China State Const'n

Fri, 26 Jun 2009

Break on through to other side

BUY (int. coverage)

Ticker:	3311.HK	12 mth range:	HK$0.60-3.22
Price:	HK$2.80	Market cap:	US$884.4m
Target:	HK$3.46 (+24%)	Daily t/o, 3 mth:	US$3.6m
		Free float %:	36.7%

Financial summary

Year to Dec	07A	08A	09F	10F	11F
Turnover (HK$m)	10,168.3	11,021.4	13,153.9	15,049.9	18,422.8
Net Profit (HK$m)	404.9	489.3	544.4	638.5	759.9
EPS (HK$)	0.172	0.192	0.222	0.261	0.310
EPS Δ%	62.1	11.6	15.9	17.3	19.0
P/E (x)	15.3	14.0	12.6	10.7	9.0
P/B (x)	3.2	2.7	2.7	2.7	2.5
EV/EBITDA (x)	11.5	10.0	8.0	9.1	9.1
Yield (%)	1.7	2.9	2.4	2.8	3.3
ROE (%)	25.9	20.9	21.4	24.9	28.9
ROCE (%)	28.2	20.4	17.3	18.6	19.0
N. Gear. (%)	Cash	Cash	Cash	11.7	57.7

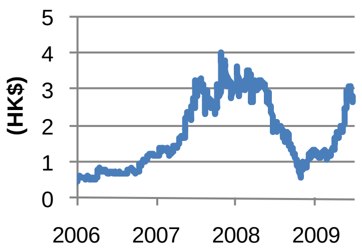
Source: SBI E2-Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+4.2	+56.0	+64.3
Actual price changes (%)	+13.4	+104.4	+35.3

	09F	10F	11F
Consensus EPS (RMB)	0.236	0.284	0.377
Previous forecasts (RMBm)	-	-	-
Previous EPS (RMB)	-	-	-

Price Chart



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Key points:

- CSCI is a multi-disciplinary infrastructure and building engineering contractor covering HK, mainland China, Macau, Dubai, Abu Dhabi and India.
- CSCI has aggressive stance to gain a foothold in China's infrastructure construction segment by working together with its parent's CSCECL with current backlog in mainland china of HK$3.14b.
- CSCI secured first BT project of the Tangshan Binhai Avenue in mainland china with an estimated contract size of RMB3.2-4.0b, of which CSCI is entitled to 50% through their equity ownership in the JV with parent co.
- With market leader position in HK, CSCI would be the key beneficiary of HKSAR government's aggressively step to roll out infrastructure investment.
- Sustainable growth model through 1) geographic diversification and 2) vertical integration of infrastructure investment and Build Transfer projects.
- For 1-5M 2009, CSCI secured new contracts of HK$7.5b new contracts. At end-May 2009, CSCI had a contract backlog of HK$25.0b.
- We expect mainland China and HK would be the main growth driver for the company in the near term. We estimate its net profit increase 11.3% for FY12/09F and accelerating to 17.3% for FY12/10F.
- We initiated coverage CSCI with BUY call. Our DCF derived target price of HK$3.46 represents 15.6x FY12/09F P/E and 13.3x FY12/10F P/E.

Company background. China State Construction (CSCI) is a multi-disciplinary infrastructure and building engineering contractor. The company's core geographical markets are in Greater China (Hong Kong, China and Macau) as well as emerging countries/regions such as Dubai, Abu Dhabi and India. In addition to engineering construction, the company also undertakes infrastructure investment in China. The company has been established since 1979 (30 years track record) and is 62.9%-owned by China Overseas Holdings Ltd., which is ultimately owned by China State Construction Engineering Corp Ltd. (CSCECL) and State-owned Assets Supervision & Administration Commission (SASAC) and is the sister company to China Overseas Land & Investment Ltd. (688 HK, HK$18.22). CSCI was listed by way of introduction in Jul 2005. The company has >4,456 staff collectively, located in its presence regions.

Investment theme I: Entry into China's infrastructure sector

Taking a step towards RMB4,000b. While CSCI had always had a presence in China undertaking building construction works, they do not hold the necessary licenses to undertake infrastructure constructions works. In order to gain entry into China's infrastructure sector and potentially capture a slice of the Chinese government's RMB4,000b fiscal stimulus package (which primarily focuses on rollout of infrastructure), CSCI announced in Apr, they had entered into a sub-construction engagement agreement whereby: 1) the company may engage the parent's

CSCECL as construction sub-contractor and/or project management contractor in the PRC and UAE and 2) CSCECL may engage CSCI as construction sub-contractor in the PRC, upon successful tender of a construction project for a 3-year term commencing 1 Jul 2009 and ending 30 Jun 2012. They promptly followed this up by announcing that it has formed a JV with its parent on for submitting tenders to participate in infrastructure construction projects in the PRC. Note that the caps for CSCI to be CSCECL's sub-contractor under the agreement is HK$4,000m (1 Jul 2009-31 Dec 2009), HK$4,000m (for each of the financial years ending 31 Dec 2010 and 2011) and HK$2,000m (1 Jan 2012-30 Jun 2012). As a reference, the cap of HK$4,000m represented 39.5% of CSCI's FY12/08A overall construction revenues (ex. infrastructure investment and toll road operations). In our view, this relatively large cap of HK$4,000m set for 2H FY12/09 is an indication of the company's aggressive stance to gain a foothold in China's infrastructure construction segment.

