

Value Stocks

26 Jun 2008

The global economic slowdown and high inflation indicate we may be entering an 'early-cycle slowdown' economic phase.

Value investing avoids concerning ourselves with market factors that can cause fluctuations in stock prices, such as inflation, interest rates and oil prices – and shift our focus to the actual companies.

Opportunities to buy value stocks occur regardless of the equities-market outlook. Profit can be obtained by buying stocks at deflated prices not reflecting intrinsic value.

When looking for value stocks, we are not simply looking for low-priced stocks. We are searching for cheap stocks with high potential for re-rating: the best deals, companies with good fundamentals and that are trading below their intrinsic value. As soon as the market catches on to these companies' intrinsic value, a re-rating will occur, and investments in these value plays will become profitable.

Methodology overview

Our quantitative screening process consists of two stages that are complemented by qualitative analysis. We first employ a quantitative screen, which emphasizes 12-month rolling forward P/E, ROE and EPS growth, to produce a shortlist of stocks. We then score them on several parameters that indicate value. Finally, we single out stocks on this list that have already received Buy ratings from our fundamental analysts and include in-depth qualitative analysis in the appendix.

Actionable advice: here is what we found

The objective of this report is to provide a list of value stocks. Over 70 potential value stocks were captured in our quantitative value screen. Through a qualitative analysis of companies, we highlight 15 of these as Buys.

Figure 1: Value stock list

Stock code	Company	Industry sector	Market cap (HK\$m)	Total score (Max. 150)	Recommendation
590.HK	Luk Fook	Gold retail	2,098	101	Buy
3336.HK	Ju Teng	Computer-related	3,360	99	Buy
2000.HK	SIM Tech	Telecom equipment	1,260	98	Buy
1882.HK	Haitian	Machinery	5,267	74	Buy
1171.HK	Yanzhou Coal	Coal	96,760	73	Buy
1888.HK	Kingboard Laminates	Electrical components	13,680	73	Buy
3383.HK	Agile	Property (PRC)	27,119	65	Buy
3313.HK	Meadville	Electrical components	3,860	65	Buy
2018.HK	AAC	Electrical components	8,412	61	Buy
2314.HK	Lee & Man Paper	Paper manufacturing	12,989	60	Buy
1138.HK	China Shipping Develop.	Ports & shipping	80,435	60	Buy
3883.HK	China Aoyuan	Property (PRC)	4,505	56	Buy
425.HK	Mintch Group	Auto parts	5,956	55	Buy
3339.HK	CIMH	Machinery	7,984	54	Buy
868.HK	Xinyi Glass	Auto Parts	9,521	46	Buy

Sources: Bloomberg and Sun Hung Kai Financial

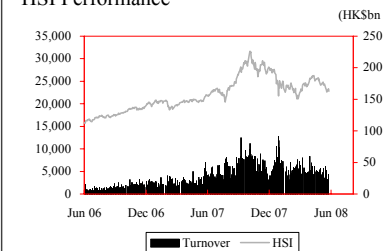
Conclusion

Despite these tumultuous times, investors need not fret. Opportunities for buying value stocks occur regardless of the equities-market outlook. Profit can be obtained by buying stocks at prices not reflecting intrinsic value. By identifying good value stocks, we can effectively avoid concerning ourselves with market factors that can cause fluctuations in stock prices, such as inflation, interest rates and oil prices – and focus on actual companies. Given current rice and oil prices, one may not know whether to feed oneself or one's car, but good investors should know that in a time of market uncertainty, value still exists.

