

3V Capital Limited

Flash Note

26 Sep 2008

Luks Group (Vietnam) (0366.HK, HK\$ 3.16, BUY) - Sustained Growth registered

Luks' posted 26% growth in net profit during 1H08 to HK\$80m, thanks to sustained growth of cement segment and rental income. With its 4th cement production line started operation this month, we expect Luks' cement output to rise 40% in FY09. We are still cautious on Luks' property development projects, which are subjected to execution risk. We value Luks totally at HK\$5.89 per share. Trading at 46% discount to NAV, we believe Luks is still a bargain due to its concrete earnings from cement and rental in Vietnam. Maintain BUY.

Upbeat results in 1H08. Luks' posted 26% growth in net profit during 1H08 to HK\$80m, better than our expectation. Cement segment and rental from Saigon Trade Centre continued to drive Luks' growth. An interim dividend of 4 HK cents was announced. The Vietnam Dong crisis in May should be a temporary event and Luks' earning remained intact.

Solid growth in cement segment. Luks' 4th cement production line has started operation this month. We expect total output to meet 1.65mt this year, in-line with the company's target. Domestic supply of cement in Vietnam still falls short of demand by around 4mt/year. Capitalized on the strong demand, Luks plans to add the 5th production line in 2010 with 2mt output. Required capex is estimated to be US\$100m.

Robust demand drives rental up in HCMC. We expect the new supply of office premises will all be digested by robust demand driven by foreign investments. Given the spot rental sets at US\$50/sqm, Luks should see room to raise rental in the near future. We assume average rental at Saigon Trade Centre to reach US\$47/sqm and US\$50/sqm in 2009 and 2010.

Target price: HK\$5.89. We apply more conservative valuation method on Luks' cement segment and the property JVs in Vietnam. An addition 50% discount is applied on all the property development projects to reflect the risk of failure. We value Luks totally at HK\$5.89 per share. Trading at 46% discount to NAV, we believe Luks is still a bargain due to its concrete earnings from cement and rental in Vietnam. Maintain BUY.

Earnings Summary

Y/E: Dec 31	2006	2007	2008F	2009F
Net profit (HK\$)	200(*)	303(*)	176	209
Core EPS (HK\$)	0.35	0.53	0.31	0.37
EPS growth (%)	296.4	51.2	-41.8	18.5
P/E (x)	9.0	5.9	10.2	8.6
DPS (HK\$)	0.08	0.08	0.1	0.1
Dividend yield (%)	2.5	2.5	3.2	3.2

(*) Revaluation gain and impairment of goodwill included

Source: 3V Capital

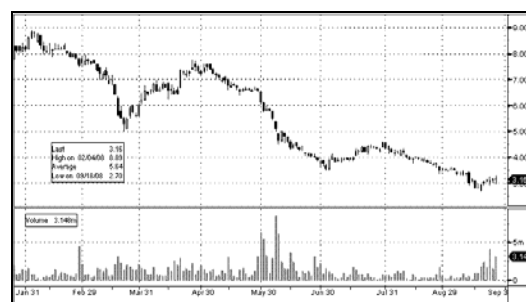
Company Background

Founded in 1975, Luks started its investment in Vietnam early in 1991 by forming a JV with a local SOE for plywood processing in Hi 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. Cemtrn is still the largest earning contributor of Luks, With production capacity currently at 780kt. A new production line, which started operation in Dec 06, sees capacity jump to 1.5mt. Saigon trade Centre has been providing stable rental income and its occupancy rate improved from 54% 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-ld side effects.

Company Data

Share price	HK\$3.16(US\$0.41)
Hang Seng Index	18,934
Shares issued	568m
Market cap	HK\$1.8b (US\$230m)
Avg daily vol (shrs)	847k
52-week Hi	HK\$ 11.50 (US\$1.47)
52-week Lo	HK\$ 2.70 (US\$0.35)
Price/book	0.8x
Net debt/equity	Net cash
Major shareholder	
- KT Holdings	10.94%
- Mr. K.T. Luk	33.07%
- Ms. Cheng Cheung	9.59%

Stock Performance



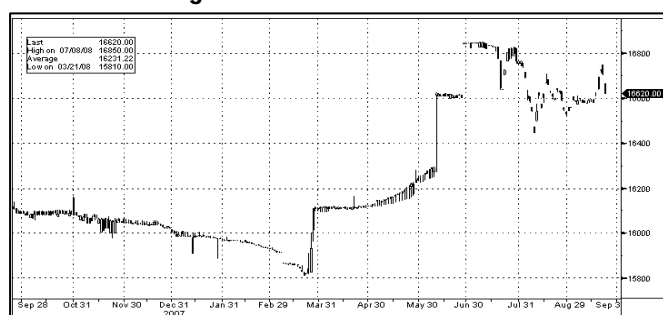
Source: Bloomberg

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Upbeat results in 1H08. Luks' posted 26% growth in net profit during 1H08 to HK\$80m, better than our expectation. Cement segment and rental from Saigon Trade Centre continued to drive Luk's growth. An interim dividend of 4 HK cents was announced. The Vietnam Dong crisis in May should be a temporary event and Luks' earning remained intact.

