

Small Cap Visit

Luks Industrial (Group) Ltd.

Luks Industrial (Luks) is transitioning into a Vietnam cement producer and real estate developer. Currently it has one cement plant and two property joint ventures in Vietnam. The company also owns Saigon Trade Center, the tallest building in Ho Chi Minh City:

- **Expand cement capacity from 800,000 tons in 2006 to 3 mn tons in 2009.** +20% demand growth in Vietnam, and Luks is the largest wholly owned foreign cement producer in Vietnam and acts faster than its state-owned competitors. We expect stable sales price and expanding margins.
- **15-20% p.a. rental income increase for STC,** driven by the short supply of office buildings in HCM City. Management expects continued rental hike and STC revaluation in 2007/08.
- **Becoming a Vietnam property developer.** Luks controls 2 joint venture projects in HCM City. it aims to build up a land bank sufficient for 5 years of development.
- **Medicine business already written off.** Management expect little losses from its traditional medicine business from 2007.
- **Valuation:** No coverage. The stock trades at 18x 2006 PE. We note that Anhui Conch is trading at 30x 2006 PE, and the Ho Chi Minh City Index (Vietnam stock index) is trading at 45x 2006 and 32x 2007 PE.

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Luks Industrial (Reuters: 0366.HK, Bloomberg: 366 HK), Historical financial data

HK\$ MM, year-end December	12/31/2004	12/31/2005	12/31/2006
Sales	278	313	374
EBITDA	146	135	133
Net Income	31	22	200
EPS (Rmb)	0.07	0.05	0.41
Return on Equity (%)	3.2	2.1	17.7
Return On Invested Capital (%)	3.9	2.4	13.6
PE Ratio (x)	100.0	162.2	18.3
Price To Book Ratio (x)	2.8	3.5	3.0
Dividend Payout Ratio (%)	114%	175%	20%
DPS (Rmb)	0.08	0.08	0.08
Div Yield (%)	1.1%	1.1%	1.1%
Working capital/sales	2%	3%	7%

Source: Bloomberg.

Hong Kong Mid/Small Caps

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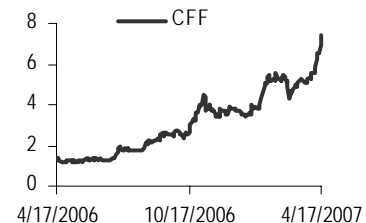
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0366.HK, Not Covered

HK\$ 3.41, April 18, 2007

Stock price chart



Source: Datastream

One-year price performance

	1M	3M	12M
Absolute (%)	39.8	92.0	453.0
Relative (%)	30.2	84.9	337.0

Source: Datastream

Company data

Price	7.41
52wk range	1.18-7.41
Mkt Cap (HK\$m)	3,657
Mkt Cap (US\$m)	470
Shares O/S (mn)	494
ADT (mn shares)	9.4
ADT (US\$m)	1.4
Exchange rate	7.8
Index (HSI)	20,789
Year-end	December

Source: Datastream

See page 5 for analyst certification and important disclosures, including investment banking relationships.

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Business highlights

95% revenues from Vietnam

A Vietnam cement and real estate play. Founded in 1975 and listed at HKSE in 1987. Luks started as an electronic producer and gradually transitioned into a Vietnam cement and real estate play. Currently 95% of its revenue and all its profits are derived from Vietnam.

Presence in Vietnam.

- **Saigon Trade Center (STC):** Luks own 100% of this landmark office building at Ho Chi Minh (HCM) City. Constructed in 1997 by Luks, this building is still the tallest building in Vietnam. It has 40,000 square meters of office space for rent, and the average rent in 2006 was US\$24 per sqm per month. The tenants include Prudential, Intel, Cisco, Standard Chartered Bank, etc.
- **Cement:** Luks owns 100% the sixth largest cement plant in Vietnam with a total capacity of 800,000 tons by 2006. Luks also owns the local limestone mine with over 50 years of reserves for its production. Due to the short cement supply in Vietnam, the ex-factory price is around US\$40/ton, and Luks achieved over 40% gross margin from the cement sales.

