

China Resources Land

Turnaround Story - End of the Tunnel

Upgrade

Overweight

Previous Rating: Underweight

HK\$1.61

08 April 2005

Price Target: HK\$2.0

- CRL reported a net profit of HK\$150.1million, up 90% Y/Y. The result is 7.5% below our estimates of HK\$162m, mainly due to HK\$117m allowance on bad debts. Excluding the non-cash items and allowance on bad debts, the core net profit came in at HK\$146.5m, 42% above our estimates.
- We are raising our 2005 EPS and NAV estimates by 30%. We are also upgrading the stock to Overweight from Underweight with a 12 month target price of HK\$2.0, based on 12x FY06E P/E and 35% discount to NAV, giving a 24% upside potential from current level.
- We expect the share price drivers to be: 1) strong CAGR of 49% over FY04-FY07E. 2) one of the major beneficiaries from the rising price in the Beijing 3) Contribution of its low cost landbank acquired in 2002 are starting to kick in, hence boosting margin and ROE, 4) End of provisioning which has dragged profit in last few years.

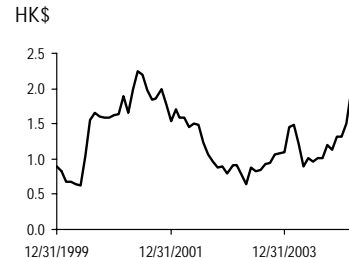
Property

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Historical share price



Source: Datastream.

Reuters: 1109.HK; Bloomberg: 1109 HK

HK\$ in millions, year-end December

	FY03	FY04	FY05E	FY06E		
Sales	1252	2409	2846	2822	52-week range	HK\$0.82-1.98
Net profit	79	150	189	250	Market cap	HK\$2,419MM
EPS (HK¢)	0.053	0.100	0.126	0.166	Market cap	US\$310MM
DPS (HK¢)	0.027	0.030	0.030	0.042	Shares	1,502MM
					outstanding	
Sales growth (%)	10.8	52.3	17.5	17.5	Free float	44.40%
Net profit growth (%)	-25.3	90.3	26.0	32.2	Avg daily value	HK\$7.7MM
EPS growth (%)	-25.3	90.3	26.0	32.2	Avg daily value	US\$0.99MM
ROE (%)	1.9	3.7	4.3	5.7	Avg daily volume	6.4MM shares
ROCE (%)	1.1	2.0	2.6	3.2	Index	HSI 13,667
P/E (x)	30.7	16.1	12.8	9.7	Exchange rate	HK\$7.8/US\$1
NAV per share (HK\$)			3.05			
EV/EBITDA (x)	-588.5	21.7	12.1	9.7	Performance	1 mth 3 mths 12 mths
Div yield (%)	1.7	1.9	1.9	2.6	Absolute (%)	-15.3 30.9 28.8
					Relative (%)	-13.9 29.4 21.7

Source: Datastream, Company, JPMorgan estimates.

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Summary: Strong underlying results; operations turning around

CRL reported a net profit of HK\$150.1million, up 90% Y/Y. The result is 7.5% below our estimates of HK\$162m, mainly due to HK\$117m allowance on bed debts. If we excluded the non-cash items from unrealized gain on China Vanke B shares, allowance on bad debts, the core net profit came in at HK\$146.5 m, 42% above our estimates. The company increases its final dividend to HK\$0.03 from HK\$0.027. Going forward, the management targets to pay at least 25% of earnings to shareholders.

The strong underlying results is driven by the strong growth from its Beijing subsidiary and new contribution from Chengdu project. The total area sold in FY04 was 367,248 sq meter GFA, up 77% Y/Y.

