Corporate Flash

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Shenzhen International: The stars are aligned

Recommendation: HOLD (downgrade from BUY) — **China Logistics**

Price	**HK$0.61**
Target price	HK$0.66 (7%)
12 mth range	HK$0.28-0.62
Market cap.	US$945.3m
Daily t/o, 3 mth	US$9.5m
Free float %	46.1%
Ticker	0152.HK/152 HK

Year to Mar	Net profit HK$m	EPS HK$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gear. %
04A	315.4	0.028	(8.2)	22.0	2.62	23.9	0.9	12.7	10.8	7.5
05A	360.3	0.032	13.8	19.3	2.23	18.3	0.9	12.5	10.6	22.2
06F	341.8	0.030	(4.6)	20.3	2.05	17.0	1.0	10.6	9.3	26.0
07F	393.6	0.035	15.2	17.6	1.88	12.4	1.1	11.0	9.5	34.6
08F	503.5	0.044	27.9	13.8	1.70	9.6	1.4	12.6	11.0	25.6

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +114.0%, +8.6%, +22.3%
Actual price changes (1 mth, 3 mth, 12 mth): +7.0%, +10.9%, +31.2%
Previous forecasts (06F-08F): HK$312.7m ($0.028), HK$383.8m ($0.034), HK$483.5m ($0.043)

Key points:

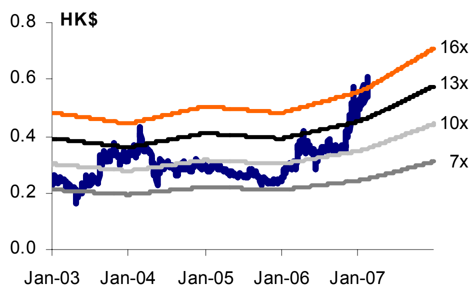
- Though slightly slower than expected, restructuring with Shenzhen SASAC progressing in right direction.
- In addition to South-China Logistics, Shenzhen Expressway (548 HK, HK$5.74, NR), recently opened Longda Expressway may potentially be a future acquisition target.
- Increased stake in Shenzhen Western Logistics to 60% from 20%. We expect demand for warehousing facilities to surge with the opening of SWC and first berth at Dachan Bay, western PRD's only deepwater bay.
- HKSAR Government policies favour SI. "Green Lane" was the first logistics-related item addressed in the Chief Executive's Action Agenda for China's 11th Five Year Plan.
- SI is in a rare position to benefit from industry growth, favourable HKSAR regulatory environment and Red Chip/SOE restructuring.
- Upgrade target price to HK$0.66 (from HK$0.45), downgrading our rating to HOLD. Though current stock price largely reflects the company's fair value estimate, we believe the counter will continue to benefit over the short to medium term from corporate restructuring and industry related news flow.

We conducted a company visit to get an operations update on Shenzhen International (SI). Key takeaways are as follows:

Restructuring slightly slower than expected, but definitely on track. Since our last report "Slight CSG dilution no impact on fundamentals" (27 Sep 2007), SI has completed the following restructuring moves:

- Increased its stake in Shenzhen Western Logistics to 60% from 20% for a consideration of RMB230.0m (1.4x P/B);
- Increased its stake in Shenzhen Expressway (548 HK, HK$5.74, NR) to 31.15% from 30.42% on the open market; and
- Transferred 5% equity interest in Meiguan Expressway from SI listco level to 31.15% owned associate Shenzhen Expressway (SE).

Chart 1: P/E bands



Source: SBI E2-Capital

Though slightly slower than anticipated, we note that the restructuring is on the right track. We prefer the company to be more diligent in acquisition negotiations rather than to pay an abnormally high price to rush through the process. Moreover, we regard it as only a timing issue since SI is the defacto logistics listing vehicle for Shenzhen State-Owned Assets Supervision and Administration Commission (SASAC).

Strong HKSAR Government support for cross-boundary truck initiatives. In the Chief Executive's *Action*

Agenda on "China's 11th Five Year Plan and the development of Hong Kong", the review of existing cross-boundary arrangement Green Lane agenda was the first item mentioned by the *Focus Group on Maritime, Logistics and Infrastructure*. This highlights the importance of the issue and is perhaps the strongest signal yet from the HKSAR Government of its aim to integrate and enhance the efficiency of cross-border road freight. The Green Lane is a key project under this initiative and we expect it to eventually be pushed through. The "China" portion (South China Int'l Logistics Centre (SILC) to Huanggang) of the Green Lane was approved at the end of last year and we expect this leg to be officially launched in at the end of 1Q FY07. For the remaining Hong Kong portion, discussions have been ongoing since Dec 2006 and we anticipate approval and full roll-out at the end 2Q FY07 / early 3Q FY07. Again, we re-iterate that even a partial opening of the Green Lane can bring substantial benefits to Hong Kong as 70% of the queuing and customs processing time occurs at the Huanggang side of the Huanggang/Lok Ma Chau checkpoint.