HSI **22,635**
 HSCEI **12,196**

Performance (%)	1m	3m	12m
HSI	(8.4)	0.8	3.7
HSCEI	(10.6)	4.0	1.3

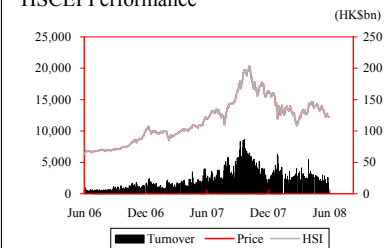
HSI Performance



Closing **22,635**
 52W high/low **31,958/19,387**

Source: Bloomberg and Sun Hung Kai Financial

HSCEI Performance



Closing **12,196**
 52W high/low **20,609/10,253**

Sources: Bloomberg and Sun Hung Kai Financial

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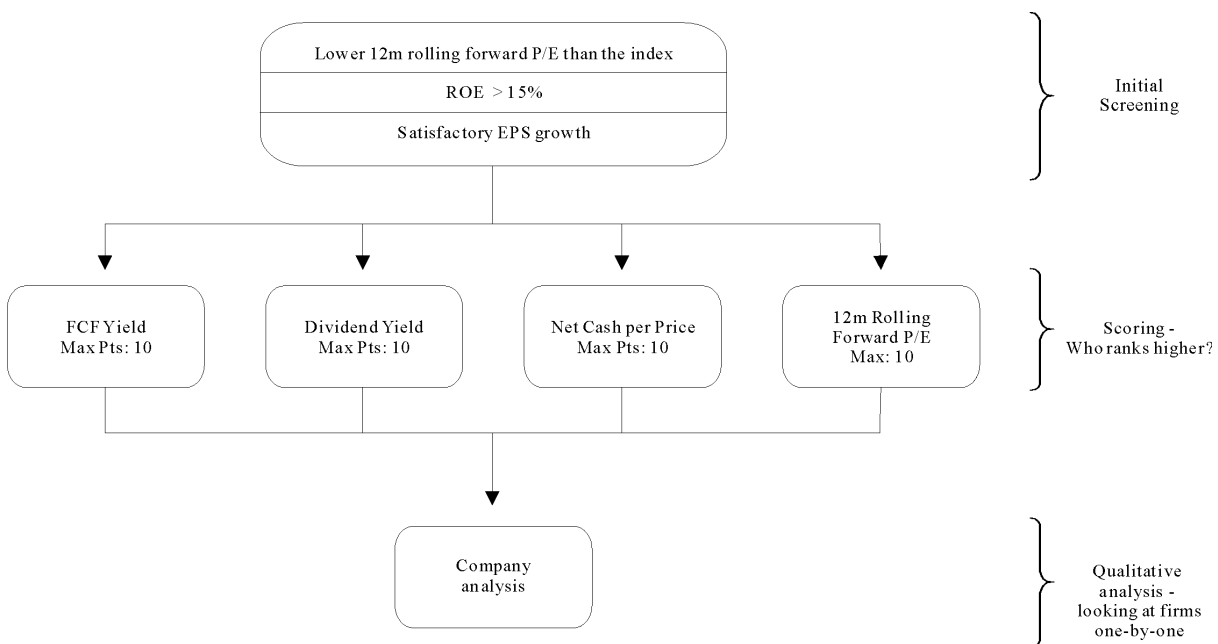
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Methodology and Results

- We determine the best value plays through two quantitative stages, followed by qualitative analysis. Our initial quantitative screen produces a shortlist of stocks, which is then scored based on certain parameters to further narrow down our list of value stocks.
- Because we feel that results from these two stages form a useful platform for further in-depth, one-by-one analysis, we then scratch the surface of qualitative analysis. We single out stocks that have received Buy ratings from our fundamental analysts.

Figure 2: Methodology Flowchart



Source: Sun Hung Kai Financial

Stage 1: Initial screening

Methodology

- The initial screening process looks for stocks on the Hong Kong stock exchange that satisfy three criteria:
 1. 12-month rolling forward P/E multiple lower than its pertaining index (HSI or HSCEI).
 2. ROE higher than 15%.
 3. Falls into at least one of the three following tiers of EPS-growth characteristics from FY07 to FY09
 - Accelerating growth (where EPS growth for 07-09 is expected to accelerate);
 - High growth (where EPS growth for 07-09 exceeds our nominal GDP-growth forecast of 15%);
 - Satisfactory growth (where 08 EPS growth exceeds 07 EPS growth AND 09 EPS growth exceeds 15%).
- **12-month rolling forward P/E – finding the cheap stocks.** To begin our search for the best value stocks, we comb through stocks listed in Hong Kong and compare their 12-month rolling forward P/E multiples with that of their pertaining equities index. We screen out stocks with higher 12-month rolling forward P/Es than their pertaining indices.
- **ROE > 15% – finding well-run companies.** It pays to invest in companies that generate profits more efficiently than their rivals. ROE can help investors distinguish between companies that are profit creators and those that are profit burners. Simply put, ROE indicates how well management is employing capital invested in the company. However, a company cannot grow earnings faster than its current ROE without raising additional cash. That is, a firm that has a 15% ROE cannot increase its earnings faster than 15% annually without borrowing funds or selling more shares. So ROE is, in effect, a speed limit on a firm's growth rate. A 15% ROE is usually specified as a minimum acceptable ROE when evaluating investment candidates.
- **EPS growth – finding companies with good earnings-growth prospects.** Implicit in every stock price is an estimate of the company's future growth rate. Low price may not equate to good value if a company's earnings growth is expected to decelerate or even decline. In such a case, a low price may be deserved, and may decline further. We select stocks with certain earnings-growth qualities. These include accelerating EPS growth (where EPS growth for FY07-09 is expected to accelerate); high EPS growth (where EPS growth for FY07-09 exceeds our nominal GDP-growth forecast of 15%); and satisfactory growth (where FY08 EPS growth exceeds FY07 EPS growth AND FY09 EPS growth exceeds 15%).

