



Value	Growth
Event	Momentum

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## Hong Kong Property/Cement

Reuters 0366.HK  
Bloomberg 366 HK

**Priced on 3 March 2008**  
HK HSI @ 23,585.0

**12M hi/lo** HK\$16.50/4.26

**12M price target** HK\$13.45  
**±% potential** +74%  
**Target set on** 23 Jan 08

**Shares in issue** 573.2m  
**Free float (est.)** 45.0%

**Market cap** US\$566m

**3M average daily volume**  
HK\$9.5m (US\$1.2m)

**Major shareholders**  
Management 55.0%

### Stock performance (%)

	1M	3M	12M
Absolute	(10.2)	(22.0)	57.6
Relative	(8.2)	(5.2)	29.9
Abs (US\$)	(10.1)	(22.0)	58.1



Source: Bloomberg

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## Licensed to grow

Luks remains one of our top BUY ideas in small caps post company presentation at CLSA's recent ASEAN Building Materials Access Day, positive guidance and recent market related price weakness (Luks continues to buy-back shares). What's new to us this week is Luks obtaining licenses to further expand in cement. This follows January's good news of price increases in addition to higher rental expectations for its office property. We reiterate BUY rating and TP of \$13.45.

### Cement expansion licences have come through

Luks recently received the licences to further expand in cement in building a clinker facility of 1.5MT at Hue having applied for 1.2.MT. In addition, Luks stated that they also now received licences to build a grinding station with capacity of 1.5MT in HCMC. This came through in mid January which supports our long term forecast. We continue to place a 50% 'probability factor' in the NAV of this cement business (JV with CNS) given the long-dated nature.

### On track for positive rental reversions

CLSA forecast has upside risk here but will depend on the averaging out of rental increases during the year. We learn that Luks renewed rents at more than 50% higher in FY07. Management stated that rental revenues should grow well over 20% in FY07 (CLSA: 33%). However, we could be short in FY08 and FY09 as our average spot rent for renewals (50% of leases are up for renewal) is US\$42/sqm and US\$47/sqm respectively. Luks is pointing to spot rent already at US\$48-52/sqm as at Jan 08.

### Cost pressures is the key headwind

Inflation in Vietnam spiked to 15.7% in Feb 08 (14.1% in Jan), its highest rate in 12 years. We are projecting electricity and coal costs to increase by 50% and 15% in FY08 and FY09, with both currently equivalent to c20% of group revenues. GPM should therefore decline to 39.4% in FY07 and to 38.7% in FY08 and FY09 and declining in FY10 to 35.2%.

### Cheap against existing/established businesses

Luks is trading at a 27% discount to the value of its existing and established businesses of cement and office property, which we value at HK\$10.59 combined with the current net cash position. Factoring in the value of the announced JV projects in property and cement, which we ascribe only a 45% probability into the valuation, we value Luks in total at HK\$13.45. Full year result release scheduled for mid-April.

### Financials

Year to 31 Dec	06A	07CL	08CL	09CL	10CL
Revenue (HK\$m)	374	537	751	958	1,206
Net profit (HK\$m)	59	153	275	612	904
EPS (HK¢)	12.0	28.5	47.9	106.7	157.7
EPS (% YoY)	(2.6)	138.0	68.2	122.7	47.7
PEx (@HK\$7.72)	64.5	27.1	16.1	7.2	4.9
Dividend yield (%)	1.4	1.4	1.6	1.8	2.2
FCF yield (%)	0.7	3.8	(5.7)	13.4	(10.7)
ROAE (%)	5.20	9.20	12.50	23.70	27.60
Price/book (x)	3.2	2.1	1.9	1.6	1.2
Net gearing (%)	(0.88)	(37.30)	(3.75)	(10.86)	(15.13)

Source: CLSA Asia-Pacific Markets

**Feedback from CLSA ASEAN Building Materials Access Day**

We received some positive updates from Luks last week which reaffirms my earnings forecast for FY07, with the full year result due out in mid April. Luks is our 2nd top pick in China/HK Small-caps.

