

Soho China

410 HK

Bold transformation

- Following its big strategic shift in 2012, the company is now the largest Hong Kong-listed office landlord in Beijing and Shanghai
- It has completed some 0.84m sq m of commercial property; another 0.96m sq m is scheduled to be completed in 2015-18
- It posted gross rental income of CNY424m for 2014; long-term target of CNY4bn. DPS maintained at CNY0.25/share since 2011

Target (HKD): **n.a.**

Up/downside: -

13 Mar price (HKD): **5.13**

■ Not Rated



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■ Background

Soho China reported its 2014 results on 6 March. In this report we include a post-results Q&A with management, and illustrate in charts and tables how the company has adapted to the changing landscape of China property in recent years, and how it is faring after switching its business model from developing commercial property into being an office landlord.

■ Highlights

Early entrant to China property.

Set up in 1995, Soho China was one of the first companies to establish a presence in the China Property Sector. In its early years, the company focused on building office property for sale on a strata-title basis to wealthy investors in China.

Listed during China property boom. Soho China raised USD1.9bn in its IPO and was listed on the Hong Kong Stock Exchange on 8 October 2007, ie, several months before the 2008 downturn in the China Property Sector that led to big deratings for the sector's major stocks. Soho China used its IPO proceeds to acquire prime commercial sites in Beijing and Shanghai over 2008-12.

Big transition. In 2012, Soho China announced a transformation of its business model and set itself the goal of becoming a developer and manager of prime office property in Beijing and Shanghai. Three years on, the company has 1.8m sq m attributable GFA of commercial property (0.84m sq m completed, 0.96m sq m under construction) and a long-term gross rental income target of CNY4bn. It reported 2014 gross rental income of CNY424m, a 51.7% increase from CNY279m in 2013.

Largest Hong Kong-listed office landlord in Shanghai and Beijing by GFA. We estimate Soho China's 1.8m sq m of attributable GFA is about three times the size of Hongkong Land's Central portfolio. According to the company, it is the largest Hong Kong-listed prime

office landlord in Beijing and Shanghai in terms of GFA.

■ Stable DPS over past 5 years.

Soho China has focused on maintaining the absolute DPS paid to shareholders. Despite the fluctuations in its reported profits for 2010-14, Soho China has kept its DPS for the same period at CNY0.25/share. At the current share price, the payout translates to a dividend yield of 6%.

■ Valuation

Based on Bloomberg consensus forecasts, the stock is trading at a 2015E PER of 5.4x, compared with a sector average of 7x. On the same basis, it is trading in the middle of its forward PER range of 2.1-8.5x for 2009-14.

Share price performance



12-month range	5.04-6.64
Market cap (USDbn)	3.43
3m avg daily turnover (USDm)	2.95

Source: FactSet, Daiwa

2014 results highlights

Revenue declined by 58% YoY to CNY6bn, due mainly to a 61% YoY reduction in property sales. Nevertheless, rental income growth was on track relative to prior guidance, rising by 52% YoY to CNY424m.

Accordingly, gross profit and core net profit dropped by 62% YoY and 60% YoY to CNY3bn and CNY1.8bn, respectively. The gross profit margin came in at 50% and the net profit margin at 29%, which compare favourably with industry norms.

Net gearing was 20% at end-2014 (vs. 17% at end-2013) and the effective interest rate was 5.7%. According to management, cash on hand of over CNY13bn should be sufficient to fund the CNY8bn in capex needed to complete all investment properties under construction in 2015-18.

In 2H14, the company launched Soho 3Q, its new business model targeting cost-conscious small companies. The rent is set at CNY1,000/week/desk, and Soho expects to expand to 8,000 desks by the end of 2015 (1,500 desks/seats currently).

Management's outlook for 2015

For 2015, management expects most of the revenue to come from rental income from existing offices, which in total have a leasable GFA of about 0.8m sq m, located in Beijing and Shanghai.

According to management, rental increases in 2015 should be driven by the 4 projects completed in 2H14 in Beijing and Shanghai, which together comprise about 0.44m sq m of leasable GFA.

Management said there will be no properties ready for sale in 2015 and it has no plans to dispose of any projects this year.

The company expects its remaining investment properties to be fully completed by end-2018 and its total leasable GFA to be 1.8m sq m by then.

