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Initiate Coverage

Current S$0.20
Target S$0.26

MAIN ACTIVITIES

Pan Hong develops residential and commercial properties in China, with a special focus on middle to upper middle end residential projects.

ISSUE STATISTICS

No of shares: 490m
Market cap: S$102.9m
Year Hi/Lo: S$0.93/S$0.110
Listing Bourse: SGX-Main Board
Listing Date: 20 Sep 2006

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Pan Hong Property Group

Undervalued Niche Player

Buy

Pan Hong is primarily involved in property development, particularly in the mid end residential sector in PRC's second and third tier cities.

The ongoing credit crunch is hitting global consumption and China is not spared either. The widespread impact on credit facilities has hit the property sector particularly hard with some development projects remaining in half-completed.

In view of the misty short to mid term outlook of the sector, we expect Pan Hong to witness delay in project launches and growth in turnover. We have trimmed our cash flow forecast, lengthened the project completion duration as well as applied a 7.5% risk premium to the cost of capital.

Small scale developers such as Pan Hong will trade at huge discounts, especially when compared to their bigger size peers. However, at the current price of 20 cents per share, the counter looks fairly attractive on book value basis. Indeed, our conservative estimates have given us a price target of 26 cents per share, which is 21.2% below the book value of 33 cents per share.

Buying into this counter at book value might yield potential upside in the long term horizon. We initiate coverage with a "**Buy**".

Financial Summary

Year End Mar (RMB$'m)	2006*	2007*	2009F	2010F
Turnover	151	565	85	254
Operating Profit	67	287	13	37
Earnings	49.4	184.9	(9.0)	6.9
EPS	0.13	0.38	(0.02)	0.01
EPS change (%)	(24)	201	(105)	(177)
P/E (x)	7.5	2.5	(50.9)	66.4
P/BV (x)	0.68	0.58	0.59	0.58
ROE (%)	9.0	23.4	(1.2)	0.9
Current ratio (x)	12.29	2.77	2.86	2.86

Source: Company, SIAS Research
**For FY06 & 07, the financial year end falls on Dec*

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COMPANY

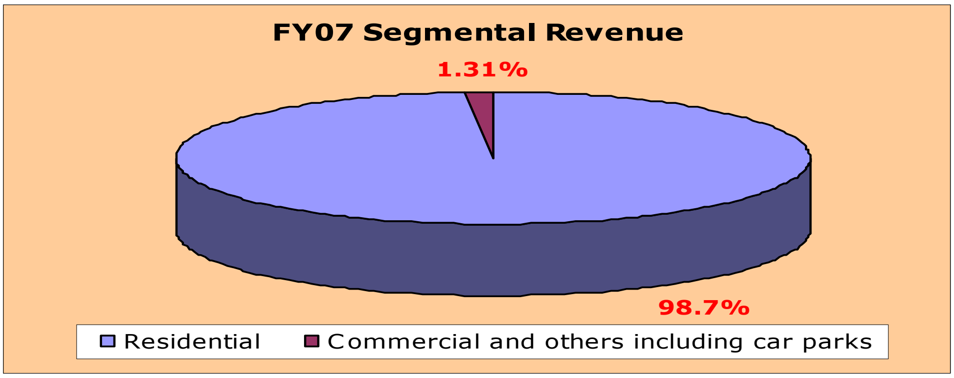
Background and Business Activities: Incorporated in Bermuda in December 2005, the Pan Hong Property Group was listed on the SGX Mainboard in September 2006. The group is a niche residential and commercial developer for quality residential and commercial projects in China. The group concentrates its development in cities whose property markets possess substantial growth potential. Examples include the Hangzhou City and Huzhou City in Zhejiang Province as well as the Nanchang City in Jiangxi Province.

The group originated in Hong Kong as a property development company. In 1992, Pan Hong began to concentrate its property development projects in Zhejiang as the province, with its growing population, growing economy and rising standard of living, was seen as one of the wealthier provinces in China. Due to its position in the centre of the Yangtze River Delta as well as its high per capita income and urbanization levels, Pan Hong identified the Huzhou City as an area with significant growth potential. Accordingly, the group has repeatedly attempted to increase its land reserves in Huzhou City since 2000. Additionally, in 2002, the group expanded its land acquisition exercise into Nanchang City which is the capital of the Jiang Province.