Secures first China infrastructure project in Tangshan. CSCI delivered by recently securing its first major infrastructure win in China (Jun 2009). The project is a build-transfer (BT) project of the Tangshan Binhai Avenue (Section from Seaport Development Zone to Caofeidian). The 39.2km long expressway (comprising at-grade road, 3 large sized bridges and 1 medium bridge) involves an estimated total investment amount of RMB3.2-4.0b. According to management, the project will involve a 2 year construction period and government buyback period of 3 years. Up to 90% of the total project investment is expected to come from bank loans to be guaranteed by Tangshan government. Given that CSCI holds 50% in the JV that secured this project, their capital commitment is around HK$200.0m (~5.0%). Management indicated that they would initially inject 2.5% into the project with the remaining injected on a pro-rata basis as the project entity draws down its credit line from the banks.

How does the BT model work? Under the Build-Transfer (BT) model, the company (or in this case the project JV) invests up front to construct the infrastructure project. The capital investment will be a combination of equity and debt, with the debt portion guaranteed by the local government. Given the central governments' current favourable policies towards infrastructure investment, the company is able to borrow up to 90% of the projects' total investment cost. On completion of project, it is transferred and the government pays back to the company the project investment cost, plus a nominal interest, over a predefined period (typically ~2 years). The company will be responsible for the interest expenses associated with the bank loans.

CSCI prudent in selecting local government partners. Opportunities for CSCI to participate in BT projects arise as local governments focuses on funding central government planned, cross provincial projects which may have a longer time horizon (e.g. railway projects). Local governments are therefore open to partnering with strong enterprises, such as CSCI, to allow them to participate in local government infrastructure projects. The risk for CSCI is relatively low, as the local government guarantees the loan, though the company also takes measures to contain risk. This includes concentrating on partnerships with local governments of 2nd tier cities, as well as undertaking infrastructure projects with a "reasonable" duration (bridge, expressway, port projects etc).

Symbiotic relationship with parent. There are clear synergies on reasons parent CSCECL would partner with CSCI to participate in China's BT infrastructure sector each party's strengths tends to complement the other's weakness. For CSCEL, while they are one of China's largest building contractors, its infrastructure construction reference is not as prominent. In addition, being a SOE conglomerate, there is internal competition for its capital resources. CSCI is able to complement as it possesses an infrastructure construction track record of over 30 years (with key projects including Hong Kong International Airport, Baiyun International Airport, and West Kowloon Reclamation amongst others). CSCI is also strictly focused on engineering construction and operation and being a listed entity in Hong Kong, has the ability to tap equity markets for funding. On the other hand, CSCI can use CSCECL's infrastructure permits as well as leverage its 200,000 strong labour force, allowing it to scale up effectively in China.

Table 1: Synergy Matrix

		China Overseas Holdings Ltd. (COHL) / China State Construction Engineering Corp Ltd. (CSCECL)			
		Limited track record in infrastructure	COHL is a conglomerate with internal competition for capital	CSCECL has licenses/permits for infrastructure and building construction	CSCECL as the largest building contractor in China, has a staff of >200,000
China State Construction Int'l (3311 HK)	30 yrs infrastructure track record	✓			
	Substantial infrastructure construction project management experience	✓			
	Focus on BT infrastructure projects with ability to tap equity markets		✓		
	Does not have infrastructure construction permit in China			✓	
	Needs scalable business model				✓

Source: SBI E2-Capital

Investment theme 2: Market leader in Hong Kong in investment environment

Market leader in Hong Kong and Macau. CSCI is the market leader in the infrastructure and building engineering construction sector in Hong Kong with around 10.0-15.0% share of the capital works contracts. The company is one of the few companies in Hong Kong to be "fully licensed", that is hold Group C licenses in the areas of Ports, Road & Drainage (i.e. road and bridge works), Site Formation Waterworks and Building. A Group C license allows the company to undertake projects of unlimited size within these 5 respective areas. CSCI has a similarly substantial market share in Macau, where we estimate to be around 15.0-20.0% of market share.