Soho plans to focus on domestic companies as its main tenants, instead of foreign companies, as domestic companies are the main drivers of China's office market.

Post-results briefing: Q&A

From Soho China's 2014 post-results meeting, here are some of the questions attendees put to management, along with the company's answers:

1. How was the company's cash flow management in 2014?

- The major cash inflow items were the disposal of 3 projects in Shanghai for CNY8bn, and the sale of other development projects for CNY3bn. The major cash outflow items were tax: CNY6.7bn, construction costs: CNY3.3bn, and interest and other operating costs: CNY1bn.

2. What's the company's outlook for 2015 (including rental growth and the sales pipeline)?

- 2014 was a tough year for the office market, even in Beijing and Shanghai. Management believes preleases could be tough to achieve, given the market will have plenty of new supply in 2015.
- For Soho China, in Beijing, almost 100% of its new tenants are Internet companies. In Shanghai, the supply/demand dynamics are weaker than in the capital city, as local governments are competing with one another to lease office space while demand is not too strong.
- Although management thinks the office market could be tougher in 2015, reflecting a potential further slowdown in GDP, it does not expect considerable volatility in office rentals.
- As the company has not yet seen any decline in asset values (or property prices), it is keeping cash on hand now ahead of any decline in asset values that might present a good buying opportunity. It will focus in particular on the equity market.
- Since there are no potential M&A targets, it has not budgeted any capex for new construction.

3. Can management give more details about Soho 3Q?

- According to management, Soho 3Q, its new business model under which a customer can rent a small amount of office space and desk on a weekly basis, is an exciting new product targeting cost-conscious companies.
- With Soho 3Q, customers can rent a small space (ie, a room, a desk or even a chair) for CNY1,000/week/desk, including the use of all the equipment in the 3Q offices.

- Management plans to expand Soho 3Q to 8,000 desks/seats in 10 office buildings in Beijing and Shanghai by end-2015. It is also considering expanding the concept to airports.
- Each seat in the Soho 3Q offices takes up 10 sq m. The company estimates its all-in cost at CNY30,000/seat. One difference between Soho and other industry peers is that Soho 3Q customers can make online payments through a mobile application.

4. What's the reason for the decline in the interest expenses capitalisation rate (from 91% in 2013 to 76% in 2014)?

- The company underwent less construction work in 2014.

5. How does management view the existing valuation of the current assets of Sky Soho?

- The company sold half of the GFA at Sky Soho, an office building completed in November 2014 and located in Shanghai, to CTRIP and retains the other half for leasing. The sale to CTRIP was for CNY30,000/sq m, compared with a total cost of around CNY15,000/sq m (CNY6,000/sq m land cost +CNY9,000/sq m construction cost).

As for the leasable part, management thinks the key aspect is to adjust the leasing prices and see how fast it can lease out the GFA. It believes that in a market with consistent supply, there would be no point in offering prelease deals, as tenants want to see the actual office before deciding whether to take it up. The company tends to prefer standardised on-line leasing contracts, which enable a 100% collection rate every month and cut labour costs.

6. Does management have any plans for block sales in 2015?

- No.

7. Is the company sticking with its CNY4bn rental income target for the long term?

- There are no changes. Management expects rentals for its office buildings to pick up when the market becomes more mature. It noted that there is always a 25-40% discount on rents when a building is first leased. However, rents tend to correct from the second round of leases.

8. What is management's land acquisition strategy? Any primary development plans?

- There are no plans for primary developments. Management thinks costs in Beijing and Shanghai are too high to purchase land. It would rather look at the possibility of M&A of existing assets.

9. How does the leasing rate for Soho 3Q compare with other leasing rates in similar areas?

- The company uses the market spot rate for Soho 3Q, with an estimated net profit margin of 15-20%.

10. How does management plan to fund construction costs in the future?

- The company has plenty of cash currently. With the cash inflow from operations, the company should not have to dispose of any assets to fund 2015 capex.

11. What is the company's dividend policy?

- The company plans to continue to pay a dividend. It has kept its DPS unchanged at CNY0.25 over the past 3 years. Based on its DPS of CNY0.25 for 2011-2014 and its current share price of HKD5.1, the stock offers a 6.1% yield. With a BVPS CNY7.57/share at December 2014, the stock is now trading at an end-2014 PBR of 0.5x, versus a past-5-year average PBR of 0.9x.

