

Update 9 May 2008

Luks Group (Vietnam)

STOCK RECOMMENDATION

OUTPERFORM

SECTOR

General Industrials

12 MONTH RANGE

HK\$16.50 – 5.00

NEXT RESULTS DUE

October 2008 (H1)

LAST RESULTS

15 April 2008 (FY)

ANALYST

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With its Vietnamese operations accounting for 96% of group revenue, Luks is almost a **pure Vietnam play**. After trading in-line with the Vietnamese market (down 45% between end-October 2007 and mid-March 2008) the share price has now decoupled. This is justified, in our view, given the robust supply demand dynamics for Luks' two main earning streams – cement and HCMC office rents – and we believe this decoupling is sustainable.

We reiterate our **Outperform on Luks with a new fair value of HK\$10.00 offering upside of 40%**. In deriving this new fair value, we have focused purely on the value of existing assets and confirmed expansion. Our previous fair value (set 10 September 2007) of HK\$14.52 included HK\$3.59 of 'blue-sky' possible project value.

Luks's adjusted earnings grew by 74% to HK\$139m in 2007, following growth of 79% in 2006. While the FY07 number was roughly HK\$10m lower than our forecast, the difference can be attributed to set-up costs for its HCMC property development ventures (essentially non-recurring) and to lower than expected yields from cement operations as a result of rising input costs (coal and electricity) without an increase in selling price.

Three cement price rises in December 2007, February 2008 and April 2008 totalling US\$6.4/MT (+15%), combined with a shift from outsourcing to in-house limestone mining and in-house cement bag production should drive margin expansion. Our forecast is for **yields to increase from US\$11/MT in 2007 to US\$13/MT in 2008 and US\$14/MT in 2009**. The addition of a further 1.3m MT of capacity in mid-2008 will **increase** average annual **capacity by 36% in 2008E and 37% in 2009E**, with utilisation (92% in 2H07) set to remain high because of domestic supply shortages. Of Luks' 2.8m MT of capacity in place by mid-2008, about 71% will be less than two years old.

PRICE

HK\$7.14

REUTERS CODE

0366.HK

BLOOMBERG CODE

366 HK

MARKET CAPITALISATION

HK\$4.1bn (US\$525m)

ENTERPRISE VALUE

HK\$3.5bn (US\$443m)

CHANGE IN STOCK / SECTOR RECOMMENDATION

No

CHANGE IN EPS ESTIMATES

2008E -16% 2009E -18%

Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	+5	-19	-26
Relative to sector	-	-	-
Relative to Hang Seng Index	0	-25	-39
Average daily volume shares (12 months)			2.6m
Hang Seng Index			25,449

Year end: December	2006A	2007	2008E	2009E
Sales (HK\$m)	373.7	529.3	798.9	1,158.6
EBITDA (HK\$m)	115.7	193.8	304.8	443.6
Earnings – adj (HK\$m)	79.8	139.2	254.5	502.5
EPS (HK\$)	0.159	0.253	0.440	0.868
Growth (%)	+76	+59	+74	+97
DPS (HK\$)	0.080	0.080	0.080	0.100
PER (x)	44.8	28.2	16.2	8.2
Yield (%)	1.1	1.1	1.1	1.4
EV/EBITDA (x)	29.8	17.8	11.3	7.8
NAV (HK\$m)	2.4	3.9	4.5	4.9
ROE (%)	16.4	13.4	9.8	17.8
Net debt: equity (%)	cash	cash	cash	cash
No of shares in issue (m)				573.5
Major shareholder				Luk family (54.7%)

Note: Price as at 8 May 2008. Source: Company, Cazenove

Luks' other earnings stream, property rental income from the Saigon Trade Centre, should also benefit from positive supply/demand dynamics. **Average rental psm** increased by 22% to **US\$29 in FY2007**. With rates of US\$50 psm now being achieved, we forecast an achieved average rental of **US\$40 psm in 2008** and **US\$52 psm in 2009**.

Despite the positive backdrop outlined for Luks' core operations, we have lowered our earnings forecasts for FY2008 and FY2009 by 16% and 18% respectively. This reflects more conservative assumptions on the realisation of its property development profits and a delay in the timing of its cement JVs with CNS to 2010.

Year-to-date the company has **bought back 7.57m shares** at an average price of **HK\$7.37**.