Luks also has a traditional Chinese medicine business which loses money. However the company has stopped investing into the TCM business and has written off most of the goodwill associated with it. The company will focus all its energy and resources to expand the Vietnam cement and real estate business in the future.

Aggressive expansion of the Vietnam cement business

- **Raising capacity from 800,000 tons in 2006 to 3 million tons in 2009.** In early 2007, Luks has completed another 700,000-ton of cement capacity expansion project and raised its total capacity to 1.5 mn tons. The company has received Vietnamese authority's approval to raise cement capacity to 2.2 mn tons in 2008, and 3.0 mn tons in 2009.
- **Cement price remains stable.** Management believes that the cement price at Vietnam should at least remain stable if not becoming more expensive. Cement demand in Vietnam grew by over 20% p.a. for the past 3 years, and management expects the growth to accelerate in the future.
- **Lukewarm competition.** In Vietnam, 50% cement production are controlled by Vietnam National Cement Corp. (VNCC), a state-owned company. Another 25% of the market are shared by 4 VNCC-controlled joint ventures. Luks is the largest wholly-foreign owned cement producer in Vietnam, and the management believes that they are much faster in capacity expansion compared to VNCC-affiliated producers.

Moreover, Vietnam is a net cement importer. However, since it imposes high tariff on China imports, currently most imports are from ASEAN countries (especially Thailand) and their prices are higher than local products.

- **Expected margin expansion due to better economy of scale.** Luks believes that it can further enhance its gross margin after production volume increases. Currently, it enjoys over 40% gross margin for its cement production.

Currently, Luks enjoys a net profit of US\$10-11/ton of cement produced. The company plans to invest US\$55mn in total for 2007 and 2008 expansion.

Rental and NAV hike for Saigon Trade Center

- **15-20% rental price increase for STC in 2007.** Due to the short supply of top-end commercial buildings in HCM City, Luks is able to raise STC's rental by 15-20% in 2007. Management is confident they are able to achieve US\$12-14 mn rental income and about US\$10 mn net profit from STC.
- **Higher STC appraisal value.** Although the appraisal value of STC was US\$82 mn by the end of 2006, management said they have received an offers to acquire STC at US\$12 mn. The company are confident that with the booming economy of Vietnam and fast increase of rental income, the STC property will be appraised higher in 2007 which will add to the re-valuation gain.

Becoming a Vietnam property developer

Luks has signed 2 project joint ventures to develop properties at HCM City.

- **Binh Chanh, outskirts of HCM City, Luks has 70% interest.** Luks plan to develop this 100,000 sqm GFA area into mid-range apartment buildings. Management estimates the total cost of land and construction to be US\$380/sqm, and the market average selling price at US\$650/sqm. The project will commence pre-sale in mid-08.
- **District 2, center of HCM City, Luks has 90% interest.** Luks plan to develop this 71,000 sqm GFA area into high-end apartment buildings. Management estimates that the total cost of land and construction to be US\$500/sqm, and the market average selling price at US\$1,000/sqm. The project will commence pre-sale in mid-08.

Going forward, Luks aspires to build up a land bank reserve in Vietnam that is sufficient for the next 5 years of development. In the next several years, the company aims to construct and sell 100,000-150,000 sqm GFA each year.

TCM business will stop bleeding in 2007

- Luks wrote off HK\$169mn and HK\$78mn goodwill in 2005 and 2006, respectively, mainly related to its TCM business.
- By 2006 there was only HK\$16mn goodwill on Luks balance sheet. We consider the negative income impact due to goodwill write-off is limited going forward.
- Luks will control the TCM business costs to HK\$5-6mn a year, and actively finding buyers of the business. We do not expect the TCM business to become a profit drag from 2007 onward.

Financials and valuation

- **Currently, Luks is trading at 18.3x 2006 PE.** The company is under-covered and there is no forecast for this company. However, management expects continued strong profit growth for the next 3 years: (1) its cement production should double in 2007 and have another 50% growth in 2008, (2) its STC rent is increasing 15-20% a year, (3) big upside for STC re-valuation, and (4) bright future for its property development business in Vietnam.
- **As a comparison, Anhui Conch is trading at 30x 2006 PE.** Hence, the Ho Chi Minh Index is trading at 45x 2006 and 32x 2007E P/E, both much higher than Luks PE multiples.
- The company has secured a bank loan of US\$20mn for its Vietnam expansion and believes that they do not need equity funding in the short-term.

