

China Resources Land

FY05 final results : Hope value embedded

- **China Resources Land** (CRL) posted strong FY05 final results with net profit surging 18 times to \$384.5 million from FY04. Core net profit grew 191% Y/Y to HK\$230 million, 19% ahead of our estimates. DPS rose by 10% to HK¢3.3 from HK¢3.0 in 2H04.
- We raised our 12-month price target for CRL to HK\$6.0 from previous HK\$3.90 due to (1) development pipeline after the sites were cleared/resettled or have concluded the land premium payment, (2) revaluation of investment properties and (3) hope value on further injection coming on stream. We estimate development land bank which can be monetized in the near term would more likely to be injected, which could enhance CRL's NAV by HK\$1.31 (Rmb 1.36) per share based on our assumptions.
- Our price target is based on a 20% discount applied to investment property NAV and no discount on development properties. Added to this would be the hope value on the upcoming injection realizable within a 6-month horizon. We believe the major risks to our price target would be (1) policy risks and (2) injections not being realizable or bringing in less value enhancement.

Overweight

HK\$4.90

27 March 2006
Price Target: HK\$6.00

**Hong Kong
Property**

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Figure 1: Share price chart



Source: Datastream.

Table 1: Reuters: 1109.HK, Bloomberg: 1109 HK

HK\$ millions, year-end Dec

	FY05	FY06E	FY07E	FY08E		
Sales (HK\$MM)	2,707	3,778	5,904	11,325	52-week range	HK\$1.15-\$5.4
Net profit (HK\$MM)	385	717	863	1454	Market cap (HK\$MM)	16764.6
EPS (HK\$)	0.255	0.233	0.281	0.473	Market cap (US\$MM)	2149.3
DPS (HK\$)	0.033	0.065	0.079	0.118	Shares outstanding (MM)	3,104.6
Sales growth (%)	43.2	39.6	56.3	91.8	Free float	44.40%
Net profit growth (%)	1267.3	22.8	14.9	0.0	Avg daily value (HK\$MM)	32.8
EPS growth (%)	1267.3	22.8	14.9	0.0	Avg daily value (US\$MM)	4.21
ROE (%)	9.5	7.0	7.8	0.0	Avg daily volume (shs)	11.6404MM shares
P/E (x)	21.1	23.2	19.2	11.4	Index	HSI 15716.46
EV/EBITDA (x)	69.0	17.8	14.8	15.5	Exchange rate	HK\$7.8/US\$1
Div yield (%)	0.6	1.2	1.5	2.2	Performance	1 mth 3 mths 12 mths
NAV per share (HK\$)	5.63	6.8			Absolute (%)	24.8 53.1 214.1
BVPS (HK\$)	2.69	3.34	3.59	0.00	Relative (%)	25.7 49.6 198.5

Source: Company reports, JPMorgan estimates

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FY05 final results review

Results beat our estimates

China Resources Land (CRL) posted strong FY05 final results with net profit surging 18 times to \$384.5 million from FY04 which was restated on project completion basis. Stripping out (1) revaluation surplus of HK\$23 million net of deferred tax, (2) gains of HK\$97 million from disposal in Vanke B-shares and (3) forex gains of HK\$34 million from Rmb appreciation, core net profit grew 191% Y/Y to HK\$230 million, 19% ahead of our estimates.

Core net profit grew 190% to HK\$230 million

Higher admin expenses but tax rates are lower

Major discrepancies stem from the higher selling/marketing and admin expenses, as well as higher debt provision, which was offset by the lower tax. As CRL is extending its presence in other provincial cities (mainly Chengdu), the ratio of selling and admin expenses to revenue has increased. Nevertheless, some of the projects in western China enjoyed lower tax rates of below 33%. Also, the disposal gains of Vanke are non-taxable and this has thus led to a lower effective tax rate. Apart from these, the development profits were quite in line with our estimates.

DPS grew 10% Y/Y

Final DPS rose by 10% to HK¢3.3 from HK¢3.0 in 2H04. No interim dividends were paid in 1H05 and 1H04. Based on core profits, dividend payout dropped to 22% in FY05 from 57% in FY04. CRL has stepped up DPS throughout the past few years but this is far behind the strong run of CRL's share price since last October, resulting in a 0.6% yield. Nevertheless, we expect the company would pay out higher dividends this year as the rental income starts contributing to the company's bottom line, thus help stabilize cash flow and earnings.