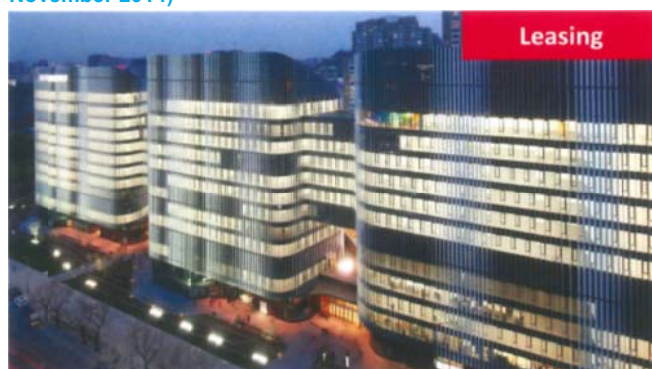
Charts and tables: historical indicators

- Soho China: Wangjing Soho – Beijing (completed in September 2014)



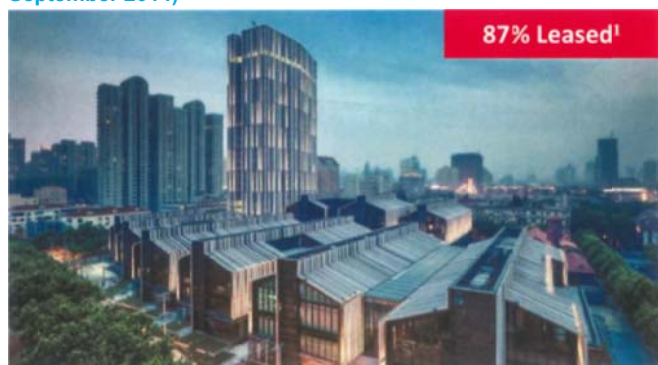
Source: Company

- Soho China: Guanghualu Soho II – Beijing (completed in November 2014)



Source: Company

- Soho China: Soho Fuxing Plaza – Shanghai (completed in September 2014)



Source: Company

- Soho China: Sky Soho – Shanghai (completed in November 2014)



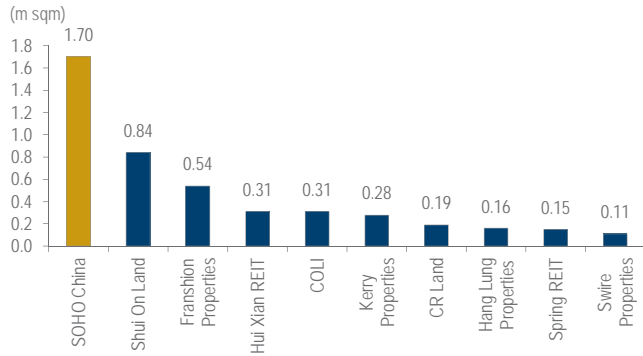
Source: Company

- Soho China: quality investment property portfolio

Project	Status	Completion date	City	Interest	Total planned GFA ('000 sq m)	leasable GFA ('000 sq m)	Office ('000 sq m)	Retail ('000 sq m)	Hotel ('000 sq m)
Qianmen Avenue	Completed	-	Beijing	100%	54.7	54.691	-	54.691	
Soho Century Plaza	Completed	-	Shanghai	100%	59	42.954	42.522	0.432	
Wangjing Soho Tower 3	Completed	Sep-14	Beijing	100%	170	127.894	123.568	4.326	
Guanghualu Soho II	Completed	Nov-14	Beijing	100%	166	95.906	64.032	31.874	
Sky Soho	Completed	Nov-14	Shanghai	100%	171.5	128.128	102.964	25.164	
Soho Fuxing Plaza	Completed	Sep-14	Shanghai	100%	137	88.328	57.039	31.289	
Others	Completed	-	Beijing/Shanghai	100%	80	62.349	23.888	38.461	
Bund Soho	Under development	May-15	Shanghai	90%	130	75.475	51.615	23.86	
Hongkou Soho	Under development	Aug-15	Shanghai	100%	96	65.069	60.729	4.34	
Soho Tianshan Plaza	Under development	Nov-16	Shanghai	100%	170	111.684	72.643	15.139	23.902
Soho Leeza	Under development	Nov-18	Beijing	100%	170	124			
Gubei Project	Under development	Dec-18	Shanghai	100%	150	105.476			
8-1 project	Joint-controlled Entity	Dec-15	Shanghai	50%	213	145.485			
Commune by the Great Wall	Completed	-	Beijing	100%	30.714	30.714			

