

Too avant-garde.... but someone likes it

➤ **08 interim results turned red.** SOHO China released its 08 interim results last week. Turnover dropped 75.3% to RMB 105m because of the reduction in the areas booked from 14,591 sqm in 1H07 to 3,173 sqm in 1H08. However, ASP of properties booked surged to RMB 35,437/sqm in 1H08 from RMB 28,874/sqm one year ago. Therefore, gross profit margin expanded to 61% from 55% in the corresponding period. Surging SGA expense and loss in FX resulted in a loss of RMB 146m in 1H08.

➤ **3 projects will complete soon.** 3 properties for sales will complete in coming months. Namely, Guanghualu SOHO, Beijing SOHO Residences and Chaoyangmen SOHO I. Total GFA amounts to 209k sqm. Since all Guanghualu SOHO and 41% of Beijing SOHO Residences are sold out, about 50% of properties completed in 2008 are locked-in. Furthermore, Sanlitun SOHO was launched in July 2008 and received a prompt response with RMB 5.9bn properties pre-sold. The company expects that contracted sales amount will double this year from RMB 4bn in 2007.

➤ **Healthy financial position facilitates future acquisitions.** In mid-08, SOHO had RMB 10.7bn cash on hand while bank borrowing amounted to RMB 3.8bn. In other words, the company owned net cash of RMB 9.9 bn or cash per share was RMB 1.9. SOHO purchased two projects, Chaoyangmen SOHO and Zhongguancun SOHO, with total considerations of RMB 6.4bn in May and August. Currently, the company was negotiating with other parties for more acquisitions.

➤ **Estimated net cash of HK\$3.24 per share at end-08.** We forecast net profit to be RMB 1.61bn, RMB 2.61bn and RMB 3.55bn in 2008-10E, respectively. Using SOTP method, we estimate end-08 NAV per share to be HK\$8.84. Applying 30% discount to GAV, target price is HK\$7.16. Upside potential is 159%. Maintain as **BUY**

HK\$1=RMB0.88

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Industry China Properties

Price HK\$ 2.76

Target price HK\$ 7.16
(+159%)

Stock code 410

Market cap. HK\$14,398mn

O/S shares 5,217mn

52wk high/low HK\$ 11.98/2.5

NAV per share HK\$8.84

Major shareholder Marita Pan
(63.5%)

Earning Summary

Year-end 31 Dec	FY06A	FY07A	FY08E	FY09E	FY10E
Turnover (RMB m)	1,740	6,954	6,478	9,399	11,415
Growth (%)	(55)	300	(7)	45	21
Net Profit (RMB m)	342	1,966	1,609	2,611	3,551
Growth (%)	(52)	476	(18)	62	36
EPS (RMB)	0.091	0.477	0.308	0.501	0.681
Growth (%)	N.A.	424	(35)	62	36
PER (x)	26.7	5.1	7.9	4.9	3.6
DPS (RMB)	0.000	0.100	0.100	0.180	0.230
Yield (%)	0.0	4.1	4.1	7.4	9.5

Source: Company information, FSSL

Price Performance



Source: Bloomberg

08 interim results turned red

Loss in 1H08

SOHO China released its 08 interim results last week. Turnover dropped 75.3% to RMB 105m because of the reduction in the areas booked from 14,591 sqm in 1H07 to 3,173 sqm in 1H08. Since the company did not have any new properties completed in 1H08, properties booked in the period were unsold inventories. However, ASP of properties booked surged to RMB 35,437/sqm in 1H08 from RMB 28,874/sqm one year ago. Therefore, gross profit margin expanded to 61% from 55% in the corresponding period. Selling and administration expenses surged to RMB 263m in 1H08 from RMB 140m in 1H07 because of marketing expenses incurred for Sanlitun SOHO and Beijing SOHO Residences. In addition, administration expense also soared because of the expansion in operation. Furthermore, a loss in foreign exchange in RMB 95m was recorded in the period. So, SOHO made a loss of RMB 146m in 1H08, compared with net profit of RMB 63m one year ago.

Table 1: 2008 Interim Results

(RMB m)	1H08	1H07	Change
Revenue	104.6	423.4	-75.3%
Gross profit	63.9	232.3	-72.5%
Operating profit	(139.7)	135.3	N.A.
Finance charge	20.5	16.9	21.4%
Associated companies	0.0	0.0	N.A.
Exceptional items	0.0	0.0	N.A.
Pre-tax profit	(119.2)	152.2	N.A.
Taxation	(31.7)	(91.4)	-65.3%
Minorities	5.1	2.2	131.2%
Net profit	(145.8)	63.0	N.A.