Table 2: CRL-FY05 results summary

	FY04	1H05	2H05	FY05	Y/Y	Comment	FY05E	Var (%)
Property Sales	2,313	1,166	1,381	2,547	10%	Phoenix City Phase 2 booked in 2H05; 2 blocks of Grand Constellation sold	2,867	-11%
Rental Income	22	34	34	68	211%		69	-1%
Property management & others	74	40	52	92	24%		77	19%
Turnover	1,890	1,240	1,467	2,707	43%		3,013	-10%
Property development	205	250	275	525	156%	Improving margin from higher selling prices	530	-1%
Rental	4	17	16	33	799%		35	-6%
Pty management	1	2	6	7	916%		3	145%
Other operating income	27	16	30	46	69%		29	58%
Selling & marketing expenses	(19)	(16)	(31)	(47)	153%	Higher expenses due to expansion in other cities	(31)	51%
General admin expenses	(68)	(39)	(76)	(116)	69%	Ditto	(78)	48%
Allowance for bad debts	(68)	0	(116)	(116)	69%	Bad debt all cleared	(50)	131%
Net interest expenses	(29)	(49)	(23)	(67)	135%		(73)	-8%
Operating profit	5	180	71	237	5040%		365	-35%
Associate profit	16	2	14	16	-2%		5	229%
Exceptionals	59	55	177	232	295%		126	84%
Profit before tax	80	237	248	485	510%		496	-2%
Taxation	(109)	(24)	(23)	(47)	-57%	Lower tax as some of the tax have been paid in previous FY; also lower tax rate for Chengdu and disposal gains of Vanke are not taxable	(149)	-68%
Minority interest	50	(16)	(38)	(54)	-207%		(34)	58%
Net profit	21	197	188	385	1800%		313	23%
Core net profit	79	151	79	230	191%		194	19%
EPS	0.014	0.131	0.039	0.255	1702%		0.207	23%
Core EPS	0.053	0.101	0.052	0.152	188%		0.128	19%
DPS	0.03	0.00	0.03	0.033	10%		0.03	10%

Source: Company, JPMorgan estimates

Maintain Overweight; PT raised to HK\$6.0

**Our current NAV estimate is
HK\$5.63 per share**

NAV due to more land available for development

We revised our current NAV estimate to HK\$5.63 from HK\$5.06 per share. The upgrade was driven by more land sites included in the development pipeline after the sites were cleared/resettled or have concluded the land premium payment. Also, some HK\$200 million increase was contributed by an increase in the capital value of China Resources Building in Beijing. The building achieved a monthly rental of Rmb 7.3 million in August 2005 when the property was appraised for injection. Yet the gross rental income for FY05 reached Rmb 111.2 million and we believe this is due to the high-rent lease renewals and kick-in of turnover rents for the retail portion.

Table 3: CRL- Current NAV breakdown

HK\$	Current NAV (HK\$ million)	(\$/share)	% of GAV
<i>China development Properties</i>			
Residential	7,737	2.52	38.7%
Office	2,008	0.65	10.0%
Retail	275	0.09	1.4%
Others			
Sub-total	10,020	3.26	50.1%
<i>China rental Properties</i>			
Residential	321	0.10	1.6%
Office	2,792	0.91	14.0%
Retail	6,399	2.08	32.0%
Others		0.00	0.0%
Sub-total	9,512	3.09	47.5%
Hotels	479	0.16	2.4%
Gross Asset Value	20,011	6.51	100.0%
Net debt	-2,710	-0.88	
Net Asset Value	17,301	5.63	

Source: JPMorgan estimates.

**NAV enhancement through
landbanking and solid organic
growth**

Drivers ahead: asset injection and landbanking

Like other listed peers, CRL would rely on land acquisitions ahead that drive along its production volume and hence earnings. As it has proven its success in regional expansion and the capability to handle high production volume in the provincial cities, we believe CRL's execution risks should be small compared to those that just started regional expansion. The company's NAV could thus be enhanced when they acquire new sites due to the solid operating performance. In fact, CRL would continue to acquire landbank in Wuhan and Shanghai, and would provide re-rating opportunities.

