

COSCO International: Still undervalued

Recommendation: BUY (unchanged)

Hong Kong Conglomerate

Price	HK\$4.28	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$5.92 (+38.3%)	Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$1.43-4.38	04A	219.2	0.155	na	27.5	5.4	29.9	0.6	19.6	9.6	32.6
Market cap.	US\$795.9m	05A	496.5	0.350	125.5	12.2	3.8	45.0	1.1	36.6	23.7	Cash
Daily t/o, 3 mth	US\$2.6m	06F	390.1	0.273	(22.0)	15.7	3.1	20.2	1.6	21.7	18.7	Cash
Free float %	42.5%	07F	556.9	0.386	41.5	11.1	2.4	18.2	2.3	24.2	21.4	Cash
Ticker	0517.HK/517 HK	08F	624.8	0.433	12.2	9.9	1.9	16.6	2.5	21.4	19.2	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +43.3%, +35.6%, +123.9%

Actual price changes (1 mth, 3 mth, 12 mth): +43.6%, +44.1%, +183.4%

Consensus EPS (06F-07F): HK\$0.240, HK\$0.360

Previous forecasts (06F-08F): HK\$390.1m (\$0.273), HK\$556.9m (\$0.386), HK\$624.8m (\$0.433)

Key points:

- Target price revised up by 32.4% to HK\$5.92.
- SORED's land bank has increased 91.2% since June 2006.
- SORED's net debt position should be improved
- Valuation of COSCO International remains attractive.

Revise up target price by 32.4%. Despite a 35.4% increase in COSCO International's share price since our last report on 7 February 2006, its valuation is still not far away from trough, in our view. As the current share price is close to our target price, we revisit our assumptions (especially for SORED) and lift our NAV per share and target price estimate to HK\$5.92. The counter is trading at ex-cash P/E of 9.1x for FY12/07F and 8.1x for FY12/08F. With a further potential upside of 38.3%, we reiterate our BUY recommendation on the group.

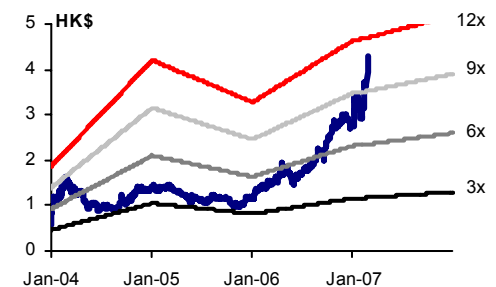
Land bank expansion. In our previous NAV model for COSCO, we used the book value of HK\$1,455.2m for Sino Ocean Real Estate Development (SORED), which was way too prudent and did not reflect the current market value of land in China, in our view. Besides, we estimate that size of SORED's land bank has expanded 91.1% to 6.5m sq.m since June 2006. Thus, we re-visit our pervious valuation on SORED and change some of our pervious assumptions.

Valuation of land in the capital city. We estimate that 85.1% of SORED's land bank is in Beijing. According to "City Land Price Monitor System" (www.landvalue.com.cn), in 2H06 general-use land in the city fetched RMB3,503.0 per sq.m, residential RMB5,823.0 per sq.m and commercial RMB4,016.0 per sq.m Since we do not have the details of SORED's land bank in Beijing, we adopt the general land price in Beijing to value the company's land in the capital.

Valuation of other land. We use the price of residential land (RMB1,408.0 per sq.m) and industrial land (RMB581.0 per sq.m) to value SORED's land bank in Tianjin. We adopt a 30.0% discount to the general land price of RMB2,718.0 per sq.m in Guangzhou and RMB1,326.0 per sq.m in Shenyang to arrive at the valuation of the group's land bank in Zhongshan and Dalian.

Net debt position assumed to be intact. At the end of June 2006, SORED's net debt stood at RMB3,812.9m and we believe it did not increase with its land bank expansion. In the meantime, the company has also generated some sales revenue and brought in three strategic investors, including the private equity investment arm of Standard Chartered (2888 HK, HK\$234.0, NR), which has put in US\$35.0m. According to media reports, the other two are Morgan Stanley and Merrill Lynch. Therefore, we estimate the developer's net debt position at

Chart 1: P/E bands



Source: SBI E2-Capital

RMB3,812.9m.

Risks associated with our appraised NAV on SORED. Based on the new assumptions, we appraise SORED's blended NAV at RMB16.9b. Nevertheless, this is subject to a number of uncertainties because we do not know the details and status of SORED's land bank. We have insufficient information on how much in GFA the developer has sold YTD. The size of its net debt remains unclear. Last but not least, should SORED go public, its share capital will be enlarged and COSCO International's stake diluted. In order to factor in the risks, we discount SORED's blended NAV by 50.0% to RMB8.4b, which is still substantially larger than its book cost previously adopted in our valuation model for COSCO International.