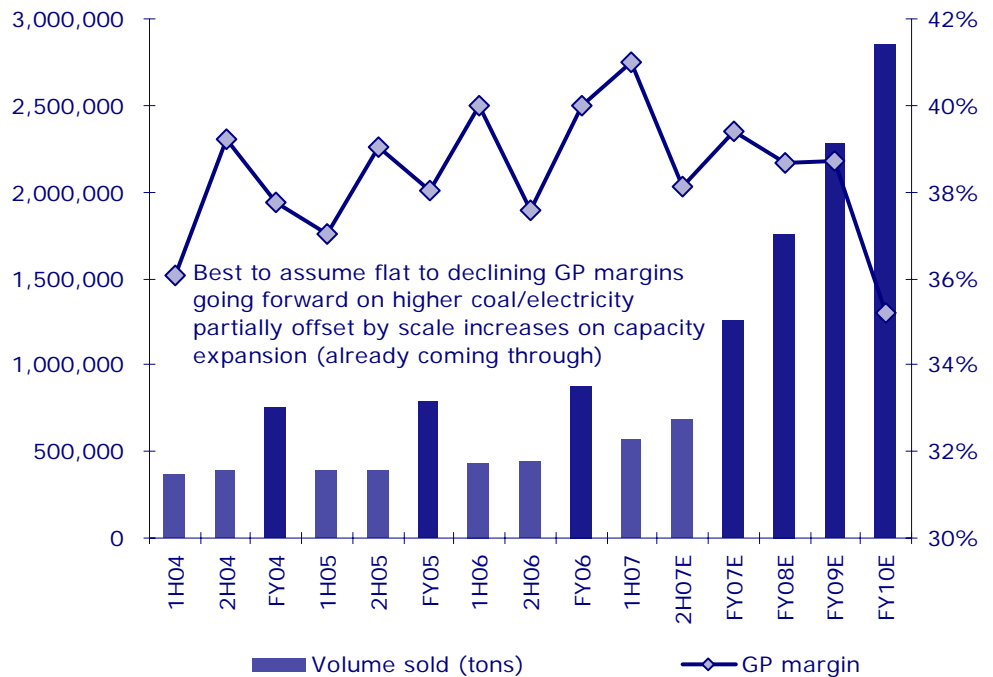
**Cement business**

Those less familiar with Luks should note there are two parts to Luks' cement business. Firstly there is the existing wholly owned cement plant (known as Luks Cement) and from mid-2007, Luks has also entered into a JV to develop cement (JV referred to as CNS Cement) going forward.

On Luks Cement, there is no new news in terms of what we gathered from CLSA's Las Vegas Forum in Jan 08, where the company is seeing higher ASP's that came through last year which, combined with another round of price increases in the next month should slightly offset cost pressures. This led us to upgrade Luks Cement then in Jan 08 (click [here](#) for research note). Luks reiterated their focus on looking at further ways to take cost out as they do envisage rising raw material costs going forward, with plans to take bag production in-house and also to mine its limestone mine by themselves (currently sub-contracted). Bottom line, don't expect too much margin growth here, which is already at quite a high level at GPM of 40% as reported in FY06 (41% in 1H07). We are projecting electricity and coal costs to increase by 50% and 15% in FY08 and FY09, with both currently equivalent to c20% of group revenues. GPM should therefore decline to 39.4% in FY07 and to 38.7% in FY08 and FY09 and declining in FY10 to 35.2%. Some offset will occur on the back of scale as capacity increases and volume ramps up from 800,000 tons in FY06 to a projected 2.8 m tons by FY10.