Table 1: CRL—FY04 results summary

HK\$ in millions, year-end December

	2003	2004	Y/Y%	2004E	Var (%)	Comments
Property sales	1,184.0	2,313.2	95%	1,836.7	26%	Higher sales volume in Beijing than expected
Rental income	8.0	21.9	174%	9.6	128%	Contribution from Xidian Cultural center
Property management, trading of building materials	60.3	73.7	22%	61.5	20%	
Turnover	1,252.3	2,408.8	92%	1,907.8	26%	
Property sales	62.1	261.0	320%	183.6	42%	Higher sales volume in Beijing than expected
Rental income and property management	(10.7)	3.6	-134%	(2.1)	-271%	
Allowance for bad and doubtful debts	(54.9)	(116.7)	112%	0.0	n/a	
Others	(2.7)	(11.3)	321%	(5.0)	127%	
EBIT	(6.2)	136.7	n/a	176.4	-23%	
Net interest income/(expense)	(32.0)	(27.7)	-13%	(31.5)	-12%	
Operating profit	(38.1)	109.0	-386%	144.9	-25%	
Associates	7.4	20.0	170%	8.1	148%	More contribution from Huawei Centre
Exceptional items	67.1	58.8	-12%	58.8	0%	Unrealized gain from China Vanke "B" shares
Profit before tax	36.4	187.8	416%	211.8	-11%	
Taxation	(17.3)	(81.0)	367%	(50.8)	59%	
Profit before minority interest	19.0	106.8	461%	161.0	-34%	
Minority interests	59.8	43.3	-28%	1.3	3312%	
Net profit	78.9	150.1	90%	162.2	-7%	
Core net profit	30.7	146.4	377%	103.4	42%	
EPS	0.053	0.100	90%	0.108	-7%	
DPS	0.027	0.030	11%	0.027	11%	

Source: Company, JPMorgan estimates.

Table 2: CRL—Properties sold in FY04

	Exp completion Date	GFA sold in FY04 (sq m)	Average price (RMB)
La Firenze 1	Completed	16,539	6,828
La Firenze 2	2H05	85,760	5,825
Top Box	Completed	22,831	12,727
U-Space	Completed	18,450	9,415
Jingtong Sunny Uptown	Completed	28,055	5,075
Grandstellation	1H05	7,099	18,382
Phoenix City 2	2H05	38,586	11,166
Chengdu Jade City1	1H05	121,944	3,542
Other residential		9,014	3,091
Car Park		18,971	3,091
Total/average		367,248	6,368
Beijing subtotal		23,569	7,830
Chengdu subtotal		131,680	3,542

Source: Company.

Earnings and NAV estimate revised up by 30%

In view of strong underlying results and improving fundamentals of the company, we are raising our earnings and NAV estimates, and our recommendation of CRL to Overweight. Our NAV revision was mainly due to the new development schedule with more projects can be completed in FY06 and higher estimated sales price based on the price achieved in FY04. We also adjust the earnings base on the new accounting standard which development profit can only be booked upon completion. Since the Company development volume is increasing, therefore, changing the revenue recognition from stage of completion method to completion method should not affect CRL net profit growth.

Table 3: CRL—Earnings and NAV changes

HK\$ in millions, year-end December

	FY05E	FY06E	FY07E
Net Profit			
Old	145.0	167.0	-
New	189.2	250.1	481.2
% change	30%	50%	-
EPS			
Old	0.10	0.11	-
New	0.13	0.17	0.32
% change	30%	50%	-
NAV			
Old	2.3		
New	3.05		
% change	32%		

Source: JPMorgan estimates.

Upgraded to Overweight from Underweight

We are upgrading the stock to Overweight from Underweight with a 12m target price of HK\$2.0 based on 12x FY06E PER and 35% discount to NAV, which provide an upside potential of 24% from the current level. Our reasons for the upgrade are as follows:

Strong earnings growth over FY04-FY07E

We expect CRL will achieve strong earnings growth of 48% CAGAR over the next three years on the back of its rising development profit. The new sites which CRL

acquired in 2002 and 2004 will be completed in 2005 onwards. We expect CRL can achieve development margin between 16% and 21% in these newly acquired projects compared to only a low single digit margin in the past. We expect the overall development margin will improve to 15% in FY06E from 11% in FY04.

Provisioning should come to an end

CRL provided HK\$117 million provision on its bad and doubtful debt in the receivable account in FY04 and CRL has written down a total of HK\$ 496 million on these accounts in the past 5 years. According to the management, only HK\$50m left in these accounts. We believe the chance for further provisions on the receivable account should be minimal.

