

COSCO International: Positive outlook

Recommendation: BUY (upgrade from HOLD)

Hong Kong Conglomerate

Price	HK\$7.98	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$9.30 (+16.5%)	Dec	HK\$m	HK\$	Δ %	x	x	x	%	%	%	
12 mth range	HK\$2.65-12.90	05A	496.5	0.350	125.5	23.1	7.2	69.8	1.0	31.2	26.2	Cash
Market cap.	US\$1,510.9m	06A	616.6	0.429	22.4	18.8	5.3	68.9	0.7	32.5	27.9	Cash
Daily t/o, 3 mth	US\$11.6m	07F	2,740.7	1.885	339.5	4.3	5.1	23.9	1.0	121.4	105.6	Cash
Free float %	43.1%	08F	1,160.9	0.813	(56.9)	9.9	4.3	18.1	1.3	46.2	40.2	Cash
Ticker	0517.HK/517 HK	09F	2,177.2	1.493	83.6	5.4	3.7	15.9	1.5	73.9	63.8	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): -26.7%, +10.1%, +88.4%

Actual price changes (1 mth, 3 mth, 12 mth): -34.4%, +27.1%, +166.9%

Consensus EPS (07F-08F): HK\$0.45, HK\$0.48

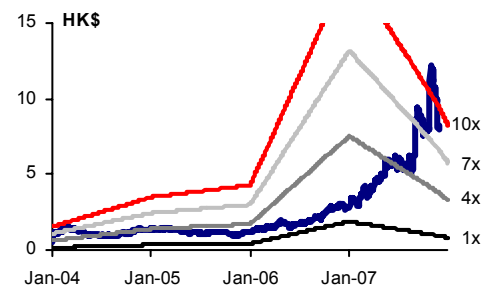
Previous forecasts (07F-08F): HK\$556.9m (\$0.386), HK\$624.8m (\$0.433)

Key points:

- Improved transparency after non-core asset divestments and the listing of Sino Ocean Land.
- Positive outlook for the marine services division on new vessel deliveries between 2007 and 2010.
- Marine services three-year CAGR projected at 33.5% between FY12/07F and FY12/10F.
- Asset injections – another share price catalyst.
- NAV target price of HK\$9.3 implying an upside potential of 16.5%, upgrade to BUY.

Investment summary. The September listing of its subsidiary Sino Ocean Land (3377HK, HK\$10.26, NR) has unleashed the embedded value of COSCO International and we expect the company's re-rating to continue on Sino Ocean Land's positive outlook amid China's negative interest rate environment. COSCO International's transparency has also improved after a series of non-core asset divestments. Backed up by its parent's giant fleet, the outlook of its marine services divisions remains positive. Its core business is set to benefit from a delivery of new vessels between 2007 and 2010. Asset injection stories will be another catalysts of its share price, given its strong balance sheet and parent's rich portfolio of quality assets.

Chart 1: P/E bands



Source: SBI E2-Capital

Coating division. Revenue surged 64.2% YoY to HK\$818.3m in 1H FY12/07A and operating profit 129.0% to HK\$69.1m. The group's marine paint manufacturing JV with Jotun, COSCO Jotun, reported a 317.1% YoY surge in pre-tax profit to HK\$14.6m due to its ASP hikes and higher sales volume driven by growing demand. During the period, we estimate that the ASP of container paint rose about 17.0% YoY, marine paint 6.0% and anti-corrosion coating 6.0% respectively. The sales volume of container paint was up 41.0% YoY at 36,514 tons, marine paint up 51.0% at 16,940.0 tons and anti-corrosion coating up 48.0% at 4,650.0 tons. In 1H, the company's container paint accounted for 25.0% of China's container paint market (Chugoku had 30.0% and Hempel 27.0% of the market).

Industry outlook positive. We expect the paint division's performance to remain strong on strong demand for container and marine paint in 2008, fuelled by the expansion of the global container fleet, which according to AXS-Alphaliner should increase at a four-year CAGR of 11.1% between 2007 and 2011 (in TEU terms). The global container fleet will expand 15.5% YoY to 11.1m TEUs in Jan 2008 and 14.4% YoY to 12.7m TEUs in Jan 2009. According to Maxmart, 476 new container ships and 408 new bulk carriers are to be delivered in 2008. It is estimated that a new vessel with D.W.T. (dead weight ton) of 0.2-0.3m tons consumes about 431.0 tons of marine paint, a capsized bulk carrier 344.8 tons and VLCC 862.0 tons. We expect strong growth in the group's anti-corrosion paint division on the back of China's robust fixed-asset investment. The marine coating business

should also continue growing on orders from its parent's huge fleet.