Apart from organic growth, CRL's major value driver is likely to be strong support from its parent, China Resources Holdings (CRH). CRL is being transformed into the flagship property development/investment arm of CRH, which intends to invest Rmb 6 billion in property development in China. Since 2H05, CRH has acquired four sites in Beijing (Qinghe with CRL), Hangzhou, Wuxi and Chengdu, which totaled 3.6 million sqm on attributable basis, almost the same as the current landbank size of CRL (3.72 million sqm on attributable basis).

Table 4: Recent land acquisitions by CRH

Location	Total site area (sqm)	Total GFA (sqm)	Consideration (Rmb MM)	AV (Rmb psm)	CRH's % stake	Att GFA (sqm)	Att land costs (Rmb MM)
Qinghe, Beijing	311,830	728,000	2,565	3,523	49%	356,720	1,257
#2 Leihu Xincheng, Wuxi	118,637	1,450,000	2,510	1,731	60%	870,000	1,506
Sheung QiaoZi, Dongshe District Chengdu	560,280	2,050,000	2,142	1,045	100%	2,050,000	2,142
Hangzhou		522,500	1,100	2,105	60%	313,500	660
Total*		4,750,500	8,317			3,590,220	5,565

*Assume GFA for ancillary activities are excluded

Source: Company data

Hope value: We estimate at Rmb1.36 per share

The last asset injection of investment properties from CRH into CRL in October 05 at a decent 35% discount to market value has led the market to anticipate further injections of assets into CRL at similar discounts. We are of the view that CRH would rather inject its development landbank at costs and leave the development margin to CRL. Besides, the substantially large size of the Chengdu site would allow the project to be developed in 9-10 years. Likewise, the Wuxi project could span across several years. Meanwhile, the Hangzhou site is zoned for commercial/office usage and would take at least 3 years to complete. Hence we believe CRL would likely acquire from its parent the portion of the landbank that could be monetized in the near term, which points to development landbank up to 2009-10 only.

On such a scenario, we assume a timeframe for the projects to be developed and applied a DCF valuation for each of the phases. We estimate that the landbank that could be developed up to 2010 is worth Rmb1.36 per CRL share. In return, CRL would have to reimburse CRH for the land premium paid and other related costs, as well as the outstanding land premium.

Table 5: CRL-Asset injection scenario

Project	Eff % interest	Total GFA to be developed during 2007-2010 (Sq m)	Att GFA to be developed during 2007-2010 (Sqm)	NAV enhancement (Rmb per share)	Est payment to CRH for land prm already paid (Rmb MM)	O/S land premium payment (Rmb MM)
Qinghe, BJ	45%*	698,332	312,574	0.36	(319.8)	(795.4)
#2 Leihu Xincheng, Wuxi	60%	812,000	487,200	0.27	(147.6)	(695.8)
Sheung QiaoZi Ph1, Cheungdu	60%	865,556	865,556	0.73	(209.0)	(255.4)
Total		2,375,888	1,665,329	1.36	(676.4)	(1,746.6)

Beijing operations are 91.9% owned

Source: JPMorgan estimates.

Theoretically, the consideration (HK2.4 billion under our hypothesized scenario) could be met by the sales proceeds of Rmb 3-4 billion generated each year and/or borrowings, as the company has low net gearing of 29.5% after the January share placement. That said, we do not rule out the possibility that the company could seek equity financing. We have assumed a 10% potential dilution impact on the NAV in setting our price target.

