

Waiting for more M&A

BUY (unchanged)

Profit estimates lowered. We have cut our net profit estimate by 35.2% to HK\$752.5m for FY12/08F and 56.4% to HK\$948.3m for FY12/09F, due to lower earnings forecasts for COSCO International's 20.7%-owned property arm, Sino Ocean Land (3377 HK, HK\$8.09, NR). Sino Ocean Land is expected to account for 74.2% of COSCO's estimated FY12/08F profit and 76.5% of FY12/09F profit. COSCO's core earnings are forecast to increase at a CAGR of 17.3% between FY12/07A and FY12/10F (HK\$160.5m in FY12/07A). Net profit of its shipping segment (including 50.0%-owned COSCO-Jotun) is estimated at HK\$194.5m and HK\$222.4m, respectively.

Challenging times ahead. We are concerned about the prospects of the group's shipping services business, due to the global economic slowdown. The company's COSCO-Kansai division, which accounted for 42.9% of shipping service pre-tax earnings in FY12/07A, is facing surging raw material costs. Vessel trading should fare better due to numbers of vessels scheduled for delivery this year. Since we do not cover Sino Ocean Land, we adopt consensus forecasts and believe that the Chinese government's austerity measures may erode its earnings this year.

Share price catalysts. 1) Sino Ocean Land's share price performance, which is vulnerable to sentiment shifts in the China property sector; 2) acquisition and asset injections - the company is looking at parent's (COSCO Group) assets. It has plenty of resources to finance potential purchases, with net cash of HK\$814.5m at end-FY12/07A and the market capitalization of its Sino Ocean Land's stake of about HK\$7.2b.

New target price at HK\$6.9. We value the group shipping services at 10.0x of its FY12/09F earnings. For the valuation of Sino Ocean Land, we adopt a mark-to-market approach and put the group's NAV per share at HK\$7.0. On 28 Nov 2007, when it traded at HK\$7.98, we set the target price at HK\$9.30. The share price reached HK\$9.27 in Dec 2007 and retreated to HK\$3.54 in Mar 2008. Our new target price represents a 26.1% discount to its appraised NAV. Thus, we reiterate our BUY call on the group.

Stellar FY12/07A results. COSCO International's FY12/07A net profit surged more than four-fold to HK\$2,572.6m, thanks to a HK\$1,925.5m gain from the restructuring and listing of Sino Ocean Land (previously known as Sino Ocean Real Estate Development). Stripping off the exceptional gain, HK\$4.1m fair value gain on investment properties, HK\$2.9m gain on disposal of subsidiaries, HK\$6.8m write-back of provisions and HK\$472.8m contribution from Sino Ocean Land, the group's core earnings reached HK\$160.5m.

Hong Kong Conglomerate

Wed, 09 Apr 2008

Andes Cheng

(852) 2533 3721

andescheng@sbi2capital.com

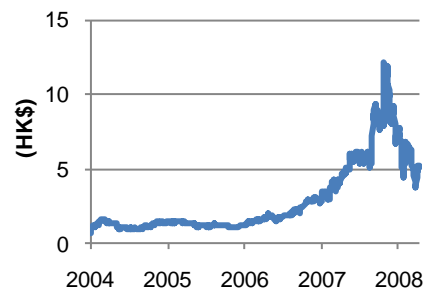
Stock data

Price	HK\$5.10
Target price	HK\$6.90 (+35.3%)
12 mth range	HK\$3.54-12.90
Market cap.	US\$985.4m
Daily t/o, 3 mth	US\$1.8m
Free float %	56.1%
Ticker	0517.HK/517 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	1,866.5	2,309.1	2,365.5	2,693.8	3,054.0
Net profit (HK\$m)	616.6	2,572.6	752.5	948.3	714.1
EPS (HK\$)	0.429	1.760	0.508	0.640	0.482
EPS	21.7	305.9	(70.1)	26.0	(24.7)
P/E (x)	12.4	3.0	10.2	8.1	10.7
P/B (x)	3.41	1.56	1.60	1.96	2.78
EV/EBITDA (x)	52.6	46.7	27.5	21.8	19.2
Yield (%)	1.0	1.2	0.8	0.9	1.0
ROE (%)	28.0	52.5	15.8	24.3	26.0
ROCE (%)	24.4	47.4	14.6	21.7	21.6
N. Gear. (%)	cash	cash	cash	cash	cash

Price Chart



SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbi2capital.com, thomsononeanalytics.com, factset.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.