Table 2: Construction licenses held by CSCI

Region	Category	License Held
Hong Kong	5 major categories of ports, roads & drains, site formation, waterworks, building	Group C
Macau	All categories	Qualified Contractor
India	All categories	Qualified Contractor
UAE	All categories	Qualified Contractor
Mainland China	Building & foundation	Class 1

Source: Company data and SBI E2-Capital

Beneficiary of previous downturn. CSCI's strong positioning in Hong Kong was a direct result of: 1) steady build up of strong portfolio of reference projects and 2) taking advantage of market weakness during the previous downturn in 1999-2004. Prior to 1998, Hong Kong's engineering construction industry was extremely fragmented, with many overseas players. However, the downturn significantly escalated tender competition. The resulting lower tender prices forced many overseas players to downsize, or to exit the Hong Kong market entirely. This left CSCI as one of the few local contractors with the necessary scale to undertake sizeable projects. As a result, CSCI was able to grow both market share as well as operating scale.

Aggressive infrastructure in Hong Kong. To kick-start the local economy in the face of the global economic downturn, the HKSAR government has reiterated is stance to aggressively roll out infrastructure investment. Commonly referred to as the "10 key infrastructure projects", the programme is expected to ramp up government spending to levels previously seen between 1996-1998. We expect construction tender for these projects would gradually begin to roll out from 4Q 2009 onwards, leading to accelerating government infrastructure spending into 2010 and beyond. Being the leading engineering contractor in Hong Kong, we think that CSCI is in a prime position to take advantage of this improved investment environment. Based on our channel checks, the current earmarked schedule for the 10 key projects are shown below.

Table 3: Implementation time frame for 10 key projects

	Project	Type	Timetable Commence	Timetable Completion
1	Kai Tak Development	Comprehensive development		
2	Guangzhou-Shenzhen-HK Express Rail Line	Rail infrastructure	2009	2014-15
3	Shatin-Central Link	Rail infrastructure	2010	In phases 2015-19
4	HK-Zhuhai-Macau Bridge	Road infrastructure	2010	2015-16
5	West Kowloon Cultural District	Comprehensive development	2010	(Phase 1) 2014-15
6	South Island Line	Rail infrastructure	2011	2015
7	Tuen Mun West Bypass	Road infrastructure	2011	2016
8	Hong Kong-Shenzhen Airport Cooperation	Air traffic infrastructure	Consultancy stage	N.A.
9	Hong Kong-Shenzhen Boundary Area Development	Comprehensive development	Consultancy stage	N.A.
10	New Town Development	Comprehensive development	N.A.	Tentative 2019

Source: Company data and SBI E2-Capital

Competition to increase, but expect CSCI to remain dominant. While this massive infrastructure roll out is expected to invite some foreign competition back into Hong Kong, we expect CSCI to remain in a dominant position. The chief reason is that in our opinion, the foreign players are only likely to re-enter in a modest capacity, concentrating in specialist areas e.g. tunneling, seaborne erection etc. This will require them to partner with strong local contractors with the ability to secure sizeable projects. In this respect, we think CSCI will be in a favourable position where they can select the most suitable foreign player to partner with.

Investment theme 3: Strategically planned business model leads to long term sustainability

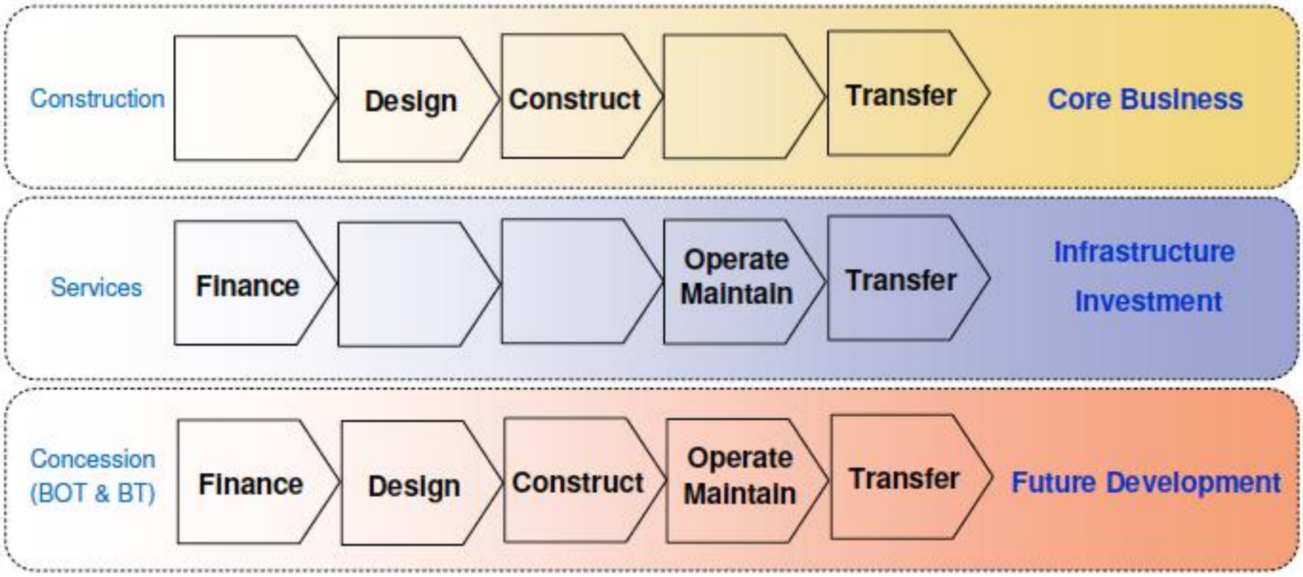
Business model drives sustainability. In our view, CSCI's business model, which is built upon strategic diversification in: 1) geography and 2) revenue stream, as well as 3) increasing integration along the value chain, is a key competitive advantage for the company and differentiates it from other peers within the sector.