Pan Hong embarked on an acquisition trail after its listing on the SGX and purchased land reserves in four cities in 2007, namely Leping, Yichun and Fuzhou cities in Jiangxi Province, as well as Jiangmen city in Guangdong Province. Currently, the group has land reserves that could potentially yield around 2.9 million of gross floor area in China. These land reserves which span Huzhou, Hangzhou, Nanchang, Fuzhou, Yichun, Leping and Jiangmen cities, comprise around 33,000 sq m of completed properties, 446,000 sq m of properties under development and 2.4 million sq m of future developments.

Business Activities: Pan Hong is primarily concerned with property development. From the chart below, it can be seen that most of its revenues are derived from the residential segment. In FY07, this segment generated 98.7% or RMB 557.5m of revenue.

Figure 1: Segmental Revenue



Source: Company, SIAS Research

Future Strategies

The group's strategy is to focus on development in second and third-tier cities which are likely to have higher growth potential. The company plans to build up substantial land banks in these cities to capitalise on their expected economic expansion. The table below contains FY07 statistics pertaining to these cities as well as the group's sizable land reserves in each city in FY07.

Figure 2: City Statistics and Land Reserves

City	2007 GDP (RMB'B)	GDP Growth	Annual Disposable Income per Capita (RMB)	Annual Disposable Income Growth	Land Reserves (Square Metres)
Huzhou	89.6	14.4%	19,663	12.3%	352,023
Hangzhou	410.4	14.6%	21,689	14.0%	36,751
Nanchang	139.0	15.5%	13,253	17.9%	252,521
Leping	8.6	16.7%	8,464	20.7%	420,000
Yichun	51.2	14.0%	10,806	18.1%	1,310,000
Fuzhou	36.8	14.0%	11,101	21.7%	476,000
Jiangmen	109.5	15.3%	15,149	9.2%	49,000

Source: Company, Statistical Bureaus

Pan Hong intends to consolidate its position as one of the premier property developers in the PRC, particularly in the second- and third-tier cities. The group has accumulated fairly sizeable land reserves that should provide a pipeline of developments over the coming years. The Group's initial strategy in 2008 was to focus on rolling out new property developments. However, property market in China started to slow as a result of the measures implemented by the authorities to cool the property sector.

In July 2008, Pan Hong launched phase 2 of its project in Nanchang with an initial batch of 270 residential units. As at 3 November 2008, the take-up rate was around 20%. In view of the slowdown in the property scene, coupled with the global credit crisis and impending slowdown of the world's economy, the group deferred its launch schedule for the remaining residential units of Phase 2 Nanchang project, as well as for its three other current projects under development in Huzhou and Hangzhou – Huzhou Liyang Jingyuan Phase 2, Hangzhou Liyang Yuan and Hua Cui Ting Yuan. The group has guided that it is looking to unveil these three projects before 31 March 2009.

INDUSTRY ANALYSIS AND OUTLOOK

With over 98% of Pan Hong's revenue coming from the Chinese residential property development sector, Pan Hong is highly dependant on the state of the economy and property market in China. Listed below are some of the prominent factors relating to the industry.

Slowing Chinese Economic Growth: According to a Bloomberg survey, Chinese economic growth slowed for a fourth consecutive quarter on the back of slowing export demand. The panel estimates that Chinese GDP growth slowed to 10.3% in 3Q08 compared to the previous year.

Government Regulation: A rising interest rate environment and tighter monetary policy was implemented by the Chinese government in late 2007 to curb rising prices. This had led to the slowest growth in loan growth in June for more than two years. Property developers are currently finding it difficult to cope with the resulting loan curbs and decreasing sales. However, in light of the slowing economic growth and the slight easing of inflation in 2Q08, the government has indicated that its focus will shift from containing inflation to sustaining growth. In fact, Premier Wen Jiabao this month pledged efforts to maintain "sound and fast" economic growth. Moves that would facilitate growth could include deferring interest rate rises which tend to hurt developers.

In addition, the People's Bank of China, the Ministry of Housing and Urban-Rural Development and other ministries have conducted consultations on ways to stabilise the property market. A National Development and Reform Commission report stated that a decline in property prices will decrease demand and disrupt economic growth. This indicates that the Chinese government will place strong emphasis on new policies that would make it easy for property developers to raise financing.

