

Franshion Properties (China) Ltd.

Challenges everywhere

We remain cautious on Franshion. Hotel business is disappointing due to higher opening expenses and more competition; rental income growth was sluggish and is facing threat from new supply. Primary land development business has shrunk by more than half due to poor land market in Changsha. The only good item is property development, but at current scale Franshion may face an expansion bottleneck and may see stale returns in the next few years. All of these added up to low ROA (2.5%) and ROE (9.2%) despite its high leverage (103% adjusted net gearing). Further expansion in development properties and land development added on to operational risk, and the steep discount to NAV will continue until the Company can prove that they can walk through the bottlenecks. At 55% discount to NAV, we **remain Neutral** with Dec-2015 PT of **HK\$2.10** per share.

- Development business remains challenging:** Franshion started off its development properties business well a few years back when they first launched in Beijing, however as the scale expanded, the margin has quickly reverted back to a normal level. Property development business is challenging to all developers given the oversupply nature, and we have not seen much edge to Franshion yet. Their asset turnover is not particularly fast, and margin for new landbank is also just tracking industry average of 25% to 30%. We think returns could be better if they do more investment property development.
- Land sales unlikely to see recovery:** Changsha primary land sales were slow in 1H2014, and stopped in 2H. We think this is due to the oversupply in the area on the back of intensive land sales back in 2012 and 2013. The area is flooded with branded developers, and most of them, even for CSEEC and Vanke, cannot yield good returns. Franshion already has three projects in the area and we do not think they can take up more as they also see inventory build up. Even if the market rebounds, land sales in the area is very likely to remain slow.
- Hotel result disappointing:** With average room rate coming down for matured properties, the organic EBITDA for the hotel portfolio has come down by 5% Y/Y. That together with a higher-than-expected pre-opening expenses for its three new hotels, overall EBIT from hotel was 75% below estimate. The operating environment has remained challenging and hence growth is likely to remain slow in the coming 12-18 months in our view.

Franshion Properties (China) Ltd. (Reuters: 0817.HK, Bloomberg: 817 HK)

HK\$ in mn, year-end Dec	FY13A	FY14A	FY15E	FY16E	FY17E
Revenue (HK\$ mn)	21,508	31,055	32,436	40,397	57,137
Net Profit (HK\$ mn)	4,227	5,296	3,801	3,712	5,472
Core Profit (HK\$ mn)	2,380	3,282	3,484	3,395	5,154
EPS (HK\$)	0.43	0.55	0.38	0.37	0.57
Core EPS (HK\$)	0.26	0.36	0.38	0.37	0.57
Core EPS growth (%)	30.0%	39.3%	6.2%	(2.6%)	51.8%
DPS (HK\$)	0.10	0.12	0.13	0.13	0.18
ROE	7.6%	9.2%	9.0%	8.2%	11.7%
P/E (Core)	8.0	5.8	5.4	5.6	3.7
P/BV (x)	0.6	0.5	0.5	0.4	0.4
BVPS (HK\$)	3.66	4.15	4.42	4.66	5.05
RNAV/Share			4.85	-	-
Dividend Yield	4.5%	5.5%	6.0%	6.2%	8.6%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Neutral

0817.HK, 817 HK

Price: HK\$2.09

Price Target: HK\$2.10

China Property

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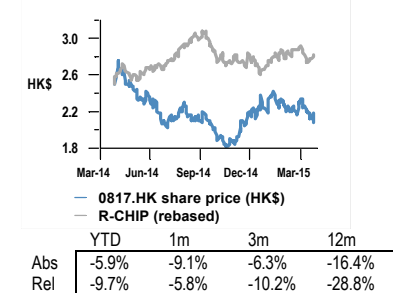
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Price Performance



Company Data	
Shares O/S (mn)	9,068
Market Cap (HK\$ mn)	18,953
Market Cap (\$ mn)	2,444
Price (HK\$)	2.09
Date Of Price	26 Mar 15
Free Float(%)	37.1%
3M - Avg daily vol (mn)	8.09
3M - Avg daily val (HK\$ mn)	18.41
3M - Avg daily val (\$ mn)	2.4
R-CHIP	4515.05
Exchange Rate	7.75
Price Target End Date	31-Dec-15
Price Target (HK\$)	2.10

See page 14 for analyst certification and important disclosures, including non-US analyst disclosures.

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Table 1: Franshion - valuation and financial summary

Key catalyst for the stock price: • Stronger sell-through rate and higher-than expected margin	Upside risks to our view: • Earlier than expected corporate restructuring	Downside risks to our view: • Further tightening in property measure in Beijing • Slowdown in hospitality market in China • Potential office oversupply in Shanghai Pudong
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Key financial metrics	FY12A	FY13A	FY14A	FY15E
Revenues (LC)	18,021	21,508	31,055	32,436
Revenue growth (%)	106.3%	19.3%	44.4%	4.4%
EBITDA (LC)	6,102	7,782	9,451	10,077
EBITDA margin (%)	33.9%	36.2%	30.4%	31.1%
Tax rate (%)	24.2%	25.6%	26.7%	26.7%
Net profit (LC)	3,061	3,910	4,979	3,484
EPS (LC)	0.33	0.43	0.55	0.38
EPS growth (%)	51.0%	27.7%	28.6%	-30.0%
DPS (LC)	0.07	0.10	0.12	0.13
BVPS (LC)	3.15	3.66	4.15	4.42
Operating cash flow (LC mn)	(277)	(9,350)	(12,915)	2,523
Free cash flow (LC mn)	(288)	(9,700)	(12,090)	2,863
Interest cover (X)	7.74	7.23	11.30	7.40
Net margin (%)	17.0%	18.2%	16.0%	10.7%
Sales/assets (X)	0.24	0.21	0.24	0.23
Debt/equity (%)	82.0%	75.8%	83.0%	77.4%
Net debt/equity (%)	42.9%	44.5%	58.1%	55.5%
ROE (%)	6.7%	7.6%	9.2%	9.0%

Key model assumptions	FY15E
Residential price growth	0-5%
WACC	9.54%

Source: J.P. Morgan estimates.

Sensitivity analysis	NAV	EPS
Sensitivity to	Dec-15	FY15E
5% chg in residential ASP	9.8%	4.7%
1% chg in WACC	2.0%	n/a

Source: J.P. Morgan estimates.