Little known OBTIS government initiative may complement Green Lane. A potentially complementary project to the Green Lane is the On-Board Trucking Information System (OBTIS), incepted by the Hong Kong Productivity Council (HKPC). The initiative is a pilot project involving the installation of an intelligent/electronic on-board logistics unit, together with back-end network support and service centre for 500 cross-border trucks in Hong Kong. The OBTIS system can potentially utilize a borderless service such as that offered by Green Lane, as its charter is to improve the downstream operation efficiency of road freight delivery from Hong Kong to the Guangdong region. Tender for the OBTIS project closed recently and the service is scheduled to launch in early 2008.

Good move to secure majority stake in Shenzhen Western Logistics. We think there is significant development potential for Shenzhen Western Logistics and that it was prudent for SI to secure a majority stake at this time. The complex has a total site area of 400,000m^2 and warehouse logistics area of 372,000m^2 and stands to benefit from the land link Shenzhen Western Corridor (SWC) and Dachan Bay, the largest of the three port terminals on the west side of PRD. In addition, it is the only deepwater port in the western PRD, which brings strategic advantages to Shenzhen Western Logistics. In 2005, the throughput capacity of the Shenzhen Western port area was 8.53M TEUs, exceeding that of Yantian Terminal (7.67M TEUs). However, available bonded and regulated warehouse area is only 71,400m^2 compared with some 600,000m^2 at Yantian, suggesting a high level of demand for services that will be offered by Shenzhen Western Logistics.

SWC and Dachan Bay openings paving way for acceleration of construction schedule. SWC is presently scheduled to open on 1 July 2007 and the first berth terminal at Dachan Bay aims to commence operation at the end of 2007. The availability of a deep port berth and improved road infrastructure is expected to increase throughput growth of the entire Shenzhen Western port area beyond its present levels, leading to a surge in demand for bonded warehouse facilities in the area. We believe that SI will be eager to take Shenzhen Western Logistics' existing competitive strengths and first mover advantage and accelerate the construction schedule of Shenzhen Western Logistics. The current schedule is for Phase I (37,000m^2 warehouse area) to be completed by 3Q FY07. Our model projects Shenzhen Western Logistics to start contributing meaningful revenue in mid FY08.

Potentially more injections by Shenzhen SASAC in the form of Longda Expressway. After a series of corporate reorganizations by the Shenzhen Government in Jul 2006, Shenzhen SASAC is now overlooking 388 state-owned business units with a total asset value of RMB8,000m. Its logistics related business units includes stakes in Shenzhen Western Logistics (40.0%), South-China Logistics (33.3%) and Shenzhen Expressway (18.9%), all of which are current subsidiaries or associates of SI. In addition, we note that Shenzhen SASAC also owns a 90% stake in Longda Expressway. The expressway runs parallel to a portion of Guangshen Expressway and commenced operation recently. We believe that this asset would be another potential acquisition target for SI over the long term. However, the near term focus of the company will still be to complete previous acquisition plans with respect to South-China Logistics and Shenzhen Expressway.

Table 1: Logistics related business units held by Shenzhen SASAC

Logistics unit	% held by Shenzhen SASAC
Shenzhen Western Logistics	40.0*
South-China Logistics	33.3
Shenzhen Expressway	18.9
Longda Expressway	90.0

Source: Company data

** Company acquired 40.0% of Shenzhen Western Logistics from Shenzhen SASAC in Dec 2006.*

Opportune time to dispose of CSG stake? SI presently holds 22.9% in China Southern Glass (CSG) (000012 CH) comprising of 219m non-tradable A-shares and 11m B-shares. From May 2007, the lock-up period for the

A-shares will begin to progressively expire. We believe that SI will look to dispose of this non-core asset prior to the expiration period to maximize potential gains. We note that the book value of CSG on SI's books is at an average of HK$2.80/share, a steep discount to the current RMB14.73 A-share trading price. As detailed in our previous report "Slight CSG dilution no impact on fundamentals" (27 Sep 2006), CSG had previously announced a proposed new A-shares issuance (Proposed Issuance) to raise funds for expansion as well as a Bonus Issue in Sep 2006. As of today, both the Proposed Issuance and Bonus Issue is still subject to the approval of the shareholders. The company stands to reap a deemed disposal gain of HK$174.0m (Proposed Issue completed but Bonus Issue not completed) or HK$208.0m (both Proposed Issue and Bonus Issue completed).