Figure 1

**Luks Cement – volume and GP margin forecast**



Source: CLSA Asia-Pacific Markets

**CNS Cement JV – Licences approved**

Luks recently received the licences to build a clinker facility of 1.5MT at Hue having applied for 1.2.MT. This came through in mid January, and hence lends

confidence in our forecast for this new business (should also allay some investor concerns that cement expansion has been plagued with delays). In addition, Luks stated that they also now received licences to build a grinding station with capacity of 1.5MT in HCMC. The only outstanding licence is one required to expand the grinding capacity to 3MT (from the approved 1.5MT). In short no delays in any of the cement projects. We see this as an important development as the Vietnamese Government did for the latter part of last year, suspend the granting of licences to expand for all players as there were concerns of a over-supply situation that could emerge (sooner than expected). At the current run-rate and based on industry observers we find that demand and supply equilibrium could balance out on a best case in 2009. The reality on the ground however suggest most of the supply forecast are at risk of lengthy delays which could push out the equilibrium point further out.

### Office property - Saigon Trade Centre

CLSA forecast has upside risk here but will depend on the averaging out of rental increases during the year. In FY07, Luks renewed rents at more than 50% higher. Rental revenues should grow well over 20% in FY07. We are forecasting 33%. However, we could be short in FY08 and FY09 as our average spot rent assumption for renewals (50% are up for renewal) is US\$42/sqm and US\$47/sqm respectively. Luks is pointing to spot rent at Jan 08 already at US\$48-52/sqm. This will obviously depend on how it all averages out, but note the pace of rental increases is strong. CB Richard Ellis recently released its forecast for Grade A HCM office (which the Saigon Trade Ctr is) to be US\$65-70/sqm in 2008. We think the latter point serves more as an indication on direction (up!) as opposed to be a data point that we would want to factor into our forecast.

Figure 2

CLSA forecast for Saigon Trade Centre							
HK\$m	04A	04A	05A	06A	07CL	08CL	09CL
Sales	0	47	64	82	109	129	140
Sales growth	0.0%	26.3%	34.6%	28.0%	33.3%	18.8%	8.7%
Ebitda	0	22	39	52	71	90	101
Ebitda margin	0.0%	47.2%	60.8%	63.8%	65.4%	70.0%	71.8%
Occupancy	71%	71%	86%	95%	100%	100%	100%
Rental (US\$/sqm/mth)	0	17	20	22	29	35	38
Rental growth	0.0%	3.2%	14.0%	12.9%	29.8%	18.8%	8.7%
Spot rent (US\$/sqm/mth)					28	42	47

Source: CLSA Asia-Pacific Markets

The Saigon Trade Centre's book value as at 31 Dec 06 is US\$82m, which was a 30% y/y increase. Management believes this will have increased significantly over the last 12 months following the strong performance of the property in addition to Vietnam joining the WTO in Jan 07. In other words, the upcoming result will reflect revaluation gains on this property (will distort core earnings but company has clarified this well in the past).

### Residential Property development

These projects are all under JV's numbering 4 in total, currently not contributing any earnings. Luks appears positive they can make the first pre-sales in one of the JVs by the end of FY08, as construction is to take place in mid year. As outlined in our research in Jan 08, both expected selling prices and cost of construction have increased across all four JVs, but net net expected margins have expanded. We still think it's very applicable to discount all these JVs by approximately 50% in the calculation of NAV to

**Luks is well entrenched in Vietnam, having first entered the country in the early 90s**

account for uncertainty in timing and execution. Our sum of the parts valuation follows later in this report.

Luks is well entrenched in Vietnam, having first entered the country in the early 90s and have entered into five local JVs this year. Luks plans to form two joint stock companies in Vietnam, with the intention to list both on the Vietnamese Stock Exchange in three years (by 2010).

Figure 3

<b>Luks JVs with local partners</b>			
Local partner	Project	Luks interest	GFA
Thanh Phat	Residential property development	70%	115,000
Hong Phuc	Residential property development	90%	73,000
CNS	Residential property development	30%	146,400
CNS	Cement	45%	na
Indochine	Residential property development	95%	167,787