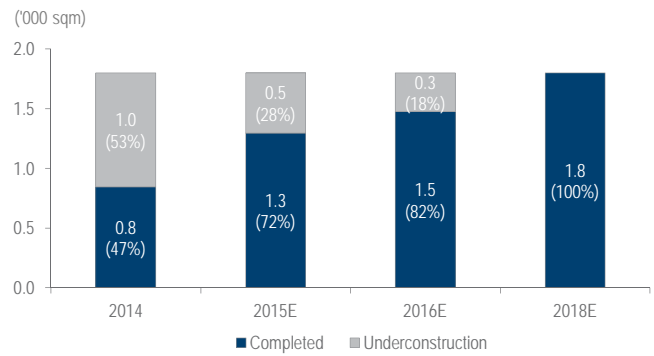
Source: Company

■ **Soho China: a leading landlord of prime office space in Beijing and Shanghai**



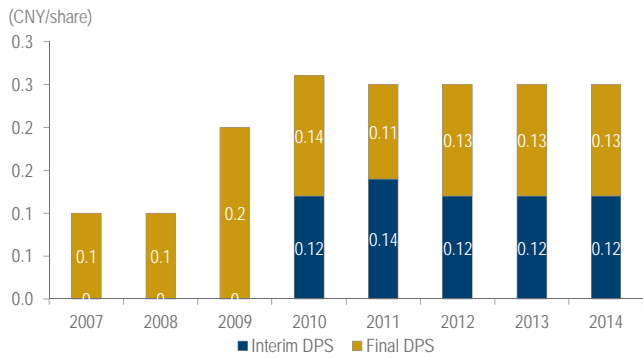
Source: Company

■ **Soho China: estimated time schedule of completion of its investment property assets**