Stage 1 Results: Overview

- Out of more than 1,000 stocks, we found that 124 stocks had a lower 12-month rolling forward P/E than their pertaining index and an ROE larger than 15%.
- After then filtering out stocks that did not qualify in terms of EPS growth, we produced a list of 76 stocks (Figure 3).

Figure 3: Results from stage 1 quantitative screening

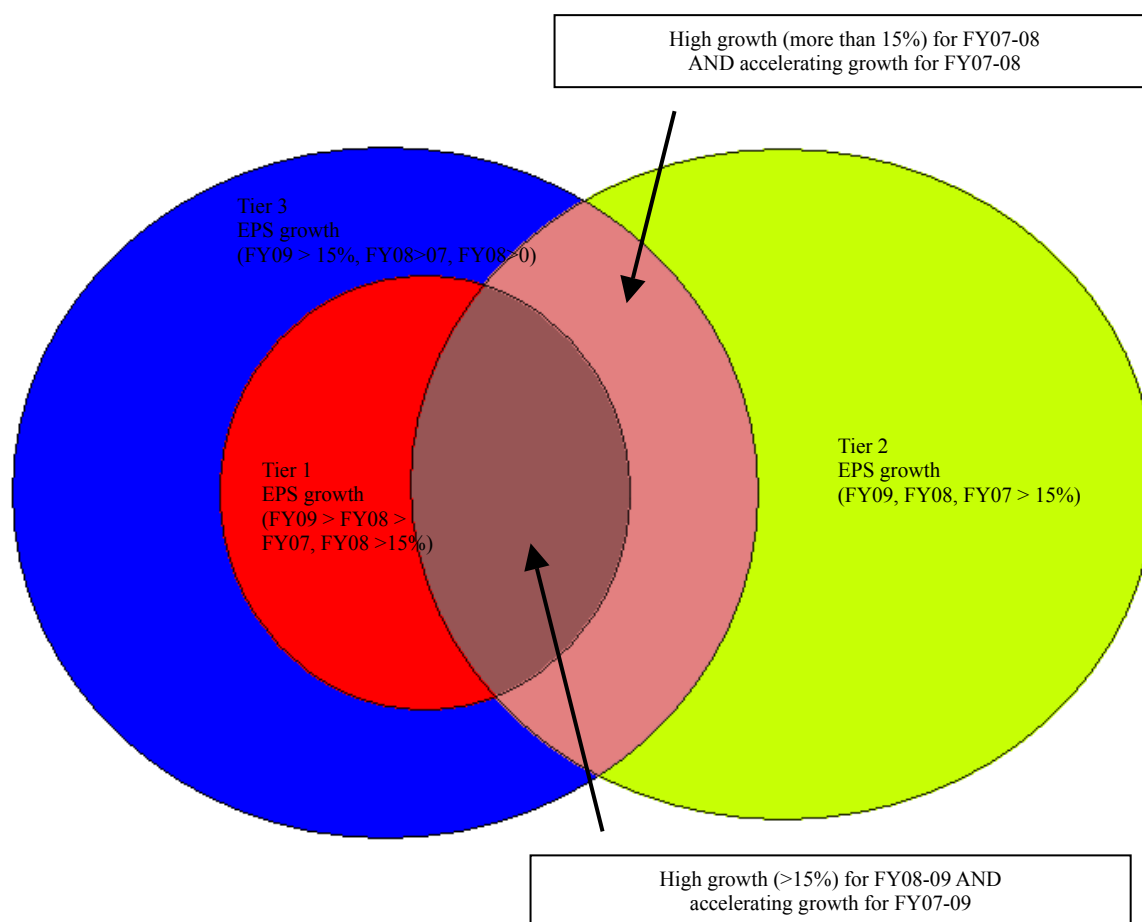
Stock code	Company	12M rolling forward P/E (X)	ROE (%)	EPS growth (%)			
				FY06	FY07	FY08	
919.HK	Modern Beauty Salon	7.8	61.6	11.3	13.5	13.8	17.9
590.HK	Luk Fook	6.5	28.8	(24.5)	104.6	17.9	26.3
755.HK	Shanghai Zendai	2.3	26.0	9.5	8.7	60.0	62.5
3336.HK	Ju Teng	4.8	26.0	(17.5)	102.0	44.6	28.7
2000.HK	SIM Tech	4.2	19.8	12.2	(35.9)	9.4	22.4
8108.HK	Fava	3.8	44.9	N/A	1650.9	30.3	33.1
52.HK	Fairwood	7.5	29.6	98.4	11.4	24.2	22.3
856.HK	Vst	2.3	57.9	258.8	35.8	71.6	41.9
2368.HK	Eagle Nice	4.5	15.2	(35.6)	0.6	31.9	29.2
299.HK	Sinocom Software	9.2	24.9	20.2	55.7	22.1	28.9
733.HK	Hopefluent Group	5.8	22.1	11.9	35.3	20.4	27.8
3399.HK	Guangdong Nan Yue Logistic	4.3	15.9	(14.0)	2.7	31.3	20.8
330.HK	Esprit	13.3	49.5	15.3	36.6	26.4	21.1
8058.HK	Shandong Luoxin Pharmacy	9.3	35.4	25.3	102.0	45.0	34.5
3889.HK	Global Sweeteners	5.3	19.5	94.8	(17.4)	33.5	37.7
2889.HK	China Nickel Resources	3.4	20.0	(42.6)	50.3	38.8	144.1
752.HK	Pico Far East	6.7	21.0	118.6	4.9	23.2	30.0
3989.HK	Hembly	3.5	29.2	12.9	10.5	43.8	53.4
285.HK	BYD Electronic	5.7	28.5	1850.0	48.7	22.1	37.0
