

## Shenzhen International: Taking the right steps

### Recommendation: BUY (unchanged)

### China Logistics

Price	HK\$0.35	Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.
Target price	HK\$0.45 (+29%)	Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	%
12 mth range	HK\$0.23-0.43	04A	315.4	0.028	(8.2)	12.8	1.53	32.2	1.5	12.7	4.0	7.5
Market cap.	US\$517.5m	05A	360.3	0.032	13.8	11.2	1.30	32.3	1.5	12.5	3.6	22.2
Daily t/o, 3 mth	US\$1.9m	06F	312.7	0.028	(12.7)	12.7	1.19	11.0	1.6	9.7	8.6	21.7
Free float %	46.1%	07F	383.8	0.034	22.7	10.4	1.09	9.0	1.9	11.0	9.5	20.3
Ticker	0152.HK/ 152 HK	08F	483.5	0.043	26.0	8.2	0.98	7.3	2.4	12.6	11.0	18.4

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): -1.6%, -4.4%, +19.3%

Actual price changes (1 mth, 3 mth, 12 mth): +1.4%, +6.0%, -2.7%

Consensus EPS (06F-07F): n/a

### Key points:

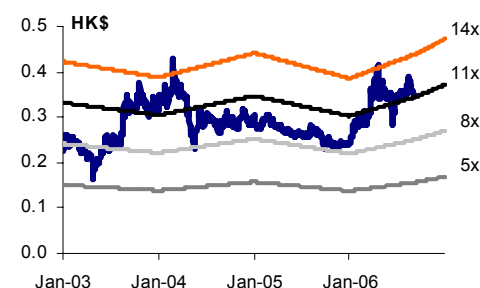
- Net profit was up 11.4% YoY HK\$187.1m on a proforma basis.
- Key drivers were the company's toll assets. Shenzhen Expressway's (548 HK, HK\$4.29, NR) and Wuhuang Expressway's profit contribution rose 20% and 33% respectively.
- SILC recorded a maiden operating profit of HK\$3.0m as bonded warehouse and cargo transfer services commenced. "Green Lane" remains on track for implementation in 1Q 2007.
- Company is moving in the right direction to become a multidisciplinary logistics conglomerate. We maintain our BUY call and target price of HK\$0.45, using our sum-of-the-parts valuation, representing 16.1x FY12/07F P/E.

**Interim profit up 11.4% YoY.** Shenzhen International (SI) recorded a 38.1% YoY increase in turnover to HK\$187.1m, while net profit dropped 3.6% YoY to HK\$128.2m. On a proforma basis, excluding a HK\$17.9m writeback of receivables provision in 1H FY12/05, net profit rose 11.4% YoY despite surging finance costs of HK\$30.4m (c. HK\$7.0m) due to the issue of convertible bonds and increased bank loans from the Wuhuang Expressway acquisition in Aug 2005. Bottom line gains was mainly driven by the company's toll road assets, Wuhuang Expressway and Shenzhen Expressway (548 HK, HK\$4.29, NR). Top line was slightly below expectations due to weakness in wholly-owned subsidiary Total Logistics.

**Toll assets the star performer.** As expected, SI's toll road assets provided the main impetus for growth in 1H FY12/06. Shenzhen Expressway's (SE) profit before tax was up 20.3% YoY to HK\$308.4m on strong toll revenue and traffic volume growth from existing assets such as Meiguan Expressway and Jihe (East and West) Expressway and Shuiguang Expressway, as well as full six months contribution from 55%-owned Wuhuang Expressway. Including its interest in SE, SI has a 61.7% effective stake in Wuhuang Expressway. The Hubei based toll road's revenue and net profit came in at HK\$145.0m and HK\$74.4m, up 18% and 33% YoY respectively. The growth was the result of a moderate increase in average daily traffic volume and a switch to "toll by weight" charging from the previous "toll by vehicle type" since Apr 2006. The new charging scheme essentially reduces toll avoidance by goods vehicles.