Table 6: CRL-fair price estimate

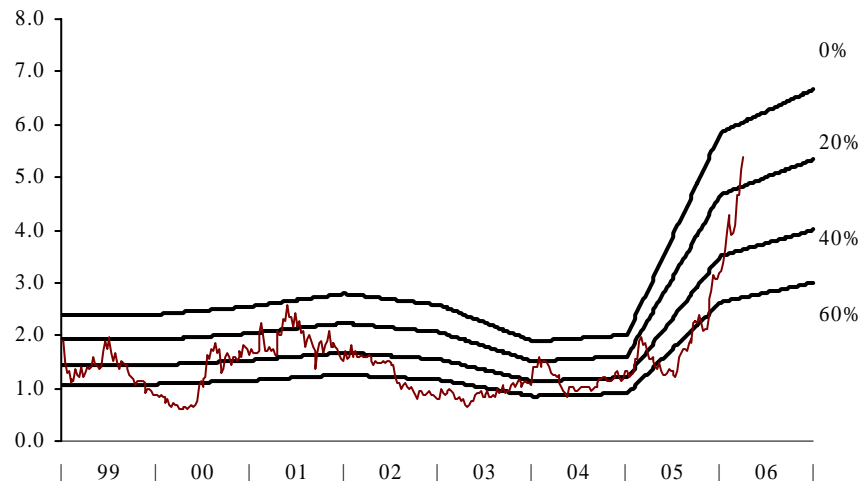
Fair value estimate	Value HK\$ MM	Value HK\$ / share	Discount	Fair price HK\$/ share
Development properties	10,020	3.26	0%	3.3
Investment properties	9,512	3.09	20%	2.5
Fair price before hope value				5.7
Hope value on injection				1.31
Assume potential dilution from share issuance				10%
Fair price incl hope value				6.0

Source: JPMorgan estimates.

Our revised 12-month price target of HK\$6.0 is based on a 20% discount applied to investment property NAV and no discount on development properties. Added to this would be the hope value on the upcoming injection realizable within a 6-month horizon. At current price levels, our price target implies some 18.5% upside potential. We believe the major risks to our price target would be (1) policy risks, eg tax changes, (2) injections are not realizable or bring in less value enhancement, and (3) share issuance at deep discount to NAV which may lead to a significant NAV dilution.

Figure 2: CRL - NAV discount band chart

HK\$



Source: DataStream, JPMorgan.

Earnings outlook

Resilient earnings growth in FY06-FY09 due to volume gain and margin expansion

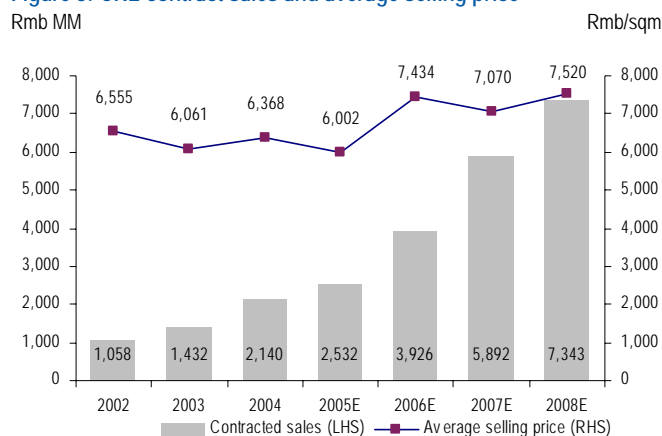
We revised up FY06 net profit forecast mainly due to the change in FY06 completion schedule. CRL has pre-sold 57% of the FY06 completions including >100,000 sqm of Chengdu Jade City Phase 2 at an ASP of Rmb 4,555psm, compared to the market average of below Rmb 4,000 in the city. We leave the FY07 figures unchanged for the time being. We expect net profit of CRL to grow resiliently beyond FY07 mainly driven by volume, but we expect development margin to grow in tandem. And despite the gradual shift of geographical focus to Chengdu, we believe the average selling price can remain at above Rmb 7,000psm.

Table 7: CRL - Earnings estimates change

	FY06E	FY07E	FY08E
Net profit (HK\$MM)			
Old	626.5	856.0	na
New	716.6	862.7	1,454
% change	14.4%	0.8%	na
Core net profit (HK\$MM)			
Old	560.6	856.0	
New	712.6	862.7	1,454
% change	27%	1%	na
EPS (HK\$)			
Old	0.204	0.279	na
New	0.233	0.281	0.473
% change	14%	1%	na
Core EPS (HK\$)			
Old	0.18	0.28	na
New	0.232	0.281	0.473
% change	27%	1%	na