Source: Company

Bright long-term outlook

Although SOHO China recorded the loss in 1H08, we are still confident to its future. More properties will be completed in 2H08 and this will bring in handsome profit to the company. Furthermore, global stock market has the short-term shock due to the financial crisis in the US investment banks. However, we believe that long-term outlook in Mainland property market is still promising as the strong demand in the property market in China is existed.

3 projects complete in 2H08

3 projects deliver in 2H08

3 properties for sales will complete in coming months. Namely, Guanghualu SOHO, Beijing SOHO Residences and Chaoyangmen SOHO I. GFA of above premises are 75,766 sqm, 66,333 sqm and 66,845 sqm respectively. Thus, total GFA delivered in 2008 amounts to 209k sqm. Since all Guanghualu SOHO and 41% of Beijing SOHO Residences are sold out, about 50% of properties completed in 2008 are locked-in. Chaoyangmen SOHO I will hit the market in 4Q08. In 1H08, pre-sales of SOHO China mainly came from two projects, Guanghualu SOHO and Beijing SOHO Residences. Presales in 1H08 amounted to RMB 703m.

Table 2: Pre-sale activities in 1H08

Project	Total saleable area (sqm)	% of saleable area by mid-08	Total pre-sale amount by mid-08 (RMB m)	Pre-sale amount in 1H08 (RMB m)	Pre-sale area in 1H08 (sqm)	ASP in 1H08 (RMB/sqm)
Guanghualu SOHO	58,860	100%	2,242	91	2,277	39,793
BJ SOHO Residences	54,325	41%	1,066	613	12,707	48,230

Source: Company

Prompt response of Sanlitun SOHO

In addition, Sanlitun SOHO was launched in July 2008 and received a prompt response with RMB 5.9bn properties pre-sold, of which RMB 4.9bn will be booked in 2009. Office, shopping mall and residential units in Sanlitun SOHO were sold at RMB 36,800/sqm, RMB 58,500/sqm and RMB 41,400/sqm. The company expects that contracted sales amount will double this year from RMB 4bn in 2007.

Table 3: Pre-sale activities for Sanlitun as at 12 Sept 2008

Type	Pre-sale amount (RMB m)	Pre-sale area (sqm)	ASP (RMB/sqm)
Retail	3,814	65,226	58,478
Office	1,655	45,019	36,766
Residential	469	11,351	41,340
Total	5,939	121,596	48,840

Source: Company

Sound financial status

Ample cash on hand

In mid-08, SOHO China had RMB 10.7bn cash on hand while bank borrowing amounted to RMB 3.8bn. In other words, the company owned net cash of RMB 9.9 bn or cash per share was RMB 1.9. Without any gearing, SOHO is financial strong enough to do any acquisition with attractive terms.

Two acquisitions in 2008

SOHO purchased two projects, Chaoyangmen SOHO and Zhongguancun SOHO, with total considerations of RMB 6.4bn in May and August. Chaoyangmen SOHO is located within the Second Ring Road in Beijing. Total GFA is 485,166 sqm, of which a portion of 53,075 sqm in Phase I was sold to Bank of China. Remaining area in Phase I (about 66,845 sqm) will be launched later this year. SOHO acquired another project, Zhongguancun SOHO in August 2008. Construction of Zhongguancun SOHO is expected to complete by end-08. The company will upgrade the interior design and decoration of Zhongguancun SOHO and then launch the project in 2009.

Explore Shanghai market

After IPO last October, SOHO acquired 800,000 sqm land bank in the central area of Beijing. Currently, the company was negotiating with other parties for more acquisitions. Acquisition not only limits to the projects in Beijing, SOHO is also interested to acquire any properties in Shanghai, especially along two sides of the Bund.

Figure 1: Potential acquisitions in Beijing



Source: Company

Attractive valuation

High margin

We have mildly adjusted downward our earning forecasts in order to reflect larger than expected LAT as well as administration cost. We forecast net profit to be RMB 1.61bn, RMB 2.61bn and RMB 3.55bn in 2008-10E, respectively. That translates into a CAGR for EPS of 12.6% in the coming three years. Meanwhile, gross margin is expected to maintain at 48-60% level because SOHO focuses on the development of high-end product.