Geographical diversification. In addition to China, CSCI has strategically positioned itself in emerging countries/regions including Dubai, Abu Dhabi, India and Macau. This allows CSCI to tap fast growth opportunities in different regions and diversify geographical risk. Case in point. During 2004-2007, when the Hong Kong market was in a relatively muted development phase, the company was able to tap the building boom in both Macau and later, Dubai. Now, when global economic downturn is adversely affecting the volume of construction works in these regions, CSCI can continue to grow by leveraging the aggressive fiscal government investment in both China and Hong Kong. We expect the next region of growth to be India, where CSCI already has a solid presence. Moreover, CSCI continues to diversify geographically. The company has spent the last 1.5 years to establish a footprint in Abu Dhabi, where investment has been less affected by the global downturn. Management aims to secure its maiden project win in this area towards the end of 2009.

Revenue stream diversification. Revenue stream diversification into infrastructure investment has allowed CSCI to generate a recurring revenue stream, and in the process, improve earnings visibility and in the process, decrease the company's reliance on sustaining a sizeable project backlog. The company currently operates a heat generation plant in Huanggu, Shenyang (acquired from parent in 2007) as well as Xin Ba Yi and Nanchang bridges in Nanchang (acquired from parent 2008). Though revenue from infrastructure investment accounted for only 3.9% of overall revenues in FY12/08A, the segment contributed 22.6% of gross profit for that year.

Migration to BOT. CSCI's development in its business model over the years from an engineering contractor, to infrastructure investment, to more recently BT projects, suggests that the company is gradually integrating vertically to an eventual build-operate-turnover (BOT) model. This would allow CSCI to eventually become a total solutions provider along the value chain with the ability to finance, design and construct, operate and maintain large scale infrastructure projects. In our view, CSCI's current BT projects is extremely important towards achieving this overall goal as it allows CSCI to develop a track record with Chinese banks and equity markets, and in the process broaden its financing channels.

Chart 1: Business model migration of CSCI



Source: Company data

Financials. CSCI's net profit between FY12/06A to FY12/08A grew at a CAGR of 48.4%. Turnover grew at a CAGR of 3.5% though gross profit grew at a higher CAGR of 40.7%. The strong gross profit growth was mainly due to margin expansion in high growth areas such as Macau, China and UAE, as well as contribution from its infrastructure investment segment. Though infrastructure investment revenues accounted for only 3.9% of revenues, it contributed 22.6% of gross profit (FY12/08A). The higher gross margins for Macau and China was mainly due to the higher proportion of cost-plus type and project management type contracts in these regions. For FY12/08A, revenue was up 8.4% YoY to HK$11,021.4m with gross profit up by 18.7% YoY to HK$909.4m. Net profit came in at HK$489.3m, up 20.9% YoY. Gross margin expanded 0.8pcp to 8.3% led by improving margins in its largest geographical region Hong Kong and contribution from infrastructure investment.

Table 4: Revenue breakdown

	06A			07A			08A		
Year end Dec (HK$m)	**Revenue**	***YoY (%)***	***%***	**Revenue**	***YoY (%)***	***%***	**Revenue**	***YoY (%)***	***%***
Hong Kong	7,509.5	*19.7*	*72.9*	5,501.4	*(26.7)*	*54.1*	6,191.5	*12.5*	*56.2*
Mainland China*	-	-	-	360.8	-	*3.6*	432.6	*19.9*	*3.9*
Mainland China**	-	-	-	302.4	-	*3.0*	449.4		*4.0*
Macau	1,536.6	*261.2*	*14.9*	1,586.8	*3.3*	*15.6*	2,078.2	*31.0*	*18.9*
Dubai	794.5	*509.3*	*7.7*	2,065.4	*160.0*	*20.3*	1,797.3	*(13.0)*	*16.3*
India	454.1	-	*4.4*	351.4	*(22.6)*	*3.5*	72.4	*(79.4)*	*0.7*
Total	10,294.8	*50.0*	*100.0*	10,168.3	*1.2*	*100.0*	11,021.4	*8.4*	*100.0*