Source: CLSA Asia-Pacific Markets

### Buy-back summary

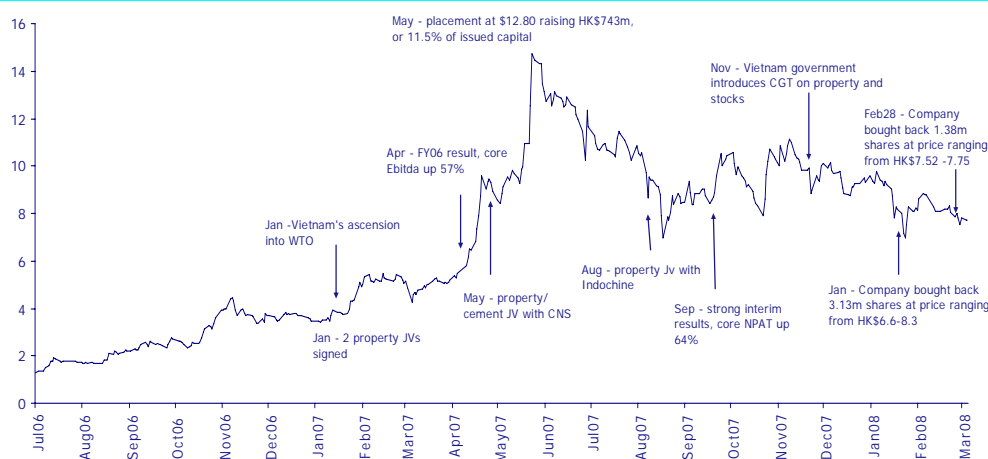
Figure 4

<b>Buy-back summary</b>					
Date	# Buy Backs	High Price	Low price	Total Paid HK\$m	% of total
16-Jan	700,000	7.86	7.80	5,486,360	0.14%
17-Jan	176,000	8.30	7.96	1,444,260	0.03%
21-Jan	322,000	8.10	8.00	2,588,260	0.06%
22-Jan	702,000	7.60	7.33	5,300,340	0.14%
23-Jan	1,002,000	7.35	6.59	6,883,700	0.20%
24-Jan	224,000	7.60	7.19	1,676,340	0.04%
28-Feb	1,382,000	7.75	7.52	10,528,000	0.27%
	<b>4,508,000</b>		<b>Total</b>	<b>33,907,260</b>	<b>0.88%</b>