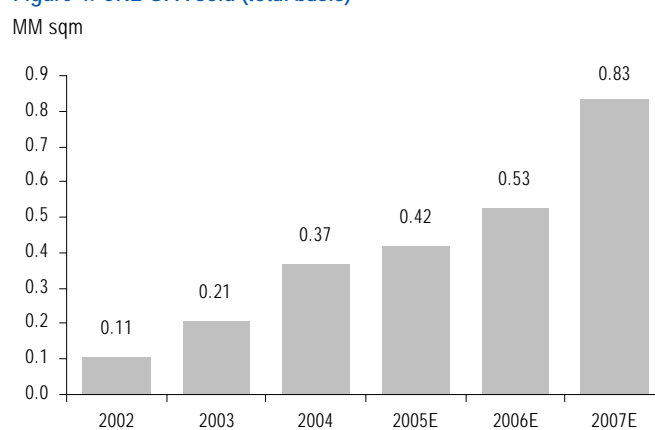
Source: JPMorgan estimates.

Figure 3: CRL-contract sales and average selling price



Source: JPMorgan estimates.

Figure 4: CRL-GFA sold (total basis)



Source: Company, JPMorgan.

Other major highlights

No more bad debt provisions

CRL has made another HK\$103 million bad debt provision. Having made provisions of HK\$600 million since 2000, company states that there would be no more provision starting from FY06. This would lift the major drag on earnings. The provisions made in previous years and slow sales explained mostly the low ROE of the company.

Sharp rental growth of investment properties

Performance of investment properties fared well. The average monthly rents of Shenzhen City Crossing (MIXc) in 2005 were some 34% higher than the rents achieved in August 05. As the mall was only launched for a year, turnover rents in late 2005 have been growing strongly. The average monthly rents of China Resources Building were 26% higher than the level in August, while Shanghai CR Times Square was 9% higher. This backs our view that the investment properties were grossly undervalued when injected into CRL as the rental growth potential has yet been fully reflected. The revaluation has thus led to a significant NAV enhancement thereafter.

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China Resources Land (1109.HK/HK\$5.40/Overweight)

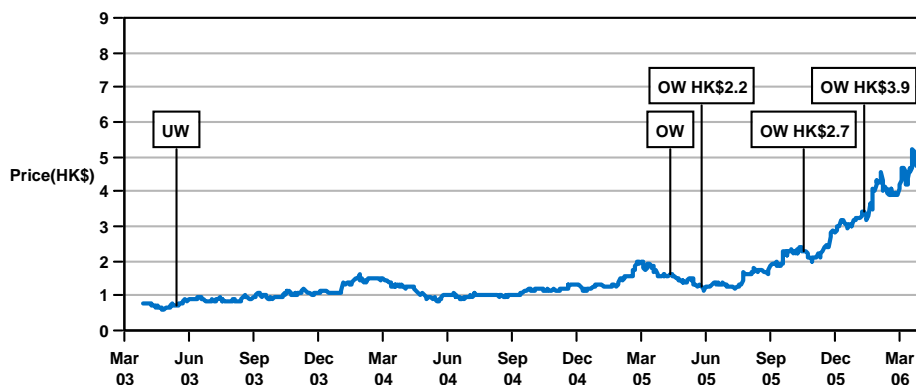
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China Resources Land (1109.HK) Price Chart



Date	Rating	Share Price (HK\$)	Price Target (HK\$)
13-May-03	UW	0.74	-
10-Apr-05	OW	1.59	-

Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends. Initiated coverage May 13, 2003. This chart shows JPMorgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period. As of Aug. 30, 2002, the firm discontinued price targets in all markets where they were used. They were reinstated at JPMSI as of May 19th, 2003, for Focus List (FL) and selected Latin stocks. For non-JPMSI covered stocks, price targets are required for regional FL stocks and may be set for other stocks at analysts' discretion. JPMorgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

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Table 8: China Resources Land-summary of financials