Property Market Fundamentals: Long-term property market fundamentals in the Chinese property market generally look promising. The increasing pace of urbanisation and greater consumer affluence fuelling the demand for better living standards are factors which should support housing prices. However, the current credit crunch, falling transactions and falling prices have adversely impacted the property market. Although average property prices in 70 cities have increased by 1.6% YoY in October, prices in some areas such as the Pearl River Delta region have experienced monthly declines. Furthermore, the official Chinese property outlook index, a good proxy for Chinese property sentiment, has been falling since reaching its peak in November 2007.

Foreign Funds Tie-up: Given increased difficulty and cost of obtaining financing as well as the slowing growth of property prices, many developers are trying to strengthen their capital base. A possible way to achieve this is to team up with international funds. Several developers are attempting to do this. However, these funds can now drive a harder bargain where prior to the credit crunch worsening, developers were in a stronger bargaining position. In addition, foreign funds are faced with a range of regulatory obstacles which make it difficult for them to bring money into China as well as to take funds out of Country. Given their stronger bargaining positions, they may demand better deals from developers.

INVESTMENT MERITS

Focus on Development on Tier 2 and 3 Cities: Pan Hong has focused its development in tier 2 and 3 cities in China. Given the rising costs in tier 1 cities, tier 2 and 3 cities have become relatively more attractive locations for companies to relocate. Average wages in tier 1 cities have surpassed RMB30,000 per year as at end 2007 according to the National Bureau of Statistics. However, in Pan Hong's tier 2 and 3 cities excluding Hangzhou, average wages are substantially lower, ranging from RMB9,877 to RMB 23,874. The combination of lower average wages and costs as well as preferential government policies will likely result in more companies relocating to tier 2 and 3 cities, thus pushing up demand for housing and property prices.

Growth in real estate capital has begun to shift to tier 2 and tier 3 cities. Statistics from the Ministry of Land and Resources PRC indicate that tier 1 cities received 42.9% of international real estate capital in 2006, falling from 61.9% in 2004. However, lower tier cities received 57.1% in 2006 compared to 38.4% in 2004. Not only does this increased investment indicate an expected increase in demand in these cities but the ability to tap international funding may be critical in the current environment of increased finance costs.

Continued Ability to Obtain Funding: The ability to obtain funding is critical to developers as most developers depend on debt to fund a substantial part of their projects. A survey by the China Index Academy found that the liabilities of domestically listed Chinese developers reached 76.5% of their assets at the end of 2007 compared to 69.1% at the end of 2006. As the 70% mark is considered the warning threshold, many of these developers are considered highly leveraged and may struggle to obtain financing for further projects.

Pan Hong has been able to bolster its working capital base despite the tightening credit environment in the PRC. In May 08, it secured two 18-month term loans for the total amount of RMB108m from the Bank of Communications to develop its Hua Cui Ting Yuan and Hangzhou Liyang Yuan projects located in Zhejiang Province. In the same month Pan Hong also secured a RMB150m 36-month term loan facility with ICBC for the development of Phase 2 of the Nanchang Honggu Kaixuan project. The ability to obtain an aggregate total of RMB258m in loans in the current environment is an indication of the strength of Pan Hong's financial position and relationships with its banks.

Huge Land Bank: Pan Hong has a substantial land bank in a number of cities which could potentially yield 2.9m square metres in total planned gross floor area. This is triple the size of its land bank when it listed on the SGX in Sep 06. This also compared favourably with its competitors listed on the SGX. The size of Pan Hong's land bank will enable it to have a steady pipeline of development projects over the next few years and allow it to continue growing.

INVESTMENT RISKS

Volatile Earnings: Pan Hong's revenue recognition policy is based on the completion method of accounting. As such, revenue is only recognised when the purchaser of the property unit is legally able to take possession of the property unit. Thus, even though Pan Hong may have pre-sold the unit, Pan Hong will not be able to recognise the proceeds as revenue or profit. This may result in volatile revenue and earnings during a financial period particularly if there is a delay in completion of projects.