317.HK	Guangzhou Shipyard	6.8	42.1	97.5	252.0	21.8	33.0
628.HK	Dore	0.4	22.4	N/A	N/A	906.5	34.8
319.HK	China Metal	5.3	18.2	(12.8)	55.8	17.7	19.5
838.HK	Eva Precision Industrial	6.1	21.7	5.1	21.6	40.0	31.7
408.HK	Yip's Chemical	7.5	22.5	35.0	31.3	19.1	17.1
581.HK	China Oriental Group	6.6	24.8	24.1	11.1	49.6	30.1
1882.HK	Haitian	6.8	22.7	N/A	(2.7)	13.5	22.3
8313.HK	International Elite	4.5	18.5	N/A	N/A	22.5	53.1
3933.HK	United Laboratories	6.4	26.8	46.2	152.6	37.5	30.3
1171.HK	Yanzhou Coal	10.0	23.5	(18.6)	37.5	64.1	19.4
819.HK	Tianneng Power	4.5	24.1	100.0	4.5	21.7	32.1
1888.HK	Kingboard Laminates	6.4	24.0	45.1	5.4	11.4	19.9
321.HK	Texwinca	8.9	23.5	4.0	30.1	25.3	23.6
359.HK	China Haisheng Juice	5.8	31.6	(55.4)	146.1	52.7	25.4
2341.HK	Ecogreen Fine Chemicals	6.0	20.6	21.8	35.3	16.2	36.2
543.HK	Pacific Online	8.3	19.4	N/A	N/A	26.5	26.7
1883.HK	CITIC 1616	10.7	26.3	105.2	20.2	29.4	21.6
531.HK	Samson	5.5	15.2	(2.6)	(45.9)	30.0	24.6
767.HK	Pacific Plywood	1.3	20.0	N/A	66.7	600.0	57.1
8149.HK	TSC Offshore Group	5.8	16.6	35.2	(91.3)	2327.2	48.0
999.HK	IT	9.6	19.3	0.0	33.3	20.6	21.2
3322.HK	Win Hanverky	4.3	18.2	N/A	(10.8)	12.6	17.3
672.HK	Zhong An Real Estate	5.2	18.4	100.0	333.3	46.2	75.0
3888.HK	Kingsoft Corp	11.8	19.7	156.2	45.8	35.0	40.8
210.HK	Prime Success	13.2	31.8	13.2	31.9	27.4	24.4
3383.HK	Agile Property	7.0	28.3	(8.0)	58.0	39.0	32.8
3313.HK	Meadville	5.2	21.9	N/A	(19.0)	90.0	24.8
268.HK	Kingdee International Sftwr	12.5	26.0	37.5	36.4	29.3	32.0
682.HK	Chaoda Modern Agriculture	7.5	20.7	3.6	28.1	18.3	33.1