Comparative metrics

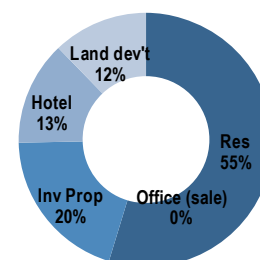
	CMP	Mkt Cap	P/E		NAV discount		P/BV		YTD
			LC	US\$m	FY14E	FY15E	Current	Forward	
Evergrande Real Estate	3.65	6,885	8.2	10.0	-38%	NA	0.8	0.7	18%
China Overseas Land Investment	23.55	24,819	7.5	6.7	-11%	-26%	1.2	1.1	5%
China Resources Land	20.80	17,514	10.6	9.7	-44%	-50%	1.1	1.0	2%
China Vanke - H shares	17.66	23,381	8.2	7.3	-18%	NA	1.5	1.3	-1%
Franshion Properties	2.14	2,502	5.6	5.7	-56%	NA	0.5	0.5	-6%
Sino-Ocean Land	4.76	4,602	7.1	6.1	-63%	NA	0.6	0.6	6%
Shui On Land	1.72	1,774	15.8	9.1	-68%	NA	0.3	0.3	-8%
Shimao Properties	16.06	7,190	5.4	5.1	-31%	-21%	0.8	0.7	-9%
Guangzhou R&F	7.69	3,195	3.7	3.2	-47%	-42%	0.5	0.4	-21%
Agile Property	4.60	2,323	4.1	4.2	-27%	NA	0.3	0.3	1%
KWG Property	5.15	1,956	3.9	3.1	-55%	-59%	0.6	0.5	-2%
Longfor Properties	10.34	7,745	6.6	6.3	-36%	-44%	0.9	0.8	1%
Country Garden	2.97	7,793	4.3	3.7	-27%	-19%	0.8	0.7	-5%

Source: Bloomberg, Company and J.P. Morgan estimates. Prices are as of 26 March 2015.

Valuation and price target basis

Our Dec-15 PT is based on a 60% discount to NAV, translating to 0.5x 2015E P/BV. The NAV discount applied is wider due to Franshion's multiple assets focus, which is not viewed favorably in the market at this time.

NAV breakdown (Dec-15E)



Source: J.P. Morgan estimates.

JPMe vs. consensus, change in estimates

EPS	FY15E	FY16E
JPMe old	0.36	0.35
JPMe new	0.38	0.37
% chg	5%	6%
Consensus	0.40	0.46

Source: Bloomberg, J.P. Morgan estimates.

Challenges in all business segments

We retain our cautious view on Franshion. Hotel business is disappointing due to high opening expenses and a more competitive environment; rental income growth was sluggish and is facing threat from new supply. Primary land development business has shrunk by more than half due to poor land market in Changsha. The only good thing is property development, but at current scale, Franshion is likely facing an expansion bottleneck and we expect it to see stale return in the next few years. All of these have added up to a low ROA (2.5%) and low ROE (9.2%) despite its high leverage (103% adjusted net gearing). Further expansion in development properties and primary land development added on to the operational risk, and the steep discount to NAV will continue until the Company can prove that they can walk through the bottlenecks shortly. At 55% discount to NAV, we **remain Neutral** with Dec-2015 PT of HK\$2.10 per share.

DP getting close to the first expansion bottleneck

Franshion has continued with its aggressive expansion into the development properties (DP) market, and in 2H2014, 92% of the EBIT come from it. With a scale of selling only Rmb18.5 bn, Franshion is now exposed to 11 cities, which is quite scattered and is cost-ineffective. Moreover, Franshion's ASP is the highest among the major developers. With an aggressive target to grow in scale, Franshion will inevitably need to expand into cities with lower ASP, facing more mass-end demand. This is the bottleneck of most developers, and we think this is also applicable to Franshion. Return from DP is likely shrinking in the coming three years. Moreover, with land price stayed high and developers losing pricing power due to over-supply, we are worried that Franshion could over expand and put stress on its balance sheet. Indeed its completed unsold inventory has gone up to Rmb

Changsha land development is a drag to Franshion

We have been holding the view that primary land development is not a good business, and this has been proved by Franshion's 2014 result. Franshion's land sales in Changsha have decreased from HK\$7.16 bn in 2013 to HK\$3.65 bn in 2014, which the Company attributes to the local government not allowing them to cut price.

However, we think this is not the only reason. The Changsha Meixi Lake area is very over-supplied, with Kaisa, COLI and Vanke in the area, but without anyone fetching a good return. Franshion has done well in revamping the area, but with land supply of over 20 mn sqm, the demand is not sufficient for Franshion to monetize the landbank quickly. With low margin and slow asset turnover, the return on such business is low. This if not disposed will remain a drag on Franshion.

Upcoming competition from Shanghai Tower

Shanghai Tower will open in 2Q2015. Although the office performance of Jin Mao Tower was decent with 12% growth Y/Y. The supply in Shanghai Tower nearby will create competition for Jin Mao Tower very soon. And based on the experience when SWFC was open, in 2008, the rental in Pudong has seen a downcycle for 2 years until rebounding back to the original level. We think Franshion will be able to maintain a high occupancy rate, but there are downside to rental income in our view.

2014 result briefing takeaway

Franshion hosted an analyst briefing on March 26, 2015. Chairman He Cao, CEO Li Congrui, and CFO Jiang Nan participated.

Outlook/strategy

- **2015 sales target:** Rmb24.8bn for property development with sellable resources of Rmb40 bn, implying sell-through of 62%. Overall sell-through rate was 70% in 2014.
- **Five-Year plan:** Management set up the five-year plan with sales target of Rmb80 bn in 2019 (30% CAGR), of which Rmb50 bn will come from property development sales, Rmb20 bn from rental income/hotel operations (28% CAGR), and Rmb10 bn from primary land sales. They also expect to achieve sales of Rmb50 bn in three years.
- **JV projects:** will continue to cooperate with other developers in the future. Management believes it can leverage Franshion's premium brand name and product quality while lowering financial risks.
- **"Sell and Keep" strategy for IP:** the breakdown would be 80% (Sell) vs 20% (Keep) for new investment properties in the future.
- **Overseas expansion:** will consider overseas property development business but Franshion will not do it in large scale.

