3V Capital Limited

Flash Note

30 Jan 2007

Luks Industrial (0366.HK, HK$4.97, BUY)

- Property Projects in Vietnam Adds New Value

Luks' strategic move lately to enter the highly protected Vietnamese property development market is highly rewarding. The two residential and commercial projects in Ho Chi Minh City, which are expected to be completed in 2009, will raise Luks' NAV by HK$0.63/share. Meanwhile, cement remains its main growth driver in the short term. Higher ASP and output see its operational profit from the segment to surge 2.7x between FY06 and FY08. Our sum-of-parts valuation gives Luks a NAV of HK$6.77 per share, based on FY08 earnings. We raise our target price on the stock from HK$3.55 to HK$6.09, 10% discount to its FY08 NAV. Maintain BUY.

Vietnam property projects bring new growth. Luks announced the formation of JVs lately in Vietnam to develop two residential / commercial projects with GFA of 90k sq m and 73k sq m respectively. Total investment is estimated to be HK$175.9m, which will be funded by bank loans and internal resources. It is expected that Luks will start booking revenue from the two projects in FY08. We estimate Luks' NAV will be enhanced by HK$325m in total, or HK$0.63/share, as a result.

Cement segment on track for fast growth. The new cement production line has started operation last month and the effect will be fully reflected in 2007. Luks is also planning to build another 1.4mt production line, with completion expected in 2008. As demand is projected to continue to outstrip supply, cement prices in Vietnam should have more upside. Given both higher ASP and output, we expect Luks' cement EBIT to surge from HK$64m in FY06 to HK$178m in FY08.

Target price set at HK$6.09. We adjusted upward Luks' FY07 and FY08 earnings by 1.8% and 105.2% respectively due to higher cement prices and property development revenue. We expect net profit to grow from HK$82.2m in FY06 to HK$316.2m in FY08. Using 18x FY08 P/E to value Luks' cement segment and 8.0% cap rate for its rental properties, we come up with a revised NAV of HK$6.77/share. We raised our target price on the stock to HK$6.09/share, 10% discount to its FY08 NAV. Maintain BUY.

Earnings Summary

Y/E: Dec 31	2005	2006F	2007F	2008F
Net profit (HK$m)	22.6	74.4	183.9	364.2
Core profit (HK$m)	50.5	82.2	129.3	316.2
Core EPS (HK$)	0.10	0.16	0.25	0.61
EPS growth (%)	18.6	62.6	57.4	144.5
P/E (x)	50.7	31.2	19.8	8.1
DPS (HK$)	0.08	0.10	0.11	0.12
Dividend yield (%)	1.6	2.0	2.2	2.4

Source: 3V Capital

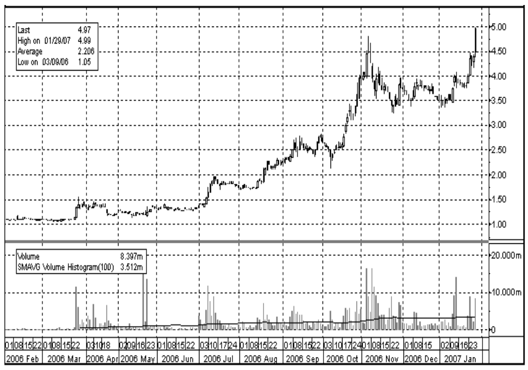
Company Background

Founded in 1975, Luks started its investment in Vietnam early in 1991 by forming a joint venture with a local SOE for plywood processing in Hl Chi Minh City. It diversified into cement production in 1992 and later completed Saigon Trade Centre, an investment property in Ho Chi Minh City, in 1997. Cement is still the largest earning contributor of Luks, with production capacity currently at 780kt. A new production line, which started operation in Dec06, sees capacity jumped to 1.5mt. Saigon trade Centre has been providing stable rental income and its occupancy rate improved from 54% in 2002 to 86% in 2005. In 2002, Luks started its Chinese medicine business by acquiring 10% stake in Vigconic Ltd, which develops and manufactures traditional Chinese medicine products. Luks later increased its stake in Vigconic to 75% in 2003. Major products include VI-28, for anti-aging purpose, and Vigchemo, which deals with chemotherapy-led side effects.