Source: CLSA Asia-Pacific Markets

Figure 5

### Key events and share price performance



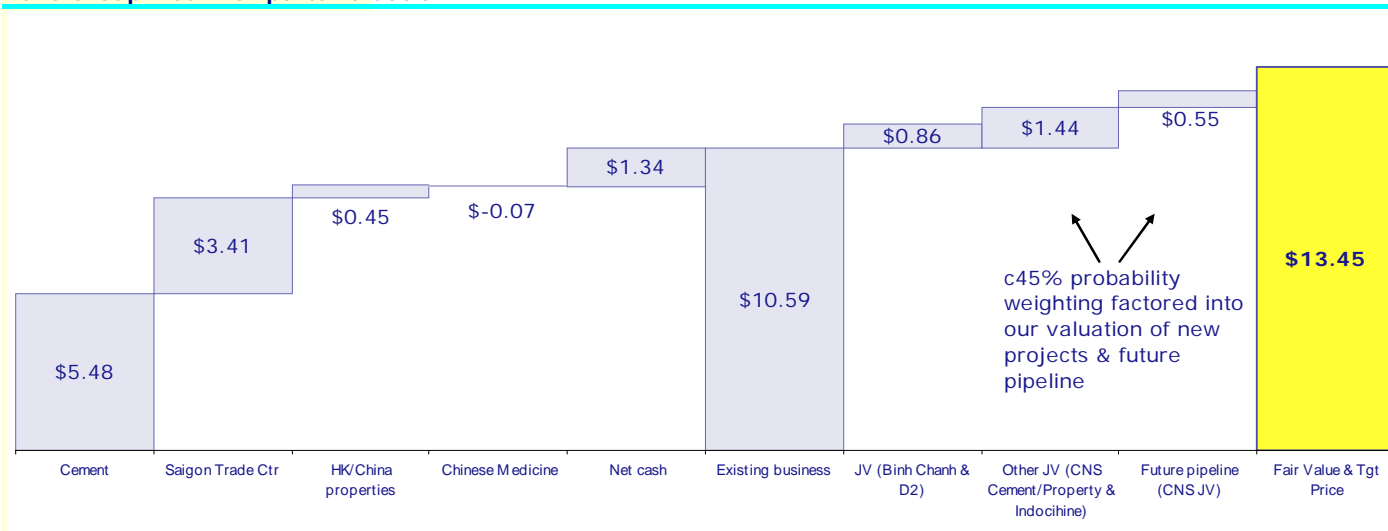
Source: CLSA Asia-Pacific Markets

**Valuation summary**

At the current price, Luks is trading at a 27% discount to the value of its existing and established businesses of cement and office property, which we value at HK\$10.59 combined with the current net cash position. Factoring in the value of the announced JV projects in property and cement, which we ascribe only a 45% probability into the valuation, we value Luks in total at HK\$13.45.

Figure 6

**Luks Group – sum-of-parts valuation**



Source: CLSA Asia-Pacific Markets

Figure 7

**Sum of the parts key assumptions**

	Valuation approach	HK\$m	HK\$/shr
<b>Existing business:</b>			
Cement	DCF, implied EV/T: US\$145, based on 2.8MT (1.5MT currently)	3,168	5.48
Saigon Trade Centre	NAV at US\$6,000/sqm, a premium to one-recent transaction for vacant land in CBD area for US\$4,000/sqm	1,972	3.41
Other properties	Reported book value	260	0.45
Chinese Medicine	DCF	-45	-0.08
Add: Net cash	FY07E	773	1.34
<b>Sub-total (existing business)</b>		<b>6,128</b>	<b>10.59</b>
<b>New projects:</b>			
Residential prop JV (Binh Chanh and Dist 2)	20% disc to DCF	499	0.86
CNS JV Cement, 45% interest	DCF, EV/T: US\$113, 50% probability	577	1.00
CNS JV Property, 30% interest	20% disc to DCF, 50% probability	41	0.07
Indochine JV Property, 95% interest	20% disc to DCF, 70% probability	215	0.37
Longer term projects	20% disc to DCF, 30% probability	319	0.55
<b>Total equity value</b>		<b>7,779</b>	
No of shares & options (m)			579
<b>Valuation per share</b>			<b>13.45</b>

Source: CLSA Asia-Pacific Markets

### Investment risks

- Luks has entered into five JVs with local parties this year to develop property and build another cement production line. We acknowledge there is some uncertainty as to when the projects will be completed (all expected by 2010), which is why we have incorporated a probability weighted discount in our valuation for each of the projects (see valuation summary in body of this research report).
- Most of Luks' competitors in cement are indirectly state-owned. However we do not see this as a risk to Luks for two reasons. Firstly, Luks has been established in Vietnam for a long time (since mid-90s) and secondly, it has close relationships with the provincial governments, especially in Hue, where the company is a key contributor to the local industry. Recent events also confirm our view that the company is allowed to operate and grow in line with its state-owned peers.
- Vietnam is an emerging economy, and while there have been major reforms (ie, shift to free market), regulatory and legislative inefficiencies still need to be ironed out. Relevant to Luks and other companies in real estate in Vietnam, we find that regulations and processes in vacating existing tenants to be opaque and in our view increases the risk of delays (and costs) in property projects.
- Soaring inflation is a key concern for the economy. We are projecting electricity and coal costs to increase by 50% and 15% in FY08 and FY09.



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**Summary P&L forecast (HK\$m)**

Year to 31 December	2005A	2006A	2007A	2008CL	2009CL
<b>Revenue</b>	<b>313</b>	<b>374</b>	<b>537</b>	<b>751</b>	<b>958</b>
Operating Ebitda	73	115	193	284	361
Operating Ebit	53	97	156	226	296
Interest income	3	5	16	29	24
Interest expense	(6)	(11)	(10)	(21)	(28)
Other items	37	3	5	137	551
<b>Profit before tax</b>	<b>87</b>	<b>94</b>	<b>167</b>	<b>371</b>	<b>843</b>
Taxation	(23)	(37)	(15)	(59)	(162)
Minorities and other	(3)	2	0	(38)	(69)
<b>Profit, pre-abnormal items</b>	<b>60</b>	<b>59</b>	<b>153</b>	<b>275</b>	<b>612</b>