**SILC turns in maiden profit.** South China International Logistics Centre (SILC) is making the right strides to become a prominent logistics park in Shenzhen. Revenues from the facility was up 133.3% YoY to HK\$20.2m as new cargo transfer and bonded warehouse operations commenced. The facility increased its warehousing area from 20,000m<sup>2</sup> to 45,000m<sup>2</sup> in 1H FY12/06. Management indicated that the bonded warehouse has been 100% utilized since May 2006 and we expect warehousing area to reach 60,000m<sup>2</sup> by early 2007. SILC turned in a maiden operating profit of HK\$3.0m for 1H FY12/06 and we are expecting this to further expand to HK\$5.0m in 2H FY12/06F. Roll out of "green lane", the integrated land-based feeder platform between

Chart 1: P/E bands



Source: SBI E2-Capital

HKSAR and Shenzhen, is largely on-track. Management indicated that the remaining HKSAR trial is presently in progress and the company is scheduled to undertake large scale promotion campaigns in HKSAR in Oct 2006. We are still expecting the platform to be launched some time in 1Q 2007. SE is interested in SILC through a 66.67% stake in Shenzhen-South China Logistics.

**Softness in ancillary logistics business** Wholly-owned multidisciplinary logistics subsidiary Total Logistics was some softness in its operations during 1H FY12/06, primarily in aviation related operations. Though profit contribution of HK\$5.0m from Shenzhen Airport International Express Supervision Centre was up 3.7% YoY, central government's focus on developing Guangzhou Baiyun International Airport offset the healthy macro environment of the China air cargo industry. Muted by new operating hour restrictions and other new procedural regulations, express cargo volume at the facility declined 14% YoY in 2Q 2006. Meanwhile, rising oil prices affected the profitability of 10%-owned Shenzhen Airlines and it did not declare any dividends (c. HK\$26.6m) for its financial year ended 30 June 2006. The dividend was previously booked in SI's top line and its absence was the key reason for the decline in gross and operating margins. Going forward, we will continue to expect some softness in this subsidiary.

**Non-core glass manufacturing business was solid.** 22.86%-owned China Southern Glass (CSG) (200012 CH) exceeded expectations amid a tough operating environment. Turnover increased 29.0% YoY to HK\$1,226m while net profit was flat YoY at HK\$146m. CSG mitigated declining prices in the float glass industry by growing its presence in more stable downstream products such as construction glass and automotive glass.

**Maintain BUY call and target price of HK\$0.45.** We have revised down our net forecast by 1.7%, 7.1% and 1.8% to HK\$312.7m (fully diluted EPS: HK\$0.023) for FY12/06F, HK\$383.8m (fully diluted EPS: HK\$0.028) for FY12/07F and HK\$483.5m (fully diluted EPS: HK\$0.035) for FY12/08F respectively to account for the better than expected results of toll assets, and the softness in Total Logistics. Note that given the difficult operating environment in the aviation industry, we have stripped out the dividends from Shenzhen Airlines from our estimates. With the continuing ramp up of SILC and implementation of green lane in 2007, we expect South China Logistics to join SE and Wuhuang Expressway to form a trio of growth drivers for SI in FY12/07. We maintain our target price of HK\$0.45, derived using sum-of-the-parts method, representing 16.1x FY12/07F P/E. Management re-iterated that the company's assets restructuring plans are on track and we continue to see further re-rating potential on these announcements.

**Table 1: Interim results**

6 months to June	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	Operating profit (HK\$m)	Operating margin (%)	Net profit (HK\$m)	Basic EPS (HK\$)
1H 06	187.1	54.4	29.1	46.1	24.6	128.2	1.12
1H 05	135.4	48.5	20.1*	44.3	17.7*	133.0	1.16
YoY (%)	38.1	12.1		4.1		(3.6)	(3.4)

\* Effective gross and operating margins, excluding HK\$26.6m dividend from Shenzhen Airlines.

