

## Acquisition drive

## China Conglomerates

### Shenzhen Investment (604 HK, HK\$2.33)

### Not Rated

**We participated in Shenzhen Investment's telephone conference yesterday. The major takeaways are as follows:**

**Acquisition.** Shenzhen Investment (SI) has acquired a 91% stake in Jingdong Expressway from Huayin Traffic. The total proceed is estimated to be around RMB1.25b. The deadline for the road completion may be extended up to 31 Oct. 2006. Jingdong Expressway is a two-way toll road with 4 lanes. It is strategically located in the Hubei section of the principal national high way and is expected to benefit the increasing traffic flow between central China and southern China.

**15% IRR.** According to the estimates from the external consultant (Sallmanns), the IRR for the whole acquisition will reach 15%. SI also estimates a 10.6% IRR on a worst-case scenario. Assuming a 30-yr CAGR of 8.8%, the consultant estimates its 2007 revenue to reach RMB237m as opposed to SI's worst-case scenario of RMB137m under an assumption of a 30-yr CAGR of 5.5%.

**Financial arrangement.** The company has about RMB\$3b cash on hand for infrastructure investments and further land acquisition. The total estimated book value for non-core disposal assets is around RMB 1.3b. Its current gearing ratio is around 14%. The company has sufficient internal cash for the acquisition of Jingdong Expressway. The company pointed out that it is unlikely to issue new shares in the next 12 months.

**Land bank replenishments.** The near term property sentiment is affected by the government austerity measures. The secondary market transaction volume dropped as a result of the weakened consumer confidence. However, the company would like to make use of this opportunity to accumulate more land bank at cheaper costs. According to management, the company is expected to achieve its targets to expand its land bank to 5 m sqm GFA earlier than the original scheduled end of FY06.

**Two-year plan.** Management also revealed their two-year plan as follows:

- ❑ Sell all non-core assets by April 2007. The company expects to dispose Mawan project by the end of 2006.
- ❑ Increase land bank by 3 m sqm.
- ❑ Increase property development completion to 500,000 sqm in 2008.
- ❑ Acquire 1-2 toll bridges.
- ❑ Dividend payout ratio will be higher than 50%.
- ❑ ROE to reach 20% by 2008 (ROE in 2005: 12.6%).

**Valuation.** SI's own appraised NAV stood at HK\$4.77 per share as at 2 August 2006 and HK\$0.35 –0.50 may be added if the acquisition completed. The counter is trading at 9.6x FY12/06 PE and 7.40x FY12/07 PE according to market consensus.

**Risks.** If the property prices of the large flats (over 90 sqm) continue to rise, the central government may implement more severe policies towards the speculators.

**Table 1: Toll Road Revenue Forecasts by Sallmanns and Shenzhen Investment (RMBm)**

	2007	2008	2009	2010
Revenue by consultant	236.9	263.3	292.0	327.8
Revenue by SI	136.9	157.4	181.0	226.2
Net profit by consultant	47.3	54.8	76.2	101.1
Net profit by SI (Traffic-adjusted depreciation)	2.6	19.2	27.3	53.2
Net profit by SI (Straight-line)	(50.2)	(30.0)	(5.2)	42.1
Net cash flow by consultant	213.4	222.3	233.8	248.4
Net cash flow by SI	117.2	136.3	158.4	201.3

Source: Company data

**Table 2: Appraised NAV as at 2 August 2006**

Asset	Valuation method	HK\$ per share
1. Land bank	1.9 m sqm of attributable GFA @ RMB2,500=RMB4.75b (HK\$4.56 b)	1.82
2. Projects under construction	0.79m sqm GFA @ RMB4,000 = RMB3.16bn (HK\$3.03bn)	1.21
3. Investment property	HK\$2.2b (book)	0.88
4. Road King	HK\$1,284m@HK\$8.75	0.51
5. Mawan Power	HK\$864m (10x 2005 NPAT)	0.35
6. Cable TV	HK\$315m (15x 2004 NPAT)	0.13
7. Transport	HK\$128m (book)*0.8 = HK\$102m	0.04
8. Industrial	HK\$397m (book)*0.6= HK\$238m	0.1
Deduct:	Net debt: HK\$674m	(0.27)
	<b>Shares outstanding</b>	<b>2,501m</b>
<b>Appraised NAV (per share)</b>		<b>*HK\$4.77</b>

Source: Company data \*Jingdong Expressway to add HK\$0.36 –0.50 NAV per share