Table 4: CRL—Development schedule summary

	Total GFA	Est. total cost	Est. sales prices	EBIT margin	Est. dev profit book			
		Rmb/sq m	Rmb/sq m	%	FY05E	FY06E	FY07E	FY08E
<i>Inventory</i>								
Jing Tong Sunng Up Town	355,239	4,659	5,000	7%	1.7	0.0	0.0	0.0
Top Box Majestic Garden Ph2	58,163	10,563	12,500	16%	18.8	0.0	0.0	0.0
U-Space Ph1	62,099	8,240	9,400	12%	6.5	0.0	0.0	0.0
La Firenze Ph1a (formerly known as Jade City)	57,939	5,405	6,800	21%	23.7	0.0	0.0	0.0
<i>FY05 completion</i>								
Phoenix City Ph2	129,616	9,480	11,100	15%	162.5	47.4	0.0	0.0
Resources Center	40,589	15,349	18,000	15%	73.9	12.9	0.0	0.0
La Firenze Ph1b (formerly known as Jade City)	8,750	5,405	6,850	21%	12.6	0.0	0.0	0.0
La Firenze Ph2b (formerly known as Jade City)	83,132	4,921	6,000	18%	89.7	0.0	0.0	0.0
Cheungdu Project-Jade City Ph1	125,659	2,888	3,300	12%	51.8	0.0	0.0	0.0
<i>FY06 completion</i>								
U-Space Ph2	33,755	8,825	10,000	12%	0.0	31.7	7.9	0.0
Fortune Island	110,475	4,739	6,000	21%	0.0	118.5	20.9	0.0
Phoenix City Ph3	54,139	9,920	11,400	13%	0.0	64.1	16.0	0.0
Cheungdu Project-Jade City Ph2	55,948	3,012	3,600	16%	0.0	32.9	0.0	0.0
Wuhan Project Ph1	69,450	3,900	4,600	15%	0.0	48.6	0.0	0.0
Hefei Project Ph1	40,000	3,120	3,800	18%	0.0	27.2	0.0	0.0
The BundSide Ph1 (Shanghai Project)	29,327	12,765	15,800	19%	0.0	89.0	0.0	0.0
<i>FY07 completion</i>								
Majestic Garden Ph3	74,400	10,730	11,800	9%	0.0	0.0	43.8	23.9
Phoenix City Ph3a	75,972	9,920	11,500	14%	0.0	0.0	60.0	48.0
Phoenix City Ph3-commercial	196,500	10,810	12,500	14%	0.0	0.0	166.0	132.8
Hefei Project Ph2	70,000	3,120	3,800	18%	0.0	0.0	33.3	14.3
Wuhan Project Ph2	69,450	3,900	4,700	17%	0.0	0.0	33.3	16.7
Fortune Shopping	5,469	4,950	6,500	24%	0.0	0.0	4.2	4.2
The BundSide Ph2 (Shanghai Project)	56,671	12,765	15,800	19%	0.0	0.0	137.6	34.4
The BundSide Ph2a (Shanghai Project)	102,364	12,765	15,800	19%	0.0	0.0	186.4	124.3
Cheungdu Project - Jade City Ph3	102,637	3,012	3,600	16%	0.0	0.0	45.2	15.1

Source: Company, JPMorgan estimates.

Benefit from residential price pick up in Beijing

CRL has a total of 0.58 million sq meter of attributable GFA developing landbank in Beijing. These projects are sufficient for sale over FY05 -FY07. Last year, CRL acquired 0.11m sq meter GFA of land in land auction for Rmb\$200m and the project is expected to be completed in FY07 and will start its presales towards the end of this year. We expect CRL will continue to replenish Beijing' landbank this year.

Beijing's overall residential prices in 2004 actually have turned around with experiencing its largest price increase of 7% Y/Y since 1997. The reasons for the tremendous pick up in last year demand can be explained by high GDP growth of

13.2%, and an accelerate 27% Y/Y growth in FDI (highest since 99). The spill over effect from Olympic Game begins to impact the city and we expect the property price will continue to rise in a steady pace. Therefore, we believe CRL should be one of the major beneficiaries from the rising price in the Beijing market.

