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Company Update

Pan Hong Property Group

9 Apr 09

Project Visit

Focus is on Sales

Key Takeaway: We visited four of Pan Hong's property development projects in China. Following the recent scandals at various S-shares, our visit has assured us that all the current development projects announced by the Company are presently under construction.

Brief Sales Overview: Three of the four current projects have had pre-sales launches of their residential spaces. Nanchang Honggu Kaixuan Phase 2 was launched in Jul 08 whereas Huzhou Liyang Yuan Phase 2 and Hangzhou Liyang Yuan were launched in Dec 2008 and Jan 2009 respectively. As at 9 Feb 2009, Pan Hong reported take-up rates of 51% and 31% for Huzhou Liyang Yuan and Hangzhou Liyang respectively. The pre-sales activity of the fourth project, Hua Chi Ting Yuan, is currently slated to take place in the middle of this year.

Slow Sales for Nanchang Phase 2: As mentioned, pre-sales for the first batch of 270 residential units at Nanchang Honggu Kaixuan commenced in mid 2008. However, as at 9 February 2009, only 21% of the first batch has been sold. This works out to a mere 6% sales of the total 1003 residential units planned for this project. Unlike other developers, we understand management has not slashed prices of its units. Although management has its reasons for its pricing strategy, the slow sales is an area of concern. The residential and commercial space from this project accounts for 65% and 71% respectively of the total residential and commercial spaces from the current four projects. If the company is able to improve its sales momentum for this project, it will be a catalyst for the company's earnings as the relatively larger scale of this project will have a greater impact on the company's earnings position.

Huzhou Liyang Phase 2: The second phase of this project has around 17,000 sq m, or 150 units, of residential space and 11,000 sq m of office space. 77 units were pre-sold at an average selling price of RMB 4,883 psm. During our visit, we noted satisfactory progress of the construction of this

Hold (Downgraded)

Target Price	**S$0.215**
Current Price	**S$0.125**

Report Snapshot

We recently visited and noted the quality of the ongoing projects in Huzhou, Nanchang and Hangzhou cities but are concerned with the low level of sales at Nanchang Honggu Kaixuan Phase 2. On the contrary, pre-sales at its recently-launched projects in Huzhou and Hangzhou did better. We will review our recommendation if positive sales momentum can be achieved in the following months for the Nanchang P2 project.

Financial Highlights

*(Y/E Dec/Mar)**	FY07	FY09F	FY10F
Revenue (RMBm)	564.9	40.1	252.0
Gross Profit	230.6	17.4	88.2
Earnings	184.9	-14.4	44.6
EPS (Scts)	38.4	-2.0	9.1

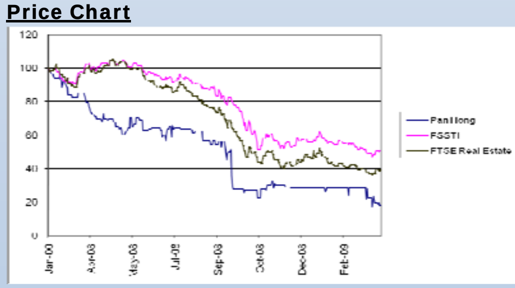
*FY07 year end in Dec. FY09 and FY10 year end in Mar
Source: Bloomberg, SIAS Research

Key ratios (FY09F)

PER	n.m.
P/BV	0.39x
ROE	-2.0%
Net gearing	0.3
Current ratio	2.7x

Source: Bloomberg, SIAS Research

Price Chart



52wks High-Low	*S$0.60/0.08*
Number of Shares	*490.0m*
Market Capitalization	*S$61.25m*

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development. The residential space is slated for completion in calendar period 3Q09 to 4Q09. Ground works for the adjacent office development have started. The first two levels of the office building will comprise of retail units.

Huzhou Liyang Phase 2 is located in a well developed area with transportation networks and other amenities such as banks, shopping malls, postal and mobile services. The project is also near schools, making it attractive to parents.

Hua Cui Ting Yuan Phase 1: The second project we visited is based on the townhouse concept, as opposed to the low-rise apartment block concept at Huzhou Liyang Yuan. This development, which boasts of a modern oriental design, is 15 minutes away from the Huzhou city centre. Pan Hong aims to launch this project in the second quarter of this year.

Pan Hong plans to develop this plot of land in two phases. The first phase, currently under construction, consists of 2-storey and 3-storey units, with each having GFA ranging from 180 sq m to 250 sq m. Around 180 residential units are expected to be available for sale under Phase 1.

Hua Cui Ting Phase 1 is situated in the Taihu Lake Resort. It faces a piece of land earmarked for the development of a fishermen's wharf, which is one of the attractions for the development of the Taihu Lake Resort. This attraction is expected to be ready in mid 2009.

The second phase may consist of some duplex houses. However, these plans could be changed based on customers' response to Phase 1.