Difficulty of Obtaining Land: As increase in urbanisation has resulted in a reduction of arable land for farming, the government has been attempting to ensure adequate supply of land to farmers. The Ministry of Land Resources together with the Ministry of Finance and People's Bank of China issued a circular in Dec07 stating that respective local governments systematically track land supply with the objective of improving the land reserve system. The fact that a large portion of China's farmland is situated in Tier 2 and 3 cities may result in less land in these cities being available for development by Pan Hong.

Furthermore, the government has also implemented a low-rent housing guarantee policy in Dec 07. This policy requires local governments to reserve a minimum of 70% of land allocated for residential construction for smaller, more affordable commercial homes or low rent units. This will subtract from the pool of land plots Pan Hong would be able to bid.

Cloudy Economic Outlook: The economic outlook for Pan Hong going forward is cloudy. Slowing economic growth and the increased difficulty of obtaining credit is likely to crimp demand for housing, resulting in lower selling prices going forward. Furthermore, the high level of inflation this year has increased the cost of raw materials for construction. This may result in cost overruns or delays on current projects and increase the cost of new projects. In the current economic climate, Pan Hong may find it difficult to pass on higher costs to customers.

Cost of Financing: The ongoing credit crunch as well as government policy to curb speculation have resulted in increased financing costs for developers. Although Pan Hong has just secured new loans at reasonable interest rates, interest costs may rise in future, resulting in reduced profitability.

FINANCIALS

Tough Time for Revenue Growth: In 3Q08, revenue came mainly from the sales of the remaining residential units of Nanchang Honggu Kaixuan Phase 1 and Huzhou Liyang Jingyuan Phase 1. The Group had launched the pre-sale of the second phase of its Nanchang Honggu Kaixuan property in July 2008. However, the pre-sold residential units would not be recognized as revenue until the completion of handover.

Only 4 residential units of Nanchang Honggu Kaixuan Phase 1 were sold during 3Q08. The remaining revenue in 3Q08 was derived from the sales of residential units of Huzhou Liyang Jingyuan Phase 1. As at 30 Sep 08, 98.6% of the residential units were sold.

In all, the group's 3Q revenue dropped 72.7% YoY to RMB 3.5m. However, on a nine month basis, revenue rose 84.6% YoY to RMB 32.8m. As revenue recognition depends on the launch of new projects and completion of handover of sold properties, the group's revenue and profitability tends to be lumpy on a quarterly basis.

Slipping into the Red: Due to lower revenue and other income as well as higher expenses in 3Q08, Pan Hong incurred a pretax loss of RMB 6.5m. After a taxation of RMB 2.5m, the group posted a net loss of RMB 9m. And though the group's revenue and gross profits were higher on a nine-month basis, the group still incurred a net loss of RMB 6.1m.

Credit Analysis: In the midst of the current credit crunch, we have chosen to undertake greater scrutiny on the credit status of Pan Hong. Below are some of our findings:

<u>Net Debt Position</u>: As at 30/09/2008, the group has amassed a total of RMB 233.5m in the form of pledged bank deposits and cash. As for interest bearing liabilities, the group has on hand a total of RMB 367.5m which comprise mainly bank borrowings and shareholders' loan. The resulting net debt is therefore RMB134m. If we were to take into account another RMB 44m that was placed as collateral for bank loans, the effective net debt will drop to RMB 90m.

<u>Loan Repayable within a Year</u>: As at 30 September 2008, current liability stood at RMB 166.5m. Pan Hong's cash position and total bank deposits that were used as collateral for borrowings stood at RMB 251.5m, is more than enough to pay off all its short term loans.

Balance Sheet & Cash Flow Analysis: As at 30 September 08, current ratio improved to 3.1 times, relative to 2.8 times nine months ago while net gearing remains healthy at 18%. Going forward, we expect a moderate slow down in property sales new project implementation. Cash flow from operation should remain negative initially, only to turn positive when the impact from the slow down in new project kicks in.

VALUATION

Final Verdict: In view of the misty short to mid term outlook of the sector, we expect to see more delay in project launches. Instead of taking a huge discount on NAV, we have chosen to trim our cash flow forecast, lengthen the project completion duration and apply a 7.5% risk premium to the cost of capital.

Small scale developers such as Pan Hong will continue to trade at huge discounts, especially when compared to their bigger size peers. However, at the current price of 20 cents per share, the counter is fairly attractive on book value basis (Compared to current book value of 33 cents per share; that is a 40% discount).

