

China Residential Property Sector

Key takeaways from investors meeting

We held a one-day investors meeting with Hopefluent (733), R&F Properties(2777) and Evergrande(3333) on May 18. The investors' concerns were on sales momentum, liquidity of property developers, and policy risks of the sector.

After the talk with the management we expect May's sales to be broadly stronger than April. Going forward, backed by policy bias on genuine demand and price cut offered by property developers, we are expecting to see normalizing genuine demand. The destocking activity of property developers is expected to continue and ASP may follow downward trend. However, with supply (GFA start + inventory) continuing to go down, we see possibility that the ASP trend will stabilize and developers regain pricing power in 6-12 months.

Volume stays strong:

- According to Hopefluent, one of the leading agents in China, the transaction volume in May is expected to see 5-10% improvement against April and may reach the high level in Mar. Early May is one of the traditional peak season which partly explained the increase in sales volume but the major reason is a result of price incentives.
- Price downward trend continues, according to Hopefluent. Pricing strategy are general the same with projects in outskirts area offering most discount which is at 15-20% YoY while 5-10% YoY in the downtown.
- Some of investors doubt whether the momentum can sustain into Jun-Jul as a mid-year weak season is coming. The management of Hopefluent explained that they expect the mass market buyers, the current dominant demand, are not very sensitive to seasonal factor compared to upgraders and investors. With more projects launch in June, they expect the sales momentum more likely to continue.
- The management of Hopefluent agreed that the release of pending demand was first seen in first tier cities while in May, the rebound is coming in broad-based. And regional difference is no longer a key factor for differentiated sales performance but the location and positioning. The projects in downtown area or mass market targeting outperformed.

We are expecting to see normalizing genuine demand backed by policy bias on genuine demand and price cut offered by property developers. The developers are still keen to destock inventory at current stage.

For the whole year 2012, we maintain our view that the primary

Investors Meeting

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April Sales Performance of China Developers
Dated on 15 May 2012

Mar Sales Performance of China Developers
Dated on 12 April 2012

Jan Sales Performance of China Developers
Dated on 14 Feb 2012



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residential GFA sold will decline by 11.2% YoY to 861mn sq.m.

With the GFA start declining (according to NBSC) and the destocking activity continuing, the over-supply situation in residential market will improve gradually. We see possibility that the ASP trend will stabilize and developers regain pricing power in 6-12 months.

Liquidity improving: R&F Properties and Evergrande both expect to see net gearing (ie. net debt/ equity) to come down by end-2012.

R&F intends to achieve end-2012 net gearing of 80.0%, down from 85.1% in end-2011. Evergrande expects the end-2012 net gearing to drop below 60.0% from 67.5% in end-2011.

With sales on track, slowing down in land acquisitions and GFA start, the liquidity situation of property developers has been improving. We expect the PBOC to slash bank reserve ratio further for the rest of this year in a bid to boost economy. We understand that any liquidity easing may not directly target to property sector. However, the more credit availability will support the release of genuine demand and the financial situation of property developers will therefore continue to improve.

Tightening policy remains intact while police stance will be still on genuine demand side: All the management we have met expects China's property austerity drive to continue this year. However, a differentiated mortgage policy will maintain to ensure first home mortgage access.

Investors observed some of banks stop offering discount for newly approved first home mortgages. Management of R&F believed that it is due to deployment of loans elsewhere instead of policy stance change from government.

We expect government to introduce more measures such as favorable mortgage rate, easier approval for pre-sales permits on high ASP projects, selective home purchase restriction easing to boost the genuine demand for new homes and to avoid over-turbulence on economy as well.



Evergrande(3333) -Maintain BUY

Key Data

Price(18/5/2012)	HK\$3.66
Price target	HK\$5.82
Upside potential	59.0%
52Wk H/L(HK\$)	6.27/2.13
Issued shares(mn)	14,927
Market Cap(HK\$m)	54,632.8
15-day avg vol(mn)	83.8
Auditors	PwC
Major shareholder:	
Xu jiajin*	68.1%

Source: Company data & Bloomberg

*The founder and Chairman of the group

Key takeaways from investors meeting on May 18

We maintain our POSITIVE view on Evergrande. The risk profile of the group is improving and the valuation will therefore be enhanced in longer term. Although the sales outlook on Shanghai Qidong project remains an overhang, the short term sales momentum regains. The counter is trading at 62.3% discount to 2012NAV of HK\$9.7 or at est FY12PE of 4.2x and PB of 1.1x. The PB valuation is approaching to 0.83x, the lowest level since listing. We expect the stock to find strong support at HK\$3.29, representing 1.0x PB. Based on 40% of NAV(HK\$9.7), our target price is at HK\$5.82. We maintain our BUY rating on the stock.

