Corporate Snippet

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Margin pressure despite strong sales growth — China Logistics

GD Nan Yue (3399 HK, HK$3.56) HOLD (downgraded from BUY)

Target price: HK$3.80(+6.7%)

Results summary

- FY12/06A results came inline with our expectations, with 14.0% YoY increase in net profit to RMB155.8m. Sales rose 29.5% YoY to RMB5.6b. However, operating profit grew slower at 13.0% YoY to RMB272.3m on shrinking margins. EPS amounted to RMB0.37. DPS amounted to RMB0.11, representing a payout ratio of 29.7% and a dividend yield of 3.1%. Despite the Group's ability to grow its top-line, margins continued to decline across the board reflecting its lower operating efficiency. The gross margin showed the most significant decline from 12.2% in FY12/05A and 11.5% in 1H FY12/06A to 10.6%, mainly due to higher costs involved in managing newly added service zones, which has led to 15.7pcp YoY decline to 34.1% in the gross margin of the expressway service zone segment.

Table 1: Sales breakdown by segment

RMBm	05A	06A	YoY %
Material logistics services	3,243.8	4,255.3	*31.2*
Expressway services zones	278.5	370.2	*32.9*
Transportation intelligence services	474.3	623.3	*31.4*
Toll incomes	84.8	104.3	*22.9*
Coach business	256.8	262	*2.0*
Others	13.7	20.3	*48.0*
Sales	**4,352.0**	**5,635.4**	***29.5%***

Source: Company data

Table 2: Operating profit margin breakdown by segment

%	05A	06A	Changes
Material logistics services	2.1	2.1	-
Expressway services zones	26.1	19.3	(6.8)
Transportation intelligence services	3.6	2.9	(0.7)
Toll incomes	80.3	80.9	0.6
Coach business	15.9	14.2	(1.7)
Others	30.9	29.2	(1.7)

Source: Company data

Table 3: Financial summary

Year to Dec	Net profit RMB m	EPS RMB	EPS Δ%	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	136.6	0.327	25.6	11.3	1.32	6.8	2.2	16.1	20.7	Cash
06A	155.8	0.373	14.0	9.9	1.17	6.2	3.1	13.2	18.5	Cash
07F	182.0	0.436	16.9	8.5	0.95	5.2	3.7	12.3	17.8	Cash
08F	201.8	0.483	10.9	7.7	0.73	4.9	4.1	10.8	15.9	Cash
09F	223.2	0.534	10.6	6.9	0.56	4.8	4.5	9.1	13.5	Cash

Table 4: Overall margin trends

%	1H05	1H06	05A	06A
Gross margin	13.4	11.5	12.2	10.6
Operating margin	7.0	5.8	5.5	4.8
Pretax margin	6.3	5.5	5.2	4.6
Net margin	3.9	3.3	3.1	2.8

Source: Company data

Operation highlights

I) Material logistic services:

Table 5: Volume of construction materials handled

	05A	06A	YoY %
No. of logistics projects handled	19	24	-
Total volume of material supplied (tonnes)			
- cement	2.200	1.220	*(44.2)*
- steel	0.655	1.150	*75.2*
- steel strand	0.023	-	-
- asphalt	0.130	0.111	*(14.9)*
- iron ore	-	0.301	-
- coal	-	0.401	-
Total	**3.010**	**3.190**	***6.0***

Source: SBI E2-Capital

- Sales rose 31.2% YoY to RMB4.3b, inline with our estimates. Gross margin narrowed 0.1pcp to 4.9%, while operating margin remained at 2.1% as a result of transportation of higher-margin materials, such as coal and iron ore.
- Transportation of asphalt was disappointing, with the total volume down 14.9% YoY compared with FY12/05A, which implies that the company failed in its strategy to aggressively expand its asphalt transport business through setting up additional warehouse and infrastructure facilities, which was stated during its interim results announcement.

II) Expressway service zones.

- Sales grew 32.9% YoY to RMB370.0m, as the total number of service zones rose to 43 pairs in FY12/06A (FY12/05A: 40 pairs) and the service scope has widened to include vehicle repair and maintenance. However, both gross and operating margins narrowed to 34.0% (FY12/05A: 49.8%) and 19.3% (FY12/05A: 26.1%), respectively, as a result of slow business in new service zones and higher operating costs.

III) Coach business:

- Sales remained stable with 2.0% YoY growth to RMB262.0m. While gross and operating margin declined to 24.8% (FY12/05A: 26.2%) and 14.2% (FY12/05A: 15.9%), respectively, mainly as a result of higher gasoline prices and stable average fare prices despite a 4.0% YoY increase in total passengers carried to 3.89m.

IV) Tai Ping Interchange:

- Toll income rose 23.0% YoY to RMB104.3m mainly due to an increased traffic flow on the opening of Jiangzhong Expressway, resulting in increased vehicles via Tai Ping Interchange from West Guangdong and Pearl River Delta to Dongguan, Shenzhen and Huizhou. The average traffic volume rose 18.0% YoY to 50,612 vehicles daily. Gross and operating margin stayed at 84.2% and 80.9%, respectively.

V) Intelligent transportation services (ITS):

- Sales grew 31.4% YoY to RMB623.3m as a result of more projects. The division returned to profitability from a loss of RMB2.42m in 1H FY12/06A. However, gross and operating margins were disappointing. Gross margin declined 1.9pcp YoY to 15.9% and operating margin 0.7pcp YoY to 2.9%.

Valuation. We believe upside rests mainly on its 1) ability to sustain top-line and 2) potential asset injections from its parent, Guangdong Provincial Communications Group Company Limited (GCGC). In view of decelerating margin trends, we believed the company should focus on enhancing its operating efficiency when growing sales. We revised down our earnings forecast based on lower margins. Based on our blended P/E valuation, we revised down our target price to HK$3.8 (from HK$4.6), equivalent to 9.1x P/E in FY12/07F. We downgrade it from BUY to HOLD. Upside remains on its asset injections from parent GCGC.

Table 6: Blended P/E valuation

Sum-of-the-parts Valuation	EBIT FY12/07F (HK$m)	Adj. comparable P/E	HK$m
Material logistics services	107.4	7.0	752.0
Expressway services zones	50.5	5.0	252.4
Transportation intelligence services	18.2	5.0	91.1
Toll incomes	99.7	5.0	498.3
Coach business	34.7	3.0	104.1
Others	7.3	3.0	21.9
Enterprise value			1,719.8
Less debt			(140.0)
Equity value			1,579.8
Value per share (HK$)			3.8

Source: SBI E2-Capital