Operations

- **Dividend payout ~30%** in 2014 and will maintain at similar level going forward
- **Sellable resources:** Rmb40 bn in 2015 and the split is 40%/60% in 1H/2H. Rmb5.7bn will be from inventory and the rest are new launches (including existing projects).
- **Primary land sales:** The weak land sales in 2014 was mainly because local government is reluctant to lower land price and Franshion couldn't adjust it to stimulate land sales. Management expects the land sales will be about HK\$3-4bn in the future. In Jan 2015, Franshion also acquired 80% equity control of Nanjing Shangfang Primary Development Project with GFA of 3.8mn sqm at estimated cost of Rmb17 bn. Franshion expect to complete the development for eight years. The nearby land cost is at A.V of Rmb7,500 psm.
- **Property leasing:** Rental income of HK\$1.4 bn in 2014, up 12% Y/Y, and the occupancy rate is >97% on average.
- **Hotel business:** Revenues of HK\$2.1bn in 2014, up 3% Y/Y. Three hotels were opened in 2014, including Hyatt Regency in Chongming Shanghai, Renaissance Beijing Wangfujing, and Grand Hyatt Lijiang. They target to increase total number of hotels to 18 by 2017 (including under construction and in operation).
- **Landbank and acquisition:** acquired 7 parcels of land lots with GFA of 2.9mn sqm at total consideration of Rmb25.5 bn in 2014 and the outstanding land premiums is about Rmb4 bn. Total landbank was GFA of 32mn sqm, including primary development, which will be sufficient for development in the following years. Among that, GFA of 9.8mn sqm is for property development, GFA of 553k sqm for investment property, and GFA of 573k sqm for hotel operations.

- **Shanghai Daning project:** Franshion plans to launch the project in April 2015 with first batch of ~250 units and estimated ASP >Rmb70,000 psm. Management commented that more than 700 people have registered for the pre-sale. Total sellable resources for the project are Rmb6 bn with sales target of Rmb4 bn this year.
- **New construction starts:** 2.47mn sqm in 2014 and 1.6mn sqm in 2015.
- **Sold but unrecognized sales** are HK\$20 bn as of Feb-2015 (excluding land sales)

Financial

- **GP margin:** 34% (pre-LAT) for property sales and 46% for land sales in 2014. Management guided that they will keep the GP margin 10-15% higher than other peers' so the target GP margin would be >35%.
- **Gearing ratio:** Management's guidance for gearing is <60% (Net debt/total equity).
- **Financing cost:** average financing cost at 5.4% in 2014, improved slightly from 5.6% in 2013.
- **Debt profile:** on-shore borrowing accounted for 45% of total borrowing and offshore accounted for 55%.
- **Convertible securities:** the perpetual convertible securities of US\$600mn will be redeemable after the date of Oct 11, 2015. Management may consider redeeming it but all the details are still to be determined.
- **Share repurchase:** Management may repurchase the shares again this year if the stock price doesn't perform well.
- **Cash flow** for 2014 and management 2015 budgeted cash flow:

Table 2: Franshion – Company budgeted key cash flow items, 2014-15E

Rmb bn	2014	2015E
Land premiums	13.8	4.0
Construction costs	7.0	10.0
SG&A expenses	1.9	2.0
Tax payment	3.0	5.0
Interest expenses	2.1	2.5
Cash outflow	27.8	23.5
Contract sales	16.5	25.3
Rental income	1.3	1.3
Hotel income	1.8	2.0
Cash inflow	19.6	28.6
Surplus/(shortfall)	(8.2)	5.1

Source: Company data, J.P. Morgan estimates.

2014 final results review

Sound earnings performance in FY14; Core EPS up 38% Y/Y

Franshion reported 2014 core net profit of HK\$3,282 mn, up 38% Y/Y, mainly due to more delivery of property development, slightly offset the declining land sales. Core EPS was HK\$0.30, up 38% Y/Y. Franshion proposed a final dividend of HK\$0.115 per share, up 21.1% Y/Y, representing a payout ratio of 32% and a dividend yield of 5.50%.

Margin more normalized with inventory build up

Franshion's revenue in FY14 was HK\$29,548 mn, up 43% Y/Y. Among that, land sales revenue was HK\$3,650 mn, down 49% Y/Y, and accounted for 12% of the total revenue, down from 34% in 2013. The weak land sales in 2014 were mainly on the back of uncertain market sentiment last year to affect land market. Because local government was reluctant to lower land prices, Franshion couldn't adjust it to stimulate land sales.

Properties that are sold but not yet booked amounted to HK\$19.5 bn (excluding land sales) as of Feb 28, 2015. Gross margin for property sales decreased to 34% (2013: 45%) and gross margin for land sales recorded at 46% from 36% in 2013, due mainly to lower A.V. achieved for the land sales. We think the margin for Franshion should continue to decline gradually going forward from the peak in 2013 along with the downward margin trend in the industry. But management guided that they will keep GP margin 10-15% higher than other peers' so the target GP margin would be >35%. However, we are **very skeptical** on this as Franshion is just getting land from the open market.

Improving cash flow; expand primary development in Nanjing

The spending in 2014 was aggressive for the budget with Rmb14 bn land capex and Rmb7 bn construction capex due to the acquisition of Shanghai Daning project. For 2015E, most cash flow budget has remained the same for Franshion except with less land payment and the higher construction costs. The management set up the guidance of Rmb4 bn land payment for the outstanding land premiums and construction capex of Rmb10 bn and they expect to see positive cash flow in 2015. However we think management will remain aggressive in landbanking and we are likely to see the year ending with negative free cash flow again. Management treat the convertible perpetual as real perpetual, and have no plan to de-gear anyway.

In January 2015, Franshion also acquired 80% equity control of Nanjing Shangfang Primary Development Project with GFA of 3.8mn sqm at estimated cost of Rmb17 bn. Franshion expect to complete the development for eight years. The nearby land cost is at A.V of Rmb7,500 psm.

Debt profile remains healthy due to its SOE background

With its SOE background, Franshion has financing cost advantage and the average interest rate stands at 5.4%, slightly down from 5.6% in 2013. The total borrowings (including PCS) increased by another 27% from last year to HK\$51 bn as of end-2014. Debt maturity is healthy – loans with maturity within two years only accounted for 22% of the total borrowings. In addition, the on-shore loans accounted for 45% of the total borrowings and the off-shore loans are about 55%. The healthy debt profile and low financing cost will give Franshion advantage when the liquidity of credit market is getting tight.

