54.3%	43.1%	31.0%
Underlying net profit	45.9%	48.0%	31.9%	30.8%	42.9%
Margin %					
Gross margin	54.2%	41.9%	55.3%	52.3%	54.6%
Gross margin (post-LAT)	8.7%	19.3%	24.7%	26.4%	28.5%
EBIT margin	36.7%	33.7%	46.6%	44.8%	46.8%
Core net margin	17.7%	15.8%	20.8%	21.6%	22.1%
Key assumptions					
Contracted Sales (HKDm)		13,230	17,761	23,573	36,646
GFA sold (m sqm)		0.31	0.51	0.87	1.02
ASP (HK$/sqm)		43,009	34,902	27,102	35,918
Booked Sales (HK$)		10,796	12,208	20,883	28,085
GFA delivered (m sqm)		0.46	0.29	0.66	0.87
Booked ASP (HK$/sqm)		23,328	42,571	31,431	32,367

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (FY11A-FY15E)

Dec-end (HKDm)	FY11A	FY12A	FY13E	FY14E	FY15E
Current assets	**24,968**	**38,199**	**36,001**	**49,193**	**62,651**
Cash	12,224	12,888	12,270	26,964	41,623
Restricted cash	368	576	576	576	576
Trade & other recievables	105	2,003	2,003	2,003	2,003
Properties under development	7,030	10,384	10,384	10,384	10,384
Properties held for sale	840	3,078	3,078	3,078	3,078
Land under development	2,623	6,696	5,116	3,614	2,413
Other current assets	5,240	12,348	10,767	9,266	8,065
Non-current assets	**44,803**	**44,303**	**58,768**	**55,660**	**50,000**
Property, plant & equipment	6,891	6,956	7,018	7,073	7,121
Properties under development	11,844	13,047	27,450	24,287	18,579
Land under development	9,223	5,408	5,408	5,408	5,408
Investment properties	14,890	16,575	16,575	16,575	16,575
Investment in Associate and JCE	36	39	39	39	39
Other non-current assets	1,919	2,279	2,279	2,279	2,279
Total Assets	**69,771**	**82,502**	**94,769**	**104,853**	**112,651**
Current Liabilities	**17,610**	**25,726**	**35,285**	**40,676**	**42,199**
Short term borrowings	6,028	8,952	13,952	18,952	18,952
Trade & other payables	5,349	6,233	6,233	6,233	6,233
Pre-sales deposits	5,229	8,235	12,794	13,185	14,709
Other current liabilities	1,005	2,306	2,306	2,306	2,306
Non-current liabilities	**21,613**	**22,273**	**22,273**	**22,273**	**22,273**
Long term borrowings	19,171	19,323	19,323	19,323	19,323
Other payables	-	-	-	-	-
Other non-current liabilities	2,442	2,950	2,950	2,950	2,950
Total Liabilitiies	**39,224**	**47,999**	**57,558**	**62,949**	**64,473**
Net Assets	**30,547**	**34,503**	**37,210**	**41,904**	**48,179**
Shareholders Equity	**21,583**	**24,290**	**26,215**	**28,831**	**32,856**
Perpetual Convertible Securities	4,588	4,588	4,588	4,588	4,588
Minority Interest	4,377	5,625	6,408	8,486	10,734
Total Equity	**30,547**	**34,503**	**37,210**	**41,904**	**48,179**
Key ratio					
Gross debt (HKDm)	25,199	28,275	33,275	38,275	38,275
Net debt (HKDm)	12,607	14,811	20,429	10,736	(3,923)
Net gearing (%)	48%	51%	66%	32%	-10%
Contracted sales/ Total assets (x)	-	0.16	0.19	0.22	0.33

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (FY11A-FY15E)

Dec-end (HKDm)	FY11A	FY12A	FY13E	FY14E	FY15E
EBITDA	2,641	6,022	9,172	13,032	17,001
Change in Working Capital	(8,642)	(4,186)	(7,363)	6,101	9,552
Tax payement	(1,110)	(1,137)	(4,046)	(5,656)	(7,985)
Operating CF	**(7,111)**	**699**	**(2,237)**	**13,477**	**18,568**
Purchase of PP&E	(207)	(310)	(300)	(300)	(300)
Addition of Investment Properties	(7)	(20)	0	0	0
Investment in Associate/ JCE	0	0	0	0	0
Proceeds from Disposals	0	0	0	0	0
Others	3,488	(968)	197	303	523
Investing CF	**3,274**	**(1,298)**	**(103)**	**3**	**223**
Debt raised	30,470	16,488	10,000	10,000	10,000
Debt repaid	(24,338)	(13,369)	(5,000)	(5,000)	(10,000)
Interest expenses	(787)	(949)	(2,000)	(2,325)	(2,488)
Equity raised	0	0	0	0	0
Convertible securities raised	(317)	(317)	(312)	(312)	(312)
Dividend to shareholders	(229)	(366)	(916)	(1,099)	(1,283)
Others	33	(222)	(50)	(50)	(50)
Financing CF	**4,831**	**1,264**	**1,721**	**1,213**	**(4,132)**
Net cash inflow/ (outflow)	**994**	**665**	**(618)**	**14,693**	**14,659**
Cash- beginning	11,230	12,224	12,888	12,270	26,964
Cash- year-end	**12,224**	**12,888**	**12,270**	**26,964**	**41,623**

Source(s): Company, ABCI Securities estimates

Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate
Hold	Market return – 6% ≤ Stock return < Market return rate
Sell	Stock return < Market return – 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months
Market return: 5-year average market return rate from 2007-2011
Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	2.6 ≤180 day volatility/180 day benchmark index volatility
High	1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 ≤180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.
Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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