

SOHO CHINA (410.HK)

At the Key Phase of Business Transformation

HONG KONG | PROPERTY | COMPANY UPDATE

26 August 2015

Summary

- Realized revenue of SOHO China dropped by 92% yoy to RMB393 million while realized core profit fell by 94% yoy to around RMB72 million. The sharp deterioration in income statement of the company was directly related to its change in business model. During the period, gross profit margin jumped by 25%-point yoy to 75%, reflecting that gross margin of the property leasing business is significantly higher than that of property sales business.
- Rental income of SOHO China for the period jumped by 164% to RMB439 million. The remarkable increase in rental income was mainly attributable to the rental contribution from new projects, such as SOHO Tower 3, which were completed in the second half of 2014. SOHO China now has 6 completed projects for leasing, with total leasable GFA of 522,100 sq. m. The average occupancy rate was around 73%.
- In January 2015, SOHO China launched its first online product, SOHO3Q, which is an “online + office space leasing” product. Its key features include online leasing, flexible lease terms and the creation of a communitized platform for exchange. By the end of July 2015, 5 SOHO3Q centers were established with over 3,000 seats in place.
- Can SOHO China become the Chinese version of WeWork? This will depend on whether SOHO3Q can transform from the current asset-intensive operating to the economy sharing model that is adopted by venture companies like Uber and Airbnb. The Economy Sharing + Asset-Light model is the major reason for the high valuation given by investors to WeWork. Of course, we believe that even the valuation of SOHO3Q is not as high as WeWork, it is still expected to be an important product for SOHO China during its business transformation, and will be the key driver of its earnings and valuation.
- By the end of June 2015, cash and cash equivalents and deposits of SOHO China amounted to RMB9.77 billion. Its net debt was RMB10.2 billion and its net gearing ratio increased by 6%-point from 2014. With the transition of its business model, SOHO China will see the trend of decreasing cash and cash equivalents as well as higher net gearing ratio. We believe that this situation will last to 2017, until the scale of its property leasing business will be grown to a meaningful level and its occupancy rate can be sustained at a higher level. Overall speaking, while the safety margin of its financial position decreases, we believe the balance sheet of SOHO China will remain intact.
- For the first time, SOHO China did not record any contribution from property sales in its income statement. Investors already expected a plummet in its earnings during its 2015 interim result. The sharp increase in the contribution from rental income was positive to the company but the sustainability of growth will be under pressure amid slower economic growth. With its new business model of “online + office space leasing”, SOHO3Q will become a key growth driver of SOHO China’s earnings valuation. We expect during the important transition period of its business transformation, there is low visibility of the impact from the exit from the old business and the expansion of the new business on the fundamentals of company. We recommend a Neutral rating, with a 12-month target price of HKD3.5. (Closing price as at 24, August, 2015)

Neutral (Update)

Closing Price: HKD 3.30

(Closing price as at 24, August, 2015)

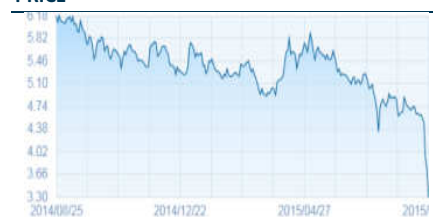
Target Price: HKD 3.50 (+6%)

O/S SHARES (MN) :	5,200
MARKET CAP (HKD MN) :	17,158
Ent. Value (HKD MN) :	27,683
52 - WK HI/LO (HKD) :	6.47/3.68

SHARE HOLDING PATTERN, %

PROMOTERS :	63.94
NON PROMOTER CORP. HOLDINGS :	9.08
PUBLIC & OTHERS :	26.98

PRICE



Source: Phillip Capital Research

KEY FINANCIALS

RMB Mn	FY13	FY14	FY15E	FY16E
Revenue	14,621	6,098	872	1,189
Net Profit	7,388	4,079	478	633
EPS	1.527	0.780	0.092	0.122
P/E (X)	3.25	5.46	30.47	23.00
BVPS	6.98	7.98	7.67	7.81
P/B (X)	0.71	0.53	0.37	0.36
DPS	0.256	0.250	0.030	0.035
Div. Yield	5.16%	5.86%	1.07%	1.25%

Source: Phillip Capital Research Est.

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Financials

FYE Mar	FY09	FY10	FY11	FY12	FY13	FY14	FY15F	FY16F
Valuation Ratios								
P/E (X), adj.	4.60	6.40	5.52	2.13	3.25	5.46	30.47	23.00
P/B (X)	1.28	1.21	0.99	0.73	0.71	0.53	0.37	0.36
Dividend Yield (%)	6.79%	5.78%	6.04%	5.73%	5.16%	5.86%	1.07%	1.25%
Per share data (RMB)								
EPS, reported	0.636	0.701	0.750	2.044	1.527	0.780	0.092	0.122
EPS, adj.	0.636	0.701	0.750	2.044	1.527	0.780	0.092	0.122
DPS	0.200	0.260	0.250	0.249	0.256	0.250	0.030	0.035
BV/PS	3.32	3.71	4.19	5.98	6.98	7.98	7.67	7.81
Growth & Margins (%)								
Growth								
Revenue	137.52%	145.73%	-68.79%	183.96%	-9.43%	-58.29%	-85.70%	36.35%
EBIT	220.49%	154.68%	-71.59%	167.13%	-32.53%	-43.26%	-86.61%	26.49%
Net Income, adj.	727.07%	10.21%	6.46%	173.35%	-30.20%	-44.79%	-88.29%	32.50%
Margins								
Gross profit margin	52.03%	50.82%	48.00%	55.79%	55.49%	50.48%	75.00%	75.02%
EBIT margin	522.01%	529.67%	42.99%	120.00%	89.39%	121.61%	113.88%	105.63%
Net profit margin	44.52%	19.97%	68.11%	65.56%	50.53%	66.89%	54.79%	53.24%
Key Ratios								
ROE (%)	19.16%	18.88%	17.90%	34.16%	21.87%	9.77%	1.20%	1.56%
ROA (%)	10.34%	8.49%	4.60%	15.09%	9.33%	5.28%	0.52%	0.81%
Net Debt/(Cash)	Net Cash	Net Cash	Net Cash	942	6,545	7,823	10,538	12,165
Net Gearing (X)	Net Cash	Net Cash	Net Cash	3.1%	17.5%	19.9%	25.9%	30.3%
Income Statement (RMB mn)								
Revenue	7,413	18,216	5,685	16,143	14,621	6,098	872	1,189
Cost of sales	(3,556)	(8,958)	(2,956)	(7,137)	(6,508)	(3,020)	(218)	(297)
Gross profit	3,857	9,257	2,729	9,006	8,113	3,078	654	892
EBIT	3,378	8,603	7,252	19,372	13,070	7,416	993	1,256
EBT	5,658	8,700	6,862	18,194	12,470	6,689	785	1,033
Tax	(2,264)	(4,928)	(2,376)	(7,548)	(5,034)	(2,538)	(302)	(389)
Tax rate	40.01%	56.64%	34.63%	41.49%	40.37%	37.94%	38.50%	37.65%
Profit for the year	3,394	3,772	4,486	10,646	7,436	4,151	483	644
Minority interests	(95)	(135)	(594)	62	48	72	5	11
Net profit	3,300	3,637	3,872	10,584	7,388	4,079	478	633

Source: SOHO and Phillip Securities

(Financial figures as at 24 August 2015)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within ± 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock’s risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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