

Hong Kong Property



Still downside

Key points:

- Hong Kong has entered a technical recession, with falling retail sales, rising unemployment and increasing economic uncertainties
- Centaline's property index has fallen 18.3% to 59.93 in November, and total registered secondary residential market transactions are expected to hit a 65-month low in November
- Depressed economies of China and the US will weigh down the local economy, prolonging Hong Kong's property down cycle
- NAV-wise property counters look attractive but we expect developers to revalue their assets downwards
- Factoring a 20% downward NAV revision, the sector still has a 27% downside to its historical valuation trough

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Tue, 18 Nov 2008

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Technical recession. Hong Kong's GDP grew 1.7% in 3Q 2008, compared with 4.2% in 2Q and after two consecutive quarters of slowing growth, the SAR has officially entered a technical recession. We expect a further growth moderation in 4Q. The government has cut its 2008 GDP growth forecast to 3-3.5% from 4-5%. Asset prices have already begun falling, resulting in private consumption expenditure growing by only 0.5% in real terms, compared with 4.2% in 2Q. Although the unemployment rate rose only 0.2pct to 3.4% in 3Q, we believe labour market conditions have deteriorated rapidly since the beginning of October, with many SMEs and large businesses across many industry groups imposing hire freezes or announcing layoffs. We expect the unemployment rate to reach 5.0%+ by mid-2009. With wage growth expectations vanishing overnight, the level of uncertainty in the economy is rising rapidly.

Warning bells from Hongkong Land. The city's barometer landlord, Hongkong Land (HKL SP), has indicated that rents for commercial properties in Central and retail properties were likely to fall 50-60% and 25%, respectively. We think that this vicious circle of wealth destruction (declining property prices, stock market and exports, weakening consumer confidence, contracting retail sales, which account for around 14% of the gross asset value, resulting in a shrinking GDP) will continue to pressure property prices in Hong Kong.

Obvious deterioration. Between June and November, local property agency Centaline's property index has fallen 18.3% to 59.93. The number of confirmed secondary residential market transactions recorded with the Land Registry has been falling since Apr 2008 and totaled 56 in October, the lowest level since Oct 2003. For November, Centaline forecasts total registered second hand residential transactions at 2,800, down 24.3% MoM, a 65-month low. November's transaction value is forecast at HK\$7.5b, down 27.3% MoM. The weakening property environment is further exacerbated by rising mortgage rates and lower loan-to-value (LTV) ratios. With Hong Kong's property market traditionally sentiment driven, mounting concerns may culminate in panic selling.

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Lengthened down cycle to cap property appreciation. Hong Kong's corporate sector is a lot less leveraged compared with that of China. Hong Kong property plays average a net gearing of 14% and their China counterparts 47.7%. Thus, we believe that the deleveraging process in Hong Kong will be shorter and the local economy is likely to bottom out faster. However, US GDP growth is likely to stay negative for the next 4-5 quarters and the effects of China's fiscal stimulus package are unlikely to filter through to domestic consumption until 2H 2009. In the past, property down cycles lasted a minimum of 18 months, but this time China's and US' depressed economies may continue to drag down the local economy for much longer, capping any property appreciation potential.

Property counters – still room to fall. Hong Kong property developers are trading at an average of 37.7% to BV and 43.0% to NAV on a consensus basis. On face value, the sector looks attractive, considering that traditionally during historical troughs they trade at a discount of around 50% to NAV and 45% to BV (SARS: 45%; Asian financial crisis: 49%). However, we expect many developers to further revalue down their assets, thus narrowing down their discount to BV and NAV. Factoring a 20% downward NAV revaluation, the sector will average a 29% discount to NAV, suggesting some 27% downside to valuation troughs. Given that we are only at the beginning of the property down cycle, we believe that Hong Kong's property sector will continue to trend down.

Table 1: Sensitivity analysis (NAV)

Consensus NAV	CK	HLG	Hen	SHK	NWD	Wheel	Sino	HLP
Base case	130.1	37.7	76.2	142.1	24.6	8.9	19.0	25.4
-10.0%	117.1	33.9	68.6	127.9	22.2	8.0	17.1	22.8
-20.0%	104.1	30.2	61.0	113.7	19.7	7.1	15.2	20.3
-30.0%	91.1	26.4	53.4	99.5	17.2	6.2	13.3	17.8
-40.0%	78.1	22.6	45.7	85.3	14.8	5.3	11.4	15.2
-50.0%	65.1	18.9	38.1	71.1	12.3	4.5	9.5	12.7
-60.0%	52.0	15.1	30.5	56.8	9.8	3.6	7.6	10.1