Company Data

Share price	HK$4.97 (US$0.637)
Hang Seng Index	20,236
Shares issued (options adj.)	515.7m
Market cap	HK$2,563m (US$329m)
Avg daily vol (shrs)	3.5m
52-week Hi	HK$4.99 (US$0.64)
52-week Lo	HK$1.05 (US$0.14)
Price/book	2.21x
Net debt/equity	12.1%
Major shareholder	
- K.T. Luk	61.9%

Stock Performance



Source: Bloomberg

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New excitement from Vietnam property projects. Leverage on its market knowledge and strong connection, Luks entered into agreements to form two JVs with local partners in Oct06 and Jan07 respectively to engage in property development projects in Vietnam. In both cases, the partners will inject land into the JV. We understand that other than partnering with local parties, no foreign investors could own land in Vietnam. Hence, the moves allowed Luks to participate in the booming, yet highly protected, Vietnam property market. We estimate Luks' total investment in the projects will reach HK$175.9m, which will be funded by bank loans and internal resources.

Much hidden value for the An Lac Ward project. The An Lac Ward project is a joint venture with Thant Phat, a local company in Vietnam. Luks plans to build 6 – 8 blocks of 16-storey buildings. We estimate the total saleable commercial and residential areas to be 90k sq m. Although the location is 35 minutes traveling time away from the urban area of Ho Chi Minh City, it will be shortened to 15 minutes upon the operation of a new expressway in 2008. Hence, it is not surprising to see selling price to go higher afterwards. We expect the ASP per sq m to increase from US$600 in 2008 to US$700 in 2010. NAV of the project is estimated to be HK$175m (HK$122m attributable).

Prime site at Thao Dien Ward secured. Luks has recently entered into a MOU with Hong Phuc for a development project in Thao Dien Ward district, near the centre of Ho Chi Minh City. Luks and Hong Phuc will form a 90:10 JV, with an option granted to Luks to increase the stake to 100% if the Vietnamese government's approval on the project obtained. Hong Phuc will inject a parcel of land of 9,935 sq m site area into the JV. A 22-to-24-storey apartment building of not less than 73,000 sq m GFA is planned to be built. We expect pre-sale to start in 2008 at prices around US$1,200 per sq m, much higher than that of the An Lac Ward project. Based on the above assumptions, we come up with a NAV of HK$226m (HK$203m attributable) for the project.

Sales Projection of Property Development Projects

Project	GFA (sq m)	Revenue (HK$m) 2008F	2009F	2010F
An Lac Ward	90,000	117	126	136
Thao Dien Ward	73,000	233	233	101
Total		350	359	237

Source: 3V Capital

Cement segment on track for fast growth. The new cement production line has started production last month and the effect will be fully reflected in 2007. Luks is also planning to build another 1.4mt production line, which should be completed in 2008. Meanwhile, according to the management, prices of cement are still in an uptrend in Vietnam. ASP of cement in 2006 reached US$40/t versus US$39/t in 2005 on a tight supply. We expect cement prices to increase further to US$42/t in 2007 and US$44/t in 2008. With both higher ASP and output, EBIT of the segment is expected to surge from HK$64m in FY06 to HK$178m in FY08.

Earnings Projection - Cement Segment

Y/E: Dec	2006F	2007F	2008F	2009F
Capacity (kt)				
Cement	682	1,260	1,890	2,520
Clinker	120	140	210	280
Total Capacity	803	1,400	2,100	2,800
Sales (HK$m)				
Cement	213	413	619	826
Clinker	29	34	52	69
Total Sales	242	447	671	894
Operational Profit (HK$m)	64	119	178	237

Source: 3V Capital

Price target HK$6.09. We adjusted upward Luks' FY07 and FY08 earnings by 1.8% and 105.2% respectively due to higher cement prices and property development revenue. We expect net profit to grow from HK$82.2m in FY06 to HK$316.2m in FY08. Using 18x FY08 P/E to value Luks' cement segment and 8.0% cap rate for its rental properties, we come up with a revised NAV of HK$6.77/share. We upgraded our target price on the stock to HK$6.09/share, 10% discount to its FY08 NAV. Maintain BUY.