Capacity expansion. The third container and anti-corrosion plant of COSCO Kansai (64.7% owned by COSCO International) came on stream in Sep 2007. We expect it to run at full capacity in FY12/08F. The plant will boost the group's container coating production capacity by 38.1% to 87,000.0 tons per annum. COSCO Jotun plans to invest RMB300.0m in a new marine coating plant with an annual production capacity of 25,000.0 tons, which would boost its capacity by 147.1% to 42,000.0 tons per annum. Since the plan is still at the preliminary stage, we do not factor it in our model.

Ship trading - growth to pick up in FY12/08F. The group's 60.0%-owned vessel trading arm received new orders for 3.28m DWT, representing an annual growth rate of 4.5% bringing its order books to 10.26m DWT at end 1H FY12/07A. We expect the division's growth momentum to pick up from next year since commission income will be realized upon vessel deliveries, which are scheduled between 2008 and 2010. Its net profit is expected to rise at a three-year CAGR of 48.3% from HK\$12.5m to HK\$40.5m. The operating margin is lucrative at 49.0%, thanks to light asset requirements. Should the group secure more orders, the margin will widen further.

Marine supplies and insurance brokerage. The group provides marine supplies via Yuantong Marine Service. It is principally engaged in the sales and installation of marine equipment and spare parts for vessels and offshore oil E&P project. We expect the division to benefit from the global fleet expansion and the fact that ship owners are willing to restore their vessels more frequently due to the limited shipping capacity and high charter rate. The company's non-wholly owned insurance brokerage arm in Shenzhen, Shenzhen COSCO Insurance Broker, is yet to deliver any meaningful contribution but its outlook remains positive backed by its parent giant fleet.

Sino Ocean Land - core asset. After the listing of Sino Ocean Land, COSCO's stake in the Chinese property developer was diluted to 20.4% (914.8m shares) from 44.0%. Consensus forecasts put Sino Ocean Land's net profit at HK\$1.71b in FY12/07F, HK\$3.0b in FY12/08F and HK\$7.7b in FY12/09F. The consensus NAV/share estimate for FY12/07F is HK\$9.34. This January, the company divested Block 5 of Kingswell Garden, a hotel-style service apartment complex in Shanghai for HK\$31.2m and in July, it sold its 51.0% stake in Shenyang COSCO Yihe Property Development for HK\$57.5m. Major assets of Shenyang COSCO Yihe Property Development are the remaining units at a property development project in Shenyang, the Shenyang COSCO Yihe Garden. COSCO is expected to recognize an exceptional gain of HK\$2.0m from the transaction. Upon the completion of the divestments, the company's property assets will be its stakes in Sino Ocean Land and 1,841 m² of retail space and 193 parking lots at Fragrant Garden, a property development project in Shanghai.

Earnings forecast. We expect COSCO's net profit to soar 344.5% YoY to HK\$2.74b in FY12/07F, on the non-cash exceptional gain of HK\$1.94b realized upon the listing of Sino Ocean Land. Based on consensus forecasts on Sino Ocean Land's earnings, we expect the company to share HK\$348.7m from the property developer. Core earnings of its shipping related business are estimated at HK\$163.5m for FY12/07F (no YoY comparison in the absence of historical after-tax figures). The core marine services division's net profit should rise at a three-year CAGR of 33.5% between FY12/07F and FY12/10F from HK\$163.5m to HK\$388.8m. Though we do not cover Sino Ocean Land, we believe its outlook is positive amid China's negative interest rate environment, strong demand for residential units and RMB appreciation.

Valuation. Selected marine service providers are trading at one-year forward P/E of 8.9x and two-year forward P/E of 13.7x. We expect the aggregate net profit of the group's marine services division to hit HK\$163.5m in FY12/07F and HK\$249.8m in FY12/08F. Based on peers' average forward P/E, we arrive at our valuation for the marine services division of HK\$2.7b for FY12/07F and HK\$3.4b for FY12/08F. The market value of COSCO's shares of Sino Ocean Land is HK\$9.4b. We estimate the value of its retail space and parking lots at Fragrant Garden at HK\$75.0m. As of end-1H FY12/07F, the company had HK\$737.9m cash in hand. Taking all the above into account, we arrive at our FY12/08F NAV-based target price of HK\$9.3. With a potential upside of 16.5%, we upgrade the counter to BUY. The Sino Ocean Land stake accounts for 68.9% of its FY12/08F NAV and the share price performance of the property developer is crucial to our NAV-based valuation.