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1.1 Fair value

We continue to prefer a sum of the parts approach to derive a fair value for Luks. Our new fair value is HK\$5.74bn, equivalent to HK\$10.00 per share (40% upside). Of this HK\$8.73 relates to existing assets: principally the Saigon Trade Centre (at 12% yield based on 2008E average rents, or 15% based on prevailing rents), the cement operations (EV/MT of US\$140 based on the average of Asean listed cement companies) and the end–December net cash balance. The remaining HK\$1.27 relates to two confirmed projects where all necessary permits/approvals have been secured. These are the CNS cement JV in Hue and the Binh Chanh residential development in HCMC, where construction is scheduled to commence mid–2008.

Fig 1 Sum of the parts valuation

	Saigon Trade Centre	Vietnam Cement operations	Other assets	Net cash / (debt)	Total US\$m	Total HK\$m	Per share HK\$
GFA (sqm)	40000						
Rent (US\$ psm / month)	40						
Gross capitalisation yield	12%						
Value (US\$m)	159				159	1,243	2.17
Capacity at Dec 07 (MT m)		1.5					
Capacity to be added Mid 08(MT m)		1.3					
Capacity (MT m)		2.8					
EV/MT (US\$)		140					
Simple valuation (US\$m)		392					
Outstanding capex (US\$m)		–28					
Value (US\$m)		364			364	2,843	4.96
HK & China property			36				
Traditional Chinese Medicine			0				
Value (US\$m)			36		36	278	0.49
31.12.07 net cash				82	82	642	1.12
Total value of existing assets					642	5,006	8.73
Binh Chanh residential dev			18		18	142	0.25
Capacity of cement JV with CNS (MT m)		1.85					
EV/MT (US\$)		140					
Capex (US\$/MT)		50					
Ownership stake (%)		45%					
Value (US\$m)		75			75	588	1.02
Total value pre–blue sky	159	440	54	82	735	5,736	10.00

Source: Cazenove

We believe that Luks' multiple years of operating in Vietnam, and the contacts, experience and understanding that arise from this, will result in opportunities over and above those detailed in our sum of the parts valuation. With a net cash position it has sufficient resources to take advantage of such opportunities. In addition, we would expect some value accretion to emerge from its own property development activities (its District 2, District 9 and Singer sites) and its JV operations with CNS (cement grinding and property development in HCMC) all of which have been omitted from our valuation/P&L because of uncertainties on timing.

It is this more conservative approach that largely accounts for the downward revision in fair value from HK\$14.52 set 10 September 2007, which included a blue–sky valuation of HK\$3.59.

1.2 Operational review

Fig 2 Divisional adjusted operating profit

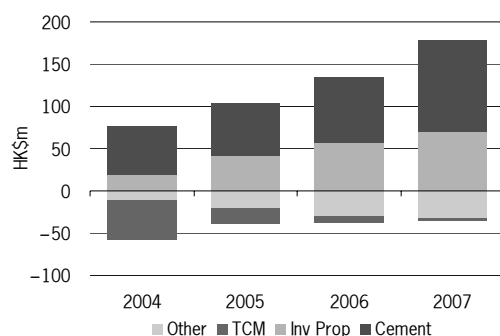
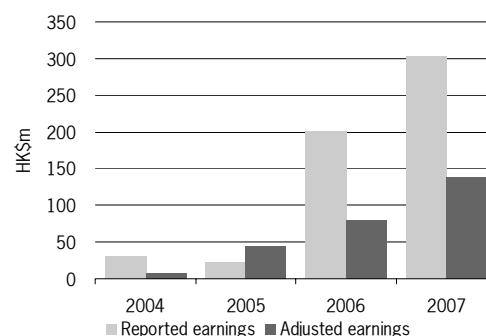


Fig 3 Earnings – reported and adjusted



Source: Cazenove

Cement

In late 2006, Luks' cement production capacity was increased from 0.8m MT to 1.5m MT. This extra capacity, and maintenance work on its old plant, resulted in utilisation dropping to 76% in 1H07. In 2H07 utilisation rebounded to 92%, resulting in full year sales volume of 1.26m MT.

Despite the introduction of new and more modern equipment, and economy of scale benefits, yield (EBIT/MT) was flat at US\$11 in both 1H and 2H 2007. This is the net result of rising operating costs, principally coal and electricity, without a corresponding increase in selling price which averaged US\$41/MT in both 1H and 2H 2007.

