

Analyst: Kelvin Li

Main Board Listing – Research

Hong Long Holdings Ltd. [Stock Code: 1383] 鴻隆控股有限公司

Global coordinator, sole bookrunner & lead manager : China Everbright Securities
Sponsor : China Everbright Capital
Co-lead managers : China Merchants Securities Kingsway Financial
Sector : Real Estate
Business : Real Estate development

<p>Total share offer: <u>250,000,000</u> shares (25% of the enlarged share capital)</p> <p>Public Offer: 25,000,000 shares (10%)</p> <p>Placing: 225,000,000 shares (90%)</p> <p>Greenshoe: 37,500,000 shares</p>	<p><u>Business of Hong Long Holdings (HLH)</u></p> <p>Hong Long is a property development company based in Guangdong. The company started its first project in 2002 and has an established brand-name in Shenzhen. It focuses on developing mid-range residential and commercial properties including shopping malls in Shenzhen, Huizhou and Meizhou cities. The company also holds some commercial properties for long-term lease.</p> <p>Hong Long currently has a total land bank of 1.4 million sq. m. The land reserves comprise of 6 parcels of land situated in Huizhou and Meizhou, with an aggregate site area and expected GFA of 529,291 sq. m. and 1.26 million sq. m. respectively. Hong Long Plaza, a residential and commercial complex in Shenzhen, is the flagship project of the Group. Both the residential and commercial portions have been available for occupation in late 2006.</p> <p>The development strategy of Hong Long is to acquire land through acquisitions of equity interests in other property developers instead of via land auctions so that land cost can be kept relatively low. Directors expect the future property development will focus on mid-range residential and commercial properties.</p>
<p>Price: HK\$1.43– HK\$2.06 per share</p> <p>Market Cap: HK\$1,430 – HK\$2,060 million</p> <p>Pro-forma basic FY06 PER: 6.8X – 9.8X</p> <p>Adjusted NTA per share: HK\$0.45 – HK\$0.60</p> <p>Staffing: 189</p>	
<p>HK Public Offer period: 8th February 07 – 13th February 07 noon</p> <p>Receiving bank: Bank of China (HK)</p> <p>Share registrar: Tricor Investor Services Limited</p> <p>Listing date: 22nd February 2007</p>	

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Grand Prosperity*	67.0%
Lehman Brothers Commercial Corporation Asia Ltd. (LBCCA)^	6.6%
Dr. Han Qinchun, the vice Chairman and co-president of the Group and an executive Director	1.4%
	<u>75.0%</u>

* Grand Prosperity is 80% and 20% owned by Zeng Sheng and Zeng Yunshu respectively. Zeng Sheng is vice Chairman and co-president of the Group and an executive Director of the Group. Zeng Yunshu is the chairman and president of the Group.

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[^] A convertible note (CB) was issued on 5 Oct 2006 to LBCCA by Access Achievement, a wholly-owned company of Hong Long. On the listing date, the CB will be automatically and mandatorily converted into 66,000,000 shares, or 6.6% of the enlarged share capital of HLH.

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$400 million. *(Being the mid-point of the offer price range [HK\$1.75 per share] and assuming the over-allotment option is not exercised)*

	HK\$ million
For the expansion of land reserves mainly in Guangdong province and other cities in southern China	160
For the development project of Greenview Garden in Huizhou	90
For the development project of Shenzhen Yinghua in Baoan District	80
For repayment of part of the Loan Note – a secured zero coupon loan note dated 5 Oct 2006 in the principal amount of USD17 million provided by LBCCA	63
For general working capital	7

Financial Highlights

RMB million	Year ended 31 st December			Eight months ended 31 st Aug
	2003	2004	2005	2006
Revenue	65.56	197.75	148.54	17.40
Gross profit	24.92	64.14	92.58	10.09
Increase in fair value of investment properties	4.39	0.76	7.25	6.48
Operating profit	7.79	54.49	72.22	(2.41)
Attributable profit	5.07	40.16	63.53	0.08
Gross Margin	38.0%	32.4%	62.3%	58.0%
Operating Margin	11.9%	27.6%	48.6%	NA
Net Margin	7.7%	20.3%	42.8%	0.4%

Breakdown of turnover by activities

	2003		2004		2005		Eight months ended 31 st Aug	
	RMB million	%	RMB million	%	RMB million	%	RMB million	%
Sales of properties	56.74	86.5	183.79	92.9	130.00	87.5	3.589	20.6
Rental income & management fee	8.82	13.5	14.00	7.1	18.54	12.5	13.809	79.4
Total	65.56	100.0	197.79	100.0	148.54	100.0	17.40	100.0

Strengths/Opportunities

- ✓ **Property leasing business provides recurring income** Hong Long's business model relies more on recurring rental income than other real estate developers.
- ✓ **Reasonable valuation.** The IPO price range of Hong Long indicates a FY06E pro-forma fully diluted PER range of 7.0X – 10.0X should be attractive relative to its peers. The sector average FY06E and FY07E PER for HK-listed Chinese property stocks are about 20.2X and 14.1X, respectively. If only those players with strong focus in Guangdong are included for comparison purposes, the average FY06E and FY07E PER lower to 17.8X and 12.8X, respectively. Estimated NAV of the Group is about HK\$2.25/ share, which translates into some 36.4% to 8.4% discount to NAV at the IPO price range. The discount to NAV of comparable peers ranges from 11% to 37%.



Weaknesses/Threats

- × **Competition is growing** Both Hopson (0754.HK) and Shenzhen Investment (0604.HK) own material land bank in Shenzhen and Huizhou. Shenzhen Investment has about 3.2 million sq. m. land bank in Guangdong and Hopson has about 7.8 million sq. m. Those 2 companies have longer operation history, stronger balance sheet and larger land bank than Hong Long.
- × **Land bank replenishment can be a challenge** Government's latest policy to control land supply may pose difficulty in replenishment land bank. On the other hand, land auction results are monopolized by large property developers. As a relatively new developer, Hong Long may face challenges in getting new projects for development.
- × **The overhang of LAT provisions** Hong Long made provisions for Land Appreciation Tax (LAT) of RMB1.945 million during the 8 months ended 31 Aug 2006 but did not make any payments. No LAT provision in respect of pre-sales of Hong Long Plaza has been made during FY05 and the 8 months ended 31 Aug 06. The related LAT was charged to the income statement upon the delivery of Hong Long Plaza since Oct 06. The LAT for FY06E is estimated to be RMB97 million.
- × Hong Long should be viewed as a property investment company rather than property development company in the PRC. Accordingly, investors should demand for a deeper NAV discount in the range of 20% to 30%.

Recommendation: Caveat Emptor

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