Shareholding structure

- The Luk family in aggregate controls 63% of the company.

Companies Recommended in This Report (all prices in this report as of market close on 18 April 2007)

Luks Industrial Group Ltd (0366.HK/HK\$3.41/Not Covered)

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Luks Industrial (366 HK, NR): Summary historical financials

Profit and loss statement				Cash flow statement			
(Year-end December, HK\$ mm)	12/31/2004	12/31/2005	12/31/2006	(Year-end December, HK\$ mm)	12/31/2004	12/31/2005	12/31/2006
Revenues	278.1	313.1	373.7	EBIT	92.2	114.6	114.1
% change yoy	11.1	12.6	19.4	Depreciation & amortisation	53.9	20.4	18.6
Gross margin (%)	49.9	50.2	53.6	Change in working capital	30.3	-33.5	-29.6
EBITDA	146.1	134.9	132.7	Taxes	0.0	2.8	62.9
% change yoy	48.9	-7.6	-1.6	Cash flow from operations	83.0	115.1	172.6
EBITDA margin (%)	52.5	43.1	35.5	Cashflow from investing	-36.5	-154.9	-84.8
EBIT	92.2	114.6	114.1	Cashflow from financing	-57.3	-2.0	106.6
% change yoy	80.8	24.2	-0.4	Net changs in cash	-10.7	-41.8	-62.3
EBIT margin (%)	33.2	36.6	30.5	Dividends paid	-35.0	-39.3	-40.5
Net interest	-4.0	-6.0	-10.9	DPS	0.08	0.08	0.08
Earnings before tax	46.4	58.9	261.1				
% change yoy	33.0	26.9	343.0				
Tax	-3.6	-33.3	-62.9				
as % of EBT	7.7	56.5	24.1				
Net income	30.6	22.4	200.3				
% change yoy	51.8	-26.8	793.9				
Shares outstanding	413.5	490.7	493.5				
EPS (reported)	0.07	0.05	0.41				
Balance sheet				Ratio Analysis			
(Year-end December, HK\$ mm)	12/31/2004	12/31/2005	12/31/2006	(Year-end December, HK\$ mm)	12/31/2004	12/31/2005	12/31/2006
Cash and Cash Equivalents	159.8	117.5	111.0	EBITDA margin (%)	52.5	43.1	35.5
Accounts receivable	14.2	20.1	24.9	Operating margin (%)	33.2	36.6	30.5
Inventories	13.5	13.5	19.5	Net profit margin (%)	11.0	7.2	53.6
Others	32.4	29.6	21.9				
Current assets	219.9	180.6	177.3	Sales growth (%)	11.1	12.6	19.4
LT investments	0.2	1.0	0.0	Net profit growth (%)	51.8	-26.8	793.9
Net fixed assets	858.1	1057.2	1416.7	EPS growth (%)	51.8	-38.3	788.8
Total Assets	1349.9	1350.9	1594.0	Interest Coverage (x)	23.1	19.0	10.5
Liabilities				Net debt to total Capital (%)	Net cash	0.3	0.4
ST bank loans	33.8	58.3	77.4	Net debt to equity (%)	Net cash	0.3	0.4
Payables	22.6	24.9	19.9	Sales/Assets (%)	20.6	23.2	23.4
Others	117.9	85.3	112.4	Assets/Equity (%)	121.8	129.1	130.8
Total current liabilities	174.3	168.5	209.7	ROE (%)	3.2	2.1	17.7
Long term debt	23.4	62.8	38.4	ROCE (%)	3.9	2.4	13.6
Other liabilities	43.5	73.5	127.2				
Total liabilities	241.2	304.7	375.3				
Shareholder's equity	1108.7	1046.1	1218.7				
BVPS	2.68	2.13	2.47				

Source: Bloomberg.