Three price increases – US\$1.9/MT in December 2007, US\$1.5/MT in February 2008, and US\$3.0/MT in April 2008 – should result in yield expansion in 2008. Further support should come from shifting the limestone mining to an in-house function in early 2008 (it was earlier outsourced) and the production of its own cement bags in 2H08.

Luks' next stage of capacity expansion, a further 1.3m MT, which will take total capacity to 2.8m MT, is on schedule to come on stream in mid-2008. In percentage terms it will increase average annual capacity by an estimated 36% in 2008 and 37% in 2009.

This extra capacity, and the resulting change in mix towards more efficient modern equipment (71% of capacity will be less than two years old) and the benefit of widening yields (forecast to rise from US\$11/MT in 2007 to US\$13/MT in 2008 and US\$14/MT in 2009) should underpin robust earnings growth.

Our forecast is for the group's own cement assets operating profit (excluding the capacity to be added under the CNS joint venture) to increase by 74% in FY2008E and 51% in FY2009E.

With regard to cement, the only disappointment is the slip in timing of the CNS JVs (clinker production in Hue and the grinding station in HCMC) to 2010. With Luks owning only 45% of this JV, the impact, however, is relatively small.

Investment property

On virtually full occupancy (impressive given the fragmented tenant structure) the average rental income for the Saigon Trade Centre increased from US\$24 psm in 2006 to US\$29 psm in 2007. With rental rates of c.US\$50 psm now being achieved, we estimate that average rental income will increase to US\$40 psm in 2008 and US\$50 psm in 2009.

The net impact of the resulting HK\$25.4m increase in rental income in 2007 was however diluted by a HK\$12.5m increase in costs – odd at face value given that this should be a relatively fixed cost operation. On further investigation we understand that a significant proportion of these costs were one-off in nature – namely: the incorporation of Singer Vietnam and the costs of setting-up the property development operations.

Going forward we have assumed further modest increases in costs in 2008 and 2009 of HK\$1.4m and HK\$2.1m respectively. With revenues forecast to increase by HK\$41m in both FY2008 and FY2009E the net result is forecast expansion in investment property operating profit, pre-revaluation gains, of 57% in FY2008E and 35% in FY2009E.

Property development

The only area of real disappointment has been the speed of progress made on realising management's ambitions of moving into residential property development in HCMC. Original targets were for construction to start on both the Binh Chanh and District 2 sites in late 2007. The timing of the Binh Chanh site has now slipped to mid-2008 and the timing of when District 2 will move into a construction phase remains uncertain. Booking of profits on the Binh Chanh site will now only be in 2009 and 2010. Furthermore, the pace of securing land bank has been slower than anticipated, with the only material progress being the acquisition of a 16 hectare site in District 9 announced in September 2007. With limited infrastructure in the vicinity, this is a long-term project.

On the property JV with CNS, the going has also been slow and no new injections of sites into the JV have been announced. We have omitted any contribution from these in our model.

1.3 Financials/forecasts

Fig 4 Adjusted and reported earnings

Year end: December	2004	2005	2006	2007	2008E	2009E
Growth in adjusted earnings		+563%	+79%	+74%	+83%	+97%
Adjusted earnings	7	44	80	139	254	503
Revaluation gain	-	141	245	207	-	-
Deferred tax relating to abnormal items	-2	-22	-52	-64	-	-
Tax write-back	-	-	-	17	-	-
TCM write-down	0	-172	-78	-	-	-
Other non-trading items	26	31	5	3	-	-
Reported earnings	31	22	200	303	254	503
Growth in reported earnings		-27%	+801%	+51%	-16%	+97%

Source: Cazenove

Reported earnings grew by 51% in FY2007. This, however, includes further revaluation gains on the group's investment properties (principally the Saigon Trade Centre in HCMC) and a write-back of a previous over-provision of tax. On an adjusted basis, excluding the above and other non-trading items, earnings actually grew at a more impressive rate of 74%.

Based on our positive assumptions for the core cement operations and the Saigon Trade Center, and aided by a first time contribution from property development profit in 2009, we are forecasting acceleration in adjusted earnings growth rates to 83% in 2008E and 97% in 2009E.