**Summary cashflow forecast (HK\$m)**

<b>Operating Ebit</b>	<b>53</b>	<b>97</b>	<b>156</b>	<b>226</b>	<b>296</b>
Depreciation/amort	20	19	37	57	65
Working capital - trade	14	58	(8)	(14)	(13)
Other operating items	146	5	99	482	792
<b>Operating cashflow</b>	<b>233</b>	<b>178</b>	<b>285</b>	<b>752</b>	<b>1,139</b>
Net interest/taxes/other	(6)	(42)	(9)	(51)	(166)
<b>Cashflow</b>	<b>227</b>	<b>136</b>	<b>276</b>	<b>701</b>	<b>973</b>
Capital expenditure	(93)	(108)	(120)	(953)	(382)
Acq/inv/disposals	(47)	1	0	0	0
<b>Free Cashflow</b>	<b>87</b>	<b>30</b>	<b>156</b>	<b>(253)</b>	<b>591</b>
Ord div paid/Other items	(178)	(31)	606	(434)	(367)
Decrease in net debt	(91)	(1)	762	(687)	224

**Summary balance sheet forecast (HK\$m)**

Cash & equivalents	133	127	939	526	671
Debtors - trade	20	25	51	72	92
Inventories - trade	13	19	14	21	28
Other current assets	0	0	0	0	0
Fixed assets	400	482	566	1,462	1,779
Intangible assets	94	16	16	16	16
Other term assets	691	925	925	925	925
<b>Total assets</b>	<b>1,351</b>	<b>1,594</b>	<b>2,511</b>	<b>3,021</b>	<b>3,510</b>
Short-term debt	58	77	111	294	241
Creditors - trade	25	20	34	47	60
Other current liabs	85	112	112	112	112
Long-term debt/CBs	63	38	55	146	120
Other long-term liabs	73	127	127	127	127
Minorities/other equity	0	(2)	(2)	(2)	(2)
Shareholder funds	1,046	1,221	2,074	2,297	2,851
<b>Total liabs &amp; equity</b>	<b>1,351</b>	<b>1,594</b>	<b>2,511</b>	<b>3,021</b>	<b>3,510</b>

**Ratio analysis (HK\$m)**

Revenue growth (%)	12.6	19.4	43.6	40.0	27.5
Op Ebitda growth (%)	11.6	57.2	67.5	46.9	27.1
Op Ebit growth (%)	347.3	82.5	61.3	45.2	30.7
Op Ebitda margin (%)	23.4	30.9	36.0	37.8	37.7
Op Ebit margin (%)	16.9	25.9	29.1	30.1	30.9
Net profit margin (%)	19.3	15.9	28.5	36.6	63.9
Dividend payout (%)	24.4	91.1	36.8	26.1	13.1
Tax rate (%)	26.8	39.0	8.8	15.9	19.2
Ebitda/net int exp (x)	25.2	20.7	(31.6)	(35.1)	88.1
Net debt/equity (%)	(1.1)	(0.9)	(37.3)	(3.8)	(10.9)
Gross debt/equity (%)	11.6	9.5	8.0	19.2	12.7
Net debt/op Ebitda (x)	(0.2)	(0.1)	(4.0)	(0.3)	(0.9)
Gross debt/op Ebitda (x)	1.7	1.0	0.9	1.5	1.0
Return on equity (%)	5.7	5.2	9.3	12.6	23.8
ROCE (%)	8.8	8.9	12.9	20.7	35.7
Return on assets (%)	4.5	4.0	7.4	9.9	18.7

Source: CLSA Asia-Pacific Markets

**Key to CLSA investment rankings:** BUY = Expected to outperform the local market by >10%; O-PF = Expected to outperform the local market by 0-10%; U-PF = Expected to underperform the local market by 0-10%; SELL = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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