Table 2: Lock up expiration timetable for SI's stake in CSG

Timing for lock up expiration	Cumulative shares (A-shares)
May 2007	101m
May 2008	203m
May 2009	219m

Source: Company data

Upgrading FY06F and FY07F net profit estimates. We have revised up our FY06F net profit to HK$341.8m (from HK$312.7m) to incorporate: 1) SILC metrics tracking ahead of our estimates and 2) deemed disposal gain from the 5% disposal of Meiguan Expressway. Similarly, we have also upgraded our FY07F estimates to HK$393.6m (previously HK$383.8m), boosted by faster ramp up in SILC together with an increased stake in associate Shenzhen Expressway. We are projecting SILC net profit contributions of HK$9.7m in FY12/06F and HK$27.7m FY12/07F. Our estimates presently do not factor in the expected stake increase to 50%+ in Shenzhen Expressway or the anticipated disposal of CSG.

All macro drivers pointing in the right direction. SI is in a rare position to benefit from industry growth, favourable HKSAR regulatory environment and Red Chip/SOE restructuring. These specifically include: 1) anticipated throughput growth in the Shenzhen Western port area; 2) HKSAR Government's aim to further integrate cross-border road freight with the Mainland to enhance efficiency and 3) continuing logistics related asset injections from Shenzhen SASAC. With all macro drivers aligned in the right direction, we expect a series of growth opportunities to emerge for SI over the short and long term.

Target price upgraded to HK$0.66, downgrade to HOLD. We have upgraded our target price to HK$0.66 (from HK$0.45) and downgraded our rating to HOLD. Our appraised NAV assumes mark-to-market with a 10% holding discount on both Shenzhen Expressway and CSG and 1.0x book value for Shenzhen Western Logistics. At present, we do not expect any further M&A announcements until after the company's FY06 results announcements in late Mar / early Apr 2007. Though the current stock price largely reflects the company's fair value estimate, we believe that the counter will continue to benefit over the short to medium term from further corporate restructuring and news flow from announcements of logistics related initiatives by the HKSAR Government.

Table 3: Sum-of-the-parts valuation

	% Holdings	Valuation method	(HK$m)	HK$/share
South China Logistics	*66.67*	15x adj. FY12/08F P/E	601.3	0.043
Western Logistics	*60.00*	1.0x book value	251.2	0.018
Total Logistics	*100.00*	12x adj. FY12/07F P/E	372.8	0.027
Wuhuang Expressway	*45.00*	13x adj. FY12/07F P/E	883.2	0.063
Shenzhen Expressway (548 HK)	*31.15*	Mkt value (10% discount)	4,629.8	0.330
CSG (200012 CH)	*22.90*	Mkt value (10% discount)	2,570.8	0.183
Add: Net cash			441.4	0.031
Appraised NAV			**9,750.4**	**0.696**

Source: SBI E2-Capital

Table 4: P&L

Year to Dec (HK$m)	2004	2005	2006F	2007F	2008F
Turnover					
Logistics related business	235.2	317.0	397.0	524.4	631.4
Property investments	18.9	-	-	-	-
	254.1	**317.0**	**397.0**	**524.4**	**631.4**
Cost of sales	(177.4)	(224.8)	(277.5)	(339.8)	(387.2)
Gross profit	76.7	92.1	119.5	184.6	244.2
Other revenues and gains	153.2	143.5	91.5	59.2	62.1
Selling and distribution costs	(14.8)	(14.4)	(11.9)	(15.7)	(22.1)
Administrative expenses	(65.3)	(77.2)	(43.7)	(53.7)	(67.9)
Other operating expenses	(27.2)	(8.2)	(0.5)	(0.3)	(1.0)
Operating profit	122.5	135.8	155.0	174.0	215.3
Finance costs	(2.5)	(25.8)	(59.2)	(67.9)	(60.2)
Share of profits and losses of jointly controlled entities	-	-	-	-	-
Share of profits of an associated	202.2	254.2	273.2	331.7	404.1
Profit before taxation	**322.2**	**364.2**	**368.9**	**437.8**	**559.2**
Taxation	(7.7)	(4.2)	(18.4)	(34.5)	(43.5)
Profit after taxation	**314.4**	**360.0**	**350.5**	**403.4**	**515.6**
Minority interests	0.9	0.3	(8.7)	(9.8)	(7.8)
Profit attributable to shareholders	**315.4**	**360.3**	**341.8**	**393.6**	**503.5**
% chg	*(6.9)*	*14.2*	*(5.1)*	*15.2*	*27.9*

