

Stellar FY12/06A results

Hong Kong Conglomerates

COSCO International (517 HK, HK\$4.60)

BUY (unchanged)

Target price: HK\$5.73 (+24.6%)

Stellar results. COSCO International's headline earnings increased 24.2% YoY to HK\$616.6m, against a 28.1% YoY increase in turnover to HK\$1.87b. The results were 58.1% ahead of our forecast of HK\$390.1m. Stripping off its HK\$4.9m fair value gain on investment properties and HK\$279.0m gain on the deemed disposal of partial interest in Sino Ocean Real Estate Development (SORED), the group's core earnings surged 73.0% YoY to HK\$332.6m. A final dividend of HK\$0.043 per share was proposed, bringing the whole year dividend payout to HK\$0.053, representing a payout ratio of 12.5%. As of the end of FY12/06A, the group had HK\$783.7m in net cash in hand.

Restructuring completed. The group divested most of its non-core businesses during the year, including a plot in Kutong, in Hong Kong's New Territories for a consideration of HK\$13.0m and its equity interest and shareholder's loan in COSCO Construction to COSCO HK Property for the consideration of HK\$2.00. It also divested its 54.0% stake in Henan Xin Zhong Yi Electric Power and 10.0% in International Paint of Shanghai for HK\$42.3m and HK\$38.1m, respectively. The group also sold Block 5 of Kingswell Garden, a serviced apartment complex in Shanghai, for HK\$31.2m in January 2007. The disposals streamlined its business model into two major divisions: ship trading & supply services and property development.

Strong growth in coating manufacturing. The strong growth in the coating division boosted pre-tax profit of the group's ship trading and supplying services by 37.4% YoY to HK\$168.5m. Due to the increase in ASP and margin expansion, turnover of its coating division rose 36.0% YoY to HK\$1.2b and earnings 133.0% YoY to HK\$98.0m. The ASP of the group's container coatings, and marine coating increased 12.0% and 18.0%, respectively, to RMB17,000.0/ton and RMB19,000.0/ton. The ASP of its anti-corrosion coating increased 13.2% YoY to RMB21,500/ton. The gross profit margin of container coatings widened by 5.0pcp to 22.0%, while the gross profit margin of marine coating remained flat at 24.0% and that of the anti-corrosion coating narrowed 5.0pcp to 35.0%, mainly due product mix changes. The coating division's pre-tax profit accounted for 54.4% of the total pre-tax profit of the ship trading and supply services divisions.

Other ship trading and supply services. Pre-tax profit of its ship trading agency services and marine supplies division decreased 13.0% YoY and 27.0% YoY to HK\$26.0m and HK\$22.0m, respectively. During the year, the group traded 84 vessels, or 6.14m dead weight tons (DWT), representing an annual growth rate of 123.0%. The commission rate of the ship trading division stood at 0.5-3.0% and we believe that commission income was generated from orders placed between 2003 and 2004. Turnover of the group's marine supplies division dropped 11.0% YoY due to changes in ship owners' equipment procurement cycle. Pre-tax profit of the group's insurance brokerage division increased 5.0% YoY to HK\$22.0m with turnover up 13.0% YoY at HK\$43.0m.+

Table 1: Financial summary

Year to Dec	Net profit HK\$m	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
04A	219.2	0.155	na	29.6	5.8	32.2	0.5	19.6	9.6	32.6
05A	496.5	0.311	99.8	14.8	4.1	48.4	1.0	36.6	23.7	Cash
06A	616.6	0.411	32.4	11.2	3.1	29.4	1.2	32.5	27.9	Cash
07F	608.8	0.413	0.4	11.1	2.6	17.7	2.2	25.1	22.2	Cash
08F	635.9	0.431	4.4	10.7	2.1	17.0	2.3	21.5	19.2	Cash

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Property development. SORED contributed HK\$152.8m in earnings, against HK\$59.2m in FY12/05A, as the group's stake in the company increased to 44.0% from 24.0%. After restructuring at end-2006, SORED brought in strategic investors, which diluted the group's interests in the company to 30.8% and generated a gain of HK\$279.0m. The group sold 525 residential units at Shenyang COSCO Yihe, with a GFA of 56,600 sq.m.. The ASP and gross profit margin of the project were RMB3,940.0/sq.m and 18.0-20.0%, respectively. Pre-tax profit from the property development division dropped 95.0% YoY to HK\$17.0m, as fewer units were sold.

Catalysts in FY12/07F. With the launch of COSCO Kansai's new paint plant in Zhuhai in July 2007, the production capacity of its container coating JV will expand 38.1% to 87,000 t.p.a.. With more than 7.0m DWT orders in hand, commission income from the ship trading division is expected to be stable until FY12/08F. We expect SZ COSCO Insurance Brokers, which can offer insurance brokerage services to vessel flying Chinese flag, to start contributing and expanding the group's potential market. COSCO group has more than 700 vessels and COSCO International's insurance brokerage arms can cover 80.0% of its parent fleet. Besides, SZ COSCO is eyeing risk management brokerage services for other COSCO group members. The company also plans to sell the remaining units at its Shenyang COSCO Yihe (90,000.0 sq.m.). We expect the group would realize an exceptional gain should SORED go public by the end of FY12/07F.

Remain a BUY. Since the group booked the HK\$279.0m gain on the deemed disposal of its partial interest in SORED in FY12/06A, one year ahead of our expectation, we revise down our earnings projection for FY12/07F by 26.3% to HK\$608.8m. Given the dilution of the group's interest in SORED, we cut our NAV per share estimate by 3.2% to HK\$5.73 and trim our target price to HK\$5.73. With a potential upside of 24.7%, we reiterate our BUY recommendation.