Using the DCF approach, we have arrived at a target price of 26 cents per share, which happen to be 21.2% below the current book value per share of 33 cents.

Buying into this counter at below book value may yield potential upside in the long term horizon. We initiate the coverage with a "**Buy**" (**Alan Lok**, **FRM**)

Figure 4: NAV Estimate

	RMB' m
Hua Cui Ting Yuan	67.5
Hangzhou Liyang Yuan	90.8
Nanchang Honggu Kaixuan	156.4
Huzhou Liyang Jingyuan	31.2
Huzhou Hailian Construction	55.1
Leping	14.6
Yichun	72.0
Jiangmen	14.7
Fuzhou	38.8
Investment Property	71.9
Property held for sale	87.6
Total Value	700.4
Cash - Debt	(134.1)
Net Value	566.3
NAV per share' RMB	1.16
Target Price' S$	0.26

Source: SIAS Research

FINANCIAL TABLES AND RATIOS

Year End Mar	*2005	*2006	*2007	2009F	2010F
Profit & Loss (RMB'm)					
Turnover	288	151	565	85	254
Operating Profit	89	67	287	13	37
Earnings	59	49	185	-9	7
Earnings per share (cts)	16	13	38	-2	1
Balance Sheet (RMB'm)					
Current Assets	361	659	1046	1196	1259
Long Term Assets	24	76	214	207	210
Current Liabilities	95	54	378	419	441
Long Term Liabilities	194	134	92	202	240
Total Equity	96	548	789	782	788
Cash Flow (RMB'm)					
Operating Cash Flow	(132)	(45)	87	49	(312)
Investing Cash Flow	(19)	(27)	(77)	6	(3)
Financing Cash Flow	143	277	20	121	22
Net cash increase/(decrease)	(8)	205	31	176	(292)
Cash at year end	(4)	207	237	413	121
Financial Ratios					
Revenue Growth (%)		(47)	273	(85)	200
Operating Profit Growth (%)		(24)	327	(95)	183
Earnings Growth (%)		(17)	274	(105)	(177)
Gross Margin (%)	32	38	41	40	40
Operating Margin (%)	31	44	51	15	14
Net Margin (%)	21	33	33	(11)	3
Current Ratio (x)	3.8	12.3	2.8	2.9	2.9
Book value per share (cts)	0.3	1.4	1.6	1.6	1.6
Net Gearing (%)	183	(17)	(9)	(13)	31
Dividend per share (cts)	1.2	1.9	0.0	0.0	0.0
Return on Equity (%)	61.5	9.0	23.4	(1.2)	0.9
Return on Asset (%)	15.4	6.7	14.7	(0.6)	0.5
Cash Conversion Days	0.7	0.3	0.6	0.1	0.2
Valuations					
PER (x)	5.7	7.5	2.5	-50.9	66.4
Price to book (x)	3.5	0.7	0.6	0.6	0.6
Dividend Yield (%)	0.0	1.3	2.0	0.0	0.0

Source: Company, SIAS Research
**For FY05, FY06 & 07, the financial year end falls on Dec*

Appendix I - Directors

Mr Wong Lam Ping
Executive Chairman and Founder

Mr Wong Lam Ping was appointed to the Board on 3 January 2006 and is responsible for the formulation and execution of overall business strategies and policies as well as the overall management of the Group. Mr Wong has over 20 years of property development experience since he established Pan Hong Co., Ltd. in 1983. Mr Wong also sits on the board of several investment holding companies. He has been a director of Jiangxi Ganxun Electronic Technology Ltd., a telecommunications company, since 1992. In 2004 and 2005, he was appointed a director of Chaozhou Jinaote Sanitary Ware Ltd. and Huzhou Wei Yuan Tang Bio-Pharmaceutical Ltd. respectively. Mr Wong completed a postgraduate course in Economics of Science and Technology and Management from the Zhejiang University of Technology in 2000. He holds an honorary degree of a Doctor of Business Management from Armstrong University.