* *Construction revenue*
** *Infrastructure investment revenue*
Source: Company data

Table 5: Key P&L items

Year end Dec (HK$m)	**06A**	**07A**	**08A**
Revenue	10,294.8	10,168.3	11,021.4
Gross profit	459.0	766.1	909.4
Profit before tax	271.0	530.0	570.7
Net profit	222.2	404.9	489.3

Source: Company data

Table 6: Geographical segment gross margin

Year end Dec (%)	06A	07A	08A
Hong Kong	4.5	3.3	3.7
Mainland China*	-	36.9	28.6
Mainland China**	-	-	47.7
Macau	7.0	17.3	13.6
Dubai	0.9	2.6	3.2
India	1.8	7.3	5.5
Total	4.5	7.5	8.3

* *Construction revenue*

** *Infrastructure investment revenue*

Source: Company data

Table 7: Gross margin contribution

Year end Dec (%)	06A	07A	08A
Hong Kong	73.3	23.4	25.1
Mainland China*	-	30.6	13.6
Mainland China**	-	-	23.6
Macau	23.4	35.8	31.0
Dubai	1.5	6.9	6.3
India	1.8	3.3	0.4
Total	100.0	100.0	100.0

* *Construction revenue*

** *Infrastructure investment revenue*

Source: Company data

Table 8: Margin breakdown

Year end Dec (%)	06A	07A	08A
Gross	4.5	7.5	8.3
EBITDA	2.5	4.5	5.5
EBIT	7.0	4.4	5.3
Net	2.2	4.0	4.4

Source: Company data

New contracts and backlogs. By the end of May 2009, CSCI had a contract backlog of HK$25.0b. The company has sustained a solid pace of contract wins thus far in 2009, securing contracts to the tune of HK$7.5b, putting it on pace to beat the amount of new contract wins for 2008. A slowdown in UAE, India and Macau has been offset by strong growth in Hong Kong and securing its first BT win in China. This is a promising sign given that we expect new contract wins to further grow in 2010, with several large contracts being rolled out in Hong Kong, continuing expansion of its business in China, potentially initial recovery in Dubai and Macau and contract wins expected from its newly established Abu Dhabi region.

Table 9: New contracts awarded

(HK$b)	2007	2008	2009 Update(by May)
Hong Kong	5.16	9.48	4.36
Macau	3.78	1.62	-
UAE	2.10	1.82	-
India	-	-	-
Mainland China	0.15	1.26	3.14
Total	11.19	14.18	7.50

Source: Company data

Table 10: Project in progress

(HK$b)	2007 Contract Value	2007 Backlog	2008 Contract Value	2008 Backlog	2009 Update (By May) Contract Value	2009 Update (By May) Backlog
Hong Kong	15.48	8.27	20.48	11.94	24.84	13.88
Macau	10.86	8.78	10.42	5.06	9.73	4.01
UAE	5.88	3.05	6.08	3.22	6.14	3.29
India	0.30	0.08	-	-	-	-
Mainland China	0.35	0.04	1.06	0.91	4.19	3.81
Total	32.87	20.22	38.04	21.13	44.90	24.99

Source: Company data

Estimates. We estimate that CSCI's revenue will increase 19.3% YoY to HK$13,153.9m for FY12/09F, 14.4% YoY to HK$15,049.9m for FY12/10F, and 22.4% YoY to HK$18,422.8m for FY12/11F. The growth would be mainly driven by the Hong Kong market and Mainland China Market. Revenue from HK market will increase 29.5% YoY to HK$8,018.9m for FY12/09F, 14.6% YoY to HK$9,192.3m for FY12/10F, and 28.8% YoY to HK$11,840.8m for FY12/11F. The construction revenue in mainland China market excluding BT project would increase 59.7% YoY to HK$1,408.6m for FY12/09F, 49.9% YoY HK$2,112.1m for FY12/10F, and 9.3% HK$2309.2m for FY12/11F. We estimate revenue from BT project in China would be HK$407.5m for FY12/09F, HK$1,689.1m for FY12/10F, and HK$2,150.1m for FY12/11F. The gross margin would decrease slightly in FY12/09F to 8.0% (from 8.3% in FY12/08A) because less contribution from Macau, which has a higher margin, and the margin decrease in mainland China construction. The gross margin would be stabilized at 8.0% for FY12/10F because the mixed effect of margin squeeze in Macau and new profit contribution from BT project. The margin would decrease slight to 7.7% in FY12/11F due to the further margin squeeze in mainland China construction. The SG&A cost would be increased between 6.0%-15% from FY12/09F to FY12/11F. We estimate that the net profit will increase 11.3% YoY to HK$544.4m for FY12/09F, 17.3% YoY to HK$638.5m for FY12/10F, and 19.0% YoY to HK$759.9m for FY12/11F.

