

## IPO REPORT

## Shui On Group to spin-off property unit on AIM

By Anette Jönsson, | 16 May 2007

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**The company, which will seek to raise about \$500 million from an IPO and a CB, will focus on distressed and partially completed property projects.**

China Central Properties (CCP), which is sponsored by Hong Kong-listed Shui On Construction and Materials (SOCAM), yesterday announced its intention to list on London's Alternative Investment Market by June 15.

The listing, which was flagged by SOCAM last month, will include the sale of £150 million (about \$300 million) worth of new shares and sources say Deutsche Bank will start pre-marketing of that issue today (May 16). In connection with the stock floatation, CCP will also issue \$200 million of five-year convertible bonds, giving it a starting capital of about \$500 million for future acquisitions.

The company will have a fund-like structure and will invest in partially completed property developments in China. Projects that are becoming available because their owners have run out of money will be a key focus, but CCP may also acquire properties that are under some form of commercial distress that the Shui On Group and its well-connected chairman Vincent Lo are in a better position to resolve. Alternatively, it may buy developments where there is nothing wrong with the asset, but they still feel they can extract more value, a source familiar with the company says.

Once acquired, the projects will be upgraded and completed, and then either sold or leased. According to a banker, this will be the first listed company focusing solely on distressed or partially completed property projects.

"The management of CCP believes that this partially-completed model is attractive as late stage involvement in these projects typically results in shorter project cycles and lower cash flow requirements than for traditional greenfield developments," the company said in its statement about the intention to float.

At the time of listing, CCP will hold five assets with a combined asset value of HK\$256 million (\$33 million), as determined by Savills, which it will acquire from SOCAM and its investment partners. The five projects, which are located in Beijing, Dalian, Qingdao and Chengdu, will be injected into CCP at a 20% discount to net asset value.

The vendors, which include JPMorgan Special Situations Group, Spinnaker Group, Value Partners, V Ventures Group and Yida Group, will get paid in the form of CCP shares, which will give them a combined 61.8% stake in the company at the time of listing.

SOCAM will also retain control of the day-to-day operation through wholly owned SOCAM Asset Management, which will be the investment manager of CCP.

The remaining 38.2% will be sold to other investors as part of the initial public offering. According to the CCP statement, the company has already secured commitments from a number of investors who will subscribe to about £101 million worth of shares, leaving only about £50 million to be sold through the market.

The company will be targeting primarily specialist property funds, but also more generalist funds looking at Hong Kong and China. There is also a "very big argument for hedge funds in this transaction, especially since it is an AIM listing,"

says an observer, noting that some of the long-only guys in Asia may not have a mandate to invest in AIM.

Among the investors who have already committed to invest in the IPO or the CB (or in some cases both) are hedge funds Och-Ziff and Spinnaker, which also count as cornerstone investors, CQS, Deutsche Bank, Stark and UBS. The CB will be convertible into shares of the company at a 34% premium to the IPO price.

The structure of the IPO has yet to be determined, but sources say it is likely that the company will follow the practice of most of the Indian real estate funds that have listed on AIM so far and offer its shares at a fixed-price of £1 each. Given the size of the offering, this would suggest a total issue size of around 150 million shares.

Given that the intention is for CCP to sell or lease the properties as soon as they have been completed, the company isn't valued on a yield basis. However, there will be a dividend payout that is estimated at between 35% and 50% of net profit each year, as well as an expected internal rate of return at the individual project level of at least 10%.

According to the source, the IRR estimate may be a bit "conservative," but since the turnaround for these projects should be quite quick at about 12 months from acquisition to sale the return should typically be lower than for a greenfield project.

About \$50 million of the IPO proceeds will be used to acquire three additional projects. The current owners will make no profit from the transfer of these projects to CCP. The listing candidate has also signed letters on intent for acquisitions that will cover about half of the remaining \$250 million in proceeds and according to the source, it is confident that it will be able to put all the proceeds to work within the next 12-18 months.

"This is something that they are likely to meet," he says, "because as part of the management agreement, the manager will get no fees if the assets aren't fully invested."

Being able to put the money to work as quickly as possible will also be important when it comes to attracting investors, since they typically don't like buying into a company or a fund that sits on a lot of idle cash. The simple reason for that is that it will drag down the overall return on assets.

One observer notes that there are plenty of assets out there that could be potential acquisition objects for CCP, but the question is "will these guys be smart enough to know which assets to decline and which to go for."

The long-time involvement by Kong Kong-based SOCAM, Vincent Lo and most of the rest of the management, in the Mainland property market should provide some comfort to investors that they know what they are doing, however. Having been listed in Hong Kong since 1997, SOCAM is a leading player within construction, cement production, property development and venture capital investments in China.

It also owns a 17.8% stake in Shui On Land, which listed in Hong Kong last year and focuses on large-scale city re-development projects in China.

According to the listing statement, SOCAM is expected to hold at least 39% of CCP at the time of listing.

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