Table 1: Assumption of SORED's appraised net asset value

Estimated land bank size (m sq.m)	6.5
Market value per sq.m in Beijing (RMB)	3,503.0
Market value per sq.m of land in Tianjin-residential (RMB)	1,408.0
Market value per sq.m of land in Tianjin-industrial (RMB)	581.0
Market value per sq.m of land in Dalian (RMB)	928.2
Market value per sq.m of land in Zhingshan (RMB)	1,902.6
Estimated GFA in Beijing (m sq.m)	5.5
Estimated GFA in Tianjin (m sq.m)-residential	0.5
Estimated GFA in Dalian (m sq.m)	0.1
Estimated GFA in Zhongshan, Guangdong province (m sq.m)	0.4
Estimated SORED's land bank value (RMBm)	20,683.1
Estimated SORED's net debt (RMBm)	3,812.9
SORED's NAV (RMBm)	16,870.2

Source: SBI E2-Capital, City Land Price Monitor System

Still under valued. As the valuation of the group's 44.0% interest in SORED was inflated by 484.3% to HK\$3.7b, our appraised NAV on the group increased 32.4% to HK\$5.92 per share. The group's valuation is still attractive, in our view as it is trading at a 27.7% discount to its appraised NAV, against peers' average P/NAV of 1.4x and at a P/E of 11.1x for FY12/07F and 9.9x for FY12/08F, compared with the sector average P/E of 19.4x for FY12/07F and 17.2x for FY12/08F. Stripping off the net cash per share of HK\$0.77, the group's valuation is even more appealing at 9.1x for FY12/07F and 8.1x for FY12/08F. Last but not least, our NAV estimation on SORED is subject to upside risk, as the China property development sector is trading at one-year forward P/NAV of 1.9x, and we just only adopt SORED's appraised NAV into our valuation model.

Table 2: Appraised Net Asset Value on COSCO International

Division	Description	NAV (HK\$m)
Coating manufacturing	Sector average P/E: 17.1x, FY12/07F earnings: HK\$83.2m	1,422.3
Insurance brokerage	Sector average P/E: 17.5x, FY12/07F earnings: HK\$38.1m	666.5
Other marine services	Sector average P/E: 19.1x, FY12/07F earnings: HK\$83.2m	1,590.1
SORED	44.0% stake in SORED, appraised NAV of RMB16.9b	3,741.5
Net cash	Net cash as of the end of June 2006	1,107.3
Appraised NAV		8,527.7
Appraised NAV/share		5.92

Source: SBI E2-Capital, Bloomberg

Risk factors. As COSCO's 44.0% interest in SORED constitutes 43.9% of its NAV, its share price performance is vulnerable to changes in sentiment on the China property sector and news on the Chinese government's austerity measures. Again, our appraised NAV on SORED is subject to a number of uncertainties, including the developer's net debt position and the details of its land bank.

Table 3: Valuation benchmark

	Ticker	Year End	Currency	Market cap (US\$m)	P/E (x) 1-yr forward	P/E (x) 2-yr forward
Coating manufacturer						
RPM International	RPM US	May	USD	2,797	15.4	13.9
Sherwin-Williams Co	SHW US	Dec	USD	8,919	14.6	13.4
Kansai Paint	4613 JP	Jun	JPY	2,355	28.5	na
<i>Average</i>					17.1	11.2
Insurance broker						
THB Group	THB LN	Apr	GBp	59	346.9	346.9
Willis Group Holdings	WSH US	Dec	USD	6,195	14.7	12.8
Jardine Lloyd Thompson	JLT LN	Dec	GBp	1,796	16.2	15.2
<i>Average</i>					17.5	15.8
Marine service providers						
ASL Marine Holdings	ASL SP	Jun	SGD	146	8.2	7.1
Cosco Corp Singapore	COS SP	Dec	SGD	3,750	21.9	16.7
SembCorp Marine	SMM SP	Dec	SGD	3,220	16.5	13.7
Sinwa	SKS SP	Dec	SGD	73	11.9	11.4
<i>Average</i>					19.1	15.1