Table 3: Franshion – 2014 final results summary

Year end December, HK\$ millions	2H2013	1H2014	2H2014E	% H/H	% Y/Y	JPM		% Y/Y	vs JPMe
						2014	2014E		
Property development	5,229.9	8,193.6	13,701.6	67%	162%	21,895.2	16,892.6	126%	30%
Primary land development	2,452.4	3,653.5	(3.5)	-100%	-100%	3,650.0	3,469.8	-49%	5%
Property investment	620.3	696.1	702.3	1%	13%	1,398.5	1,419.9	12%	-2%
Hotel operation	1,019.4	1,058.3	1,068.4	1%	5%	2,126.7	2,251.4	3%	-6%
Others	265.3	217.8	260.0	19%	-2%	477.8	595.6	-12%	-20%
Total revenue	9,587.3	13,819.3	15,728.9	14%	64%	29,548.2	24,629.3	43%	20%
Gross profit	4,013.4	5,441.2	6,117.5	12%	52%	11,558.8	9,638.0	26%	20%
EBIT breakdown									
Property development	1,766.7	2,273.8	4,310.6	90%	144%	6,584.4	5,343.9	79%	23%
Primary land development	1,066.8	1,611.3	69.7	-96%	-93%	1,681.0	1,240.0	-35%	36%
Property investment	404.5	425.7	404.7	-5%	0%	830.4	1,180.2	-15%	-30%
Hotel operation	178.9	207.1	(127.8)	-162%	-171%	79.3	311.2	-80%	-75%
Other operation	(14.1)	14.7	20.8	41%	-247%	35.5	36.4	1%	-3%
Unallocated corporate income / expenses	(88.6)	(87.4)	16.9	-119%	-119%	(70.5)	(173.5)	-51%	-59%
EBIT	3,314.3	4,445.2	4,694.8	6%	42%	9,140.0	7,938.3	22%	15%
Interest income	131.7	206.8	178.9	-13%	36%	385.7	260.4	55%	48%
Interest expenses	(722.0)	(914.7)	(307.2)	-66%	-57%	(1,221.9)	(1,457.0)	-8%	-16%
Operating profit	2,724.0	3,737.3	4,566.5	22%	68%	8,303.8	6,735.7	29%	23%
Share of results of associates	1.0	(0.6)	(32.2)	NM	NM	(32.8)	0.0	NM	NM
Profit before tax	2,725.0	3,736.8	4,534.3	21%	66%	8,271.1	6,735.7	28%	23%
LAT	(230.5)	(331.3)	(762.5)	130%	231%	(1,093.8)	(1,071.3)	-15%	2%
Income tax	(1,122.7)	(1,082.1)	(1,136.6)	5%	1%	(2,218.6)	(1,727.5)	35%	28%
Minority Interests	(356.7)	(211.8)	(1,147.8)	442%	222%	(1,359.5)	(1,360.4)	68%	0%
Perp CS distribution	(159.1)	(158.7)	(158.7)	0%	0%	(317.4)	(317.4)	0%	0%
Core Net Profit	856.0	1,953.0	1,328.7	-32%	55%	3,281.7	2,261.8	38%	45%
Fair value gain of investment properties (net of tax)	966.1	1,544.6	170.3	-89%	-82%	1,714.8	1,544.6	25%	11%
Underlying net profit	1,822.1	3,497.5	1,499.0	-57%	-18%	4,996.5	3,806.4	33%	31%
Exceptionals	11.4	(4.4)	(13.4)	202%	-218%	(17.9)	(4.4)	-111%	302%
Reported net profit	1,833.5	3,493.1	1,485.5	-57%	-19%	4,978.6	3,801.9	27%	31%
Fully diluted core EPS (HK\$)	0.090	0.205	0.140	-32%	55%	0.303	0.209	38%	45%
Fully diluted reported EPS (HK\$)	0.193	0.367	0.156	-57%	-19%	0.460	0.352	27%	31%
DPS (HK\$)	0.095	0.000	0.115	NM	21%	0.115	0.130	21%	-12%
Net gearing	77.2%	91.7%	103.3%	12%	26%	103.3%	84.8%	26%	19%
Pre-LAT development margin	41.3%	31.2%	36.2%	5%	-5%	34.3%	35.8%	-11%	-2%
Post-LAT development margin	36.9%	27.2%	30.6%	3%	-6%	29.3%	29.0%	-2%	0%
Property investment	85.0%	90.2%	87.8%	-2%	3%	89.0%	88.3%	1%	1%
Hotel EBITDA margin	31.1%	33.2%	3.6%	-30%	-28%	18.4%	23.5%	-14%	-5%
EBIT margin	34.6%	32.2%	29.8%	-2%	-5%	30.9%	32.2%	-5%	-1%
Operating margin	28.4%	27.0%	29.0%	2%	1%	28.1%	27.3%	-3%	1%
Net Margin (after MI)	8.9%	14.1%	8.7%	-5%	0%	11.2%	9.2%	0%	2%
Net Margin (before MI)	12.6%	15.7%	15.9%	0%	3%	15.8%	14.7%	0%	1%
Key ratios									
S&G % sales	-4.3%	-2.2%	-2.2%	0%	2%	-2.2%	-3.0%	1%	1%
Admin % sales	-6.9%	-5.1%	-6.7%	-2%	0%	-6.0%	-5.6%	0%	0%
Effective tax rate	-41.2%	-29.0%	-24.9%	4%	16%	-26.7%	-25.6%	-1%	-1%
LAT % sales	-4.4%	-4.0%	-5.6%	-2%	-1%	-5.0%	-6.3%	8%	1%
Cash Interest Cover (X)	3.24	3.69	3.67	-2%	43%	3.68	3.82	-14%	-14%

Source: Company data, J.P. Morgan estimates; as of 31 Dec 2014.

NAV and earnings revision

We have revised our 2015E/16E earning estimates by +4.2%/+5.0% respectively, after factoring in the latest development schedule, ASPs and newly acquired projects. We have also revised our Dec-2015 NAV down by 3.9% to HK\$4.85 per share.

