COSCO International

Niche value play

BUY (unchanged)

Associate dents bottom-line. COSCO International's headline net profit fell 43.7% YoY to HK$225.2m in 1H FY12/08A due to a 62.3% YoY drop in the profit of its 20.7%-owned associate, Sino Ocean Land (3377 HK, HK$2.38, NR). Excluding Sino Ocean Land's share, the group's core earnings increased 41.0% YoY to HK$104.6m. An interim dividend of HK$0.01 per share was proposed. At end-1H FY12/08A, the group was in a net cash position of about HK$951.4m.

Earnings estimates cut. We have slashed our earnings projections by 34.6% to HK$559.1m for FY12/08F and 49.9% to HK$632.7m for FY12/09F, mainly due to lower earnings projections for Sino Ocean Land. The group's headline earnings outlook is highly dependent on the performance of Sino Ocean Land, even though its core marine services virtually have nothing to do with the China property market. We estimate Sino Ocean Land's contribution at 62.9% of the group's headline bottom line in FY12/08F and FY12/09F. Market estimates put the developer's net profit at RMB1,500.0m in FY12/08F and RMB1,697.8m in FY12/09F. We project the net earnings of the company's marine services to increase 6.0% YoY to HK$206.0m in FY12/08F. The bottom line of its core operation should increase at a three-year CAGR of 10.1% between FY12/07A and FY12/10F.

Valuation remains attractive. We revise down our NAV-based target price to HK$3.4 from HK$6.9, mainly due to Sino Ocean Land's share price drop. In our model, we adopt the mark-to-market approach to value the group's interests in Sino Ocean Land, which represents 43.9% of its NAV. At end-Jun 2008, the BVPS of Sino Ocean Land was HK$4.02. If we adopt Sino Ocean Land BVPS in our valuation model, our NAV-based target price will rise 73.5% to HK$5.9 Further, we trim our target P/E multiple for the group's marine service divisions from 10.0x to 8.0x, to reflect the slower growth in the global shipping market. The counter is trading at a 46.2% discount to our NAV-based target price and 4.3x of its projected FY12/09F earnings, so its valuation is very attractive, in our view. Thus, we reiterate our BUY call. The group's net cash is currently HK$951.4m, or HK$0.64/share. Major share price catalysts include EPS accretive acquisitions and asset injections by its parent.

Core operations. The group's turnover increased 11.0% YoY to HK$1,259.9m in 1H FY12/08A, with shipping services contributing 94.6% and property development and investment 5.4%. Turnover of the shipping services division rose 15.3% YoY to HK$1,191.6m and its operating profit 19.0% YoY to HK$110.5m. The group's blended margin enhanced to 30.0% from 25.0%.

Hong Kong Conglomerate

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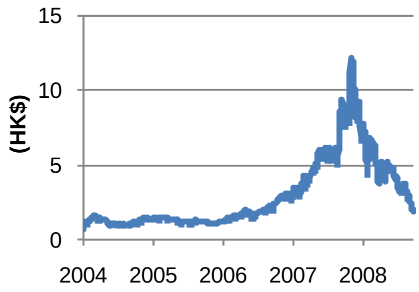
Stock data

Price	**HK$1.83**
Target price	HK$3.4 (+85.8%)
12 mth range	HK$1.6-12.9
Market cap.	US$347.3m
Daily t/o, 3 mth	US$0.74m
Free float %	42.0%
Ticker	0517.HK/517 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
Turnover (HK$m)	1,866.5	2,309.1	2,644.9	2,978.3	3,368.7
Net profit (HK$m)	616.6	2,572.6	559.1	632.7	388.0
EPS (HK$m)	0.418	1.697	0.377	0.427	0.262
EPS ∆ %	21.7	305.9	(77.8)	13.2	(38.7)
P/E (x)	4.4	1.1	4.9	4.3	7.0
P/B (x)	1.21	0.55	0.59	0.79	1.41
EV/EBITDA (x)	18.6	16.5	9.9	8.5	7.7
Yield (%)	2.9	3.4	2.3	2.6	2.9
ROE (%)	28.0	52.5	12.2	18.6	20.2
ROCE (%)	24.4	47.4	11.3	16.6	16.3
N. Gear. (%)	cash	cash	cash	cash	cash

