

## Sundart International

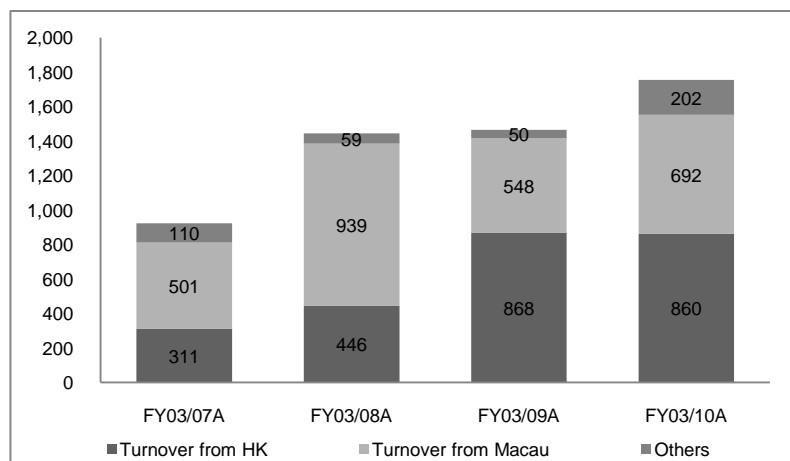
### Expecting utilization of cash pile

to summarize...

- Preliminary estimates P/E at 7.9x, 6.1x and 2.4x for FY03/11F, FY03/12F and FY03/13F, taking account into Kwun Tong project to be recognized in FY03/13F
- Fitting-out solution provider in HK and Macau with significant market share
- Net cash position of HK\$429m to ride on economic recovery
- Introduce property development project in HK of HK\$315m land cost, could yield excellent return either by reselling or developing the project
- Investment in 29.4% interest of Kailong REI paths future growth in China

**Leading fitting-out solution provider in HK and Macau.** Sundart commenced fire-proofing / dry wall construction business in HK in 1986 and started fitting-out business 2 years later in China. In 1996 and 2005, Sundart stepped into HK and Macau fitting-out market respectively. In 2008, the company captured 20%-25% fitting-out market share in HK and 15%-20% in Macau. Between FY03/07A and FY03/10A, Macau fitting-out made up 40% to 60% revenue, while HK fitting-out made up 30% to 60% revenue, depending on projects tender in the particular year.

**Chart 1. Revenue from fitting-out works in HK\$m**



Source: SBI E2-Capital

**Famous projects participated.** As main contractor, nominated sub-contractor or sub-contractor, Sundart participated in projects including 1) Four Seasons Hotel, MGM Grand Hotel, Cotai Casino and Hotel Venetian Cotai Project (Parcel 1), Wynn Resort, Galaxy Resort & Casino Cotai City in Macau; 2) Harbour Grand Hotel, Celestial Heights Phase 1&2, The Capitol, The Legend, Lake Silver, Tamar Development Project in HK; 3) Ritz-Carlton Shanghai, Hong Kong Pavilion in EXPO 2010 Shanghai in China. Capacity within residential projects could be typical flats (or part of the flats such as kitchens and bathrooms), lift lobbies and main entrance fitting-out. Fitting-out for hotels may involve guest suites, common corridors, hotel lobbies, SPA and restaurants, to name a few.

**Cash-rich for 3 major growth drivers in the future.** By end of Sep 2010, the company was at net cash position of HK\$429m after deducting amounts due to related company and jointly controlled entity. In our view, Sundart is rich in cash to 1) continue to capture fitting-out opportunities in HK and Macau upon economic recovery; 2) first participate in property development in HK; 3) increase exposure in China property development with respect to investment or fitting-out contracts.

Please refer to important disclosures at the end of this report

Ticker	2288 HK
Rating	Not Rated
Price (HK\$)	2.26
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	2.21-2.94
Market cap. (US\$m)	140.0
Daily t/o (US\$m)	0.2
Free float (%)	30.0

#### Financial summary

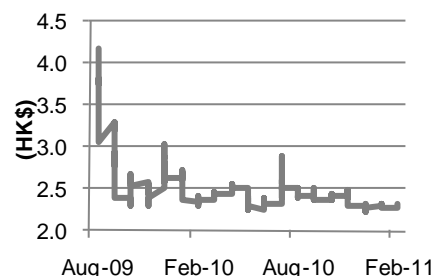
Year to Mar	08A	09A	10A
Turnover (HK\$m)	1,444	1,465	1,708
Net Profit (HK\$m)	81	144	175
EPS (HK\$)	0.17	0.30	0.36
P/E (x)	13.5	7.5	6.2
P/B (x)	4.7	4.1	1.4
EV/EBITDA (x)	10.7	6.4	5.1
Yield (%)	n.a.	n.a.	8.0
ROE (%)	39.7	58.0	33.5
ROCE (%)	39.7	58.0	33.5
N. Gear. (%)	8.0	Net cash	Net cash