Risk profile improving: With the group deliberately slowing down the land acquisition pace and targeting to maintain net gearing below 60%, the risk profile of the group will improve. Investors are therefore gaining more confidence on the group based on our talk.

- The group's land bank is expected to stabilize at 137mn sq.m. in end-2012, at the same level as in end-2011 and a huge land premium capex is not expected. A slowdown of scale expansion could reduce its operational risk in our view.
- Going forward, the management targets a gearing ratio below 60%. We expect it to be achievable as management now purses a stable growth (target a 10-20% YoY growth in major operating indicators). We estimate the end-2012 net gearing at 57.8%.

Results and forecast

FY ended 31/12	2011A	2012E	2013E
Revenue(Rmbmn)	61,918	76,788	96,232
Chg(YoY)	35.2%	24.0%	25.3%
Core net profit^ (Rmbmn)	8,610	10,535	12,210
Chg(YoY)	56.3%	22.4%	15.9%
Core EPS (Rmb/share)	0.57	0.71	0.82
PE(x)	5.3	4.2	3.6
DPS (HK\$)	0.2340	0.2166	0.2510
Yield	6.4%	5.9%	6.9%
NBV/share(Rmb)	2.15	2.71	3.35
Chg(YoY)	57.0%	26.2%	23.7%
PB(x)	1.39	1.10	0.89

^Excluding revaluation G/L on investment property;

@Rmb0.8121/HK\$

Source: Companies' announcements and ABCI Securities estimates

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We expect the improved risk profile will reduce the WACC (we using 12.7% currently) and therefore enhance its valuation in longer term. Our sensitivity analysis shows that for 1ppt change in WACC, valuation will change by 2.5-4.4%.

Targeting gross profit margin at 30-35% for FY12-13: Investors are concerned with the margin erosion. We are of view that the cost edges in land (land/ASP at 9.3%) and economies of scale will translate to sustainable margin for the group. We estimate the GP margin for FY12-13 to be at 30.8-32.3 % (vs 33.3% for FY11). The group intends to achieve GP margin of 30-35% for FY12-13.

Sales momentum regains: After a 3-5% price cut on project level in April, the group will keep the price stable in the short term and look for possibility to raise ASP in 2H12. Even without any further ASP cut in May, management expects to see encouraging sales. We expect the management's confidence comes from 6-10 new projects launch and steady pick up in demand in lower tier cities. Our channel check with Hopefluent(733) and R&F(2777) both indicated that the residential demand didn't slow down as markets were concerned. We expect the contacted sales for May to come in at Rmb9.5bn(22.1% YoY or 16.0% MoM), close to the record high of Rmb9.8bn.



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View on Shanghai Qidong project becoming conservative: The management's view on the sales outlook for the mega size project Qidong(GFA ~7mn or 5% of total land reserve) is becoming conservative. As we have mentioned that due to non-first-home buyers target and a brand new nature, demand for the project is hard to gauge at current stage. The group sets annual contracted sales budget at Rmb80.0bn for 2012. In our base case scenario, the contracted sales amount is estimated at Rmb81.9bn up 1.9% YoY and 2.3% higher than the group target. We build in 5%YoY ASP decrease or ASP at Rmb6,261/sqm for 2012 sales. As the Qidong project is not included into the sales budget, the upcoming launch of this project will swing upward of the annual contracted sales of the group .The presales for the project are scheduled in mid-June.

PB valuation approaching to bottom: The counter is trading at 62.3% discount to 2012NAV of HK\$9.7 or at est FY12PE of 4.2x and PB of 1.1x. The PB valuation is approaching to 0.83x, the lowest level since listing. We expect the stock to find strong support at HK\$3.29, representing 1.0x PB. Based on 40% of NAV(HK\$9.7), our target price is at HK\$5.82. We maintain our BUY rating on the stock.

	2H09	1H10	2H10	1H11	2H11
Price high(HK\$)	4.85	4.34	4.22	5.90	6.27
Price low(HK\$)	3.50	1.83	2.16	3.25	2.17
Ending NBV/share(Rmb)	0.86	1.01	1.37	1.84	2.15
Ending NBV/share(HK\$)	0.98	1.16	1.65	2.24	2.62
P/B high	4.96	3.74	2.56	2.63	2.40
P/B low	3.58	1.58	1.31	1.45	0.83

Source: Bloomberg and ABCI Securities



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Disclosures

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Disclosures of Interests

Li Hong-ying has financial interest in Evergrande Real Estate Group Limited as at 22 May 2012.

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