Expansion strategy – first step has proven to be successfully

CRL has started its expansion plan in 2002 by acquiring site in Shanghai and Chengdu. CRL began to presale Chengdu Jade Garden Ph1 in the beginning of 2004, all the 0.12 million sq meters were sold all in one go and the project will be completed in 1H05. Chengdu project has a total of 0.87 m sq meters GFA (5 Phases in total) and we estimate this development can bring in a total of HK\$5.9 million development profit. The success of Ph1 Chengdu Jade City will provide a solid foundation for the remaining phases. Chengdu Jade City Ph2 is scheduled to launch in 3Q05 and this phase has a total of 139,416 sq meters. The management indicated that over 10,000 potential buyers have expressed their interest in Chengdu Jade City Ph2

For the Shanghai project (The Bund Side), 90% of the resettlement has been done and CRL expects to launch the project in June of this year. Due to the prolonged resettlement process, we estimate the total cost of the development is approximately Rmb 12,800/sq meter. Even with higher than original estimated cost, we estimate that CRL can still achieve an estimated 19% development margin because Shanghai property price has increased by 70% since mid-02. We have used a conservative sale price of Rmb 15,800 psm in our profit forecast, vs. the management expectation of Rmb 17,000-18,000 psm.

CRL acquired Wuhan and Hefei site with 0.33m sq meter GFA in 1H4 for a total of Rmb 438m. The first phase of both projects will be completed in 2006 and the CRL is going to launch the projects towards the end of this year. We estimate that CRL should be able to fetch 17%-18% development margin in the Wuhan and Hefei development. These two projects all together should generate HK\$243 million development profit.

CRL is planning to expand further to other secondary cities in China with population over 2 million and GDP/capita is above US\$1,500. We expect CRL may spend approximately Rmb 500-600 million to replenish landbank in 2H05. As of the end of FY04, CRL's net gearing was 54%. Even if we expect there would be some land acquisition in this year, we forecast end of FY05 net gearing should go down to 50% because CRL should have over Rmb 700 cash inflow from sales of Shanghai and Cheungdu projects.

Table 5: CRL—Landbank breakdown (in attributable terms)

GFA sq m

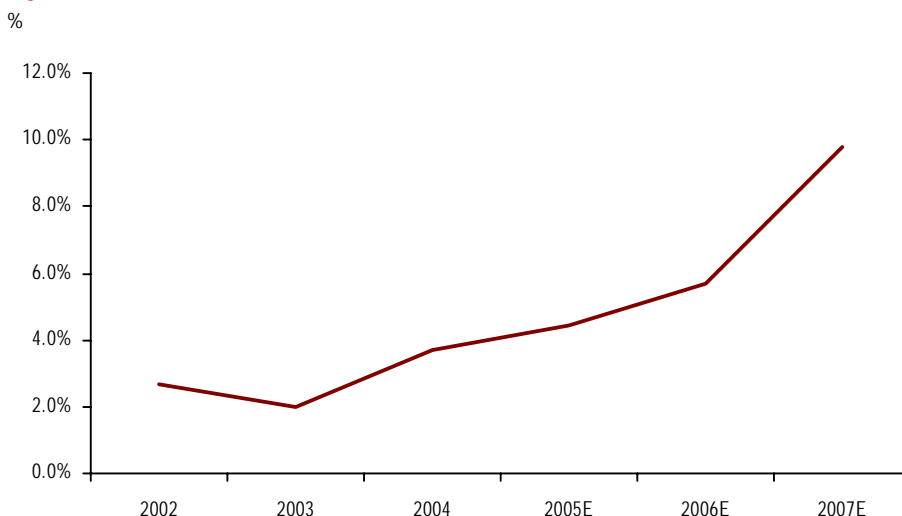
	Property under development	Property held for sale	Property held for inv or own use	Long-term land reserve	Total GFA
Beijing	584,398	97,902	71,261	25,080	778,642
Shanghai	226,079	0	0	0	226,079
Chengdu	893,212	0	0	0	893,212
Wuhan	146,900	0	0	0	146,900
Hefei	186,255	0	0	0	186,255
Total	2,036,844	97,902	71,261	25,080	2,231,088

Source: Company.

Improving ROE

CRL's ROE has been improved from only 2.0% in FY03 to 3.7% in FY04. Management targets to increase ROE to double digit within 5 years time, and we forecast that CRL's ROE should be able to reach 9.9% in FY07 due to the high volume of completion in FY07. In addition, the company has shortened the time frame between land acquisition and presales significantly to about 1-1.5 years in last year land acquisition projects. This could improve both the ROA and ROE for the company.

Figure 1: CRL—ROE



Source: Company, JPMorgan estimates.