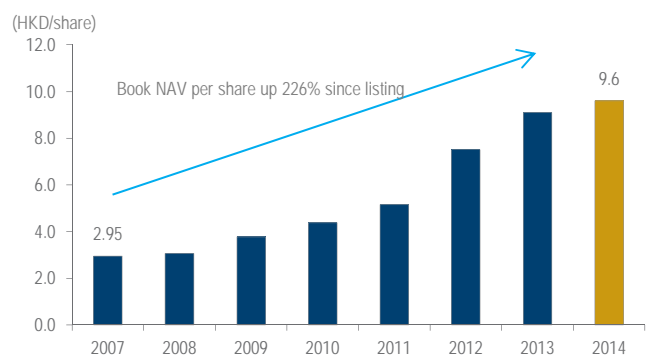
Source: Company

■ **Soho China: dividend per share**



Source: Company

■ **Soho China: book NAV per share**



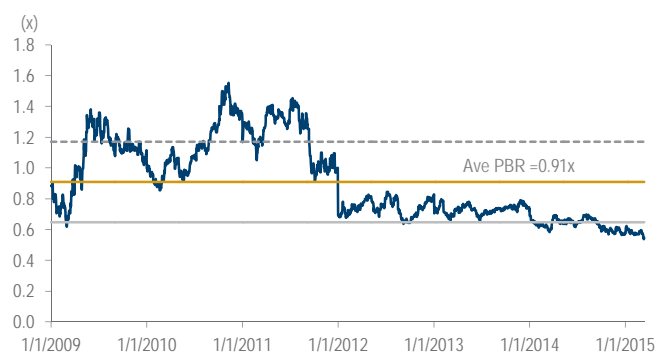
Source: Company

■ **Soho China: historical PER for the past 5 years**



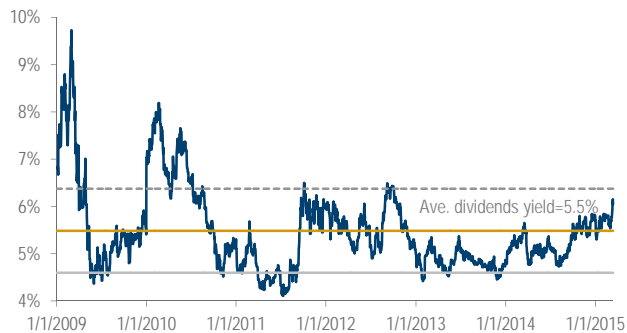
Source: Bloomberg

■ **Soho China: historical PBR for the past 5 years**



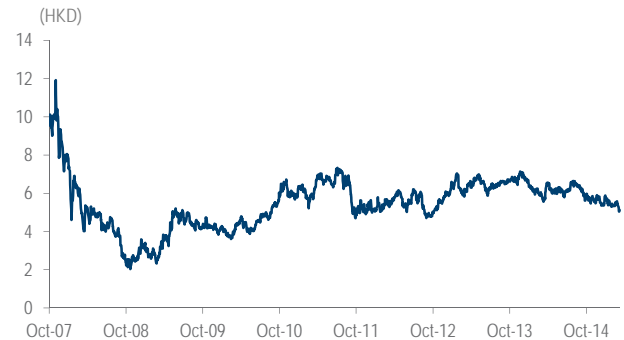
Source: Bloomberg

■ Soho China: historical dividend yield for the past 5 years



Source: Bloomberg

■ Soho China: share price since IPO



Source: Bloomberg

■ Soho China: operating KPIs

(CNYm)	2010	2011	2012	2013	2014
Revenue	18,215	5,685	16,143	14,621	6,098
Development sales	18,105	5,594	15,986	14,342	5,674
Rental	110	91	157	279	424
Gross profit	9,257	2,731	9,007	8,114	3,078
EBIT	8,724	6,452	18,321	11,789	6,311
Net profit	3,592	3,691	10,585	7,388	4,080
Selling exp./ revenue	3.0%	4.2%	2.0%	2.6%	3.3%
Admin exp./ revenue	1.1%	3.7%	1.6%	2.4%	4.6%
Gross profit margin (%)	50.8%	48.0%	55.8%	55.5%	50.5%
EBIT margin					
Net profit margin (%)	19.7%	64.9%	65.6%	50.5%	66.9%
Net debt	(7,107)	(865)	942	6,545	7,823
Net gearing ratio (%)	-36.9%	-4.0%	3.1%	17.5%	19.9%
Book NAV/share	3.71	4.19	6.04	7.09	7.57
Contract sales area (sq.m)	394,990	183,827	185,079	75,876	-
Contract sales value (CNYm)	23,810	10,913	9,468	4,687	-
Contract ASP(CNY/sq.m)	59,824	58,649	50,531	60,835	-
Recognised sales area (sq.m)	409,106	100,315	236,848	261,637	-
Recognised sales value (CNYm)	18,215	5,685	15,305	14,621	-
Recognised ASP (CNY/sq.m)	44,524	56,670	66,639	54,527	-

Source: Company

■ Soho China: key income statement indicators

(CNYm)	2010	2011	2012	2013	2014
Property sales	18,105	5,594	15,986	14,342	5,674
Rental income	110	91	157	279	424
Total revenue	18,215	5,685	16,143	14,621	6,098
Gross profit	9,257	2,731	9,007	8,114	3,078
Gross profit margin (%)	51%	48%	56%	55%	50%
Selling and marketing expenses	(547)	(238)	(327)	(373)	(200)
Administrative expenses	(205)	(211)	(254)	(348)	(278)
Other gains/ expenses	219	4,169	9,895	4,396	3,711
EBIT	8,724	6,452	18,321	11,789	6,311
EBIT margin					
Net interest income / (expenses)	(68)	209	(126)	682	378
Share of profits from associates/ JCEs	-	-	-	-	-
Profit before tax	8,656	6,661	18,195	12,470	6,689
Tax	(4,928)	(2,375)	(7,548)	(5,034)	(2,538)
Profit after tax	3,727	4,285	10,647	7,436	4,151
Minority interests	135	594	62	48	72
Reported net profit	3,592	3,691	10,585	7,388	4,080
Underlying net profit	3,512	2,734	3,335	4,440	1,778
Net profit margin (%)	19%	48%	21%	30%	29%
Gross valuation gain/ (loss)	165	4,027	9,605	4,220	3,125
Tax and other adjustments	(85)	(3,070)	(2,355)	(1,272)	(824)
Net property revaluation gain/ (loss)	80	957	7,250	2,948	2,302
EPS (CNY)	0.70	0.75	2.05	1.49	0.78
DPS (CNY)	0.26	0.25	0.25	0.25	0.25