Dong crisis has been resolved. In May, Dong forward price was once trading at 22,750/USD, 40% lower than the spot price at that time. Despite the large discrepancy between spot and forward price, Dong was only depreciated from 16,100/USD to 16,600/USD. After stabilization measure was announced by the Vietnamese government, Dong has been staying between 16,600/US\$ to 16,800/US\$. The fluctuation in Dong would affect Luks' cement segment more as the payments are made in Dong. Rental from Saigon Trade Centre are received in US\$.

Vietnamese Dong Trend in the Past 12 Months



Source: Bloomberg

Solid growth in cement segment. In 1H08, Luks' cement business recorded a 37% growth in EBIT to HK\$70m. Total output was up by 26% to 719kt when compared with 1H07. Impressively, price hike in cement was able to keep operational margin at 27.6% amid rising production cost. Luks' 4th cement production line has started operation this month. We expect total output to meet 1.65mt this year, in-line with the company's target. Domestic supply of cement in Vietnam still falls short of demand by around 4mt/year. Capitalized on the strong demand, Luks plans to add the 5th production line in 2010 with 2mt output. Required capex is estimated to be US\$100m.

Robust demand drives rental up. Meanwhile, operational profit from investment properties rose 31% in 1H08. Average rental of Saigon Trade Centre, Luk's major asset, surged from US\$29/sqm to US\$44/sqm. Foreign investment has been supporting robust growth in demand for office premises. In 1H08, Vietnam's foreign direct investment rose to an all time high of US\$31bn. According to Colliers, the average rental of Grade A office has reached US\$60-70/sqm in 2Q08. Although new office supply is expected to rise from 40,000sqm in 2008 to 120,000sqm in 2009, it is expected the new supply will all be digested. Given the spot rental sets at US\$50/sqm, Luks should see room to raise rental in the near future. We assume average

rental at Saigon Trade Centre to reach US\$47/sqm and US\$50/sqm in 2009 and 2010.

Property development: uncertainties remain. Although Luks announced its plan to diversify into property development in Vietnam since fall 2006, we are yet to see any positive progress. The company terminated 2 JV agreements, while the construction of An Lac Ward project in Binh Chanh District was delayed to 1Q09 due to slow progress on obtaining required licenses.

Recently, Luks announced another JV project in Binh Chanh District. Currently, the Vietnamese partner has finished 50% of clearance of the site while the remaining is expected to be finished within next 6 months. We remain cautious on this segment.

Luks' projects in Bin Chanh District

Location	GFA	ASP (US/sqm)	Total cost (US/sqm)
An Lac Ward	110,000	1,000	450
Binh Hung Ward	192,136	1,000	500

Source: The Company, 3V Capital

Next station: Mongolia? Luks revealed the plan to invest in cement plants in Mongolia earlier this year. However, without favorable supportive policy from the government, the company decided to drop the plan finally. Nevertheless, Luks placed a small bet on a luxurious property project in Ulaanbaatar. The project, which Luks paid US\$3m for a 60% stake, is to build a total of 600 villas and town houses with GFA reaches 232,000sqm. Management expects presales to be started by the end of this year.

Target resets at HK\$5.89. We made changes in our NAV estimation: 1) Applying 9x 09 PER to value Luks' cement segment as most of the cement plays listed in HK are trading at this multiple in average; 2) Adjusting up the discount rate for the property JVs in Vietnam from 10% to 15% to reflect the execution risk.

The cap rate at 6% to value Saigon Trade Centre is left unchanged as robust demand should support the valuation of office premises in Ho Chi Minh City. To be conservative, Mongolia property project is not factored in the current NAV. We believe the best timing to factor in this project is after Luks receives the presales amount from the first phase of the project. Also, a 50% discount is applied on all the property development projects to reflect the risk of failure. After all, we value Luks at HK\$5.89 per share in total.

Trading at 46% discount to NAV, we believe Luks is still a bargain due to its concrete earnings from cement business and rental income in Vietnam. Since 2008, the company has repurchased more than 25m shares from the market, which showed management's confidence on the prospect of the company. Maintain BUY.

Fair Value Estimates

Asset	Valuation benchmark	Value HK\$m
Cement	9x 09 PER	1,090
Property investment (Vietnam)	6% cap rate	1,313
Property investment (Others)	Book value	260
Property development (Vietnam)	DCF @15% discount, 50% discount on NAV	438
Net cash		245
Total		3,346
No. of shares (m)		568
Estimated fair value share (HK\$)		5.89

Source: 3V Capital

Earnings Projection

Y/E: Dec (HK\$m)	2006	2007	2008F	2009F
Turnover				
Cement	275	403	579	807
Property investment	91	326	101	113
Chinese Medicine	4	5	5	5
Others	4	7	2	2
Total	374	740	687	927
EBIT				
Cement	78	110	151	210
Property investment	302	279	101	113
Chinese Medicine	(8)	(3)	(3)	(3)
Others	(25)	(31)	(25)	(25)
Total	347	355	224	294
Impairment of goodwill	(78)	0	0	0
Share results from j.c.e.	(3)	(2)	0	0
Net finance cost	(6)	4	(20)	(20)
PBT	261	356	204	274
Tax	(63)	(56)	(31)	(69)
MI	2.1	3	3	3
Net profit	200	303	176	209

Source: The Company, 3V Capital

Risk factors

Cement market is still under protection of the Vietnamese government. Luk's earnings of cement segment will be adversely affected if Vietnamese government lessens the control of the cement industry. Meanwhile, the fluctuation of Vietnam Dong may also affect Luks' earnings.

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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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