Table 11: Revenue assumptions

Year end Dec (HK$m)	09F Revenue	09F *YoY (%)*	09F *%*	10F Revenue	10F *YoY (%)*	10F *%*	11F Revenue	11F *YoY (%)*	11F *%*
Hong Kong	8,018.9	*29.5*	*61.0*	9,192.3	*14.6*	*61.1*	11,840.8	*28.8*	*64.3*
Mainland China*	917.1	*112.0*	*7.0*	1,601.9	*74.7*	*10.6*	1,775.8	*10.9*	*9.6*
Mainland China**	491.5	*9.4*	*3.7*	510.2	*3.8*	*3.4*	533.4	*4.5*	*2.9*
BT project in China	407.5-		*3.1*	1,689.1	*314.5*	*11.2*	2,150.1	*27.3*	*11.7*
Macau	1,902.1	*(8.5)*	*14.5*	1,136.9	*(40.2)*	*7.6*	1,084.2	*(4.6)*	*5.9*
Dubai	1,416.8	*(21.2)*	*10.8*	919.6	*(35.1)*	*6.1*	765.5	*(16.8)*	*4.2*
India	0.0-	-	-	-	-		273.0-	-	
Total	13,153.9	*19.3*	*100.0*	15,049.9	*14.4*	*100.0*	18,422.8	*22.4*	*100.0*

* *Construction revenue* ** *Infrastructure investment and bridge revenue*

Source: SBI E2Capital

Table 12: Geographical segment gross margin assumptions

Year end Dec (%)	09F	10F	11F
Hong Kong	4.1	4.3	4.6
Mainland China*	20.0	15.0	14.0
Mainland China**	47.4	44.6	44.4
BT project in China	0.0	12.4	12.0
Macau	13.5	9.0	9.0
Dubai	3.2	3.1	3.4
India	-		5.4
Total	8.0	8.0	7.7

* *Construction revenue*

** *Infrastructure investment and bridge revenue*

Source: Company data

SBI E2-Capital

Initiate coverage with BUY call, target price HK$3.46. We like CSCI for: 1) ability to break into China's infrastructure construction market and tap growth opportunities stemming from the RMB4,000b stimulus package; 2) dominant position in HK infrastructure sector while the HKSAR government has reiterated is stance to aggressively roll out infrastructure investment; and 3) geographical diversification and gradual vertical integration, leading to long term sustainability. We initiate coverage on the counter with a DCF-derived target price of HK$3.46, considering WACC of 9.2% (cost of debt: 3.3%; market risk premium: 8%; Beta: 1.0) and terminal growth of 2.0%. The target price represents 15.6x FY12/09F P/E and 13.3x FY12/10F P/E.

Table 13: DCF valuation reference table

	Terminal Growth				
WACC	**1.0%**	**2.0%**	**3.0%**	**4.0%**	**5.0%**
6.6%	4.85	5.29	5.88	6.69	7.87
7.9%	3.93	4.19	4.51	4.92	5.46
9.2%	3.30	3.46	3.66	3.90	4.20
9.9%	3.05	3.19	3.35	3.54	3.77
10.6%	2.57	2.67	2.79	2.93	3.09

Source: SBI E2-Capital

Risks. 1) Regulatory risks in various geographical countries and regulations related to its infrastructure investment business; 2) competition; 3) financing risks related to its BT projects 4) significant deterioration in gross margins and 5) working capital and project management risks related to its construction projects.

Table 14: P & L

Year to Dec (HK$m)	07A	08A	09F	10F	11F
Turnover	**10,168.3**	**11,021.4**	**13,153.9**	**15,049.9**	**18,422.8**
Cost of sales	(9,402.2)	(10,112.0)	(12,106.7)	(13,850.4)	(16,996.4)
Gross profit	**766.1**	**909.4**	**1,047.2**	**1,199.5**	**1,426.4**
Other income	129.9	71.3	74.7	73.4	69.4
Selling and distribution costs	(10.7)	(17.8)	(20.6)	(21.5)	(24.9)
Administrative expenses	(332.0)	(394.0)	(420.9)	(451.5)	(515.8)
Other Expenses	(29.9)	12.5	(3.9)	(4.5)	(5.5)
Operating profit	**523.3**	**581.3**	**676.5**	**795.3**	**949.5**
Financial costs	(1.8)	(20.1)	(23.4)	(31.0)	(43.0)
Share of loss of a jointly controlled entity					
Share of loss of an associate	8.8	9.4	9.8	9.8	9.8
Pre-tax profit	**530.3**	**570.7**	**662.9**	**774.1**	**916.3**
Tax	(82.4)	(66.3)	(99.4)	(116.1)	(137.4)
Minority interests	(43.1)	(15.1)	(19.0)	(19.5)	(18.9)
Net profit	**404.9**	**489.3**	**544.4**	**638.5**	**759.9**