Hangzhou Liyang Yuan: The two high-rise and two mid-rise residential blocks of this project will have around 25,000 sq m of residential floor area, or 226 units and around 2,400 sq m of office space. It is expected to be completed in 4Q09.

The project is located in a hub for commercial and educational services, close to the renowned Xihu Lake. Among the facilities are shopping malls, supermarkets, primary and tertiary institutions. Since its launch, sales have been progressing well. The average selling price of the 70 units sold is around RMB 9,600 sqm.

Figure 1: Huzhou Liyang Phase 2

Source: Company

Figure 2: Model of Huzhou Liyang P2

Source: Company

Figure 3: Hua Cui Ting Yuan Phase 1

Source: Company

Figure 4: Hangzhou Liyang Yuan

Source: Company

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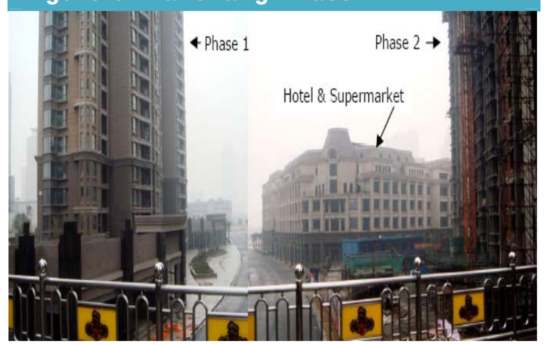
Nanchang Honggu Kaixuan Phase 2: The design of Nanchang Phase 2 is similar to that of phase 1, as shown in Figure 5. The design of the high-rise buildings is modern and appeals to the middle to upper-middle income population segment. It is located next door to a string of government buildings, making civil servants one of the target customer groups.

Figure 5: Nanchang Phase 1

Source: Company

The project is situated in the new Honggu Tan District, known as the new Central Business District for Nanchang city. This area is set to be a focal point for business, financial and government institutions.

Figure 6: Nanchang Phase 1



Source: Company

Notwithstanding the convenience of nearby amenities and the attraction of being a business hub, the take-up rate has been poor so far. Only 20% of the launched units or 5.6% of the overall residential space has been pre-sold. Due to the weak sentiment at the time of launch of the first batch, Pan Hong decided to defer the launch of the remaining units and slowed its construction to keep pace with the launch plans. Phase 2 is currently planned for completion at the end of 2009. We would need to watch how the latest governmental policies help to improve sales of this project.

Change in Fiscal Year End: Pan Hong has recently changed its year end to Mar. It will have 15 months in its FY09. Consequently, it will not have a FY08 and its FY09 will have March 2009 as its year end.

Lumpy Profitability: The group incurred a loss of RMB 9.8m for the period Jan08-Dec08. Chinese developers only recognize revenue upon handover of the units to the buyers unlike the percentage of completion recognition method used by Singapore developers. Since the pre-sales of RMB157.5m in aggregate relate to projects which will be completed during its FY10, this sales volume will not contribute to its FY09 results.

Cash Position: Jan08-Dec08 cash outflow from operating activities was RMB 302m versus a cash inflow of RMB 81.8m in Jan07-Dec07. The outflow was mostly due to the construction of the current projects.

As at end-Dec 2008, total Borrowings stood at RMB 367.8m, of which RMB 131.9m was secured against cash deposits of RMB 139.6m. Net borrowings work out to around RMB 188.2 m or 24.4% net gearing. Pan Hong has RMB162.4m in borrowings due this calendar year or in fiscal year 2010.

Our estimates suggest Pan Hong still had RMB 290m worth of construction work to be carried out on its current projects as at Jan 09. The company reported RMB 74.7m of prepayments, related mainly to construction costs, in its Dec 08 results. Outstanding construction work alone will thus require a ball park estimate of around RMB215m.

Pan Hong reported a total cash and equivalent (including deposits pledged against borrowings of RMB 139.6 m) position of RMB 187.3m as at Dec 08. The group had RMB47.8m in cash available for working capital. Pan Hong also has outstanding RMB126m cash to be collected from its RMB157.5m pre-sales (assuming 20% downpayment followed by a full payment upon delivery).

Financing Needed: In the worst-case scenario of no further sales, after considering the outstanding cash inflow from the RMB157.5m sales, available working capital and outstanding construction costs, Pan Hong would need to raise a further RMB41m. of debt to finance the remaining construction work. This would bring net gearing up to 29.8%, assuming no change in shareholder equity level.

The group has already put on hold the construction of Yichun Phase 1 due to the market condition. If it wants to prevent net gearing from growing, it will need to sell more of its projects, delay some construction work or delay payment to its contractors.

Forecast: We expect the RMB157.5m of sales to be recognized during FY10 and assume 50% more sales will be generated and recognized in that fiscal year.

