

Update 9 May 2007

Luks Industrial

STOCK RECOMMENDATION

IN-LINE

SECTOR

General Industrials

NEXT RESULTS DUE

15 October 2007 (H1)

LAST RESULTS

16 April 2007 (FY)

CHANGE IN STOCK RECOMMENDATION

n/a

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PRICE

HK\$9.49

12 MONTH RANGE

HK\$9.69 – 1.18

REUTERS CODE

0366.HK

BLOOMBERG CODE

MARKET CAPITALISATION

HK\$4,863m (US\$623m)

PRINCIPAL LISTING

HKG

CHANGE IN EPS ESTIMATES

No

Further positives

our fair value only reflects the value of existing operations

management is actively looking to increase its exposure to Vietnam

At HK\$9.49, Luks share price remains firmly above our fair value of HK\$8.35 set in our initiation of coverage report (19 April 2007). We continue to stress, however, that our fair value only reflects the value of its existing operations (1.5m tonnes of cement capacity / Saigon Trade Centre) and detailed firm expansion plans (1.5m tonnes of cement capacity / two residential development JVs in Ho Chi Minh City with a combined GFA of 165,000 sqm). Having operated in Vietnam since 1991, management is looking to leverage on its experience and contacts to increase its exposure to this market, which already accounted for 95% of revenue in FY06. Further participation, in the form of Ho Chi Minh City property (both commercial investment and residential development) is anticipated, and this, if it materialises, could materially change our fair value.

Year end: December	2006A	2007E	2008E	2009E
Turnover (HK\$m)	373.7	577.1	822.3	1,112.5
Earnings (adjusted) (HK\$m)	79.8	144.8	342.6	443.0
EPS (adjusted) (HK\$)	0.16	0.28	0.66	0.86
DPS (HK\$)	0.08	0.08	0.08	0.10
EV/EBITDA (x)	41.9	23.9	16.3	12.1
PER (x)	59.6	33.8	14.3	11.1
Yield (%)	0.8	0.8	0.8	1.1

Source: Company, Cazenove

Having studied the 2006 annual report (issued 23rd April – after the publication of our initiation note) we would note the following:

Property

According to the annual report, Luks stated strategy in property development is to aim at building 100,000 to 150,000 sqm of residential gross floor area in Ho Chi Minh City per annum. For 2007, the group aims to accumulate a land reserve sufficient to support around 400,000 sqm of residential gross floor area.

management target 400,000 sqm potential residential land bank acquisitions in 2007

With increased foreign interest and rising land costs in Vietnam post WTO entry, we expect the group to move sooner rather than later in securing this land bank. Additionally if suitable land (right price / right location) became available we would not be surprised to see Luks exceed its stated level of planned acquisition.

We understand that there are basically three routes available to secure a land bank. These are:

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- Government land auction – teaming up with a local partner who bids in the auction (foreigners can't bid) and then developing the secured site together. Typical sites are similar in size to the two sites already secured by Luks in the form of JVs.
- Existing private land owners – teaming up with a local partner who essentially contributes the land to a new JV, with Luks providing the necessary equity capital for development. This is the route adopted by the two JVs announced to date, both of which are typical in terms of site size.
- Manufacturing companies – Luks sees an opportunity in acquiring light industrial sites in good locations for re-development from existing owner / operators. These sites, which are typically no longer optimal for industrial use, tend to be larger in size.

Singer (Vietnam), with related land bank, not disclosed separately at time of acquisition

The acquisition of a 70% stake in Singer (Vietnam) Company Limited – detailed in note 19 ('interests in jointly controlled entities') of the 2006 annual report – is, we understand, an example of the last of these three methods.

Due to its small size (cash acquisition cost of HK\$1.56m) the Singer acquisition was not disclosed separately during 2006. Singer is, we understand, an effectively dormant entity, but continues to own the old manufacturing site – 20,000 sqm of land located near the old airport.

With newer offices in the area fully let and commanding a rental of US\$17psm (ie 47,000 sqm E.town2) it is possible that the Singer site, were it to obtain re-zoning permits and a lease extension, could prove to be more suitable for office investment rather than residential development. At a plot ratio of 5x this site could yield up to 100,000 sqm of office space – substantial from both a HCMC property market and Luks perspective.

Cement

According to the VNCA (Vietnamese National Cement Association) cement demand in 2006 increased by 17% to 32.5m tonnes. Official growth forecasts for 2007 have already been revised upwards from 12% to 15%. With WTO entry, and the resulting increase in infrastructure spend, we continue to believe there are upside risks to the official growth forecasts. This should continue to extend the supply / demand imbalance – an environment that is positive for Luks.

Increased scale justifies margin enhancing ancillary investments

Luks has already detailed its plans to expand its cement production capacity from 1.5m tonnes currently to 3.0m tonnes by mid-2008. In addition to simple volume growth, we continue to believe that this scaling-up will put the group in a position to justify margin enhancing ancillary investments. Of these, own cement bag production is already planned, and the building of a dedicated coal powered electricity generating plant is under consideration.

Gross profit margin for the cement business, according to the annual report is currently around 40% and EBIT margin is 28%. Both cement bags and coal/electricity are significant cost items, accounting for an estimated 15% and 40% of cost of goods sold respectively. Cost savings in these areas could have a significant positive impact on medium term margins.

AGM

On 16 May 2007, Luks will hold its Annual General Meeting. In addition to the standard ordinary resolutions, shareholders will vote on a special resolution to change the company's name from Luks Industrial (Group) Limited to Luks Group (Vietnam Holdings) Company Limited.