Fig 5 Assumption summary

Year end: December	2004	2005	2006	2007	2008E	2009E
Period end cement capacity (MT)	800,000	800,000	1,500,000	1,500,000	2,800,000	2,800,000
Average cement capacity (MT)	800,000	800,000	887,500	1,500,000	2,041,667	2,800,000
Utilisation rate (%)	95%	98%	99%	84%	90%	95%
EBIT per MT (US\$)	10	10	11	11	13	14
Saigon Trade Center rent (US\$ psm)	19	22	24	29	40	52
Occupancy (%)	64%	80%	90%	98%	100%	97%
Cement EBIT (HK\$m)	58	61	77	109	189	287
Inv property EBIT (HK\$m)	19	43	57	70	110	148
Other EBIT (HK\$m)	-58	-38	-37	-34	-35	-37
EBIT (HK\$m)	19	65	97	144	264	399

Source: Cazenove

While our new forecasts still translate into very impressive growth rates, the absolute earnings level is 16% and 18% lower than our previous forecasts for FY2008 and FY2009 respectively. This reflects a more conservative stance on the timing and quantum of both the property development profits and the profit stream from Luks' JVs with CNS. We see this as more of a deferment rather than absolute removal dynamic.

Fig 6 Revision to forecasts

	2008E Old	2009E Old	2008E Change	2009E Change	2008E New	2009E New
Cement	196	303	-3%	-5%	189	287
Investment property	109	133	+1%	+12%	110	148
Other	-25	-23	+40%	+59%	-35	-37
EBIT	280	413	-6%	-4%	264	399
Net interest	-20	-15			8	4
CNS JVs	26	122			0	40
PBT pre-property	286	520	-5%	-15%	272	442
Tax	-16	-54			-18	-54
Minority	0	0			0	0
PAT pre-property	271	467	-6%	-17%	254	388
Property development	33	145			0	115
Earnings	303	611	-16%	-18%	254	503

Source: Cazenove

Profit and loss accounts

Year end: December	2005	2006	2007	2008E	2009E
Cement (HK\$M)	231.7	274.6	401.7	630.3	949.3
Investment property (HK\$M)	74.5	91.1	116.5	157.6	198.3
Other (HK\$M)	6.9	8.0	11.0	11.0	11.0
Revenue (HK\$M)	313.1	373.7	529.3	798.9	1158.6
Cement (HK\$M)	60.8	77.0	108.6	189.4	286.7
Property investment (HK\$M)	42.6	57.1	70.0	109.7	148.3
Other (HK\$M)	-38.1	-37.0	-34.2	-35.0	-36.5
EBIT (HK\$M)	65.3	97.1	144.4	264.1	398.5
Net interest (HK\$M)	-5.6	3.4	8.0	3.5	0.0
JCE (HK\$M)	-2.6	-2.1	0.0	39.8	0.0
PBT – adjusted (HK\$M)	58.9	88.9	163.1	272.1	441.8
Tax rate (%)	0.2	0.1	0.1	0.1	0.1
Earnings – adj pre–prop dev	44.5	79.8	139.2	254.5	387.7
Prop dev earnings (HK\$M)	0.0	0.0	0.0	0.0	114.8
Earnings – adjusted total (HK\$M)	44.5	79.8	139.2	254.5	502.5
Earnings – reported total (HK\$M)	22.2	200.3	302.7	254.5	502.5
EPS – adj pre–prop dev (HK\$)	0.091	0.159	0.253	0.440	0.670
EPS – adj post–prop dev (HK\$)	0.091	0.159	0.253	0.440	0.868
DPS (HK\$)	0.080	0.080	0.080	0.080	0.100

Source: Company, Cazenove

Cash flow statements

Year end: December	2005	2006	2007	2008E	2009E
	HK\$M	HK\$M	HK\$M	HK\$M	HK\$M
EBIT	65.3	97.1	144.4	264.1	398.5
D&A	19.9	18.6	49.4	40.7	45.0
EBITDA	85.2	115.7	193.8	304.8	443.6
Working capital	29.4	16.4	-16.6	-5.1	-31.8
Other	6.3	13.2	-8.9	0.0	0.0
Cash flow from operations	120.9	145.3	168.3	299.7	411.8
Interest	-6.0	-10.9	-14.6	-16.0	-11.0
Tax	-2.8	-4.2	-2.9	-17.6	-54.1
Capex (net)	-93.0	-107.4	-254.5	-200.2	-16.0
Business cash flow	19.0	22.8	-103.8	65.8	330.7
Acquisitions/disposals	-52.6	0.0	-1.4	0.0	0.0
Other	8.8	6.9	20.8	-216.2	-355.8
Free cash flow	-24.8	29.7	-84.5	-150.3	-25.1
Dividends	-39.3	-39.4	-42.8	-45.9	-51.6
Issue of shares	0.0	11.2	761.4	0.0	0.0
Other	-26.7	-2.6	-2.9	-0.8	0.0
Net cash in / (out) flow	-90.7	-1.2	631.2	-196.9	-76.7
Closing net cash / (debt)	12.0	10.8	642.0	445.0	368.3