Table 4: Franshion – Summary of earnings changes

	FY15E	FY16E	FY17E
Revenue			
Old	31,207	39,456	NA
New	32,436	40,397	57,137
% change	3.9%	2.4%	NA
Core net profit (HK\$MM)			
Old	3,344	3,232	NA
New	3,484	3,395	5,154
% change	4.2%	5.0%	NA
Fully diluted Core EPS (HK\$)			
Old	0.309	0.299	NA
New	0.325	0.316	0.480
% change	4.9%	5.8%	NA
NAV			
	Dec-15		
Old	5.04		
New	4.85		
% change	-3.9%		

Source: J.P. Morgan estimates.

Table 5: Franshion - detailed net asset value estimate

Methodology	Dec-15 NAV				
	Rmb psm	NAV Rmb mn	EV per share	% total	
Development properties (including land cost)					
Beijing	Discounted cash flow	10,665	9,015	0.98	14%
Shanghai	Discounted cash flow	21,204	15,599	1.70	24%
Changsha	Discounted cash flow	1,272	2,008	0.22	3%
Suzhou	Discounted cash flow	5,225	1,335	0.15	2%
Nanjing	Discounted cash flow	6,140	2,794	0.30	4%
Guangzhou	Discounted cash flow	3,106	1,763	0.19	3%
Others	Discounted cash flow	2,570	3,554	0.39	5%
Less: outstanding land premium			0		
Total development properties		6,196	36,068	3.94	55%
Investment properties					
Shanghai	Income capitalization	3,502	1,777	0.19	3%
Beijing	Income capitalization	36,346	8,832	0.96	13%
Nanjing	Income capitalization	3,905	454	0.05	1%
Changsha	Income capitalization	3,098	514	0.06	1%
Lijiang	Income capitalization	17,319	225	0.02	0%
Qingdao	Income capitalization	13,831	1,345	0.15	2%
		11,504	13,148	1.44	20%
Hotel					
Jinmao REIT (6139.HK)	Market cap		5,756	0.63	9%
Others	EBITDA capitalization		3,010	0.33	5%
			8,766	0.96	13%
Primary land development					
Changsha and Hainan	Discounted cash flow		7,967	0.87	12%
			7,967	0.87	12%
Total Enterprise Value (Rmb mn)			65,948	7.20	100%
Net cash / (debt)	Book value		(30,389)	(3.32)	
Net assets value (Rmb mn)			35,558	3.88	
Number of share outstanding (mn)			9,161		
NAV per share (Rmb)			3.88		
NAV per share (HK\$)			4.85		
Share price as of Mar 26, 2015			2.09		
Discount to NAV			-57%		
If PCS is treated as equity (Convertible at HK\$2.78)					
Amount of PCS outstanding			4,588		
Adjusted NAV (Rmb mn)			40,146		
Adjusted NOSH (mn)			10,806		
NAV per share (Rmb)			3.72		
NAV per share (HK\$)			4.64		
Share price as of Mar 26, 2015			2.09		
Discount to fully diluted NAV			-55%		

Source: Bloomberg, Company data, J.P. Morgan estimates

Table 6: Franshion - detailed earnings model, 2007-2017E, Dec 31 fiscal year-ends (HK\$ mn)