Source: Company data and SBI E2-Capital

Table 15: Valuation table

Company name	Ticker	Mkt cap (US$m)	Last Price (Local)	Cur Est P/E (x)	Nxt Est P/E (x)	Cur EV/EBITDA (x)	Est ROE (%)	Est Yld (%)
HK-listed								
China Railway	390 HK	20134.2	6.36	20.9	15.7	11.0	10.1	1.2
China Railway Cons	1186 HK	18542.3	11.88	21.4	16.3	7.2	12.3	1.3
China Com Cons	1800 HK	17636.7	9.22	15.5	12.6	9.0	17.1	1.5
China State Cons	3311 HK	884.4	2.80	11.9	9.9	7.7	20.4	2.8
Average				*17.4*	*13.6*			
China-listed								
China Railway	601390 CH	20134.1	6.67	24.3	18.2	11.4	9.5	1.3
China Railway Cons	601186 CH	18542.1	10.23	21.4	16.1	7.2	10.6	1.0
Average				*22.9*	*17.2*			

Source: Bloomberg

P & L (HK$m)	07A	08A	09F	10F	11F
Year to Dec					
Turnover	**10,168.3**	**11,021.4**	**13,153.9**	**15,049.9**	**18,422.8**
% chg	*(1.2)*	*8.4*	*19.3*	*14.4*	*22.4*
Gross profit	766.1	909.4	1,047.2	1,199.5	1,426.4
EBITDA	458.4	599.2	656.3	783.8	927.4
Depre./amort.	(10.3)	(11.2)	(15.1)	(16.7)	(17.8)
EBIT	448.2	588.0	641.2	767.1	909.7
Net int. income/(exp.)	73.4	(20.1)	11.9	(2.8)	(3.2)
Exceptionals	-	(6.7)			
Associates	8.8	9.4	9.8	9.8	9.8
Jointly-controlled entit.	0.0	0.0	0.0	0.0	0.0
Pre-tax profit	**530.3**	**570.7**	**662.9**	**774.1**	**916.3**
Tax	(82.4)	(66.3)	(99.4)	(116.1)	(137.4)
Minority interests	(43.1)	(15.1)	(19.0)	(19.5)	(18.9)
Net profit	404.9	489.3	544.4	638.5	759.9
% chg	*82.2*	*20.9*	*11.3*	*17.3*	*19.0*
Dividends	(104.1)	(199.9)	(163.3)	(191.5)	(228.0)
Retained earnings	300.8	289.4	381.1	446.9	532.0
EPS (HK$) - Basic	0.183	0.201	0.222	0.261	0.310
EPS (HK$) - F.D.	0.172	0.192	0.222	0.261	0.310
DPS (HK$)	0.047	0.082	0.067	0.078	0.093
No. sh.s o/s (m) - W.A.	2,210.1	2,438.8	2,447.9	2,447.9	2,447.9
No. sh.s o/s (m) - Y.E.	2,432.8	2,447.9	2,447.9	2,447.9	2,447.9
No. sh.s o/s (m) - F.D.	2,354.8	2,549.2	2,447.9	2,447.9	2,447.9
Margins (%)					
Gross	*7.5*	*8.3*	*8.0*	*8.0*	*7.7*
EBITDA	*4.5*	*5.4*	*5.0*	*5.2*	*5.0*
EBIT	*4.4*	*5.3*	*4.9*	*5.1*	*4.9*
Pre-tax	*5.2*	*5.2*	*5.0*	*5.1*	*5.0*
Net	*4.0*	*4.4*	*4.1*	*4.2*	*4.1*

