

Toll expressway



Looking for growth/yield balance

Industry Update

Key points:

- Urban FAI up 27.6% in first nine months of 2008
- Most of the government's infrastructure investment goes to the railway transport network
- Growth of toll expressway companies slows due to moderating economic growth, natural disasters and their high earnings base in 2007
- Defensive sector with a steady income stream, strong cash flow and solid dividend yield
- Prefer Jiangsu Expressway (177 HK) and Anhui Expressway (995 HK) for their balanced mix of growth and yield underpinned by strong GDP growth in their respective provinces
- Cautious on Hopewell (737 HK), Shenzhen Expressway (548 HK) and Zhejiang Expressway (576 HK)

Transportation

Wed, 22 Oct 2008

Kennedy Tsang

(852) 2533 3713

Kennedytsang@sbie2capital.com

Sector background. China's urban fixed asset investment (FAI) rose 27.6% YoY to RMB9,987.1b in the first nine months of 2008 as the government increased its infrastructure investment to sustain the country's economic growth and mitigate the effects of the global economic slowdown. Most of this investment went into construction of railway infrastructure (RMB1.25t to be invested during the 11th Five-year Plan). Roads received less funding and their development was largely left to the private sector after the government had already invested heavily into China's road network in the 10th Five-year Plan (RMB2.0t). In the 11th Five-year Plan, the government plan to invest RMB100b in the development of the rural road network.

Our view. Growth has begun to slow for the toll expressway sector due to natural disasters (snowstorms in southern China in Jan 2008 and Sichuan's May earthquake) and the moderating of economic growth in various regions. We believe that a high earnings base in 2007, when several regions (including Hunan, Hubei, Jiangsu, Anhui) switched to weight-based toll collection (from truck classification) has also contributed to the slowdown. During the switch, many toll road companies derived some additional revenue through penalty charges (overweight), which artificially boosted their top line. The average bottom line growth of 27.7% in 2007 (based on six Hong Kong-listed companies), up from 25.8% in 2006, slowed to an average of 11.3% YoY in 1H 2008. Consensus estimates suggest that it will average 1.6% growth in 2008, before rebounding to 8.3% growth in 2009.

Challenges faced by toll road companies include: 1) slowing economic growth; 2) opening of competing roads; 3) declining IRR, down at around 9% from 11-12%; 4) competing forms of transport, e.g. rail.

Expressway operators generate steady revenue and a strong recurring cash flow, while their accounts receivables are low. Coupled with the fact that many offer good dividend yields, we consider the sector defensive. While they are almost always geared, we believe their business model can generally sustain their relatively high gearing ratios.

Our picks. Of the pure play expressway plays prefer Jiangsu Expressway (177 HK, HK\$5.78) and Anhui Expressway (995 HK, HK\$3.37) due to solid GDP growth in their provinces (13.6% and 14.2%, respectively, in 1H 2008), which should underpin traffic volume growth in the near term. Both counters offer a balanced mix of growth and dividend yield. The share price of Jiangsu Expressway has been particularly resilient in the current volatile market, declining only 18.4% on a 6-month basis and 9.5% on a 3-month basis, compared with the average of 37.8% and 15.3%, respectively. We remain cautious on Shenzhen Expressway (548 HK, HK\$2.68) and Hopewell Expressway (737 HK, HK\$4.30) since they are likely to be affected by Guangdong's slowing economy. In addition, Shenzhen Expressway has also faced delays in the construction of an adjoining expressway, thus postponing the commissioning of Qinglian Expressway. We are also negative on Zhejiang Expressway (576 HK, HK\$4.42) due to its questionable 51.9% investment in Zheshang Securities,

which may be adversely affected by the poor performance of China's stock market. On the Singapore bourse, China Merchants (CMH SP, S\$0.45) also offers good yield (estimated yield 12.0%). However, the counter is relatively illiquid and is not a pure-play, with exposure to the property market.

Table 1: Valuation table

Company name	Ticker	Mkt Cap (US\$m)	Price	Cur Yr P/E (x)	Nxt Yr P/E (x)	ROE (%)	Est. ROE (%)	Gearing (%)	Est. Yield (%)
<u>Hong Kong</u>									
Jiangsu Expressway-H	177 HK	905.5	HK\$5.78	13.6	11.9	12.3	13.6	55.1	5.9
Zhejiang Expressway	576 HK	812.5	HK\$4.42	8.9	8.2	13.5	14.0	Cash	7.2
Sichuan Expressway-H	107 HK	157.3	HK\$1.37	5.2	4.5	9.6	9.7	17.1	5.0
Anhui Expressway-H	995 HK	213.0	HK\$3.37	6.9	6.6	11.9	12.9	25.4	8.5
Hopewell Highway	737 HK	1,637.6	HK\$4.30	9.6	9.6	10.9	10.5	11.1	7.9
Shenzhen Expressway-H	548 HK	256.8	HK\$2.68	8.4	7.6	8.5	9.1	89.3	6.2
<u>Singapore</u>									
China Merchant	CMH SP	197.5	S\$0.45	5.7	6.5	8.0	8.1	Cash	12.0

Source: Bloomberg

Table 2: Price movement table

Company	Ticker	Mkt. Cap (US\$m)	Price	1m price movement	3m price movement	6m price movement
<u>Hong Kong</u>						
Jiangsu Expressway-H	177 HK	905.5	HK\$5.78	-9.5%	-15.1%	-18.4%
Zhejiang Expressway	576 HK	812.5	HK\$4.42	-10.4%	-20.5%	-38.0%
Sichuan Expressway-H	107 HK	157.3	HK\$1.37	-10.7%	-36.7%	-50.4%
Anhui Expressway-H	995 HK	213.0	HK\$3.37	-16.4%	-35.0%	-36.0%
Hopewell Highway	737 HK	1,637.6	HK\$4.30	-22.8%	-26.8%	-30.6%
Shenzhen Expressway-H	548 HK	256.8	HK\$2.68	-21.8%	-39.9%	-53.4%
<u>Singapore</u>						
China Merchants	CMH SP	197.5	S\$0.45	-36.6%	-37.5%	-45.8%

Source: Bloomberg

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

SBI E2-Capital stock ratings:

STRONG BUY : absolute upside of >50% over the next three months

BUY : absolute upside of >10% over the next six months

HOLD : absolute return of -10% to +10% over the next six months

SELL : absolute downside of >10% over the next six months

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

Analyst certification: The views expressed in this report accurately reflect 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: This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Securities Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Securities Limited 2008. All rights reserved.