	2007	2008	2009	2010	2011	2012	2013	2014	2015E	2016E	2017E
Net Revenue breakdown											
Property development	986.1	1,399.6	3,535.3	2,924.7	3,076.1	10,796.4	9,708.1	21,895.2	21,891.8	28,493.2	42,931.6
Primary land development	-	-	-	-	-	1,673.1	2,649.0	7,159.6	3,650.0	4,946.1	6,559.0
Property investment	413.0	786.1	868.9	859.6	988.5	1,106.4	1,248.8	1,398.5	1,281.6	1,487.5	1,636.5
Hotel operation	1,117.5	1,393.9	1,576.7	2,007.4	2,133.8	2,010.2	2,061.2	2,126.7	2,308.8	2,514.6	2,692.7
Others	296.3	333.9	340.0	556.3	473.8	613.6	541.2	477.8	496.9	516.8	537.5
Net Revenue	2,813.0	3,913.5	6,320.9	6,348.0	8,345.4	17,175.7	20,718.9	29,548.2	30,925.3	38,477.9	54,357.3
Cost of sales	(1,135.4)	(1,715.5)	(3,021.7)	(3,045.1)	(3,632.9)	(9,977.0)	(11,518.6)	(17,989.4)	(18,589.8)	(25,092.2)	(39,495.3)
Gross profit	1,677.6	2,198.0	3,299.2	3,302.9	4,712.5	7,198.7	9,200.3	11,558.8	12,425.4	13,391.2	14,203.0
Selling and marketing expenses	(173.2)	(168.9)	(254.7)	(266.7)	(307.1)	(439.1)	(623.8)	(654.9)	(687.7)	(722.1)	(758.2)
Admin expenses	(212.8)	(325.7)	(297.8)	(374.0)	(544.1)	(528.9)	(1,161.6)	(1,763.9)	(1,777.7)	(1,903.0)	(1,562.0)
EBIT breakdown											
Property development	547.3	633.4	1,597.5	1,293.4	1,738.8	4,076.3	3,672.5	6,584.4	6,919.2	7,315.7	7,793.4
Primary land development	-	-	-	-	635.8	582.8	2,577.4	1,681.0	1,932.0	916.4	1,073.3
Property investment	378.7	578.0	787.0	781.7	864.9	997.2	977.9	830.4	702.2	916.4	1,073.3
Hotel operation	436.6	330.6	241.7	513.8	417.1	442.9	395.3	79.3	461.3	537.1	611.4
Other operation	(124.3)	13.3	139.6	71.2	22.8	53.5	35.0	35.5	36.9	38.4	39.9
Unallocated corporate income / expenses	(104.4)	(2.1)	(136.1)	(200.3)	(244.4)	(281.4)	(144.6)	(70.5)	(91.7)	(96.3)	(101.1)
EBIT	1,133.8	1,553.1	2,629.8	2,459.8	3,435.1	5,871.3	7,513.5	9,140.0	9,960.0	10,766.2	11,882.8
Interest income	152.0	197.8	174.8	249.1	196.8	198.2	248.7	385.7	247.3	199.7	312.6
Interest expenses	(304.2)	(405.7)	(500.0)	(606.2)	(859.3)	(986.0)	(1,324.6)	(1,221.9)	(1,608.2)	(1,769.1)	(1,946.0)
Operating profit	981.6	1,345.2	2,304.6	2,102.6	2,772.6	5,083.4	6,437.6	8,303.8	8,599.1	9,196.8	10,249.5
Share of associates / JCEs	4.8	(6.2)	(0.9)	2.9	3.6	2.5	2.3	(32.8)	9.2	35.5	53.1
Profit before tax	986.4	1,339.0	2,303.7	2,105.5	2,776.2	5,085.8	6,439.9	8,271.1	8,608.3	9,232.3	10,302.6
Income tax	(59.0)	(221.4)	(643.1)	(451.2)	(670.8)	(1,230.2)	(1,649.5)	(2,218.6)	(2,297.5)	(2,457.2)	(2,738.5)
LAT	(138.4)	(155.3)	(166.5)	(263.8)	(216.1)	(1,145.3)	(1,285.9)	(1,093.8)	(1,104.2)	(1,583.6)	(995.1)
Minority Interests	(332.4)	(198.2)	(556.7)	(418.2)	(566.4)	(807.2)	(1,359.5)	(1,405.0)	(1,479.2)	(1,096.8)	
Core net profit	456.7	764.1	937.4	972.4	1,005.6	1,831.1	2,379.8	3,281.7	3,484.2	3,394.8	5,154.8
Revaluation gain / (loss) - after tax	1,847.6	74.3	126.9	645.0	899.0	1,218.3	1,373.5	1,714.8	-	-	-
Underlying net profit	2,304.3	838.4	1,064.3	1,617.4	1,904.6	3,049.4	3,753.3	4,996.5	3,484.2	3,394.8	5,154.8
Exceptional items	216.0	62.5	110.2	96.2	122.4	11.7	156.4	(17.9)	-	-	-
Reported net profit	2,520.3	900.9	1,174.4	1,713.6	2,027.0	3,061.1	3,909.7	4,978.6	3,484.2	3,394.8	5,154.8
Exceptional items											
Exchange gains/loss	23.7	26.7	0.7	30.1	118.5	11.7	13.5	(17.9)	-	-	-
Write back / (provision)	-	-	-	66.2	-	-	-	-	-	-	-
Fair value change of financial assets	83.6	35.8	-	-	-	-	-	-	-	-	-
Disposal gain / (loss)	108.7	-	-	-	-	-	142.9	-	-	-	-
Total	216.0	62.5	110.2	96.2	122.4	11.7	156.4	(17.9)	-	-	-
Margin											
Gross margin	59.6%	56.2%	52.2%	52.0%	56.5%	41.9%	44.4%	39.1%	40.2%	34.8%	26.1%
Pre-LAT development margin	59.0%	51.4%	45.9%	45.2%	62.7%	41.3%	45.0%	34.3%	36.6%	30.2%	21.9%
Post-LAT development margin	45.0%	40.3%	41.2%	36.2%	55.7%	30.7%	31.8%	29.3%	31.6%	24.7%	19.6%
EBIT margin	40.3%	39.7%	41.6%	38.7%	41.2%	34.2%	36.3%	30.9%	32.2%	28.0%	21.9%
Operating margin	34.9%	34.4%	36.5%	33.1%	33.2%	29.6%	31.1%	28.1%	27.8%	23.9%	18.9%
Effective tax rate	-6.0%	-16.5%	-27.9%	-21.5%	-24.2%	-24.2%	-25.6%	-26.7%	-26.7%	-26.7%	-26.7%
Net Margin (after MI)	16.1%	19.7%	14.8%	15.3%	12.0%	10.6%	11.5%	11.2%	11.2%	8.7%	9.4%
YoY growth (%)											
Net Revenue	0.0%	39.1%	61.5%	0.4%	31.5%	105.8%	20.6%	42.6%	4.7%	24.4%	41.3%
EBIT	0.0%	37.0%	69.3%	-6.5%	39.7%	70.9%	28.0%	21.6%	9.0%	8.1%	10.4%
Core net profit	0.0%	67.3%	22.7%	3.7%	3.4%	82.1%	30.0%	37.9%	6.2%	-2.6%	51.8%
Reported net profit	0.0%	-64.3%	30.4%	45.9%	18.3%	51.0%	27.7%	27.3%	-30.0%	-2.6%	51.8%
Development properties (HK\$ mn)											
GFA recognized (sqm) - Subsidiary	-	95,219	79,691	62,743	41,402	434,862	219,919	688,689	772,107	1,234,910	1,418,504
Y/Y%	-	-	-16%	-21%	-34%	950%	-49%	213%	12%	60%	15%
Gross revenue psm (Rmb) - Subsidiary		14,698	44,363	46,614	74,298	24,827	44,144	31,793	28,353	23,073	30,265
Y/Y%	-	-	-	-	-	-67%	78%	-28%	-11%	-19%	31%
Contracted sales (Rmb mn)						10,182	14,591	18,545	25,110	28,933	31,451
Y/Y%	-	-	-	-	-	-	43%	27%	35%	15%	9%
Contracted sales (sqm)						303,190	572,949	884,912	1,043,836	1,236,051	1,189,919
Y/Y%	-	-	-	-	-	-	89%	54%	18%	18%	-4%
Average Selling Price (Rmb psm)						33,582	25,466	20,956	24,056	23,408	26,431
Y/Y%	-	-	-	-	-	-	-24%	-18%	15%	-3%	13%

Source: Company data, J.P. Morgan estimates.