Earnings Projection

Y/E: Dec (HK$m)	2005	2006F	2007F	2008F
Turnover				
Cement	*232*	*242*	*447*	*671*
Property investment	*74*	*81*	*92*	*101*
Property sales	*0*	*0*	*0*	*350*
Chinese medicine	*5*	*5*	*5*	*5*
Others	*2*	*2*	*2*	*2*
Total	313	330	546	1,129
EBIT				
Cement	*61*	*64*	*119*	*178*
Property investment	*204*	*151*	*146*	*149*
Property sales	*0*	*0*	*0*	*172*
Chinese medicine	*-21*	*-15*	*-8*	*-3*
Others	*-11*	*-15*	*-20*	*-20*
Total	234	185	237	476
Impairment of goodwill	-169	-78	0	0
Finance cost	-6	-14	-15	-15
PBT	59	93	222	462
Tax	-33	-14	-33	-92
MI	-3	-5	-5	-5
Net profit	23	74	184	364
Core net profit	51	82	129	316

Source: 3V Capital

NAV Estimates

Asset	Valuation benchmark	Value HK$m
Cement	18x FY08 P/E	2,415
Properties investment	8% cap rate on FY08 rental	703
Properties development	DCF	325
Net cash	Estimated FY08	47
Total		3,491
No. of shares (m)		491
Shares options to employees (m)		25
Diluted no. of shares (m)		516
Estimated NAV per share (HK$)		6.77

Source: 3V Capital

Balance Sheet Projection

Y/E: Dec (HK$m)	2005	2006F	2007F	2008F
Non-current Assets				
PPE	375	492	609	710
Investment properties	657	728	782	830
Properties under dev	0	0	183	183
Goodwill	94	16	16	16
Other items	44	44	91	111
Total Non-current Assets	1,170	1,279	1,680	1,849
Current Assets				
Inventories	13	16	23	32
Receivables	49	51	79	122
PPT under development	0	0	46	183
Other items	38	38	38	38
Cash	90	108	79	213
Total Current Assets	190	214	264	588
Current Liabilities				
Payables	74	76	103	139
Tax payables	28	28	28	28
Due to other parties	8	8	8	8
Short term bank loans	58	68	78	78
Total Current Liabilities	168	181	218	254
Total Non-current Liabilities				
Long term bank loans	63	73	88	88
Rental deposits	19	22	27	31
Other items	55	55	55	55
Total Non-current Liabilities	136	150	169	174
Total Equity	1,056	1,162	1,557	2,010

Source: 3V Capital

Cash Flow Projection

Y/E: Dec (HK$m)	2005	2006F	2007F	2008F
Cash flow from operation				
EBIT	59	185	237	476
Impairment of goodwill	169	78	0	0
Revaluation gain	-141	-70	-55	-48
Depreciation	20	26	32	38
Other items	-24	0	0	0
Change in working capital	29	1	-49	-148
Total CFO	112	220	166	318
Cash flow from investment				
Capex	-96	-117	-117	-101
Investment in JV	0	-53	-47	-20
Other items	-56	0	0	0
Total CFI	-152	-170	-164	-121
Cash flow from financing				
Change in bank loan	65	20	25	0
Dividend	-39	-52	-57	-62
Other items	-28	0	0	0
Total CFF	-2	-32	-32	-62
Change in cash	-42	18	-30	135

Source: 3V Capital

Risk factors

The Vietnamese cement market is under protection of the government. Luks' earnings from the cement segment will be adversely affected if the Vietnamese government lessens its control over the industry. Meanwhile, the Chinese medicine segment is an uncertainty for Luks' profit, it is unsure if it will record losses again in 2008.

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Buy: the security is expected to outperform the benchmark index by >10% in the next six months. Hold: the security is expected to perform within 10% of the benchmark index over the next six months. Sell: the security is expected to underperform the benchmark index by >10% in the next six months.

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