

Small Cap Visit

Luks Industrial (Group) Ltd - Deeper penetration in Vietnam

Luks Industrial (Luks) is transitioning into a Vietnam cement producer and real estate developer. The company also owns Saigon Trade Center, the tallest building in Ho Chi Minh (HCM) City.

- **Partnership with HCM City government.** On May 18, 2007, Luks signed a partnership memorandum with an investment arm under the industrial department of HCM municipal government to form a cement JV (Luks owns 45%), a property JV (Luks owns 30%), and various other potential partnering projects.
- 1. **Cement JV:** It will have a total capacity of 4.25MM tons. Luks will transfer its current plant to the JV, and the Vietnam partner will inject cash and obtain necessary approvals for capacity expansion.
- 2. **Property JV:** The Vietnam partner injected 20,000 sq m of land at the prime location of HCM City. The property JV also has priority rights to develop the land owned by the Vietnam partner in HCM City.
- **Valuation:** The stock is trading at 27x 2006 historical P/E. No coverage of the company on the Street.

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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
P/E (x)	148.5	240.8	27.1
P/B (x)	4.1	5.2	4.5
Dividend payout ratio (%)	114%	175%	20%
DPS (Rmb)	0.08	0.08	0.08
Div yield (%)	0.8%	0.7%	0.7%
Working capital/sales	2%	3%	7%

Source: Bloomberg.

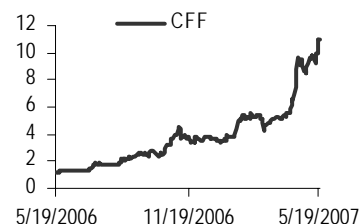
Hong Kong Mid/Small Caps

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0366.HK, Not Covered

HK\$11.0, May 22, 2007

Share price chart



Source: Datastream.

One-year price performance

	1M	3M	12M
Absolute (%)	20.9	107.9	801.6
Relative (%)	18.7	104.4	602.8

Source: Datastream.

Company data

52wk range	1.18-11
Mkt cap (HK\$MM)	5,429
Mkt cap (US\$MM)	698
Shares O/S (MM)	494
ADT (MM shares)	9.4
ADT (US\$MM)	1.9
Exchange rate	7.8
Index (HSI)	20,928
Year-end	December

Source: Datastream.

Vietnam partnership update

On May 18, 2007, Luks signed a conditional memorandum with Saigon Industry Corporation (CNS), which belongs to the industry department of Ho Chi Minh (HCM) City. The memorandum includes the proposal to set up one joint venture (JV) in cement production, and property each. It also outlines other investment projects that Luks and CNS will jointly develop—(1) investment in a thermal power plant with estimated capacity of 100MW; (2) construction of industrial zones; and (3) investment in an ecological resort.

Luks and CNS aim to list the cement JV and property JV on the Vietnam Stock Exchange within three years.

Cement JV: Luks has 45% stake

- **Total share capital:** US\$10 million.
- **Luks' stake:** 45%. The rest of the 55% belongs to CNS. Luks would invest US\$4.5 million as registered capital. Management estimates that the total investment may range to US\$76 million.
- **Proposed capacity:** A cement grinding capacity of 3MM tons per annum, and a new clinker line with 1.25MM tons capacity.
- **Licenses:** Luks has the license to build a cement-grinding plant with 1.5MM tons capacity. It will transfer its current cement grinding plant to the new JV, and the JV will apply for the license to expand the grinding plant to 3.0MM tons capacity, and a new license to build the 1.25MM tons clinker line.
- **Timetable:** The detailed construction and capital injection timetables will be specified in the formal JV contract. According to management, currently there is no fixed timetable for this deal.

Property JV: Luks has 30% stake

- **Total share capital:** US\$10 million.
- **Luks' stake:** 30%. The rest of the 70% belongs to CNS. Luks would put in US\$3.0 million as registered capital.
- **Land for development:** CNS owns three pieces of land, in total 18,300 sq m, all located in the prime location of HCM City, and will inject them into the property JV with Luks.
- **Priority right to develop other CNS lands.** CNS has granted the property JV the priority right to develop other areas belonging to CNS or its affiliates.
- **Timetable:** Within 90 days from May 18, 2007, CNS and Luks will sign a formal contract to form the property JV.

Business highlights

95% revenues from Vietnam

A Vietnam cement and real estate play. Founded in 1975 and listed on the 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, it is still the tallest building in Vietnam. It has 40,000 sq m of office space for rent, and the average rent in 2006 was US\$24 per sq m/month. The tenants include Prudential, Intel, Cisco, Standard Chartered Bank, etc.
- **Cement:** Luks owns 100% of the sixth largest cement plant in Vietnam with a total capacity of 800,000 tons by 2006. The company 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 has been loss making. However, the company has stopped investing into the TCM business and has written off most of the goodwill associated with it. Luks intends to focus all its energy and resources to expand the Vietnam cement and real estate business in future.

Aggressive expansion of the Vietnam cement business

- **Management expects to raise capacity from 800,000 tons in 2006 to 3 million tons in 2009.** In early 2007, Luks completed another 700,000-ton cement capacity expansion project and raised its total capacity to 1.5MM tons. The company has received the Vietnam authority's approval to raise cement capacity to 1.5MM tons in 2008.
- **Cement prices should remain stable.** Management expects cement prices in Vietnam to at least remain stable if not increase. Cement demand in the country has grown by over 20% p.a. in the last three years, and management expects the growth to accelerate in future.
- **Lukewarm competition.** In Vietnam, 50% of the cement production is controlled by Vietnam National Cement Corp. (VNCC), a state-owned company. Another 25% of the market is shared by four VNCC-controlled joint ventures. Luks is the largest wholly-foreign owned cement producer in Vietnam, and management believes that it is much faster in capacity expansion compared to VNCC-affiliated producers.

