Secondary market volume has started to rebound

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- A notable pick-up in secondary market activities
- Physical market is improving
- We still see room for developers to catch up further

What's new
Weekly transactions in 35 major housing estates in the week ended 15 July rose 37.8% WoW to 153 units.

What's the impact
Buying interest in the secondary market is picking up. This is the fourth consecutive weekly increase. This indicator is now at a level similar to the annual averages in 2006 and 2008, when the Special Stamp Duties (SSD) had not been imposed. We see this as evidence that sentiment in the secondary market is improving.

Our read is that some prospective buyers have adopted a wait-and-see stance in the past few months, on concerns that the new administration will implement policies detrimental to the residential property sector. We think these buyers are starting to return to the market. Meanwhile, with residential property prices almost at all-time highs, some flat owners may be tempted to lock into the gain or to switch into larger flats. We think these trends will provide support to secondary market transactions in the near term.

Primary market activities seem to point to a revival of interest among long-term investors. In any case, we think primary market sales have been doing well, with over 500 units in the Beaumont being sold since last Friday. Notably, Henderson Land’s (12 HK, HK$44.25, Buy [1]) High West has sold well (95% sold with an ASP of about HK$14,600/sq ft). So is Kowloon Development’s (34 HK, HK$7.70, Not rated) Cadogan (over 30% sold) despite its premium pricing at about HK$16,000/sq ft. We see these as indications that buying interest is spreading from mainly end-users to some long-term investors as well.

Hong Kong residential property demand tends to move in intervals, and now there look to be good prospects of a volume pick-up over the next few months. Our observation about residential property demand in Hong Kong in recent years is that there has been an increase in demand from the wealthy searching for vehicles to park spare cash and mainlanders coming to buy units in Hong Kong. This has pushed up the prices for the premier units to levels where many upgraders and end-users hesitate.

However, the holding power of the owners of private units in Hong Kong is strong, and many have not taken on a lot of leverage. Meanwhile, the total number of premier units available in Hong Kong is not enough relative to the number of people who have the wealth and income to own the units. As a result, so far each correction in Hong Kong residential property is expressed more in terms of volume, and the extent of the correction each time has been rather mild.

Based on past patterns, some of the upgraders and end-users who have been hesitating should commit eventually after accepting that the room for correction in prices is not likely to be that much. We think this pattern is still applicable now, and we expect news flow from the physical market to make a turn for the better in the coming weeks.

The perceived risk related to housing policy and the SHKP incident should also decline. We believe the sector’s valuation has suffered from a perceived policy risk discount and concerns that the SHKP incident would mark the beginning of a series of investigations and actions against property developers. We think both concerns are not well-founded and that the SHKP incident is a company-specific event. Thus, these concerns should gradually decline, which seems to be happening.

What we recommend
We reiterate our Positive stance on property investors, and we keep our Neutral stance on property developers pending further clarity on the court case related to SHKP. That said, we expect the developers’ relative share performances to catch up and we also think that Midland (1200 HK, HK43.80, Buy [1]) is well-placed to benefit from an improvement in the physical market (see our note on 12 July 2012).

How we differ
We see indications that the physical market is showing signs of improvement, but this may not have been noticed by the market.
Weekly transactions in 35 major housing estates

- 2006 avg = 142
- 2007 avg = 274
- 2008 avg = 151
- 2009 avg = 218
- 2010 avg = 247
- 2011 avg = 139
- 2012 YTD avg = 151

Source: Midland, Daiwa

HK major developers: Valuation summary

<table>
<thead>
<tr>
<th>Company</th>
<th>Ticker</th>
<th>Rating</th>
<th>16 Jul share price (HK$)</th>
<th>2012 yr-end NAV (HK$/sh)</th>
<th>Price vs forward NAV (%)</th>
<th>Target price (HK$)</th>
<th>PBR (x)</th>
<th>FY11</th>
<th>FY12E</th>
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<td>Cheung Kong 1 HK 1</td>
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<td>175.2</td>
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<td>192.9</td>
<td>(51.0) 102.20</td>
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<td>89.8</td>
<td>(50.7) 56.60</td>
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<td>21.2</td>
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<td>0.86 0.83</td>
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</tbody>
</table>

Source: Bloomberg, Companies, Daiwa

Share performance of HK property stocks - YTD

Source: Datastream, Bloomberg, Daiwa

HK major developers: P/NAV

Weighted average (disc/prem to NAV = four developers)

Source: Datastream, Daiwa

Share performance of HK property stocks – month to date

Source: Datastream, Bloomberg, Daiwa

Note: Prices as of 16 July 2012
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