Profit and Loss statement						Cash flow statement					
HKD in millions, year-end						HKD in millions, year-end					
Dec	FY03A	FY04A	FY05A	FY06E	FY07E	Dec	FY03A	FY04A	FY05A	FY06E	FY07E
Revenues	1,252	2,409	2,707	3,778	5,904	EBIT	49	150	262	1,122	1,409
% change Y/Y	10.8	92.4	12.4	39.6	56.3	Depreciation & amortisation	20	22	20	28	29
EBIT	49	150	262	1,122	1,409	Change in working capital	-630	-273	-572	-49	-650
% change Y/Y	20.2	207.5	74.6	328.4	25.6	Other items	-35	55	-31	116	153
EBIT Margin (%)	3.9	6.2	9.7	29.7	23.9	Taxes	27	-36	-109	-38	-255
Net Interest	-34	-29	-67	-66	-74	Cash flow from operations	-632	-123	-358	978	485
Earnings before tax	36	80	485	1062	1377	Capex	-3	-2	-2	-1,402	-1,502
% change Y/Y	-38.6	119.5	510.0	118.8	29.7	Disposal/ (purchase)	3	0	-35	0	0
Tax	17	109	47	319	413	Net Interest	-98	-89	-158	-148	-177
as % of EBT	161.2	-326.8	-15.4	-28.8	-28.8	Free cash flow	-648	-151	-381	-433	-1,034
Net Income (Reported)	79	21	385	717	864	Equity raised/ (repaid)	0	0	0	1,110	0
% change Y/Y	-53.4	-73.0	1705.8	86.4	20.5	Debt raised/ (repaid)	1,306	338	300	200	200
Core Net Profit	31	79	230	713	863	Other	0	0	0	0	-100
% change Y/Y	-45.1	158.0	191.2	209.2	21.1	Dividends paid	-41	-41	-45	-50	-200
Shares Outstanding	1503	1503	1518	3074	3074	Beginning cash	772	1,389	1,536	1,402	2,222
EPS (reported)	0.052	0.014	0.255	0.233	0.281	Ending cash	1,389	1,536	1,402	2,222	681
% change Y/Y	-53.4	-73.0	1,702.2	-8.7	20.5	DPS	0.027	0.030	0.033	0.065	0.079
Core EPS	0.020	0.053	0.152	0.232	0.281						
% change Y/Y	-45.1	158.0	188.2	52.7	21.1						
Balance sheet						Ratio Analysis					
HKD in millions, year-end						%, year-end Dec					
Dec	FY03A	FY04A	FY05A	FY06E	FY07E	FY03A	FY04A	FY05A	FY06E	FY07E	
Cash and cash equivalents	1,389	1,536	1,402	1,201	681	EBIT margin	3.9	6.2	9.7	29.7	
Accounts receivable	959	906	856	856	1,056	Operating margin	(3.6)	0.2	8.8	27.6	
Inventories	4,900	5,523	6,024	6,083	6,243	Net profit margin	6.3	0.9	14.2	19.0	
Others	315	286	334	75	76	SG&A/sales					
Current assets	7,564	8,251	8,616	8,215	8,055	Sales per share growth	10.806	92.352	12.375	39.566	
LT investments	1,271	1,257	1,268	1,211	1,134	Sales growth	10.806	92.352	12.375	39.566	
Net fixed assets	451	440	483	1,786	3,188	Net profit growth	-53.4	-73.0	1705.8	86.4	
Total assets	9,286	9,948	10,367	11,211	12,378	EPS growth	-53.4	-73.0	1702.2	-8.7	
Liabilities						Interest coverage (x)	0.3	1.1	6.2	6.9	
ST loans	1,231	1,937	891	1,147	1,147	Net debt to total capital	27.4	29.6	32.7	24.6	
Payables	800	2,115	2,124	1,932	1,932	Net debt to equity	50.8	59.4	65.4	36.4	
Others	0	23	23	42	142	Sales/assets	14.4	25.0	26.6	35.0	
Total current liabilities	2031	4075	3039	3121	3221	Assets/equity	233.4	266.9	255.9	109.1	
Long term debt	2181	1813	3159	3795	3995	ROE	2.0	0.6	9.5	7.0	
Other liabilities	152	4	5	469	494	ROCE	(0.0)	0.7	4.0	7.4	
Total liabilities	4364	5892	6202	7386	7710						
Shareholders' equity	3979	3728	4051	10278	11034						
BVPS	2.649	2.482	2.691	3.344	3.590						

Source: Company reports, JPMorgan estimates.