Table 7: Franshion - detailed balance sheet, 2007-2017E, Dec 31 fiscal year-ends (HK\$ mn)

	2007	2008	2009	2010	2011	2012	1H2013	2013	2014	2015E	2016E	2017E
Current assets												
Properties for sales	632.7	652.6	505.8	1,056.3	871.9	3,107.7	4,170.7	5,947.0	7,699.4	15,084.1	13,067.8	9,041.6
Properties under development	429.9	3,513.2	2,601.3	1,051.0	9,653.5	17,079.9	13,591.9	15,876.3	21,719.6	21,719.6	21,719.6	21,719.6
Receivables	431.3	298.1	405.7	273.4	1,711.1	4,404.0	7,068.7	9,488.5	8,067.0	8,067.0	8,067.0	8,067.0
Prepaid income tax	28.7	33.9	47.2	-	117.5	7.4	294.9	472.1	342.9	342.9	342.9	342.9
Amount due from related parties	322.4	10.7	4.3	12.9	21.5	135.7	12.2	143.1	3,776.5	3,776.5	3,776.5	3,776.5
Pledged deposits	940.5	1,030.3	4,029.3	2,092.2	368.5	576.0	643.7	303.4	1,598.3	1,598.3	1,598.3	1,598.3
Cash and cash equivalents	7,625.8	5,046.8	3,523.3	11,229.5	12,223.6	12,888.4	9,286.2	14,490.0	12,454.6	11,627.5	23,210.4	26,592.9
Total current assets	10,411.4	10,585.6	11,116.8	15,715.4	24,967.6	38,199.1	35,068.5	46,720.4	55,658.3	62,216.0	71,782.6	71,138.9
Non-current assets												
PP&E	3,509.1	2,153.1	1,032.3	1,262.5	1,333.1	1,511.9	9,605.6	5,465.0	4,082.7	4,399.7	4,707.5	5,006.6
Investment properties	10,671.2	11,359.4	11,539.7	12,773.6	14,889.7	16,574.7	20,284.0	22,018.5	24,356.1	25,856.1	27,356.1	28,856.1
Land use rights and property under development	4,032.0	4,695.2	10,324.9	14,272.2	22,781.3	20,119.4	36,047.1	39,875.5	39,248.2	39,248.2	39,248.2	39,248.2
Associates	45.6	123.2	118.9	33.8	36.1	38.5	40.5	42.1	1,861.2	1,920.4	2,005.9	2,109.0
Other assets	292.3	392.5	358.8	1,755.0	204.8	614.9	801.5	1,278.1	1,343.8	1,343.8	1,343.8	1,343.8
Total non-current assets	21,290.5	23,961.3	29,025.7	35,639.8	44,803.4	44,303.2	66,778.7	74,122.8	82,367.4	80,921.1	82,632.1	84,357.1
Total assets	31,701.9	34,546.9	40,142.5	51,355.2	69,771.0	82,502.2	101,847.2	120,843.3	138,025.8	143,137.1	154,414.7	155,496.0
Current liabilities												
Trade & other payables	1,195.3	900.9	719.3	787.7	2,345.5	2,525.7	5,569.5	5,304.2	8,130.6	8,130.6	8,130.6	8,130.6
Presale proceeds from customers	3,203.0	4,172.7	2,546.3	1,441.9	8,231.9	11,942.5	16,139.0	20,948.5	15,108.1	18,969.5	21,552.0	13,014.0
Tax payable	352.2	481.0	673.5	1,043.2	925.8	2,206.1	1,043.3	1,575.3	2,093.9	2,093.9	2,093.9	2,093.9
Borrowings	7,099.8	6,539.7	10,642.2	7,527.4	6,028.0	8,952.2	7,202.9	6,139.2	4,072.5	6,139.2	6,139.2	6,139.2
Amount due to related parties	278.3	2,776.2	71.0	86.2	79.3	99.6	107.9	3,443.6	2,104.9	2,104.9	2,104.9	2,104.9
Total current liabilities	12,128.6	14,870.5	14,652.4	10,886.4	17,610.4	25,726.0	32,387.0	39,603.9	33,902.9	37,438.2	40,020.6	31,482.6
Non-current liabilities												
Borrowings	2,677.3	4,088.9	5,869.8	10,707.9	19,171.4	19,323.2	24,586.4	29,667.0	42,686.9	40,445.2	45,445.2	50,445.2
Amount due to holding company	-	-	-	1,058.5	-	-	-	-	-	-	-	-
Deferred income tax liabilities	1,515.5	1,663.4	1,673.4	1,983.2	2,442.0	2,950.1	3,964.7	4,353.0	5,103.4	5,103.4	5,103.4	5,103.4
Other non-current liabilities	-	-	-	-	-	-	-	-	-	-	-	-
Total non-current liabilities	4,192.8	5,752.3	7,543.2	13,749.5	21,613.4	22,273.4	28,551.0	34,019.9	47,790.3	45,548.6	50,548.6	55,548.6
Equity attrib to equity holders of the parent												
Issued capital	6,103.2	6,493.6	9,161.5	9,161.5	9,161.5	9,161.5	9,161.5	9,161.5	9,161.5	9,161.5	9,161.5	9,161.5
Share premium	3,270.2	3,680.1	6,109.8	6,109.8	6,109.8	6,109.8	6,109.8	6,109.8	6,109.8	6,109.8	6,109.8	6,109.8
Retained profit	3,775.4	613.0	1,500.8	2,961.5	4,331.9	6,510.7	8,586.9	8,586.9	12,252.4	14,603.1	16,819.0	20,341.5
Reserves	(1,212.0)	79.3	(581.5)	74.7	1,613.1	1,866.6	2,568.5	4,245.4	4,495.9	4,495.9	4,495.9	4,495.9
Proposed final dividend	98.3	174.0	229.0	229.0	366.5	641.3	-	870.3	1,042.8	1,042.8	1,042.8	1,042.8
Perpetual convertible securities	-	-	-	4,588.0	4,588.0	4,588.0	4,588.0	4,588.0	4,588.0	4,650.0	4,650.0	4,650.0
Shareholders' equity	12,035.1	11,040.0	16,419.6	23,124.5	26,170.7	28,877.8	31,014.7	33,561.9	37,650.4	40,063.1	42,279.0	45,801.6
Minority interests	3,345.4	2,884.1	1,527.2	3,594.7	4,376.5	5,625.0	9,894.5	13,657.6	18,682.2	20,087.2	21,566.4	22,663.2
Total equity	15,380.5	13,924.1	17,946.9	26,719.2	30,547.3	34,502.8	40,909.2	47,219.5	56,332.6	60,150.3	63,845.4	68,464.8
Total liabilities and shareholders equity	31,701.9	34,546.9	40,142.5	51,355.2	69,771.0	82,502.2	101,847.2	120,843.3	138,025.8	143,137.1	154,414.7	155,496.0
Net debt to equity	17.9%	50.6%	79.1%	54.7%	67.1%	69.2%	72.6%	77.2%	103.3%	111.3%	95.8%	97.5%
Total debt / total assets	30.8%	30.8%	41.1%	44.4%	42.7%	39.8%	35.7%	33.4%	37.2%	35.8%	36.4%	39.4%
Book value per share (HK\$)	0.00	2.45	1.27	1.79	2.52	2.86	3.15	3.66	4.15	4.42	4.66	5.05