Figure 2: Revenue and gross profit

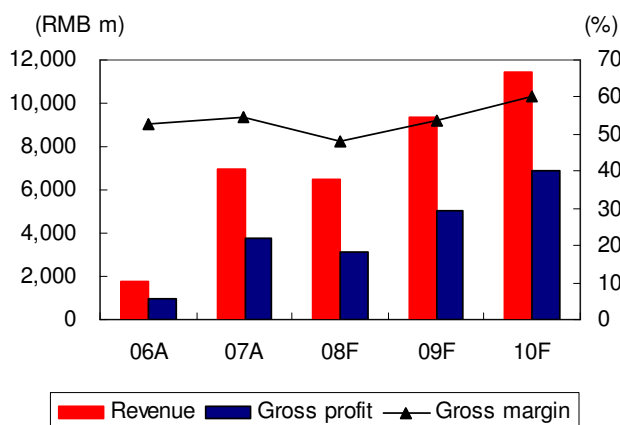
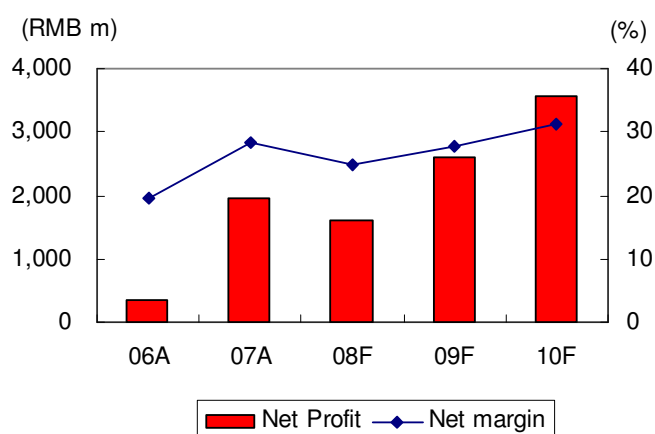


Figure 3: Net profit



Source: Company information, FSSL

Source: Company information, FSSL

Undemanding valuation

The counter is trading at 7.9x 08E PE or 4.9x 09E PE. Valuation is undemanding. Meanwhile, we estimate that net cash per share is HK\$3.24 by end-08 because the company achieved properties contracted sales amount of RMB 6,643m year-to-date. We expect cash on hand will continue to increase as Chaoyangmen SOHO I is planned to launch before year-end.

HK\$7.16 target price

Assuming 16.1% WACC, 6% cap rate and 0.86 RMB-HKD exchange rate, we estimate end-08 NAV per share to be HK\$8.84. Applying 30% discount to GAV, target price is HK\$7.16. Upside potential is 159%. Maintain as **BUY**

Table 4: 08 NAV estimation

	(HK\$ m)	NAV per share	% of NAV	Remark
Properties under development	27,497	5.27	60%	WACC of 16.1%
Investment Property	1,733	0.33	4%	6% cap rate
Gross Amount	29,230	5.60	63%	
Add: Net Cash	16,881	3.24	37%	Dec-08
NAV	46,111	8.84	100%	

Source: FSSL

End-08 exchange rate: HK\$ 1=RMB 0.86

Completion schedule

Project	Location	Interest	Total GFA (sqm)	Attributable GFA (sqm)	Selling Price (RMB/sqm)	Cost (RMB/sqm)	Gross Margin	08 NPV
In FY08								
Guanghualu SOHO	Beijing	95%	75,766	71,978	32,000	15,000	53.1%	2,195
Chaoyangmen SOHO N1	Beijing	100%	40,000	40,000	35,000	14,000	60.0%	840
Beijing SOHO Residences	Beijing	95%	66,333	63,016	40,000	25,000	37.5%	2,363
			182,099	174,994				5,398
In FY09								
Chaoyangmen SOHO N1	Beijing	100%	26,845	26,845	35,000	14,000	60.0%	434
Zhongguancun SOHO	Beijing	100%	58,850	58,850	35,000	20,000	42.9%	598
Sanlitun SOHO Phase I	Beijing	95%	200,000	190,000	32,000	14,000	56.3%	4,953
			285,695	275,695				5,985
In FY10								
Chaoyangmen SOHO N2	Beijing	100%	60,464	60,464	35,000	14,000	60.0%	736
Sanlitun SOHO Phase II	Beijing	95%	265,680	252,396	35,000	14,000	60.0%	5,853
			326,144	312,860				6,589
After 2010								
Chaoyangmen SOHO South	Beijing	100%	41,200	41,200	40,000	18,000	55.0%	342
Chaoyangmen SOHO South	Beijing	100%	88,381	88,381	50,000	20,000	60.0%	1,129
Chaoyangmen SOHO South	Beijing	100%	62,932	62,932	50,000	20,000	60.0%	804
Guanghualu SOHO II	Beijing	95%	180,000	171,000	38,000	12,000	68.4%	3,402
			372,513	363,513				5,676