Source: Bloomberg

Table 4: China property developers' valuation

Company name	Ticker	Year End	Currency	Market cap (US\$m)	P/E (x) 1-yr forward	P/E (x) 2-yr forward	P/NAV (x) 1-yr forward	P/NAV (x) 2-yr forward
Beijing Capital Land	2868 HK	Dec	HKD	815	7.6	7.1	0.8	0.9
Shanghai Forte	2337 HK	Dec	HKD	1,101	9.5	7.4	1.7	1.4
Shenzhen Investment	604 HK	Dec	HKD	1,332	11.9	8.2	1.7	1.4
Guangzhou Investment	123 HK	Dec	HKD	1,637	16.1	11.1	0.8	0.8
New World China Land	917 HK	Jun	HKD	2,200	37.4	29.5	0.7	0.7
Agile Property	3383 HK	Dec	HKD	3,063	12.5	10.3	2.6	2.2
China Resources	1109 HK	Dec	HKD	3,547	25.7	14.6	1.5	2.0
Hopson Development	754 HK	Dec	HKD	3,125	10.2	7.5	2.7	1.9
Shimao Property	813 HK	Dec	HKD	5,154	16.6	12.0	2.2	2.4
Guangzhou R&F Properties	2777 HK	Dec	HKD	5,988	13.4	9.5	2.3	3.4
China Overseas Land	688 HK	Dec	HKD	7,505	16.2	12.9	1.9	2.3
<i>Average</i>					16.6	12.1	1.9	2.2

Source: Bloomberg

Table 5: Red-chip conglomerates' valuation

Company name	Ticker	Year End	Currency	Market cap (US\$m)	P/E (x) 1-yr forward	P/E (x) 2-yr forward	P/NAV (x) 1-yr forward
Citic Pacific	267 HK	Dec	HKD	7,646	15.8	13.9	1.4
China Resources Enterprise	291 HK	Dec	HKD	7,078	25.5	22.9	1.8
Tianjin Development	882 HK	Dec	HKD	812	13.9	12.1	0.8
Beijing Enterprises	392 HK	Dec	HKD	1,530	20.4	17.9	1.1
Shanghai Industrial	363 HK	Dec	HKD	2,325	13.6	12.2	1.0
<i>Average</i>					19.4	17.2	1.4