Table 1: NAV-based valuation

(HK\$m)	2007F	2008F
Ship trading and supplying services	2,698.5	3,421.9
Market value of interests in Sino Ocean Land	9,385.4	9,385.4
Other assets	75.0	75.0
Net cash as of the end of 1H FY12/07F	737.9	737.9
Gross NAV	12,896.9	13,620.3
NAV per share (HK\$)	8.8	9.3

Source: SBI E2-Capital

Table 2: Valuation of marine service providers

	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	2,175	10.7	9.5
Sherwin-Williams Co	SHW US	Dec	USD	7,449	12.5	11.5
Kansai Paint	4613 JP	Jun	JPY	1,915	13.9	12.5
Insurance broker						
THB Group	THB LN	Apr	GBp	14	10.1	8.7
Willis Group Holdings	WSH US	Dec	USD	2,620	14.1	12.8
Jardine Lloyd Thompson	JLT LN	Dec	GBp	345	13.1	12.5
Marine service providers						
ASL Marine Holdings	ASL SP	Jun	SGD	307	9.0	7.9
Beng Kuang Marine	BKM SP	Dec	SGD	69	18.1	11.3
BH Global Marine	BHGM SP	Dec	SGD	158	13.1	11.5
SembCorp Marine	SMM SP	Dec	SGD	6,112	25.8	19.2
Sinwa	SKS SP	Dec	SGD	83	11.4	7.3
Average					16.5	13.7

Source: Bloomberg

P & L (HK\$m)	05A	06A	07F	08F	09F
Year to Dec					
Turnover	1,457.2	1,866.5	2,069.6	2,456.2	2,816.1
% chg	(13.7)	28.1	10.9	18.7	14.7
Gross profit	374.0	473.8	793.5	967.6	1,047.6
EBITDA	168.9	171.1	493.4	651.0	741.3
Depre./amort.	(6.8)	(5.2)	(12.2)	(22.5)	(29.4)
EBIT	162.1	165.9	481.3	628.5	711.9
Net int. income/(exp.)	(2.0)	32.4	27.2	34.1	38.8
Exceptionals	326.0	339.9	1,943.1	-	-
Associates	-	-	348.7	606.2	1,566.3
Jointly-controlled entit.	64.9	164.9	28.9	39.1	48.8
Pre-tax profit	551.0	703.0	2,829.2	1,307.9	2,365.8
Tax	(25.4)	(39.9)	(31.7)	(48.8)	(61.1)
Minority interests	(29.2)	(46.5)	(56.9)	(98.2)	(127.5)
Net profit	496.5	616.6	2,740.7	1,160.9	2,177.2
% chg	126.5	24.2	344.5	(57.6)	87.5
Dividends	(63.8)	(76.8)	(120.3)	(157.1)	(178.0)
Retained earnings	432.6	539.8	2,620.4	1,003.8	1,999.2
EPS (HK\$) - Basic	0.350	0.429	1.885	0.813	1.493
EPS (HK\$) - F.D.	0.344	0.418	1.849	0.783	1.469
DPS (HK\$)	0.045	0.053	0.082	0.108	0.122
No. sh.s o/s (m) - W.A.	1,416.9	1,437.2	1,453.7	1,428.0	1,458.5
No. sh.s o/s (m) - Y.E.	1,418.2	1,450.5	1,458.5	1,458.5	1,458.5
No. sh.s o/s (m) - F.D.	1,445.2	1,474.9	1,482.5	1,482.5	1,482.5

Margins (%)

Gross	25.7	25.4	38.3	39.4	37.2
EBITDA	11.6	9.2	23.8	26.5	26.3
EBIT	11.1	8.9	23.3	25.6	25.3
Pre-tax	37.8	37.7	136.7	53.2	84.0
Net	34.1	33.0	132.4	47.3	77.3

