

# Hunza Properties Bhd

*Under siege*
**NEUTRAL**

Downgraded

**RM1.54**

Target: RM1.65

Mkt.Cap: RM227m/US\$70m

Property Devt &amp; Invst

HPB MK / HUZP.KL

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## Downgrading property sector

### Sector hit on various fronts

The key driving force for the property sector – buyer sentiment and confidence – is under siege from various fronts. Political mudslinging is the main drag, bringing home to buyers the uncertain outlook in the short- to medium-term. The slowing economy and slumping stock market simply add to these woes. Steep energy, food and commodity price hikes also have a major negative psychological impact even though theoretical affordability remains strong. Combine these factors with surging construction costs and squeezed margins, and it is clear that developers are in for very tough times.

### Sales and take-up weaken

Since the elections, property launches have slowed down markedly. While developers with strong marketing prowess such as SP Setia and Mah Sing have managed to chalk up respectable sales in recent months, others have been less fortunate. Many have scaled back or postponed launches in light of weak sales and the dampened outlook. Those with overseas projects such as SP Setia in Vietnam and IOI Prop in Singapore have also been unlucky as these property markets have turned sour even more quickly than in Malaysia.

### Surging costs a big concern

The spike in building material costs over the past year has put many contractors in a precarious position. Reports of contractors returning 200 letters of awards and many facing bankruptcy are unprecedented. We think that developers will have to absorb a lot of the cost increases or risk non-delivery by subcontractors. Although developers can try to pass on the higher costs to buyers, there is a limit to their ability to do so. As a result, property margins are being squeezed on both ends, i.e. by lower sales and higher costs. Developers with poor cost management could very well slip into losses.

## What about Hunza Properties?

**Property sales trend reflects sector-wide concerns.** Looking at Hunza Properties' latest property sales trend, we see that the group raked in only around RM23m sales over the two-month period ending May 08. This is a huge drop from 2QFY6/08's RM160m and the RM53m registered during 3QFY08 which had been affected by the Chinese New Year. Based on this, it appears that the group is likely to register another sequential dip in property sales in 4QFY08 after 3QFY08's 67% qoq fall. Having said that, we note that most developers, with the exception of those with strong marketing prowess such as SP Setia and Mah Sing, have witnessed a significant slowdown in their new launches and sales achieved.

**Margin compression inevitable.** Furthermore, we believe that Hunza Properties will not be spared the sector-wide margin squeeze in the coming quarters stemming from rising costs and lacklustre property demand. Although the group has raised selling prices for its Gurney Paragon and Infinity developments by about 10-30% since their maiden launches, the lull in demand in recent months will prevent it from increasing prices further to offset fully the projected rapid increases in construction costs.

## Valuation and recommendation

**Adjusting FY09-10 earnings downwards by about 3%.** To reflect our more modest margin assumptions, we are adjusting our FY09-10 earnings downwards by 2.9-3.4%. Although there are claims that building material prices have increased by 20-30% in just the past few weeks, we expect the upward trend in building material costs to continue over the next few months.

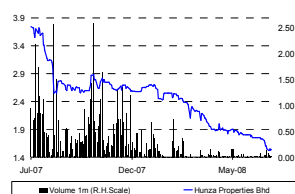
**Are dividends sustainable?** On the dividend front, our current FY08-10 DPS projection of 12.5 sen implies a solid gross yield of 8%. Although the group has migrated to the tax-exempt single-tier system, we believe it is still likely to at least match last year's grossed-up dividends amounting to 12.5 sen. Hence, no change to our DPS projections.

**Downgrade to NEUTRAL with a lower target price.** Target price-wise, we are widening our discount to its unchanged RNAV/share of RM3.68 from 40% to 55% to reflect the difficult operating environment. Our discount also reflects the stock's poor share liquidity, small market cap and sizeable exposure to the Penang market, which carries a higher degree of political risk. Accordingly, our end-CY08 target price is reduced from RM2.20 to RM1.65. Given the limited share price upside, we downgrade the stock from outperform to NEUTRAL.