Turnover and operating profit. The company's total turnover increased 23.7% YoY to HK\$2,309.1m. Core shipping services grew 25.8% YoY to HK\$2,058.3m, with COSCO-Kansai, the group's major container and anti-corrosion paint manufacturing arm, contributing 76.8% of the segmental revenue in FY12/07A. The ship trading division, parts trading division and marine insurance brokerage division accounted for 3.6%, 17.1% and 2.6%, respectively, of the group's shipping services revenue. The division's pre-tax profit increased 33.03% to HK\$240.0m, with COSCO-Kansai contributing 42.9% of core pre-tax earnings and COSCO-Jotun 11.3%. The ship trading division, marine insurance brokerage division and parts trading division accounted for 19.6%, 14.6% and 11.7%, respectively, of the group's core-pre-tax earnings. Though their revenue contributions were relatively small, the vessel trading division and marine insurance brokerage division contributed significant amounts of per-tax earnings to the group's shipping services segment, implying their operating margins were high due to their asset-light nature and synergies.

Divesting non-core assets. After the disposal of its 51.0%-owned property project in Shenyang, Shenyang COSCO Yihe Garden for HK\$57.5m, 100.0% in block five of Kingswell Garden, a service apartment complex in Shanghai for HK\$31.2m, and 100.0% in Shun Shing Construction and Engineering Company in FY12/07A, the company's only non-core assets are its 1,841.0m² retail space and 193 car parking spaces at Fragrant Garden in Shanghai, as well as Sino Ocean Land. The company plans to sell its holdings in Fragrant Garden and keep Sino Ocean Land.

Coating division. COSCO-Kansai's pre-tax profit increased 5.0% YoY to HK\$103.0m, despite the fact that the ASP of the company's container coating products and anti-corrosion paint products increased 2.8% YoY and 7.0% YoY, respectively. The GP of the container paint and anti-corrosion paint remained at 19.0% and 33.0%, respectively. High raw material costs, depreciation in the USD (sales were mostly USD-denominated and costs mostly RMB-denominated), depreciation charges and opening expenses related to the company's new plant in Zhuhai launched in Sep 2007 suppressed its profitability and the trend is expected to continue. However, the company's overall capacity boost to 87,000.0t.p.a., from 63,000.0t.p.a. in FY12/06 and possible price hikes should mitigate the negative impact. The company also plans to denominate its sales contracts in RMB instead of USD. In 2007, it was China's third largest container coating services provider, accounting for 26.1% of the market. The GP of COSCO-Jotun's marine paint products stayed at 22.0% while ASPs increased 3.0% YoY. Since the JV's plant was fully utilized last year, the management plans to build a new facility to expand capacity.

Vessel trading - major core earnings boost. We expect the ship trading division to be a major growth driver of the group's shipping services segment this fiscal year, as many vessel deliveries are scheduled between FY12/08F and FY12/09F. In FY12/07A, the division's pre-tax profit rose 81.0% to HK\$47.0m, with the trading volume up 9.0% YoY at about 6.7m DWT (dead weight ton). At end-FY12/07A, the group's orders on hand were about 12.9m DWT, up 73.0% YoY. About 11.7% of all vessels traded were second-hand, allowing the group to realize its commission income timely. In contrast, the lead time of building a new vessel is about two years, so commission income is realized only upon delivery. However, commission income from new vessels is higher than that from second-hand vessels due to higher ship prices. Currently, the group conducts its ship trading business via its 60.0%-owned subsidiary, COSCO International Ship Trading Company. In our view, the company may increase its stake in the subsidiary to 100.0%.

Table 1: NAV estimation

Division	Description	NAV
Shipping services (HK\$m)	10.0x FY12/09F earnings of HK\$222.4m	2,224.0
Sino Ocean Land (HK\$m)	923.7m shares of Sino Ocean Land @ HK\$7.71	7,149.7
Net cash (HK\$m)	Net cash as of the end of FY12/07A	814.5
Appraised NAV (HK\$m)		10,188.3
Appraised NAV/share (HK\$)		6.9

Source: SBI E2-Capital

Table 2: Valuation benchmark for the shipping service segment

	Ticker	Year End	Currency	Market cap (US\$m)	P/E (x) 1-yr forward	P/E (x) 2-yr forward
Coating manufacturers						
RPM International	RPM US	May	USD	2,799	13.3	12.0
Sherwin-Williams Co	SHW US	Dec	USD	6,725	11.6	10.5
Kansai Paint	4613 JP	Jun	JPY	1,840	12.9	11.8
Insurance brokers						
THB Group	THB LN	Apr	GBp	8	7.7	5.7
Willis Group Holdings	WSH US	Dec	USD	2,442	11.8	10.3
Jardine Lloyd Thompson	JLT LN	Dec	GBp	400	13.5	12.2
Marine service providers						
ASL Marine Holdings	ASL SP	Jun	SGD	239	5.6	4.8
Beng Kuang Marine	BKM SP	Dec	SGD	64	11.0	9.2
BH Global Marine	BHGM SP	Dec	SGD	119	9.3	8.7
SembCorp Marine	SMM SP	Dec	SGD	5,605	16.8	14.1
Sinwa	SKS SP	Dec	SGD	45	5.0	5.8
<i>Average</i>					13.3	11.7

Source: Bloomberg