

Strategic acquisition of Guangdong Feida

China Logistics

GDNY (3399 HK, HK\$3.61)

BUY (unchanged)

Target price: HK\$4.6 (+27.4%)

The acquisition. GDNY announced to acquire a 30% equity interest in Guangdong Feida (GDF) for a consideration of RMB11.2m, equivalent to 10.9x historical P/E in FY12/05A. GDF made RMB3.4m net profit in FY12/05 and has a total net asset value of RMB12m. The acquisition will be paid by the IPO proceeds. GDF is principally engaged in the provision of transportation construction services including communications, traffic monitoring and control systems, toll collection engineering, and related consulting services in the PRC. Its parent company, Guangdong Provincial Communication Group Company Limited (GCGC), has a 66.96% interest in GDF.

Potential impact

- The acquisition will benefit GDNY because of higher bargaining power in project biddings from an enlarged market share and potential synergies derived from its existing Intelligent Transportation Services (ITS) business. There are two major ITS services providers in Guangdong Province, namely GDF and Guangdong Xinyue, which is a 71%-owned subsidiary of GDNY. Since some of the services operated by Guangdong Feida overlap with GDNY, the acquisition can benefit both parties by achieving cost savings of consolidating the resources and closing down the duplicated highway service maintenance centres.
- The acquisition price translates into 10.9x P/E for FY12/05A, which is higher than the Company's own P/E.
- The ITS segment made an operating loss of RMB1.4m (FY12//05A: -RMB3.6m), despite 135% increase in sales because the Guangdong Provincial Government has imposed policy on bidding for ITS projects, from which the lowest tender wins. This has driven down GDNY's margins. Moreover, the project fees are collected in different phases depending on the progress of the implementation of ITS system since the systems sold in 1H06 have to undergo trial period for a few months. As a result, the ITS services should be profitable on a full year bases. In our valuation, we assume a 2% EBIT margin for FY12/06-07F (FY12/05A: 3.6%). Since GDF's EBIT margin is not available, we assume it earns the same percentage as GDNY's ITS service. Assuming and a flat earnings growth, the acquisition will enhance GDNY's EPS by at least 0.5% in FY12/07F.

Valuation. We have fine-tuned our sales and earnings forecasts for FY12/07F and FY12/08F after accounting the impact of the acquisition. Total net cash is expected to decrease to HK\$510m, immediately upon the payment of the deal. We maintain our BUY recommendation with a target price of HK\$4.6 based on our blended P/E valuation. It is trading at 7.9x cum-cash and 5x ex-cash FY12/07F P/E.

Table 1: Financial summary

Year to Dec	Net profit RMBm	EPS RMB	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	108.8	0.260	73.7	14.4	1.38	6.8	n.a.	19.2	27.8	Cash
05A	136.6	0.327	25.6	11.5	1.34	6.9	2.0	16.1	20.7	Cash
06F	154.4	0.370	13.0	10.2	1.25	6.7	3.1	13.5	17.6	Cash
07F	199.6	0.478	29.3	7.9	1.05	5.3	4.0	14.5	19.5	Cash
08F	262.3	0.628	31.4	6.0	0.84	4.4	5.2	15.6	21.3	Cash

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. If you would like to access our research reports and know more about our services, please contact Raymond Jook, Head of Research, on (852) 2533 3715 or raymondjook@softbank.com.hk. Find our research on: sbie2capital.com, thomsononeanalytics.com and multex.com

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other primary businesses with the companies in this report.

Analyst certification: the views expressed in this report accurately reflects the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

Table 2: Earnings model

Year to Dec (RMBm)	04A	05A	06F	07F	08F
Sales					
- Material procurement & logistics	2,720.5	3,243.8	4,251.7	5,290.8	6,422.0
- Expressway services zones	172.1	278.5	305.5	380.4	499.3
- Transportation intelligence services	346.8	474.3	948.6	1,521.3	1,977.7
- Toll incomes	77.2	84.8	93.3	102.6	112.9
- Coach business	249.2	256.8	255	258	304
- Others	30.8	13.7	16.5	19.7	23.7
	3,596.6	4,352.0	5,870.9	7,572.8	9,339.7
YoY%	171.0	21.0	34.9	29.0	23.3
Cost of sales	(3177.9)	(3823.1)	(5142.6)	(6616.0)	(8156.6)
Gross profit	418.7	529.0	728.3	956.8	1183.1
Other revenue	8.8	11.3	15.5	20.4	25.2
Interest income	3.4	6.6	15.4	11.0	12.3
Operating expenses	(226.3)	(305.9)	(491.3)	(647.1)	(777.4)
Operating profit					
- Material procurement & logistics	51.2	67.2	92.3	130.8	178.0
- Expressway services zones	50.7	72.6	64.2	79.9	105.4
- Transportation intelligence services	34.0	17.1	19.0	30.4	39.6
- Toll incomes	60.1	68.1	78.7	90.6	104.2
- Coach business	33.4	40.9	48.0	53.9	71.2
- Others	(2.6)	4.2	5.1	6.1	7.3
Unallocated expenses	(22.3)	(29.1)	(39.3)	(50.7)	(62.5)
Operating profit	204.6	240.9	267.9	341.1	443.1
Interest expenses	(18.9)	(16.3)	(15.1)	(13.9)	(12.8)
Associates	0.7	1.8	3.1	3.7	4.4
Profit before taxation	186.4	226.4	255.9	330.8	434.8
Taxation	(60.2)	(65.7)	(74.2)	(96.0)	(126.1)
Minority interest	(17.4)	(24.2)	(27.3)	(35.3)	(46.4)
Net profit	108.8	136.6	154.4	199.6	262.3
YoY%	73.7	25.6	13.0	29.3	31.4

Source: SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities acted as the Co-lead Manager/Underwriter of the IPO of Guangdong Nan Yue Logistics in Oct 2005.