2018.HK	AAC	9.2	23.9	47.2	(2.9)	32.1	25.9
2314.HK	Lee & Man Paper	5.2	20.4	42.9	61.8	27.8	41.7
1138.HK	China Shipping Development	9.7	33.5	2.5	64.8	30.3	21.9
2038.HK	Foxconn	8.6	23.6	82.8	(0.4)	16.8	20.0
8271.HK	Global Digital Creations	4.4	18.3	N/A	N/A	251.9	110.5
1169.HK	Haier Electronics	9.4	20.0	N/A	6.8	18.4	37.0
3883.HK	China Aoyuan	3.2	16.1	N/A	5.9	20.8	64.4
2007.HK	Country Garden	8.6	31.2	N/A	138.4	66.4	30.9
3311.HK	China State Construction	10.4	23.4	113.2	(4.8)	20.1	23.1
425.HK	Minth Group	8.4	16.6	2.9	25.0	36.2	30.5
3389.HK	Xinyu Hengdeli	11.9	23.5	(40.0)	273.3	19.0	29.5
839.HK	Anhui Tianda Oil Pipe	5.1	19.3	30.8	5.9	20.8	24.1
3339.HK	CIMH	8.4	23.1	87.5	(1.7)	14.9	27.1
175.HK	Geely Automobile	7.7	19.0	87.7	26.3	34.8	51.2
2337.HK	Shanghai Forte Land	5.0	15.6	(19.5)	44.8	27.1	28.5
3900.HK	Greentown China	4.8	20.7	75.8	(42.2)	53.7	41.1
337.HK	Spg Land	5.0	16.0	N/A	0.2	10.2	43.4
1868.HK	Neo-Neon	5.3	15.8	79.2	2.1	20.5	28.2
1205.HK	Citic Resources	10.3	20.7	(9.5)	21.5	377.9	82.6
3303.HK	Jutal Offshore Oil Services	10.3	15.4	N/A	14.0	28.2	33.2
868.HK	Xinyi Glass	5.5	20.7	42.2	67.1	26.3	43.2
2868.HK	Beijing Capital Land	9.2	15.8	21.5	72.4	58.9	20.0
2366.HK	Qin Jia Yuan Media	4.3	19.4	6.4	51.9	24.3	40.0
304.HK	Peace Mark	11.1	20.7	48.5	36.8	37.7	46.8
2689.HK	Nine Dragons Paper	8.1	19.3	N/A	17.7	17.0	31.7
1211.HK	BYD Co	7.4	18.3	122.6	44.4	27.4	15.9
148.HK	Kingboard Chemicals	8.5	16.3	365.0	(62.6)	9.2	16.8
3377.HK	Sino-Ocean Land	8.8	16.0	N/A	N/A	4.5	28.6