Valuation: Since the development plans on future projects are not finalized yet, we have excluded the potential surplus from future projects. Our RNAV calculation, (exchange rate 1S$ = RMB 4.497), is thus S$0.695. Each current project comes with commercial space and management has not decided whether to sell or rent the office spaces. No office space has been sold or rented yet. If we exclude surplus contribution from commercial units, the RNAV is only S$0.36.

Recommendation: Among its listed Chinese developer peers on SGX, Sunshine has the highest gearing level. Given Sunshine's net gearing of 139%, we presume Chinese banks should be comfortable with a potential 29.8% net gearing level. On this basis, Pan Hong should be able to continue to fund its development. Property developers have been trading at a discount rate of up to 70% book value. The industry has been valuing property developers using a RNAV discount rate of 30%-50%. A 40% discount rate to Pan Hong's most conservative RNAV of $0.36 would value the share at $0.215. Investors may want to buy the shares purely on a quantitative basis.

However, if investors are uncomfortable with the slow sales of Nanchang Honggu Kaixuan Phase 2, Pan Hong's biggest project, they may want to wait until the risk level is lower. We would therefore recommend a conservative approach, **Hold.**

The uptick in transaction level in Shanghai gives us reason to believe sales have the potential to improve. We would revise our recommendation following improvement in sales level, cash flow and balance sheet. **(Johnny Kwon).**

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Financial Table and Ratios

(Y/E – Mar as from FY09)	FY06*	FY07*	FY09F#	FY10F
Profit & Loss (RMB m)				
Turnover	151.3	564.9	40.1	252.0
Gross Profit	57.4	230.6	17.4	88.2
Earnings	49.4	184.9	-14.4	44.6
Earnings per share (RMB cts)	12.6	38.4	-2.0	9.1
Balance Sheet (RMB m)	**FY06***	**FY07***	**FY09F#**	**FY10F**
Current Assets	659.0	1045.6	1176.2	1130.1
Long Term Assets	76.1	238.6	236.7	244.4
Current Liabilities	53.6	378.2	430.9	192.9
Long Term Liabilities	133.5	92.4	212.2	362.2
Shareholder Equity	515.3	728.5	714.1	758.7
Cash Flow (RMB m)	**FY06***	**FY07***	**FY09F#**	**FY10F**
Operating Cash Flow	-42.7	87.1	-302.0	-87.2
Investing Cash Flow	-29.3	-76.9	0.9	0.9
Financing Cash Flow	276.3	20.4	110.7	42.0
Net cash increase/(decrease)	204.2	30.6	-190.4	-44.3
Cash at year end	221.4	243.9	47.7	96.5
Cash and equivalent at year end	221.4	256.7	158.0	116.7
Financial Ratios	**FY06***	**FY07***	**FY09F#**	**FY10F**
Revenue Growth (%)	-47.5	273.4	-92.9	528.9
Gross Profit Growth (%)	-38.4	302.0	-92.5	408.1
Earnings Growth (%)	-16.6	273.9	-107.8	-409.2
Gross Margin (%)	37.9	40.8	43.3	35.0
Net Margin (%)	32.7	32.7	-36.0	17.7
Current Ratio (x)	12.3	2.8	2.7	5.9
Book value per share (RMB)	1.07	1.49	1.46	1.55
Dividend per share (RMB cts)	1.00	1.87	0.00	0.00
Net Gearing (%)	Net Cash	Net Cash	0.21	0.24
Dividend per share (RMB cts)	1.00	1.87	0.00	0.00
Return on Equity (%)	16.2	29.7	-2.0	6.1
Return on Asset (%)	8.8	18.3	-1.1	3.2
Valuations	**FY06***	**FY07***	**FY09F#**	**FY10F**
PER (x)	4.48	1.47	n.m.	6.17
Price to book (x)	0.52	0.38	0.39	0.36
Dividend Yield (%)	1.78	3.33	0.00	0.00

**FY06 and FY07 have Dec as year end; #FY09F is 15-month long with Mar 09 as year end; FY10 year end is in Mar 2010*
Source: Company, SIAS Research

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About the Company

Pan Hong Property Group Limited is a niche property developer that focuses primarily on developing high quality residential and commercial properties in the second and third-tier cities in the PRC. Backed by over 20 years of experience in the PRC's property development industry, Pan Hong has established its presence in Hangzhou and Huzhou cities in Zhejiang Province, and Nanchang city in Jiangxi Province. Besides these cities, the Group also owns land reserves in Fuzhou, Yichun and Leping cities in Jiangxi Province, and Jiangmen city in Guangdong Province, for property development. As a testament to the quality of Pan Hong's property developments, the Group has received several awards for its current project in Nanchang – Nanchang Honggu Kaixuan. In 2007, the Group was conferred the '4th Annual Nanchang City Best Property Award', 'Most Popular Property in Nanchang', as well as accolades such as 'Reputable Brand of the Year in Jiangxi" and 'Professional Property Developer of International Standard'.

Price and Volume Chart

Source: Bloomberg

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