Price Chart



Ship trading. Turnover of the group's ship trading agency business increased 142.0% YoY to HK$63.0m in 1H FY12/08A, while the operating profit increased 238.0% YoY to HK$44.0m. During the period, the total ship trading volume increased 38.0% YoY to about 4.5m DWT, with new vessel trading volume up 37.0% YoY to about 3.9m DWT. The division's new build orders on hand at end-Jun 2008 increased 24.0% YoY to 16.0m DWT. The average commission income per DWT traded increased 25.7% YoY to HK$13.9m. In our view, despite the global shipping slowdown, the growth momentum of the division's commission income should stay strong, due to 1) decent growth in its order book thanks to COSCO Group's support; 2) the elimination of minority interests. Currently, the group owns 60.0% of the ship trading arm, COSCO International Ship Trading, and in the process of acquiring the rest for HK$161.4m.

Coating division. Revenue of the container and anti-corrosion paint unit increased 3.0% YoY to HK$846.0m. However, due to an almost ten-fold surge in bad debt provisioning to RMB41.0m, the division's operating profit declined 38.0% YoY to HK$43.0m, although the blended margin remained at 23.0% in 1H FY12/08A. Due to the weak container market in 1H 2008, the group's sales volume, ASP and gross profit margin declined. Container coating sales of three COSCO-Kansai JVs (in which the group has more than 60.0% stakes each) dropped 5.0% YoY to 34,876.0 tons while the ASP of the container coating segment dropped 9.0% YoY to RMB16,000.0/ton and the gross margin 2.0pcp YoY to 19.0%. The sales volume of industrial anti-corrosion products increased 11.0% YoY to 5,175.0 tons and the ASP 16.0% YoY to RMB25,900.0/ton. As a result, the blended margin of industrial anti-corrosion paint expanded to 37.0% from 32.0% in 1H FY12/07A. Thanks to the strong shipbuilding and ship repairing industries, the group's 50.0%-owned Jotun COSCO Marine Coating saw its sales volume surge 56.0% YoY to 29,551.0 tons.

The division's outlook is challenging amid the global shipping and economic slowdown. The drop in some raw materials prices such as zinc should provide some relief. As the aggregate production capacity of the three COSCO-Kansai JVs reached 100,000.0 ton per annum in the beginning of 2008, from 63,000.0 tons per annum in FY12/07A, the economies of scale of its container and industrial anti-corrosion paint products should improve, bringing down unit production costs. The group plans to expand its production capacity at Jotun COSCO Marine Coating in the near future. In 1H 2008, the COSCO-Kansai JVS ranked No. 2 in China's container and industrial anti-corrosion paints market.

Other marine services. The turnover of the group's marine equipment and supplies trading division increased thanks to new launches and overhauls of secondhand vessels in 1H 2008. Revenue and operating results of the division soared 53.0% YoY and 85.0% YoY, respectively, to HK$252.0m and HK$24.0m. Just like other segments, the marine equipment and supplies businesses will inevitably be affected by the global slowdown but under the COSCO Group umbrella, its orders book should remain stable. Orders from non-COSCO customers will be the main driver. Turnover and operating results of the group's insurance brokerage division, which consists of its 100.0%-owned COSCO (Hong Kong) Insurance Brokers and 55.0%-owned Shenzhen-COSCO Insurance Broker, increased 29.0% YoY and 40.0%, respectively, to HK$31.0m and HK$21.0m. Pre-tax margin of the division was lucrative at 67.7% in 1H FY12/08A, compared with 62.5% in the year-earlier period, thanks to low operating costs and light fixed asset requirements.