Balance Sheet (HK$m)	07A	08A	09F	10F	11F
Year to Dec					
Fixed assets	972.0	1,107.3	1,156.5	1,089.2	1,011.6
Intangible assets	0.0	0.0	0.0	0.0	0.0
Other LT assets	363.2	961.3	942.6	924.1	905.6
Cash	1,568.0	1,917.0	2,932.9	1,500.6	942.9
Accounts receivable	3,339.2	3,703.2	3,831.1	6,013.7	8,343.8
Other receivables	595.0	506.4	359.3	411.1	472.8
Inventories	54.5	55.5	66.6	79.9	95.9
Due from related co.s	434.0	468.3	315.7	361.2	415.4
Other current assets	281.7	264.7	263.1	301.0	346.1
Total assets	**7,607.5**	**8,983.7**	**9,867.9**	**10,680.8**	**12,534.2**
Accounts payable	(3,759.9)	(3,690.4)	(4,380.3)	(4,411.3)	(5,085.5)
Other payable	(425.9)	(301.1)	(359.3)	(411.1)	(472.8)
Tax payable	(101.5)	(114.6)	(154.4)	(200.8)	(254.9)
Due to related co.s	(325.3)	(370.1)	(339.0)	(386.4)	(442.8)
ST debts	(29.7)	(37.1)	(300.0)	(800.0)	(2,300.0)
Other current liab.	(602.1)	(710.5)	(657.7)	(752.5)	(865.4)
LT debts	(21.2)	(1,000.0)	(1,000.0)	(1,000.0)	(200.0)
Other LT liabilities	(186.1)	(236.5)	(110.9)	(157.4)	(213.8)
Total liabilities	**(5,451.8)**	**(6,460.4)**	**(7,301.7)**	**(8,119.5)**	**(9,835.2)**
Share capital	60.8	61.1	61.1	61.1	61.1
Reserves	2,094.9	2,462.1	2,505.1	2,500.1	2,637.9
Shareholders' funds	**2,155.7**	**2,523.3**	**2,566.2**	**2,561.2**	**2,699.0**
Minority interest	-	-	-	-	-
Total	**2,155.7**	**2,523.3**	**2,566.2**	**2,561.2**	**2,699.0**
Capital employed	2,206.6	3,560.4	3,866.2	4,361.3	5,199.0
Net (debt)/cash	1,517.1	879.9	1,632.9	(299.5)	(1,557.1)

Cash Flow (HK$m)	07A	08A	09F	10F	11F
Year to Dec					
EBIT	448.2	588.0	641.2	767.1	909.7
Depre./amort.	10.3	11.2	15.1	16.7	17.8
Net int. paid	73.4	(20.1)	11.9	(2.8)	(3.2)
Tax paid	(44.6)	(66.3)	(59.7)	(69.7)	(81.0)
Dividends received	0.0	0.0	0.0	0.0	0.0
Gross cashflow	**487.2**	**512.9**	**608.5**	**711.4**	**843.2**
Chgs. in working cap.	(2,164.9)	(327.1)	756.1	(2,164.9)	(1,671.9)
Operating cashflow	**(1,677.6)**	**185.8**	**1,364.6**	**(1,453.5)**	**(828.7)**
Capex	(124.6)	(215.1)	(500.0)	(260.0)	(200.0)
Free cashflow	**(1,802.2)**	**(29.3)**	**864.6**	**(1,713.5)**	**(1,028.7)**
Dividends paid	(104.1)	(199.9)	(163.3)	(191.5)	(224.5)
Net distribution to MI	-	-	-	-	-
Investments	-	-	-	-	-
Disposals	0.0	0.0	0.0	0.0	0.0
New shares	1,009.0	6.4	0.0	0.0	0.0
Others	304.8	571.9	314.6	472.7	695.5
Net cashflow	**(592.6)**	**349.1**	**1,015.8**	**(1,432.3)**	**(557.7)**
Net (debt)/cash - Beg.	2,160.5	1,568.0	1,917.0	2,932.9	1,500.6
Net (debt)/cash - End.	1,568.0	1,917.0	2,932.9	1,500.6	942.9

Interim Results (HK$m)	07A	08A
Six months to Jun		
Turnover	5,202.0	5,407.5
% chg	*6.9*	*3.9*
Profit from operations	140.6	286.0
Interest expenses	(0.1)	(6.7)
Associates	-	-
Jointly-controlled entit.	-	-
Pre-tax profit	140.5	279.4
Tax	(24.9)	(22.6)
Minority interests	-	0.4
Net profit	115.7	257.2
% chg	33.6	122.4
EPS (HK$) - Basic	0.232	0.106
DPS (HK$)	0.090	0.037

Shareholding Structure	Shares o/s (m)	%
CSCEC	1,538.0	62.83
Credit Agricole	61.7	2.53
Fidelity	56.5	2.30
Others	791.8	32.35
Total	**2447.9**	**100.00**

Background

China State Construction (CSCI) is a multi-disciplinary infrastructure and building engineering contractor. The company's core geographical markets are in Greater China (Hong Kong, China and Macau) as well as emerging countries/regions such as Dubai, Abu Dhabi and India. The company has been established since 1979 (30 years track record). CSCI was listed by way of introduction in Jul 2005. The company has >4,456 staff collectively, located in its presence regions.

Key Ratios	07A	08A	09F	10F	11F
Net gearing (%)	Cash	Cash	Cash	11.7	57.7
Net ROE (%)	25.9	20.9	21.4	24.9	28.9
EBIT ROCE (%)	28.2	20.4	17.3	18.6	19.0
Dividend payout (%)	25.7	40.8	30.0	30.0	30.0
Effective tax rate (%)	15.5	11.6	15.0	15.0	15.0
Net interest coverage (x)	-	29.3	-	276.5	284.8
A/R turnover (days)	108	117	105	119	142
A/P turnover (days)	140	134	122	116	102
Stock turnover (days)	1	2	2	2	2