Balance Sheet (HK\$m)	05A	06A	07F	08F	09F
Year to Dec					
Fixed assets	502.2	1,299.3	1,275.8	1,320.2	1,356.7
Intangible assets	79.6	79.6	79.6	79.6	79.6
Other LT assets	-	-	-	-	-
Cash	1,274.1	862.2	1,361.0	1,811.2	2,368.0
Accounts receivable	455.8	723.8	724.4	859.7	985.6
Other receivables	-	-	-	-	-
Inventories	163.9	280.0	255.2	297.7	353.7
Due from related co.s	-	-	-	-	-
Other current assets	358.8	448.2	19.5	-	-
Total assets	2,834.5	3,693.0	3,715.5	4,368.3	5,143.6
Accounts payable	(933.7)	(1,033.3)	(1,034.8)	(1,228.1)	(1,408.0)
Other payable	-	-	-	-	-
Tax payable	(7.0)	(18.7)	(16.8)	(21.9)	(27.7)
Due to related co.s	-	-	-	-	-
ST debts	(10.6)	(78.5)	(47.9)	-	-
Other current liab.	-	(114.4)	-	-	-
LT debts	(96.1)	-	-	-	-
Other LT liabilities	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Total liabilities	(1,047.5)	(1,245.0)	(1,099.6)	(1,250.1)	(1,435.8)
Share capital	141.8	145.1	145.8	145.8	145.8
Reserves	1,451.4	2,056.2	2,166.6	2,570.6	3,032.7
Shareholders' funds	1,593.2	2,201.3	2,312.4	2,716.5	3,178.5
Minority interest	193.9	246.7	303.6	401.8	529.3
Total	1,787.0	2,448.0	2,616.0	3,118.3	3,707.8
Capital employed	1,893.7	2,526.5	2,663.9	3,118.3	3,707.8
Net (debt)/cash	1,167.4	783.7	1,313.1	1,811.2	2,368.0

Cash Flow (HK\$m)	05A	06A	07F	08F	09F
Year to Dec					
EBIT	162.1	165.9	481.3	628.5	711.9
Depre./amort.	6.8	5.2	12.2	22.5	29.4
Net int. paid	2.1	(32.7)	(27.2)	(34.1)	(38.8)
Tax paid	(25.4)	(39.9)	(31.7)	(48.8)	(61.1)
Dividends received	19.7	29.3	-	-	-
Gross cashflow	165.3	127.8	434.6	568.1	641.5
Chgs. in working cap.	166.6	(145.4)	86.4	15.5	(2.0)
Operating cashflow	331.9	(17.5)	521.0	583.6	639.5
Capex	(10.9)	(29.4)	(50.0)	(30.0)	(20.0)
Free cashflow	321.0	(46.9)	471.0	553.6	619.5
Dividends paid	(49.6)	(64.8)	(97.5)	(127.3)	(144.2)
Net distribution to MI	(22.3)	(27.0)	-	-	-
Investments	4.9	(426.0)	-	-	-
Disposals	1,391.9	92.6	88.1	(0.8)	(0.9)
New shares	2.2	26.5	-	-	-
Others	-	61.8	67.9	72.5	82.4
Net cashflow	1,648.1	(383.8)	529.5	498.0	556.8
Net (debt)/cash - Beg.	-	1,167.4	783.7	1,313.1	1,811.2
Net (debt)/cash - End.	1,167.4	783.7	1,313.1	1,811.2	2,368.0

Interim Results (HK\$m)	06A	07A
Six months to Jun		
Turnover	874.4	1,139.1
% chg		30.3
Profit from operations	91.4	93.1
Interest income	16.0	12.2
Associates	-	-
Jointly-controlled entit.	36.6	342.7
Pre-tax profit	145.3	445.1
Tax	(22.6)	(21.6)
Minority interests	(22.9)	(23.3)
Net profit	99.8	400.3
% chg		301.2
EPS (HK\$) - Basic	0.070	0.275
DPS (HK\$)	0.010	0.010

Shareholding Structure

	Shares o/s (m)	%
China Ocean Shipping	829.4	56.9
Public	629.1	43.1
Total	1,458.5	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 20.44-owned Sino Ocean Land Holdings (3377 HK), the group has exposure to the booming property market in China.

Key Ratios	05A	06A	07F	08F	09F
Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Net ROE (%)	31.2	32.5	121.4	46.2	73.9
EBIT ROCE (%)	8.6	7.5	18.5	21.7	20.9
Dividend payout (%)	12.9	12.5	4.4	13.5	8.2
Effective tax rate (%)	4.6	5.7	1.1	3.7	2.6
Net interest coverage (x)	80.8	na	na	na	na
A/R turnover (days)	114.2	115.3	127.7	117.7	119.6
A/P turnover (days)	233.9	192.3	182.4	168.1	170.8
Stock turnover (days)	55.2	58.2	76.5	67.8	67.2

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HOLD : absolute return of -10% to +10% over the next six months

SELL : absolute downside of >10% over the next six months

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