Source: SBI E2-Capital

P & L (HK$m)	04A	05A	06F	07F	08F
Year to Dec					
Turnover	**254.1**	**317.0**	**397.0**	**524.4**	**631.4**
% chg	*66.0*	*24.7*	*25.2*	*32.1*	*20.4*
Gross profit	76.7	92.1	119.5	184.6	244.2
EBITDA	297.9	415.6	459.3	660.1	827.1
Depre./amort.	22.2	(30.3)	(39.4)	(164.9)	(216.0)
EBIT	320.2	385.3	419.9	495.3	611.1
Net int. income/(exp.)	2.0	(21.0)	(51.0)	(57.4)	(51.9)
Exceptionals	-	-	-	-	-
Associates	202.2	254.2	273.2	331.7	404.1
Jointly-controlled entit.	-	-	-	-	-
Pre-tax profit	**322.2**	**364.2**	**368.9**	**437.8**	**559.2**
Tax	(7.7)	(4.2)	(18.4)	(34.5)	(43.5)
Minority interests	0.9	0.3	(8.7)	(9.8)	(12.1)
Net profit	**315.4**	**360.3**	**341.8**	**393.6**	**503.5**
% chg	*(6.9)*	*14.2*	*(5.1)*	*15.2*	*27.9*
Dividends	(57.2)	(62.5)	(68.4)	(77.3)	(97.7)
Retained earnings	258.2	297.8	273.4	316.3	405.8
EPS - Basic (HK$)	0.028	0.032	0.030	0.035	0.044
EPS - F.D. (HK$)	0.026	0.030	0.025	0.028	0.035
DPS (HK cents)	0.550	0.550	0.602	0.681	0.861
No. sh.s o/s (m) - W.A.	11,376.4	11,415.8	11,355.1	11,355.1	11,355.1
No. sh.s o/s (m) - Y.E.	11,376.4	11,355.1	11,355.1	11,355.1	11,355.1
No. sh.s o/s (m) - F.D.	12,280.5	12,319.9	14,018.7	14,018.7	14,018.7
Margins (%)					
Gross	*30.2*	*29.1*	*30.1*	*35.2*	*38.7*
EBITDA	*117.2*	*131.1*	*115.7*	*125.9*	*131.0*
EBIT	*126.0*	*121.5*	*105.8*	*94.4*	*96.8*
Pre-tax	*126.8*	*114.9*	*92.9*	*83.5*	*88.6*

Balance Sheet (HK$m)	04A	05A	06F	07F	08F
Year to Dec					
Fixed assets	250.3	305.6	591.9	1,327.0	1,471.1
Intangible assets	(130.2)	659.7	644.0	524.0	404.0
Other LT assets	2,711.6	3,064.8	3,213.0	3,292.0	3,414.5
Cash	243.0	266.4	617.6	504.3	383.3
Accounts receivable	345.4	118.2	195.8	265.8	328.7
Other receivables	-	-	-	-	-
Inventories	-	-	-	-	-
Due from related co.s	-	-	-	-	-
Other current assets	0.1	53.8	53.8	37.7	26.4
Total assets	**3,420.2**	**4,468.5**	**5,316.1**	**5,950.9**	**6,027.8**
Accounts payable	(90.2)	(142.2)	(144.4)	(172.2)	(191.0)
Other payable	-	-	-	-	-
Tax payable	(16.4)	(19.1)	(20.9)	(24.4)	(28.7)
Proposed dividend	-	-	-	-	-
Due to related co.s	-	-	-	-	-
ST debts	(52.2)	(263.0)	(312.0)	(296.4)	(281.6)
Other current liab.	-	-	-	-	-
LT debts	(379.7)	(658.3)	(1,165.3)	(1,459.9)	(1,119.9)
Other LT liabilities	(166.0)	(214.1)	(219.5)	(224.9)	(230.6)
Total liabilities	**(704.4)**	**(1,296.6)**	**(1,862.1)**	**(2,177.9)**	**(1,851.8)**
Share capital	1,719.0	1,700.4	1,700.4	1,700.4	1,700.4
Reserves	925.6	1,399.1	1,672.6	1,981.8	2,372.8
Shareholders' funds	**2,644.6**	**3,099.6**	**3,373.0**	**3,682.2**	**4,073.2**
Minority interest	71.2	72.3	81.0	90.8	102.9
Total	**2,715.8**	**3,171.8**	**3,454.0**	**3,773.0**	**4,176.1**
Capital employed	3,147.7	4,093.1	4,931.3	5,529.3	5,577.6
Net (debt)/cash	(188.9)	(654.8)	(859.7)	(1,252.0)	(1,018.2)