### Financial summary

FYE Jun	2006	2007	2008F	2009F	2010F
Revenue (RM m)	116.6	186.7	237.8	270.8	287.3
EBITDA (RM m)	35.0	55.2	68.3	84.6	109.5
EBITDA margins (%)	30.0%	29.6%	28.7%	31.3%	38.1%
Pretax profit (RM m)	34.8	57.5	67.8	88.3	112.4
Net profit (RM m)	19.8	39.2	48.8	61.5	72.7
EPS (sen)	17.1	29.0	33.2	41.8	49.3
EPS growth (%)	21.2%	69.6%	14.4%	25.9%	18.1%
P/E (x)	9.0	5.3	4.6	3.7	3.1
Core EPS (sen)	17.1	27.4	33.2	41.8	49.3
Core EPS growth (%)	21.2%	60.4%	20.9%	25.9%	18.1%
Core P/E (x)	9.0	5.6	4.6	3.7	3.1
FD core EPS (sen)	13.4	24.0	30.8	38.7	45.6
FD core P/E (x)	11.5	6.4	5.0	4.0	3.4
Gross DPS (sen)	7.5	12.5	12.5	12.5	12.5
Dividend yield (%)	4.9%	8.1%	8.1%	8.1%	8.1%
P/BV (x)	0.9	0.8	0.7	0.6	0.5
ROE (%)	10.6%	17.5%	17.2%	18.2%	18.4%
Net gearing (%)	72.4%	61.4%	46.7%	40.2%	30.3%
P/FCFE (x)	9.2	22.2	2.7	4.8	42.4
EV/EBITDA (x)	10.1	7.3	6.0	4.9	3.7
% change in EPS estimates				-3.4%	-2.9%
CIMB/Consensus (x)			1.14	1.07	1.07

### Price chart



Source: Bloomberg

Source: Company, CIMB Research, Bloomberg

**Figure 1: Revalued NAV**

<b>Project</b>	<b>Size/units</b>	<b>Market value (RMpsf)</b>	<b>Stake</b>	<b>Value (RMm)</b>
Bandar Putra Bertam - Residential	435.6	10.00	70%	132.8
Bandar Putra Bertam - Commercial	48.4	40.00	70%	59.0
Sungai Petani, Kedah	393.0	3.00	100%	51.4
Alila, Penang	5.0	175.00	100%	38.1
Mutiara Seputeh	12.0	90.00	100%	47.0
Gurney Drive	3.5	400.00	100%	61.0
Infinity	3.0	200.00	90%	23.5
Alila II, Penang	9.6	175.00	80%	58.5
Surplus value from shopping mall & retail lots				186.1
Surplus value from Phase 3's office lots				14.0
Fixed assets				75.0
Net current asset less dev. prop.				36.8
Total long term borrowings				(135.7)
Proceeds from warrants conversion & rights issue				222.5
<b>Total revised RNAV</b>				<b>870.1</b>
Fully diluted no. of shares post cash call exercise (m)				236.6
<b>Revised RNAV per share (RM)</b>				<b>3.68</b>
<b>Target price @ 55% discount to RNAV/share estimate (RM)</b>				<b>1.65</b>

Source: Company, CIMB/CIMB-GK estimates

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**NEUTRAL:** The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.

**UNDERPERFORM:** The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.

**TRADING BUY:** The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 3 months.

**TRADING SELL:** The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 3 months.

### SECTOR RECOMMENDATIONS

**OVERWEIGHT:** The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

**NEUTRAL:** The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

**UNDERWEIGHT:** The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

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**UNDERPERFORM:** Expected negative total returns of 15% or more over the next 12 months.

**TRADING BUY:** Expected positive total returns of 15% or more over the next 3 months.

**TRADING SELL:** Expected negative total returns of 15% or more over the next 3 months.

### SECTOR RECOMMENDATIONS

**OVERWEIGHT:** The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

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