Corporate Snippet

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No signs of recovery in transactions — Hong Kong Properties

Midland (1200 HK, HK$3.25) — SELL (unchanged)

Target price: HK$2.09 (-36%)

Interim results disappointing. 1H FY12/06 revenue was down 35% to HK$914.5m while net profit fell 86% to HK$32m, much lower than the consensus. An interim DPS of HK$0.028 was declared (-72% YoY). According to Bloomberg, the consensus 2006 EPS forecast is HK$0.223 or a net profit of HK$165m. Nonetheless, the company beat our own forecast of a loss of HK$50-60m for 1H06.

Managed to slash staff costs. The company generated roughly the same revenue as in 2H05, but managed to turn from a loss of HK$20.4m to a slight profit for this half. The biggest discrepancy stemmed from a HK$81m reduction in staff costs HoH. In other words, the company cut staff costs by 13.9% HoH with only a 7.3% and 7.5% reduction in the number of employees and sales agents during the same period. We believe the company might have trimmed the overall commission payout % to its agents as many of them failed to hit the performance targets due to a sluggish market. The company also closed 16 shops to just 471 during the period and another 18 in July and Aug. We think all the closures are due to expiry of rental leases.

No turnaround yet. Going forward, we don't expect a huge turnaround anytime soon. Secondary residential transactions have become even more lethargic in 2H06 as developers try to speed up primary flat sales at near secondary market prices since Aug, which have attracted most buyers' attention. In fact, the July and Aug secondary residential transactions by value were down by 21.8% YoY and 5.3% YoY respectively while primary flat sales value were also down by 47.4% YoY in aggregate for July and Aug. We expect primary and secondary sales values are likely to fall by at least 35% YoY and 19% respectively in 2006 or a fall of 24% YoY on overall average.

Valuation. We now estimate a net profit of HK$78m for 2006 compared with a loss of HK$105m previously. Our new target price is HK$2.09 (was HK$1.83), based on 1.5x FY12/06F P/B.

What will be a major de-rating trigger? Despite the appalling results, Midland's share price continues to stay firm as the stock is tightly held by a number of major long-term institutional investors. In our opinion, the secondary property market will continue to slow down since developers will increasingly adopt a more aggressive pricing strategy to attract homebuyers, hence causing a continuing slump in the secondary market. In addition, rental yield for new flats, especially luxury ones, is not particularly attractive under the current interest rate environment, hence new flat value will likely see more downward pressure in the near term. All in all, a vicious cycle will keep secondary property market transactions at bay. Note that secondary market transactions accounted for 70.2% and 83.2% of the overall market by value in 2005 and the first eight months of 2006 respectively, indicating the importance to Midland's revenue contribution.

Table 1: Financial summary

Year to Dec	Net profit HK$m	EPS HK$	EPS Δ%	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	330.7	0.470	164.5	6.9	2.82	4.3	2.2	48.1	52.1	Cash
06A	213.6	0.292	(37.8)	11.1	2.38	7.1	3.1	23.6	21.8	Cash
07F	77.8	0.106	(63.7)	30.7	2.33	14.6	0.9	7.7	5.6	Cash
08F	104.6	0.142	34.5	22.8	2.24	10.5	0.9	10.0	9.1	Cash
09F	131.0	0.178	25.2	18.2	2.12	8.7	1.1	12.0	11.0	Cash