Source: SBI/Bloomberg

	10F	11F	12F
Consensus EPS (HK\$)	0.330	0.420	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(2.2)	(4.0)	(20.0)
Actual price changes (%)	(2.6)	(9.3)	(3.4)



Source: Bloomberg

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**Opportunities in HK and Macau – increasing contract backlog.** Economic recovery in HK and gaming sector investment in Macau both present good opportunities to construction sector as well as fitting-out business. Contract backlog by end of Sep 2009, Mar 2010 and Sep 2010 gradually increased from HK\$885m to HK\$1,120m and then HK\$1,320m. In Nov the company announced additional HK\$190m contracts acquired. In addition, 10 infrastructure projects in HK may bring along HK\$7,000m fitting-out contracts in 5 years. Sundart has an estimated market share of 20%-25% in HK and the company had the track record of winning Tamar Development project. Due to growth opportunities, we first assume fitting-out turnover to stay HK\$1,800m a year despite increasing backlog and demand.

**Capital requirement of current business model.** Property developer tenders fitting-out contracts at late stage of project developments. As a contractor, upon confirmation of successful tender, Sundart requests its timber subsidiary and other subcontractors to provide timber, marble, steel and metal products as well as related services. Essentially the company does not directly employ workers so that all labour intensive such as carpentry, installations and plumbing works are outsourced. Major capital requirement would be working capital in light of progressive payment throughout project cycles. Fitting-out cycles are generally shorter for hotels and office of less than 6 months. For HK\$1,500m to HK\$1,700m annual revenue between FY03/10A and FY03/11F, trade receivables, amount due from customers plus retentions receivables totaled HK\$581m, while there were trade payables and amounts due to customers totaled HK\$254m.

**A development project in Kwun Tong, HK.** Sundart acquired a property in Kwun Tong for HK\$315m in May and acquired HK builder permit C (probation) in Oct last year. The HK\$315m is provided by 40% internal cash and 60% loans. Cash payment has been reflected in interim results 1H FY03/11A. The site area is 16,500 sq feet with GFA of 198,000 sqm feet. On per sq feet basis, with HK\$1,600 acquisition cost and estimation of HK\$1,500 construction cost and HK\$1,200 extra land cost, total cost of erecting an A-grade office building is HK\$4,300 per sq feet. With current selling price of ~HK\$6,000 per sq feet in the region, another HK\$1,200m pre-sales or even revenue recognition may be seen in FY03/12F with good profit margin.

**Cash flow check and NPV of the development project.** Since Kwun Tong project is essentially the first development project of the company, we assume the project is to complete by year 2012, which is FY03/13F, and the company could only receive total proceeds from banks in FY03/13F. Accounting for development capital, fitting-out working capital and investment in Kailing REI (which will be discussed in the following paragraph), we believe the company has certain capital pressure by the end of this calendar year, yet it would remain around 25% net debt-to-equity ratio even holding dividend payout ratio at 40%. Thus, we believe the company is not overly aggressive. While under these assumptions and 15% discount rate, we estimate NPV for Kung Tong project is HK\$108m, or HK\$0.22 per share, by the end of FY03/11F. It would be profitable to actually develop the project, but we believe reselling the project could be an immediate boost to profit and cash with possibility of a special dividend.

**Table 1. Profit and loss items and cash flow items of Kwun Tong project**

HK\$m	FY03/11F	FY03/12F	FY03/13F
<u>Profit and loss items</u>			
Project sales income			1,188
Project EBIT			337
Project net profit			254
<u>Cash flow items</u>			
Cash proceeds			1,188
Land cost	(317)		
Bank loan and interest	181	(10)	(200)
Construction payment		(297)	
Land cost - add on			(238)
Tax payment			(54)
Cash flow item for NAV	(136)	(307)	697
NAV at 15% discount rate	108		
NAV per shares (HK\$)	0.22		

Source: SBI E2-Capital

**Opportunities in China.** On 15 Sep last year, the company utilized HK\$20.8m to acquire 29.4% interest of Kailong REI, a leading player in China's real estate investment / real estate fund management. Major shareholders of the fund include Carval Investors and Secured Capital Japan (2392 JP). Other investors include Citi Bank, Starwood Capital, Cargill and Rockpoint. President and co-founder of the fund is Stephen A. Roth, who also founded or co-founded Secured Capital Japan (2392 JP), STAM REI in EU and Secured Capital Corp in US. Since Sundart's exposure in China is actually, this move should enhance sales network of fitting-out portions of renovation and provide investment opportunities in China.