Profit and loss account

Year end: December	2005	2006	2007E	2008E	2009E
Cement (HK\$m)	231.7	274.6	458.7	688.1	975.3
Investment property (HK\$m)	74.5	91.1	109.8	125.7	128.7
Other (HK\$m)	6.9	8.0	8.5	8.5	8.5
Revenue (HK\$m)	313.1	373.7	577.1	822.3	1112.5
Cement (HK\$m)	60.8	77.0	134.9	205.5	301.6
Property investment (HK\$m)	42.6	57.1	73.2	86.6	87.9
Other (HK\$m)	-38.1	-37.0	-30.0	-27.5	-25.0
EBIT (HK\$m)	65.3	97.1	178.0	264.7	364.5
PBT – adjusted (HK\$m)	58.9	88.9	157.0	221.7	343.5
Tax rate (%)	19%	13%	8%	6%	13%
Earnings – adj pre–prop dev	44.5	79.8	144.8	208.4	298.0
Prop dev earnings (HK\$m)	0.0	0.0	0.0	134.2	145.1
Earnings – adjusted total	44.5	79.8	144.8	342.6	443.0
Earnings – reported total	22.2	200.3	144.8	342.6	443.0
EPS – adj pre–prop dev (HK\$)	0.091	0.159	0.280	0.404	0.577
EPS – adj post–prop dev (HK\$)	0.091	0.159	0.280	0.664	0.858
DPS (HK\$)	0.080	0.080	0.080	0.080	0.100

Source: Cazenove

Balance sheet

Year end: December	2005	2006	2007E	2008E	2009E
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
Property Plant & Equipment	375.4	460.2	762.8	931.1	911.9
Investment property	657.3	899.4	899.4	899.4	899.4
Intangible assets	93.6	15.8	15.8	15.8	15.8
Other non–current assets	44.0	41.3	137.2	425.1	110.3
Inventories	13.5	19.5	25.1	37.7	53.4
Trade receivables	20.1	24.9	36.4	51.8	70.1
Cash & equivalents	133.1	126.6	126.6	122.8	223.6
Trade payables	-24.9	-19.9	-39.5	-56.3	-76.2
Borrowings	-121.1	-115.8	-425.0	-600.0	0.0
Other net assets / (liabilities)	-129.2	-213.5	-204.0	-193.3	-180.5
Minorities	0.0	-2.1	-2.1	-2.1	-2.1
Shareholders' funds	1,046.1	1,220.8	1,317.2	1,616.5	2,010.3
Net cash / (debt)	12.0	10.8	-298.4	-477.2	223.6
Capital employed	1,167.2	1,338.7	1,744.2	2,218.5	2,012.4

Source: Cazenove

Cash flow statement

Year end: December	2005	2006	2007E	2008E	2009E
	HK\$m	HK\$m	HK\$m	HK\$m	HK\$m
EBIT	65.3	97.1	178.0	264.7	364.5
D&A	19.9	18.6	24.9	32.9	36.2
EBITDA	85.2	115.7	203.0	297.6	400.7
Working capital	29.4	16.4	-7.0	-21.9	-27.0
Other	6.3	13.2	0.0	0.0	0.0
Cash flow from operations	120.9	145.3	195.9	275.8	373.7
Interest	-6.0	-10.9	-26.0	-48.0	-28.0
Tax	-2.8	-4.2	-12.3	-13.2	-45.5
Capex (net)	-93.0	-107.4	-333.2	-201.3	-17.0
Business cash flow	19.0	22.8	-175.5	13.3	283.2
Acquisitions/disposals	-52.6	0.0	0.0	0.0	0.0
Other	8.8	-4.3	-93.3	-151.0	463.7
Free cash flow	-24.8	18.5	-268.8	-137.7	746.9
Dividends	-39.3	-39.4	-40.4	-41.0	-46.1
Issue of shares	0.0	11.2	0.0	0.0	0.0
Other	-26.7	8.5	0.0	0.0	0.0
Net cash in / (out) flow	-90.7	-1.2	-309.2	-178.7	700.8
Closing net cash / (debt)	12.0	10.8	-298.4	-477.2	223.6

Source: Cazenove

Key ratios

Year end: December	2005	2006	2007E	2008E	2009E
Interest cover (x)	10.5	24.7	6.8	5.5	13.0
Dividend cover (x)	1.1	2.0	3.5	8.3	8.6
EBITDA margin (%)	27.2	31.0	35.2	36.2	36.0
EBIT margin (%)	20.9	26.0	30.9	32.2	32.8
Revenue growth (%)	12.6	19.4	54.4	42.5	35.3
EPS growth (%)	469.1	75.7	76.1	136.7	29.3
Op cash/op profit x	1.9	1.5	1.1	1.0	1.0
Deprn/capex x	0.2	0.2	0.1	0.2	2.1
Quick ratio x	1.0	0.8	0.8	0.8	1.8
ROE %	2.1	16.4	11.0	21.2	22.0
ROCE %	5.6	7.3	10.2	11.9	18.1
Net debt/equity %	cash	cash	22.7	29.5	cash
Working cap/sales %	-12.5	-14.9	-8.4	-3.3	0.0
Receivables days	23	24	23	23	23
Inventories turnover x	23	19	23	22	21
Asset turnover x	0.2	0.2	0.3	0.3	0.5
PER x	104.7	59.6	33.8	14.3	11.1
EV/sales x	15.5	13.0	8.4	5.9	4.4
EV/EBITDA x	57.0	41.9	23.9	16.3	12.1
EV/EBIT x	74.3	50.0	27.3	18.3	13.3

Source: Cazenove

APPENDIX

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Adrian Foulger.

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RECOMMENDATION HISTORY

12 months recommendation changes for Luks Industrial (Group) Ltd;
19-Apr-2007 IN-LINE

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