Cash Flow (HK$m)	04A	05A	06F	07F	08F
Year to Dec					
EBIT	320.2	385.3	419.9	495.3	611.1
Depre./amort.	(22.2)	30.3	39.4	164.9	216.0
Net int. paid	2.0	(21.0)	(51.0)	(57.4)	(51.9)
Tax paid	(0.7)	(4.4)	(12.9)	(24.1)	(30.5)
Div. from associates	146.1	105.0	109.3	132.7	161.6
Gross cashflow	**445.4**	**495.2**	**504.7**	**711.3**	**906.3**
Chgs. in working cap.	(242.3)	279.3	(75.4)	(42.2)	(44.2)
Operating cashflow	**203.0**	**774.5**	**429.3**	**669.0**	**862.2**
Capex	(149.7)	(67.0)	(120.0)	(180.0)	(220.0)
Free cashflow	**53.3**	**707.5**	**309.3**	**489.0**	**642.2**
Dividends paid	(45.7)	(57.2)	(62.5)	(68.4)	(77.3)
Net distribution to MI	(0.5)	0.9	0.3	(8.7)	(9.8)
Investments	(36.9)	(595.9)	(400.0)	(2,900.0)	(40.0)
Disposals	40.9	1.8	3.0	2,130.0	3.0
New shares	-	-	-	-	1.0
Others	149.2	(523.1)	(55.0)	(34.2)	(285.3)
Net cashflow	**160.4**	**(465.9)**	**(204.9)**	**(392.2)**	**233.7**
Net (debt)/cash - Beg.	(349.3)	(188.9)	(654.8)	(859.7)	(1,252.0)
Net (debt)/cash - End.	(188.9)	(654.8)	(859.7)	(1,252.0)	(1,018.2)

Interim Results (HK$m)	04A	05A
Six months to June		
Turnover	**125.8**	**135.4**
% chg	*88.1*	*7.7*
Profit from operations	40.9	44.3
Interest expenses	(1.7)	(7.0)
Exceptionals		
Associates	103.3	96.4
Jointly-controlled entit.	-	-
Pre-tax profit	**142.5**	**133.7**
Tax	(1.0)	(1.0)
Minority interests	(0.2)	0.3
Net profit	**141.4**	**133.0**
% chg	*(53.3)*	*(6.0)*
Dividends	-	-
EPS (HK$) - W.A.	0.013	0.012
EPS (HK$) - F.D.	0.013	0.012
DPS (HK$)	-	-

Shareholding Structure	Shares o/s (m)	%
Shenzhen Investment	4,836.4	41.9
Cheung Kong	803.5	7.0
Deutsche Bank	579.7	5.0
Public	5,314.1	46.1
Total	**11,533.6**	**100.0**

Background

Shenzhen International Holdings is principally engaged in the provision of total logistics and transportation ancillary services. The company has a foothold in the four major subsector of the logistics industry, namely infrastructure, transportation systems, logistics and ancillary services.

Key Ratios (%)	04A	05A	06F	07F	08F
Net gearing	7.5	22.2	26.0	34.6	25.6
Net ROE	12.7	12.5	10.6	11.0	12.6
EBIT ROCE	10.8	10.6	9.3	9.5	11.0
Dividend payout	18.1	17.3	20.0	19.6	19.4
Effective tax rate	2.4	1.2	5.0	7.9	7.8
Net interest cover. (x)	na	18.3	8.2	8.6	11.8
A/R days	268.6	267.0	180.0	185.0	190.0
A/P days	108.8	188.6	190.0	185.0	180.0
Inventory days	-	-	-	-	-

SBI E2-Capital stock ratings:

STRONG BUY : absolute upside of >50% over the next three months
BUY : absolute upside of >10% over the next six months
HOLD : absolute return of -10% to +10% over the next six months
SELL : absolute downside of >10% over the next six months