**Utilization of cash pile.** 1H FY03/11A revenue and net profit were HK\$593m and HK\$72m with 43% dividend payout ratio, generally in line with dividend policy disclosed in IPO document. The interim dividend was HK\$0.065 per share, which was equivalent to 2.8% of current share price. Yet, the company is still rich in cash. While we estimate ROE at 15%-20% for FY03/11F, we believe it is for the interest of shareholders to put its cash pile into use. As discussed, the company could capture opportunities, keep its dividend payout ratio and stay below 30% net debt-to-equity ratio, in our view.

**Preliminary profit forecast.** According to Bloomberg consensus, market currently expects net profit at HK\$154m and HK\$200m for FY03/11F and FY03/12F, representing over 12% YoY fall in net profit for FY03/11F. Based on preliminary study, we estimate net profit for FY03/11F, FY03/12F and FY03/13F to be HK\$138m, HK\$178m and HK\$461m, taking account into Kwun Tong project to be recognized in FY03/13F, which represents 7.9x, 6.1x and 2.4x P/E.

**Table 2. Preliminary profit forecast**

HK\$m	FY03/10A	FY03/11F	FY03/12F	FY03/13F
Total revenue	1,708	1,500	1,818	3,024
Fitting-out revenue	1,708	1,500	1,818	1,836
Development revenue	0	0	0	1,188
EBIT	268	225	273	612
Fitting-out EBIT	268	225	273	275
Development EBIT	0	0	0	337
Net profit	175	138	178	461

Source: SBI E2-Capital

**Peers comparison.** According to our observation, Sundart ranked 2<sup>nd</sup> in terms of market capitalization among selected peers, including Depa from Dubai, Design Studio from Singapore and Interior services from UK. While its P/B valuation is at 1.4x, slightly above average of 1.2x, Sundart has good ROE of 33.5%. Its 1-FY forward and 2-FY forward P/E are lower than an average. For instance, 2-FY forward P/E of Sundart is 5.4x, considerably lower than an average of 7.3x.

**Table 3. Peers comparison**

Company name	Ticker	Financial year	Last close price (local)	Market cap (US\$m)	P/E		P/B (x)	ROE (%)
					1 FY fd (x)	2 FY fd (x)		
DEPA LTD	DEPA DU Equity	12/2009	0.69	424.2	211.2	7.1	0.9	13.0
<b>SUNDART INTL</b>	<b>2288 HK Equity</b>	<b>03/2010</b>	<b>2.26</b>	<b>140.0</b>	<b>6.8</b>	<b>5.4</b>	<b>1.4</b>	<b>33.5</b>
DESIGN STUDIO FU	DSFM SP Equity	12/2009	0.64	128.3	n.a.	n.a.	2.2	41.3
INTERIOR SRVCS	ISG LN Equity	06/2010	210.00	112.3	7.6	7.6	1.4	12.2
HAVELOCK EUROPA	HVE LN Equity	12/2009	8.00	5.0	n.a.	8.9	0.2	-17.5
LCL CORP BHD	LCL MK Equity	12/2009	Delisted					
				Average	75.2	7.3	1.2	

Source: Bloomberg

**Risk factors.** Major risk factors include 1) failure to complete and sell Kwun Tong project according to schedule; 2) economic recovery is slower than expected which reduce demand for fitting-out projects; 3) the company may not be experienced in cash flow management with respect to project development that may put cash flow chain at risk; 4) management focus may not be absolutely on existing business.

**Table 4. Profit and loss summary (half year)**

HK\$m	1H FY03/19A	2H FY03/09A	1H FY03/10A	2H FY03/10A	1H FY03/11A
Revenue	594	871	1,212	496	593
Cost of sales	(504)	(756)	(1,018)	(390)	(478)
Gross profit	89	116	194	106	115
Other gains	1	2	2	2	1
Administrative expenses	(17)	(18)	(23)	(26)	(25)
Other service costs	(0)	(0)	(10)	(10)	(5)
Other expenses	(0)	(2)	(1)	(4)	(2)
Listing expenses	(0)	(0)	(19)	(0)	(0)
Share of an associate	0	0	0	0	(0)
Operating profit	73	98	143	67	84
Finance costs	(2)	(1)	(0)	(0)	(0)
Profit before tax	71	97	143	67	84
Income tax expense	(10)	(14)	(23)	(11)	(12)
Net profit	61	82	120	56	72

Source: SBI E2-Capital

**Table 5. Balance sheet summary**

HK\$m	FY03/08A	FY03/09A	FY03/10A
Non-current assets	6	7	14
Current assets	692	697	1,047
Trade and other receivables	286	315	91
Amounts due for contract work	141	70	150
Retentions receivables	112	115	135
Bank balances and cash	152	192	658
Non-current liabilities	12	2	0
Current liabilities	453	438	280
Trade and other payables	272	354	224
Bank borrowings	148	27	2
Total equity	232	263	782

Source: SBI E2-Capital

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