Ms Chan Heung Ling
Deputy Chairman and Executive Director

Ms Chan Heung Ling was appointed to the Board on 3 January 2006 and is responsible for the management of overall project strategy, sales and marketing, as well as finance and business of the Group. She was a statistician with Jieyang Sugar, Tobacco and Wine Company in 1979 until 1982. In 1983, she co-founded Pan Hong Co., Ltd. together with Mr Wong Lam Ping, and has been involved in property development since then. She holds directorships in several companies outside our Group, namely Hong Kong Kam Fai Trading Development Ltd., China Hong Jun Limited, Kaiserin International (Hong Kong) Ltd. and Lee Tat Trading Company. She graduated from Jieyong No 1. Secondary School in 1975.

Mr Shi Feng
Executive Director

Mr Shi Feng was appointed to the Board on 14 August 2006 and is responsible for the management of project plans, quality control and contractors, as well as the management of the Group's subsidiaries. He started his career as an engineer at the Changsha Design Institute of Light Industry from 1982 to 1992. He subsequently joined Guangdong Huizhou City Hui Long Housing and Landing Development Co., Ltd. in 1992 as the manager of the engineering department which involved project development and engineering management. This was followed by six years as an assistant general manager in charged of project development and engineering management in Guangdong Huizhou City Hui Long Group Co., Ltd. Until 1999. From 1996 to 1999, he was also the general manager of Shenzhen Jin Yue Long Investment Co., Ltd. Between 1999 and 2002, he was the general manager of 3A Electronics Co., Ltd. He joined the Group in 2002 when he became General Manager of Huzhou Liyang Company, a position he still holds. In 2003, he was appointed, and still holds the offices of, Director and General Manager of Jiangxi Asia City Company. Mr Shi graduated with a Bachelor Degree in Industrial and Civil Construction from the Construction and Building Department of Hunan University in 1982. He was certified as an engineer and senior engineer by the Changsha Design Institute of Light Industry 1987 and 1993 respectively.

Ms Wang Cuiping
Executive Director

Ms Wang Cuiping joined the Group in 2002, and is responsible for the planning and financial management, and the human resource management of the Group. Before joining the Group, she spent 13 years from 1982 with the Inner Mongolia Hai Bo Wan Mining Bureau handling accounting matters, eventually becoming the head of the financial department from 1992 to 1995. From 1995 to 2002, she worked as a tax expert for the Inner Mongolia Wu Hai City State Administration of Taxation . She later joined 999 Huzhou Pharmaceutical Company as the head of the financial department, before joining the Group as senior accountant in 2002. Ms Wang graduated from the Inner Mongolia Coal Industrial School with a degree in Financial Accounting, and from the Inner Mongolia Broadcast and Television University with a degree in Industrial Accounting in 1982 and 1986 respectively. She was certified as a PRC Certified Tax Expert by the PRC Ministry of Finance, State Administration of Taxation in 2000 and as a PRC Certified Public Accountant by the Chinese Institute of Certified Public Accountants in 2004.

Mr Chan Kin Sang
Non-Executive Director

Mr Chan Kin Sang was appointed to the Board on 14 August 2006. He is currently a sole proprietor of Messrs Peter K.S. Chan & Co., Solicitors and Notaries, where he is involved in corporate and commercial law, civil law, conveyancing, litigation matters and notarial work. Mr Chan has been a practising solicitor in Hong Kong since 1982. He was an assistant solicitor in Messrs John Ku & Tam from 1982 to 1985 and a partner of Messrs. Wong and Chan from 1985 to 1996. He holds and has held several executive and non-executive directorships in various companies, including companies listed in Hong Kong and Singapore. Mr Chan graduated from the University of Hong Kong with a Bachelor of Laws degree in 1979. He was admitted first as an associate in 1985 and subsequently as a member of the Chartered Institute of Arbitrators. He was admitted as a solicitor of England and Wales in 1985, a barrister and solicitor of Australia in 1989 and an advocate and solicitor of Singapore in 1990. Mr Chan has also been a notary public in Hong Kong since 1997 and a China-appointed attesting officer since 2000.

Mr Sim Wee Leong
Lead Independent Director

Mr Sim Wee Leong was appointed to the Board on 14 August 2006. He is currently practising as a certified public accountant in Smalley & Co, a well established local accounting practice. He started his professional career in 1989 with an international accounting firm, Deloitte & Touche, prior to leaving in 1997 to join his current firm. He graduated with a Bachelor of Accountancy from the National University of Singapore in 1989.

Price Chart

Source: Bloomberg

DISCLAIMER

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