Vietnam is also 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.

- **Management expects margin expansion due to better economy of scale.** Luks' management believes that it can further enhance 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\$55 million in total for 2007 and 2008 expansion.

Rental and NAV hike for Saigon Trade Center (STC)

- **15-20% rental price increase for STC in 2007.** Due to the short supply of top-end commercial buildings in HCM City, Luks expects to be able to raise STC's rental by 15-20% in 2007. Management is confident of achieving US\$12-14 million in rental income and about US\$10 million in net profit from STC.
- **Higher STC appraisal value.** Although the appraisal value of STC was US\$82 million by end-2006, management said it has received offers to acquire STC at US\$120 million. It is 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 two joint venture projects to develop properties at HCM City

- **Binh Chanh, at the outskirts of HCM City (Luks has 70% interest).** Luks plans to develop this 100,000 sq m GFA area into mid-range apartment buildings. Management estimates the total cost of land and construction to be US\$380/sq m, and the market average selling price at US\$650/sq m. The project is scheduled to commence pre-sale in mid-2008.
- **District 2, center of HCM City (Luks has 90% interest).** Luks plans to develop this 71,000 sq m GFA area into high-end apartment buildings. Management estimates that the total cost of land and construction to be US\$500/sq m, and the market average selling price at US\$1,000/sq m. The project is scheduled to commence pre-sale in mid-2008.

Luks aims to build up a land bank reserve in Vietnam that is sufficient for the next five years of development. In the next several years, management aims to construct and sell 100,000-150,000 sq m GFA each year.

Management expects TCM business to stop bleeding in 2007

- Luks wrote off HK\$169 million and HK\$78 million goodwill in 2005 and 2006, respectively, mainly related to its TCM business.
- By 2006, there was only HK\$16 million goodwill on Luks' balance sheet. Management believes the negative income impact due to goodwill write-off is limited going forward.
- Luks plans to control the TCM business costs to HK\$5-6 million a year, and actively find buyers for the business. Management does not expect the TCM business to become a profit drag from 2007 onward.

Shareholding structure

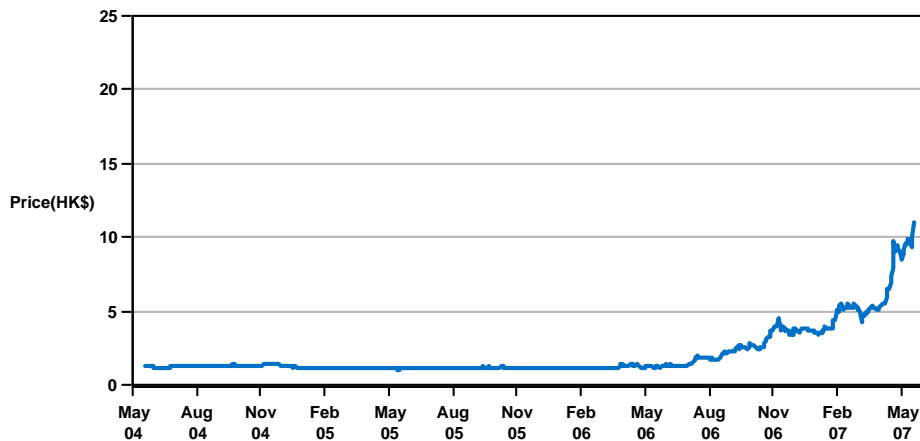
- The Luks family, in aggregate, controls 63% of the company.

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Luks Industrial Group Ltd (0366.HK) Price Chart



Source: Reuters and JPMorgan; price data adjusted for stock splits and dividends.
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Luks Industrial (366 HK, NR): Summary historical financials

Profit and loss statement				Cash flow statement			
(Year-end Dec, HK\$MM)	12/31/2004	12/31/2005	12/31/2006	(Year-end Dec, 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 change 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 Dec, HK\$ MM)	12/31/2004	12/31/2005	12/31/2006	(Year-end Dec, 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	Sales growth (%)	11.1	12.6	19.4
Current assets	219.9	180.6	177.3	Net profit growth (%)	51.8	-26.8	793.9
LT investments	0.2	1.0	0.0	EPS growth (%)	51.8	-38.3	788.8
Net fixed assets	858.1	1057.2	1416.7	Interest Coverage (x)	23.1	19.0	10.5
Total Assets	1349.9	1350.9	1594.0	Net debt to total Capital (%)	Net cash	0.3	0.4
Liabilities				Net debt to equity (%)	Net cash	0.3	0.4
ST bank loans	33.8	58.3	77.4	Sales/Assets (%)	20.6	23.2	23.4
Payables	22.6	24.9	19.9	Assets/Equity (%)	121.8	129.1	130.8
Others	117.9	85.3	112.4	ROE (%)	3.2	2.1	17.7
Total current liabilities	174.3	168.5	209.7	ROCE (%)	3.9	2.4	13.6
Long term debt	23.4	62.8	38.4				
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.