Source: Company information, FSSL

Financial Summary

Income statement						Key statistics and ratios					
Year end Dec 31 (RMB m)	2006	2007	2008E	2009E	2010E	Year end Dec 31	2006	2007	2008E	2009E	2010E
Turnover	1,740	6,954	6,478	9,399	11,415	Growth (%)					
COSG	(819)	(3,157)	(3,355)	(4,353)	(4,566)	Turnover	(55)	300	(7)	45	21
Gross profit	921	3,797	3,123	5,046	6,849	Operating profit	(53)	344	(19)	64	37
Other revenue	32	(7)	48	35	31	Net profit	(52)	476	(18)	62	36
SGA	(182)	(363)	(389)	(517)	(616)	EPS	N.A.	424	(35)	62	36
Operating profit	771	3,427	2,783	4,565	6,263	Margins (%)					
Interest expenses	16	330	138	152	149	Gross profit	53	55	48	54	60
Associated	1	0	0	0	0	Operating profit	44	49	43	49	55
Exceptional items	0	0	0	0	0	Net Profit	20	28	25	28	31
Pre-tax profit	788	3,757	2,921	4,716	6,412	Others (%)					
Tax	(377)	(1,769)	(1,248)	(2,025)	(2,745)	Effective tax rate	48	47	43	43	43
After-tax profit	410	1,987	1,672	2,691	3,667	Payout ratio	0	27	32	36	34
Minority interest	(69)	(22)	(63)	(80)	(116)	ROE	25	14	10	15	18
Net profit	342	1,966	1,609	2,611	3,551	ROA	4	8	5	8	11
Core earnings	342	1,966	1,609	2,611	3,551	Valuation					
Dividends	0	(523)	(522)	(939)	(1,200)	P/Sales (x)	5.2	1.4	2.0	1.3	1.1
Retained earnings	342	1,442	1,087	1,672	2,351	PE (x)	26.7	5.1	7.9	4.9	3.6
EPS (RMB)	0.091	0.477	0.308	0.501	0.681	P/B (x)	7.1	0.9	0.8	0.7	0.6
DPS (RMB)	0.000	0.100	0.100	0.180	0.230	P/Cash flow (x)	N.A.	5.1	2.2	N.A.	4.1
						Dividend yield (%)	0.0	4.1	4.1	7.4	9.5
Balance sheet						Cash flow statement					
Year end Dec 31 (RMB m)	2006	2007	2008E	2009E	2010E	Year end Dec 31 (RMB m)	2006	2007	2008E	2009E	2010E
Cash & deposits	1,081	13,749	16,638	14,508	14,930	Operating Profit	771	3,427	2,783	4,565	6,263
Trade debtors	434	274	480	420	500	Depreciation	19	28	52	47	57
Inventories	5,738	7,286	12,000	14,800	16,000	Change in wc	(2,888)	1,056	(3,062)	(2,940)	(1,480)
Other current assets	379	77	30	50	80	Taxation	(148)	(316)	(497)	(2,125)	(2,845)
Intangible assets	0	0	0	0	0	Others	1,456	(2,213)	6,612	(468)	1,082
Other LT assets	357	1,252	540	630	720	CF from Operation	(790)	1,982	5,887	(921)	3,078
Associated	0	0	0	0	0	Capex	(24)	(604)	(2,182)	(197)	(357)
Fixed assets	441	820	750	900	1,200	Associated investments	0	0	0	0	0
Total assets	8,430	23,458	30,438	31,308	33,430	Others	(18)	(777)	747	(100)	(100)
ST debt	0	1,000	2,400	1,800	1,200	CF from Investing	(42)	(1,382)	(1,435)	(297)	(457)
Trade creditors	629	2,342	4,200	4,000	3,800	Equity raised	0	11,382	(48)	0	0
Other current liabilities	5,411	4,343	7,800	6,800	7,400	Change of Debts	800	1,200	620	(20)	(900)
LT borrowings	800	1,000	220	800	500	Dividend paid	(156)	(106)	(523)	(522)	(939)
Deferred taxation	0	51	55	55	55	Others	(40)	(85)	(63)	(20)	(10)
Other LT liabilities	68	103	120	140	160	CF from Financing	604	12,392	(14)	(562)	(1,849)
Total liabilities	6,907	8,840	14,795	13,595	13,115	Change in Cash	(228)	12,991	4,439	(1,780)	772
S'holders' funds	1,360	14,456	15,543	17,633	20,245	FX Change	0	(324)	(250)	(250)	(250)
Minorities	163	163	100	80	70	Cash at the beginning	1,309	1,081	13,749	17,938	15,907
Total	8,430	23,458	30,438	31,308	33,430	Cash at the end	1,081	13,749	17,938	15,907	16,430
Net gearing		Net Cash	Net Cash	Net Cash	Net Cash	Adj: OD or others	0	0	(1,300)	(1,400)	(1,500)
BVPS (RMB)	0.34	2.76	2.98	3.38	3.88	Cash at BS	1,081	13,749	16,638	14,508	14,930

Source: Company information, FSSL

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