Source: Company, Cazenove

Balance sheets

Year end: December	2005	2006	2007	2008E	2009E
	HK\$M	HK\$M	HK\$M	HK\$M	HK\$M
Property Plant & Equipment	375.4	460.2	688.6	835.8	806.7
Investment property	657.3	899.4	1,116.2	1,116.2	1,116.2
Intangible assets	93.6	15.8	15.8	15.8	15.8
Other non-current assets	44.0	41.3	116.9	405.8	703.9
Inventories	13.5	19.5	13.9	34.5	52.0
Trade receivables	20.1	24.9	30.2	50.3	73.0
Cash & equivalents	133.1	126.6	945.4	595.0	518.3
Trade payables	-24.9	-19.9	-24.2	-54.7	-79.4
Borrowings	-121.1	-115.8	-303.4	-150.0	-150.0
Other net assets / (liabilities)	-129.2	-213.5	-335.3	-247.2	-231.0
Minorities	0.0	-2.1	-4.1	-4.1	-4.1
Shareholders' funds	1,046.1	1,220.8	2,259.8	2,597.4	2,821.5
Net cash / (debt)	12.0	10.8	642.0	445.0	368.3
Capital employed	1,167.2	1,338.7	2,567.4	2,751.5	2,975.6

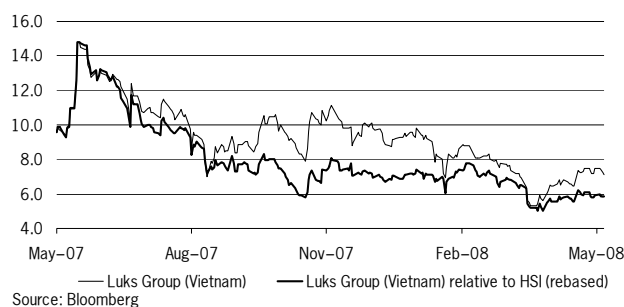
Source: Company, Cazenove

Key ratios

Year end: December	2005	2006	2007	2008E	2009E
Interest cover (x)	10.5	24.7	24.2	16.5	36.2
Dividend cover (x)	1.1	2.0	3.2	5.5	8.7
EBITDA margin (%)	27.2	31.0	36.6	38.2	38.3
EBIT margin (%)	20.9	26.0	27.3	33.1	34.4
Revenue growth (%)	12.6	19.4	41.6	50.9	45.0
EPS growth (%)	469.1	75.7	58.9	73.8	97.5
Op cash/op profit (x)	1.9	1.5	1.2	1.1	1.0
Depn/capex (x)	0.2	0.2	0.2	0.2	2.8
Quick ratio (x)	1.0	0.8	3.8	2.7	2.4
ROE (%)	2.1	16.4	13.4	9.8	17.8
ROCE (%)	5.6	7.3	5.6	9.6	13.4
Net debt/equity (%)	cash	cash	cash	cash	cash
Working cap/sales (%)	-12.5	-14.9	-7.5	-4.3	-0.2
Receivables days	23	24	21	23	23
Inventories turnover (x)	23	19	38	23	22
Asset turnover (x)	0.2	0.2	0.2	0.3	0.3
PER (x)	78.8	44.8	28.2	16.2	8.2
EV/sales (x)	11.0	9.2	6.5	4.3	3.0
EV/EBITDA (x)	40.5	29.8	17.8	11.3	7.8
EV/EBIT (x)	52.9	35.6	23.9	13.1	8.7

Source: Company, Cazenove

Share price performance



APPENDIX

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12 months recommendation changes for Luks Industrial (Group) Ltd;

10-Sep-2007 OUTPERFORM

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