Source: Bloomberg, SBI E2-Capital

Table 2: Sensitivity analysis (discount-to-NAV)

Consensus NAV	CK	HLG	Hen	SHK	NWD	Wheel	Sino	HLP	average
Base case	-48.0%	-40.6%	-65.1%	-58.9%	-72.4%	48.3%	-67.9%	-39.7%	-43.0%
-10.0%	-42.3%	-34.0%	-61.2%	-54.3%	-69.3%	64.8%	-64.4%	-33.0%	-36.7%
-20.0%	-35.1%	-25.8%	-56.4%	-48.6%	-65.5%	85.4%	-59.9%	-24.6%	-28.8%
-30.0%	-25.8%	-15.2%	-50.2%	-41.3%	-60.5%	111.9%	-54.2%	-13.8%	-18.6%
-40.0%	-13.4%	-1.0%	-41.9%	-31.5%	-54.0%	147.2%	-46.5%	0.5%	-5.1%
-50.0%	3.9%	18.8%	-30.2%	-17.8%	-44.8%	196.6%	-35.9%	20.6%	13.9%
-60.0%	29.9%	48.5%	-12.8%	2.7%	-31.0%	270.8%	-19.8%	50.8%	42.4%

Source: Bloomberg, SBI E2-Capital

Table 3: Sensitivity analysis (book value)

BV	CK	HLG	Hen	SHK	NWD	Wheel	Sino	HLP
Base case	100.4	27.6	56.5	85.5	19.4	26.1	11.5	16.0
-10.0%	90.3	24.8	50.8	77.0	17.4	23.5	10.4	14.4
-20.0%	80.3	22.1	45.2	68.4	15.5	20.9	9.2	12.8
-30.0%	70.3	19.3	39.5	59.9	13.6	18.3	8.1	11.2
-40.0%	60.2	16.5	33.9	51.3	11.6	15.7	6.9	9.6
-50.0%	50.2	13.8	28.2	42.8	9.7	13.1	5.8	8.0
-60.0%	40.2	11.0	22.6	34.2	7.7	10.4	4.6	6.4

Source: Bloomberg, SBI E2-Capital

Table 4: Sensitivity analysis (discount-to-book value)

BV	CK	HLG	Hen	SHK	NWD	Wheel	Sino	HLP	average
Base case	-32.7%	-18.8%	-52.9%	-31.7%	-64.9%	-49.4%	-47.2%	-4.5%	-37.7%
-10.0%	-25.2%	-9.7%	-47.7%	-24.1%	-61.0%	-43.8%	-41.3%	6.2%	-30.8%
-20.0%	-15.8%	1.6%	-41.1%	-14.6%	-56.1%	-36.8%	-33.9%	19.4%	-22.2%
-30.0%	-3.8%	16.1%	-32.7%	-2.4%	-49.8%	-27.8%	-24.5%	36.5%	-11.1%
-40.0%	12.2%	35.4%	-21.5%	13.8%	-41.5%	-15.7%	-11.9%	59.2%	3.8%
-50.0%	34.7%	62.5%	-5.8%	36.6%	-29.8%	1.1%	5.7%	91.1%	24.5%
-60.0%	68.4%	103.1%	17.8%	70.7%	-12.2%	26.4%	32.1%	138.9%	55.6%

Source: Bloomberg, SBI E2-Capital

Table 5: Valuation table

Ticker	Name	Mkt Cap (HK\$m)	Last Price (HK\$)	Net Gear (%)	BV/Sh (HK\$)	NAV/Sh (HK\$)	P/B (x)	P/NAV (x)	Disc to BV (%)	Disc to NAV (%)
1 HK	Cheung Kong	156,572.7	67.60	14.2	100.38	130.12	0.67	0.52	-32.7	-48.0
10 HK	Hang Lung Group	29,883.5	22.40	0.3	27.57	37.72	0.81	0.59	-18.8	-40.6
12 HK	Henderson Land	57,103.4	26.60	16.1	56.46	76.24	0.47	0.35	-52.9	-65.1
16 HK	Sun Hung Kai	149,757.1	58.40	14.6	85.51	142.10	0.68	0.41	-31.7	-58.9
17 HK	New World Dev	25,557.3	6.80	31.0	19.36	24.62	0.35	0.28	-64.9	-72.4
20 HK	Wheelock	26,820.4	13.20	21.0	26.11	8.90	0.51	1.48	-49.4	48.3
83 HK	Sino Land	29,504.3	6.10	20.0	11.54	19.02	0.53	0.32	-47.2	-67.9
101 HK	Hang Lung Prop	63,421.0	15.30	-6.2	16.01	25.37	0.96	0.60	-4.5	-39.7