Upgrade to Overweight with 24 % upside potential

CRL's shares have corrected by 19% since peaking on Feb 24 at HK\$1.98 due to the austerity measures. The stock is currently trading at 9.7x FY06E EPS, 47% discount to our estimated NAV of HK\$3.05 vs. its long term average of 15x PER and 45% discount to NAV. Although the stock is already trading at close to its long term average in terms of NAV, we believe this is justified given its improving fundamentals. We estimate CRL will have strong earnings growth with a CAGAR of 29% over FY04 to FY06E and CRL is one of the major beneficiaries of Beijing' rising property price. We upgrade the stock to Overweight with a target price of HK\$2.0, based on 12x FY06E PER and 35% discount to NAV, this provides a 24% upside potential on a 12m horizon.

The major risk to our target price is further policy intervention on the property market by the Chinese government.

Table 6: CRL—P&L

HK\$ in millions, year-end December

	2002	2003	2004	2005E	2006E	2007E
Property sales	1,057.6	1,184.0	2,313.2	2,737.9	2,712.7	5,025.6
Rental income	13.3	8.0	21.9	32.8	32.8	32.8
Property management, trading of building materials	59.3	60.3	73.7	75.2	76.7	78.2
Others	0.0	0.0	0.0	0.0	0.0	1.0
Turnover	1,130.2	1,252.3	2,408.8	2,845.9	2,822.2	5,137.6
Property sales	42.0	62.1	261.0	376.1	395.5	743.0
Rental income and property management	5.9	(10.7)	3.6	10.8	11.0	11.1
Allowance for bad and doubtful debts	(71.0)	(54.9)	(116.7)	0.0	0.0	0.0
Others	(6.9)	(2.7)	(11.3)	(36.0)	(36.0)	(41.0)
EBIT	(30.1)	(6.2)	136.7	350.9	370.4	713.1
Net Interest Income/(expense)	(1.4)	(32.0)	(27.7)	(56.6)	(37.0)	(26.8)
Operating Profit	(31.6)	(38.1)	109.0	294.3	333.5	686.3
Associates	20.9	7.4	20.0	20.0	20.0	20.0
Exceptional items	6.4	67.1	58.8	0.0	0.0	0.0
Profit before tax	(4.3)	36.4	187.8	314.3	353.4	706.3
Taxation	74.1	(17.3)	(81.0)	(88.0)	(99.0)	(211.9)
Profit before minority interest	69.8	19.0	106.8	226.3	254.5	494.4
Minority interests	35.9	59.8	43.3	(37.1)	(4.4)	(13.2)
Net profit	105.6	78.9	150.1	189.2	250.1	481.2
Core net profit	107.2	30.7	146.4	189.2	250.1	481.2
EPS	0.070	0.053	0.100	0.126	0.166	0.320
DPS	0.0270	0.027	0.030	0.030	0.042	0.080

Source: Company, JPMorgan estimates.

Companies Recommended in This Report

China Resources Land (1109.HK/HK\$1.61/Overweight)

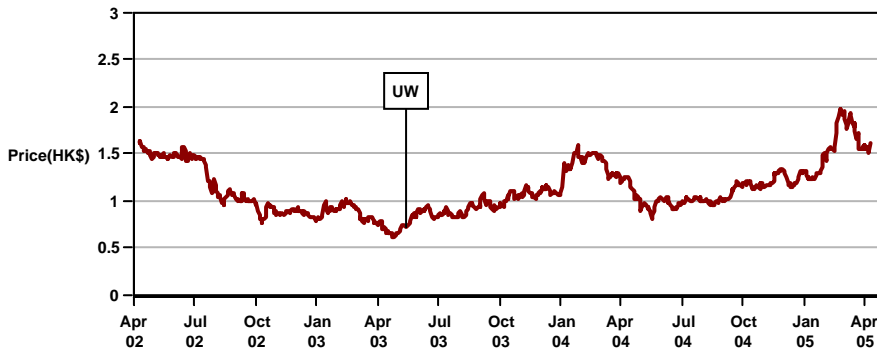
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China Resources Land (1109.HK) Price Chart



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.

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	Overweight (buy)	Neutral (hold)	Underweight (sell)
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IB clients*	47%	47%	37%
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IB clients*	66%	59%	45%

*Percentage of investment banking clients in each rating category.

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