Source: Company data, J.P. Morgan estimates

Investment Thesis, Valuation and Risks

Franshion Properties (China) Ltd. *(Neutral; Price Target: HK\$2.10)*

Investment Thesis

Franshion has improved its asset mix over the years and now has exposure in development properties, investment properties, hotels and land development. Although Franshion has done well in most segments, the lack of focus has been a problem, and for the land development segment, we think ROA is too low and has stretched Franshion's balance sheet. Corporate restructuring is the most effective way for Franshion to narrow its NAV discount, in our view, but after the divestment of Jinmao REIT, Franshion does not have further plans to get more concentrated in its business focus. Hence, we do not see any rerating catalyst soon.

Valuation

Our Dec-15 PT is based on a 60% discount to NAV, translating to 0.5x 2015E P/BV. The NAV discount applied is wider due to Franshion's multiple assets focus, which is not viewed favorably in the market at this time.

Risks to Rating and Price Target

Key upside risks are: 1) better-than-expected sales performance; 2) stronger-than-expected office take-up in Shanghai and Beijing; and 3) stronger-than-expected economy that drives hotel demand. Key downside risks are: 1) tightening in property measures in tier-1 cities; 2) further credit tightening; and 3) potential office oversupply in Shanghai and Beijing.

Franshion Properties (China) Ltd.: Summary of Financials

Income Statement					Cash flow statement				
HK\$ in millions, year end Dec	FY14	FY15E	FY16E	FY17E	HK\$ in millions, year end Dec	FY14	FY15E	FY16E	FY17E
Revenues	31,055	32,436	40,397	57,137	EBIT	3,599	3,801	3,712	5,472
% change Y/Y	44.4%	4.4%	24.5%	41.4%	Depr. & amortization	312	355	358	362
EBIT	9,140	9,959	10,766	11,882	Change in working capital	(13,586)	(2,207)	6,046	(2,919)
% change Y/Y	21.6%	9.0%	8.1%	10.4%	Others	(2,877)	742	0	0
EBIT Margin	29.4%	30.7%	26.6%	20.8%	Cash flow from operations	(12,915)	2,523	9,913	2,053
Net Interest	(836)	(1,361)	(1,569)	(1,633)	Capex	(484)	(484)	(484)	(484)
Earnings before tax	8,271	8,608	9,232	10,302	Disposal/(purchase)	807	(1,500)	(1,500)	(1,500)
% change Y/Y	28.4%	4.1%	7.2%	11.6%	Net Interest	-	-	-	-
Tax	(3,312)	(3,401)	(4,041)	(3,733)	Free cash flow	(12,090)	2,862	10,311	2,611
as % of EBT	40.0%	39.5%	43.8%	36.2%	Equity raised/(repaid)	0	0	0	0
Net income (reported)	5,296	3,801	3,712	5,472	Debt raised/(repaid)	10,953	(175)	5,000	5,000
% change Y/Y	25.3%	(28.2%)	(2.4%)	47.4%	Other	0	0	0	0
Core net profit	3,282	3,484	3,395	5,154	Dividends paid	(1,360)	(1,451)	(1,496)	(1,950)
% change Y/Y	37.9%	6.2%	(2.6%)	51.8%	Beginning cash	14,490	12,455	11,627	23,209
Shares outstanding	-	-	-	-	Ending cash	12,455	11,627	23,209	26,592
EPS (reported) (HK\$)	0.55	0.38	0.37	0.57	DPS (HK\$)	0.12	0.13	0.13	0.18
% change Y/Y	28.6%	(30.0%)	(2.6%)	51.8%					
Core EPS (HK\$)	0.36	0.38	0.37	0.57					
% change Y/Y	39.3%	6.2%	(2.6%)	51.8%					
Balance sheet					Ratio Analysis				
HK\$ in millions, year end Dec	FY14	FY15E	FY16E	FY17E	% , year end Dec	FY14	FY15E	FY16E	FY17E
Cash and cash equivalents	14,053	13,226	24,808	28,190	EBIT margin	29.4%	30.7%	26.6%	20.8%
Accounts receivable	8,067	8,067	8,067	8,067	Net margin	16.0%	10.7%	8.4%	9.0%
Inventories	7,699	15,084	13,068	9,042	SG&A/Sales	7.8%	7.6%	6.5%	4.1%
Others	25,839	25,839	25,839	25,839					
Current assets	55,658	62,215	71,782	71,138	Sales per share growth	45.9%	4.4%	24.5%	41.4%
LT investments	-	-	-	-	- Sales growth	44.4%	4.4%	24.5%	41.4%
Net fixed assets	12,423	12,553	12,678	12,800	Net profit growth	27.3%	(30.0%)	(2.6%)	51.8%
Total Assets	138,026	143,137	154,414	155,495	EPS growth	28.6%	(30.0%)	(2.6%)	51.8%
Liabilities	-	-	-	-	Interest coverage (x)	11.3	7.4	6.9	7.4
ST loans	4,072	6,139	6,139	6,139	Net debt to total capital	36.7%	35.7%	29.5%	29.3%
Payables	8,131	8,131	8,131	8,131	Net debt to equity	58.1%	55.5%	41.9%	41.5%
Others	21,700	23,168	25,751	17,213	Sales/assets	0.2	0.2	0.3	0.4
Total current liabilities	33,903	37,438	40,020	31,483	Assets/equity	3.6	3.6	3.6	3.5
Long-term debt	42,687	40,445	45,445	50,445	ROE	9.2%	9.0%	8.2%	11.7%
Other liabilities	5,103	5,103	5,103	5,103	ROCE	7.1%	7.0%	6.7%	7.7%
Total Liabilities	81,693	82,987	90,569	87,031					
Shareholder's equity	37,650	40,063	42,278	45,801					
BVPS	4.15	4.42	4.66	5.05					

Source: Company reports and J.P. Morgan estimates.

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