

Sailing past troubled waters

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Industry viewpoint:

We see the real estate sector featuring two major investment themes thus far in 2010: (i) Industry fundamentals have constantly surpassed pessimistic consensus. To illustrate, sales have picked up since Jun 10. There has been a slight decline in sales price and substantial increase in sales volume, with monthly sales figures all coming in at normal levels with the exception of May 10. Meanwhile, the real estate industry has become increasingly concentrated, with leading players such as Vanke looking set to log all-time high sales. (ii) Earnings forecasts for listed developers have generally been revised upwards and share prices have been declining.

Policy-wise, we reiterate our view that September is typically a sensitive period. As always, our optimism never stems from expectations of more relaxed policies ahead. The system pillar for healthy real estate development is still in place. Short-term policy adjustment will only extend the upward cycle.

A series of policies aimed at tightening liquidity and raising the costs of property development (e.g. strengthening supervision over pre-sales, curbing land hoarding, differentiated lending to developers, settlement of land VAT) are settling in as concrete measures to implement the State Council's overall austerity policy for the industry. The differential lending policy gives virtually no leeway. However, we remain convinced that share price is a reflection of company value in the mid-to-long term. Instead of hurting corporate earnings, industry policies will push developers to produce more and replenish their currently low resource inventories. We believe the sector has sailed past the most difficult period and the positive effect of tightening policies is being consolidated. We look to a longer up-cycle ahead.

Comment:

The provincial government of Zhejiang has issued a draft regulation on the management of commodity housing pre-sale proceeds. Effective 1 Oct 10E, all funds from commodity housing pre-sales will be booked as "supervised funds" and placed under close management. Banks will issue loans to developers by installments after receiving proof that phases of projects funded have been completed.

Industry policies can be grouped into the following types: (i) Policies to curb demand and expand supply. The chief means to suppress demand is to raise housing prices. Ways to increase supply consist of (a) faster land supply and (b) tighter liquidity control. More stringent management over commodity housing pre-sale proceeds is a representative measure to tighten liquidity for developers. Policies like this will force developers to speed up sales to increase capital return. As a result, supply will grow in the short run. At the same time, developers' enthusiasm for land acquisition will also be dampened. We do not believe that these measures will constitute a damaging blow to the current housing market.

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Performance of stock or sector relative to MSCI-China Index over next 6 months after research publications

| | Rating | Remark |
|---------------|--------------|--|
| Stock rating | Buy | Relative performance over MSCI-China Index >20% |
| | Overweight | Relative performance over MSCI-China Index 5% ~ 20% |
| | Hold | Relative performance over MSCI-China Index -10% ~ 5% |
| | Sell | Relative performance over MSCI-China Index > -10% |
| | NR | Not rated |
| Sector rating | Outperform | Relative performance over MSCI-China Index >10% |
| | Neutral | Relative performance over MSCI-China Index -10% ~10% |
| | Underperform | Relative performance over MSCI-China Index > -10% |

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