Source: Company

■ Soho China: key balance-sheet indicators

(CNYm)	2010	2011	2012	2013	2014
Cash on hand	17,725	14,489	22,062	10,525	12,439
Properties for sale	18,697	23,429	10,048	8,587	3,983
Properties under development	-	-	-	-	-
Account receivables	790	549	663	682	676
Other current assets	1,006	5,066	2,599	2,219	634
Current assets	38,219	43,533	35,373	22,012	17,731
Investment properties	3,085	13,335	38,310	48,728	52,875
Land use right					
Property, plant & equipment	554	688	682	673	651
Interests in associates and JCEs	1,212	-	4,066	4,088	4,057
Other non-current assets	4,860	2,124	2,147	2,322	1,505
Non-current assets	9,711	16,147	45,205	55,811	59,088
Total assets	47,930	59,680	80,578	77,823	76,819
Short-term borrowings	2,581	2,215	3,922	2,760	1,353
Account payable	2,586	1,950	2,657	3,586	4,621
Advance receipts from customers	6,720	13,199	8,896	3,112	337
Other current liabilities	6,967	5,682	9,571	9,793	5,206
Current liability	18,854	23,044	25,047	19,251	11,517
Long-term debt	8,037	11,410	19,082	14,310	18,909
Other long-term liabilities	1,060	2,008	4,738	5,776	5,933
Non-current liability	9,097	13,418	23,821	20,086	24,842
Minority interests	737	1,495	1,011	1,025	1,097
Shareholders' funds	19,243	21,723	30,700	37,461	39,363
Total liabilities and equities	47,930	59,680	80,578	77,823	76,819
Debt maturity profile					
Due within a year	2,581	2,215	2,760	3,922	-
Due within 1-2 years	3,323	3,657	1,650	6,365	-
Due within 2-5 years	1,804	5,311	6,471	4,112	-
Due beyond 5 years	925	455	165	315	-
Gross debt	10,618	13,624	23,004	17,070	20,262
Cash on hand	17,725	14,489	22,062	10,525	12,439
Net debt	(7,107)	(865)	942	6,545	7,823

Source: Company

■ Soho China: investment property GFA portfolio

('000 sq.m)	2010	2011	2012	2013	2014
Greater Bohai Rim					
Beijing	1,099	1,072	437	572	433
Tiananmen South	55	55	55	55	55
Chaoyang SOHO	334	330	45	11	
Wangjing Soho Tower 3	500	520		170	128
Guanghualu Soho II	167	167	167	166	96
*Soho Leeza		To be completed in Nov-18		170	124
Coomune by the Great Wall					31
Soho Peaks			170		
Danling Soho	43				
Greater Yangtze River Delta					
Shanghai	326	1,255	1,587	1,739	763
Soho Century Plaza		59	59	59	43
Soho Fuxing Plaza	137	137	137	137	88
Sky Soho		350	343	343	128
*Bund Soho		To be completed in May-15	189	190	75
*Hongkou Soho		To be completed in Aug-15	97	96	65
*Soho Tianshan Plaza		To be completed in Nov-16		170	112
*Gubei Project		To be completed in Dec-18			150
*8-1		To be completed in Dec-15	423	426	145
Soho Huilun Plaza			168	168	
Hongqiao Soho	300				
Others			568	218	62
Total	1,425	2,327	2,592	2,529	1,258

Source: Company

■ Soho China: contracted sales value

(CNYm)	2010	2011	2012	2013
Tier-1 cities				
Beijing	18,188	8,422	8,086	3,336
Shanghai	3,816	2,129	1,382	842
Others	1,806	363	-	509
National	23,810	10,913	9,468	4,687

Source: Company

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