Source: SBI E2-Capital

P & L (HK\$m)	04A	05A	06F	07F	08F
Year to Dec					
Turnover	1,688.4	1,510.7	1,920.4	1,930.3	2,195.6
% chg	-	(10.5)	27.1	0.5	13.7
Gross profit	417.5	387.0	528.4	572.0	607.1
EBITDA	207.4	137.9	307.9	340.4	372.9
Depre./amort.	(11.0)	(8.5)	(7.8)	(11.3)	(10.3)
EBIT	196.4	129.3	300.2	329.1	362.7
Net int. income/(exp.)	(12.9)	(2.1)	8.2	9.7	10.9
Exceptionals	116.9	358.9	46.2	-	-
Associates	-	-	-	-	-
Jointly-controlled entit.	12.9	64.9	168.3	344.0	377.8
Pre-tax profit	313.3	551.0	522.7	682.7	751.4
Tax	(50.4)	(25.4)	(71.0)	(66.4)	(64.5)
Minority interests	(43.8)	(29.2)	(61.6)	(59.4)	(62.2)
Net profit	219.2	496.5	390.1	556.9	624.8
% chg	-	126.5	(21.4)	42.8	12.2
Dividends	(35.4)	(63.8)	(97.5)	(139.2)	(156.2)
Retained earnings	183.8	432.6	292.6	417.7	468.6
EPS (HK\$) - Basic	0.155	0.350	0.273	0.386	0.433
EPS (HK\$) - F.D.	0.152	0.344	0.270	0.386	0.433
DPS (HK\$)	0.025	0.045	0.068	0.097	0.108
No. sh.s o/s (m) - W.A.	1,410.1	1,416.9	1,428.0	1,441.2	1,441.2
No. sh.s o/s (m) - Y.E.	1,414.4	1,422.0	1,441.2	1,441.2	1,441.2
No. sh.s o/s (m) - F.D.	1,440.1	1,445.2	1,443.6	1,441.2	1,441.2
Margins (%)					
Gross	24.7	25.6	27.5	29.6	27.6
EBITDA	12.3	9.1	16.0	17.6	17.0
EBIT	11.6	8.6	15.6	17.0	16.5
Pre-tax	18.6	36.5	27.2	35.4	34.2
Net	13.0	32.9	20.3	28.9	28.5
Balance Sheet (HK\$m)	04A	05A	06F	07F	08F
Year to Dec					
Fixed assets	1,490.1	502.2	996.4	1,290.0	1,666.3
Intangible assets	62.3	79.6	115.6	115.6	115.6
Other LT assets	-	-	-	-	-
Cash	562.9	1,274.1	1,099.2	1,556.8	2,052.0
Accounts receivable	410.2	455.8	478.6	454.7	500.2
Other receivables	-	-	-	-	-
Inventories	216.5	163.9	180.3	171.3	188.5
Due from related co.s	-	-	-	-	-
Other current assets	245.8	236.0	303.4	195.8	2.7
Total assets	2,987.8	2,711.7	3,173.6	3,784.3	4,525.3
Accounts payable	(674.0)	(810.9)	(851.4)	(808.8)	(849.3)
Other payable	-	-	-	-	-
Tax payable	(19.1)	(7.0)	(38.1)	(59.5)	(69.0)
ST debts	(122.6)	(10.6)	(25.1)	-	-
Other current liab.	-	-	-	-	-
LT debts	(865.9)	(96.1)	-	-	-
Other LT liabilities	-	(0.1)	-	-	-
Total liabilities	(1,681.6)	(924.7)	(914.6)	(868.3)	(918.3)
Share capital	141.4	141.8	143.7	143.7	143.7
Reserves	975.9	1,451.4	1,859.8	2,457.4	3,086.3
Shareholders' funds	1,117.3	1,593.2	2,003.5	2,601.1	3,230.1
Minority interest	188.9	193.9	255.5	314.8	377.0
Total	1,306.2	1,787.0	2,259.0	2,916.0	3,607.1
Capital employed	2,294.7	1,893.7	2,284.1	2,916.0	3,607.1
Net (debt)/cash	(425.6)	1,167.4	1,074.0	1,556.8	2,052.0
Cash Flow (HK\$m)	04A	05A	06F	07F	08F
Year to Dec					
EBIT	196.4	129.3	300.2	329.1	362.7
Depre./amort.	11.0	8.5	7.8	11.3	10.3
Net int. paid	12.9	2.1	(8.2)	(9.7)	(10.9)
Tax paid	(59.4)	(20.3)	(40.0)	(45.0)	(55.0)
Dividends received	19.7	19.7	54.6	134.3	143.4
Gross cashflow	180.6	139.4	314.4	420.0	450.4
Chgs. in working cap.	163.7	163.7	(65.5)	87.6	170.9
Operating cashflow	344.3	303.1	248.9	507.6	621.3
Capex	(101.7)	(53.7)	(426.1)	(10.9)	(10.9)
Free cashflow	242.7	249.3	(177.3)	496.6	610.4
Dividends paid	-	(49.6)	(64.0)	(83.2)	(139.2)
Net distribution to MI	(12.7)	(22.3)	-	-	-
Investments	(7.6)	-	-	-	-
Disposals	1.1	1,391.9	94.2	-	-
New shares	11.4	2.2	1.9	-	-
Others	(280.4)	21.5	51.8	69.3	24.0
Net cashflow	(45.4)	1,593.1	(93.4)	482.8	495.2
Net (debt)/cash - Beg.	(380.2)	(425.6)	1,167.4	1,074.0	1,556.8
Net (debt)/cash - End.	(425.6)	1,167.4	1,074.0	1,556.8	2,052.0
Interim Results (HK\$m)	04A	05A	06A		
Six months to Jun					
Turnover	906.4	947.0	878.3		
% chg	101.7	4.5	(7.3)		
Profit from operations	96.5	428.7	109.9		
Interest expenses	(6.1)	(13.1)	(1.2)		
Associates	-	-	-		
Jointly-controlled entit.	3.1	(4.2)	36.6		
Pre-tax profit	93.5	411.4	145.3		
Tax	(24.8)	(18.6)	(22.6)		
Minority interests	(25.4)	(22.9)	(22.9)		
Net profit	43.3	369.8	99.8		
% chg	5,110.2	754.1	(73.0)		
EPS (HK\$) - Basic	0.031	0.261	0.070		
DPS (HK\$)	-	0.010	0.010		
Shareholding Structure					
			Shares o/s (m)	%	
China Ocean Shipping			829.4	57.5	
Public			611.9	42.5	
Total			1,441.2	100.0	
Background					
COSCO International is engaged in the manufacture/sales of marine/container coating, provision of marine insurance brokerage service, vessel trading and supplying service. Besides, through its 44.0%-owned Sino Ocean Real Estate Development Group (SORED), the group has exposure to the booming property market in China.					
Key Ratios	04A	05A	06F	07F	08F
Net gearing (%)	32.6	Cash	Cash	Cash	Cash
Net ROE (%)	19.6	36.6	21.7	24.2	21.4
EBIT ROCE (%)	8.6	6.2	14.4	12.7	11.1
Dividend payout (%)	16.1	12.9	25.0	25.0	25.0
Effective tax rate (%)	16.1	4.6	13.6	9.7	8.6
Net interest coverage (x)	15.2	61.9	na	na	na
A/R turnover (days)	88.7	104.6	88.8	88.2	79.4
A/P turnover (days)	145.7	179.4	158.0	157.0	137.8
Stock turnover (days)	62.2	61.8	45.1	47.2	41.3

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