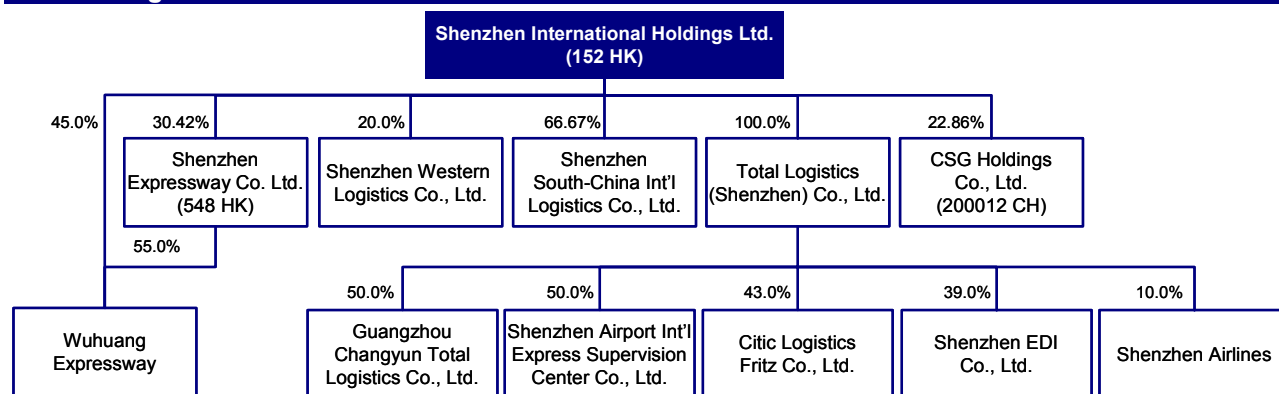
Source: Company data and SBI E2-Capital

**Table 2: Sum-of-the-parts valuation**

	% Holdings	Valuation method	(HK\$m)	HK\$/share
South China Logistics	66.67	14x adj. FY12/07F P/E	209.7	0.015
Western Logistics	20.00	14x adj. FY12/07F P/E	30.6	0.002
Total Logistics	100.00	12x adj. FY12/07F P/E	372.8	0.027
Wuhuang Expressway	45.00	11x adj. FY12/07F P/E	366.9	0.024
Shenzhen Expressway (548 HK)	30.42	12x adj. FY12/07F P/E	3,588.3	0.256
CSG (200012 CH)	22.86	Mkt value	1,306.7	0.093
Add: Net cash			441.1	0.031
<b>Appraised NAV</b>			<b>6,285.8</b>	<b>0.448</b>

Source: SBI E2-Capital

Chart 2: Organization structure



Source: Company data

Table 3: P&amp;L

Year to Dec (HK\$m)	2004	2005	2006F	2007F	2008F
<b>Turnover</b>					
Logistics related business	235.2	317.0	399.4	528.3	639.2
Property investments	18.9	-	-	-	-
	<b>254.1</b>	<b>317.0</b>	<b>399.4</b>	<b>528.3</b>	<b>639.2</b>
Cost of sales	(177.4)	(224.8)	(279.1)	(342.1)	(391.6)
Gross profit	76.7	92.1	120.3	186.2	247.5
Other revenues and gains	153.2	143.5	68.8	66.1	68.8
Selling and distribution costs	(14.8)	(14.4)	(15.2)	(20.1)	(23.6)
Administrative expenses	(65.3)	(77.2)	(51.1)	(68.7)	(86.3)
Other operating expenses	(27.2)	(8.2)	(0.5)	(4.0)	(9.1)
Operating profit	122.5	135.8	122.3	159.6	197.3
Finance costs	(2.5)	(25.8)	(59.0)	(56.0)	(53.2)
Share of profits and losses of jointly controlled entities	-	-	-	-	-
Share of profits of an associated	202.2	254.2	273.1	323.4	393.6
<b>Profit before taxation</b>	<b>322.2</b>	<b>364.2</b>	<b>336.4</b>	<b>427.0</b>	<b>537.7</b>
Taxation	(7.7)	(4.2)	(16.8)	(34.2)	(43.0)
<b>Profit after taxation</b>	<b>314.4</b>	<b>360.0</b>	<b>319.6</b>	<b>392.8</b>	<b>494.6</b>
Minority interests	0.9	0.3	(6.9)	(9.0)	(11.1)
<b>Profit attributable to shareholders</b>	<b>315.4</b>	<b>360.3</b>	<b>312.7</b>	<b>383.8</b>	<b>483.5</b>
% chg	(6.9)	14.2	(12.7)	22.7	26.0

Source: SBI E2-Capital

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