Sources: Bloomberg and Sun Hung Kai Financial

A Closer Look at the Stage 1 Results - EPS Growth

- The 76 stocks we captured in our value-screening net fit into one or more tiers of EPS-growth trends:
 1. **Tier 1 – Accelerating EPS growth**
 2. **Tier 2 – High EPS growth**
 3. **Tier 3 – Satisfactory EPS growth**
- Preference:
 1. **Tiers 1, 2, and 3** - Some stocks fall into more than one tier. We consider those that fall into all three tiers to have the most favorable and promising earnings-growth prospects (dark pink).
 2. **Tiers 2 and 3** – We prefer those that fall into Tiers 2 and 3 next. This is because these stocks possess not only high but accelerating (although short-term) growth (pink)
 3. For those that fell into just one of the tiers, we prefer them in the order from Tier 1 being the most favorable to Tier 3 (red, green and blue respectively)
- Following is a diagram displaying these tiers, distinguished by different colors.

Figure 4: EPS-growth color diagram



Source: Sun Hung Kai Financial

- Below are tables sorting the stocks by EPS-growth tier.

Figure 5: EPS-growth tier lists

Tiers 1, 2 and 3 (dark pink):

Stock code	Company	EPS growth (%)				Characteristics
		FY06	FY07	FY08	FY09	
543.HK	Pacific Online	N/A	N/A	26.5	26.7	High and accelerating EPS growth for FY07-09 <ul style="list-style-type: none"> FY07, FY08, and FY09 EPS growth > 15%
1169.HK	Haier Electronics	N/A	6.8	18.4	37.0	
175.HK	Geely Automobile	87.7	26.3	34.8	51.2	
8313.HK	International Elite	N/A	N/A	22.5	53.1	<ul style="list-style-type: none"> FY09 EPS growth > FY08 EPS growth > FY07 EPS growth
3303.HK	Jutal Offshore Oil Services	N/A	14.0	28.2	33.2	

Tier 2 and 3 (pink):

Stock code	Company	EPS growth (%)				Characteristics
		FY06	FY07	FY08	FY09	
1883.HK	CITIC 1616	105.2	20.2	29.4	21.6	High and satisfactory growth for FY08-09 <ul style="list-style-type: none"> FY07, FY08 and FY09 EPS growth > 15%
856.HK	VST	258.8	35.8	71.6	41.9	
425.HK	Minh Group	2.9	25.0	36.2	30.5	
1171.HK	Yanzhou Coal	(18.6)	37.5	64.1	19.4	<ul style="list-style-type: none"> FY08 EPS growth > FY07 EPS growth
767.HK	Pacific Plywood	N/A	66.7	600.0	57.1	
838.HK	Eva Precision Industrial	5.1	21.6	40.0	31.7	
1205.HK	CITIC Resources	(9.5)	21.5	377.9	82.6	

Tier 1 (red):

Since Tier 3's criteria are a less strict form of Tier 1's criteria, stocks that fall into Tier 1 also fall into Tier 3.

Stock code	Company	EPS growth (%)				Characteristics
		FY06	FY07	FY08	FY09	
2038.HK	Foxconn	82.8	(0.4)	16.8	20.0	Accelerating growth <ul style="list-style-type: none"> FY09 EPS growth > FY08 EPS growth > FY07 EPS growth FY08 EPS growth > 15%
3889.HK	Global Sweeteners	94.8	(17.4)	33.5	37.7	
752.HK	Pico Far East	118.6	4.9	23.2	30.0	
839.HK	Anhui Tianda Oil Pipe	30.8	5.9	20.8	24.1	
755.HK	Shanghai Zendai	9.5	8.7	60.0	62.5	
3883.HK	China Aoyuan	N/A	5.9	20.8	64.4	
3989.HK	Hembly	12.9	10.5	43.8	53.4	
819.HK	Tianneng Power	100.0	4.5	21.7	32.1	
3311.HK	China State Construction	113.2	(4.8)	20.1	23.1	
1868.HK	Neo-Neon	79.2	2.1	20.5	28.2	
304.HK	Peace Mark	48.5	36.8	37.7	46.8	

Sources: Bloomberg and Sun Hung Kai Financial

Figure 5: EPS-growth tier lists (continue)

Tier 2 (green):

Stock code	Company	EPS growth (%)				Characteristics
		FY06	FY07	FY08	FY09	
2889.HK	China Nickel Resources	(42.6)	50.3	38.8	144.1	
319.HK	China Metal	(12.8)	55.8	17.7	19.5	High growth
408.HK	Yip's Chemical	35.0	31.3	19.1	17.1	▪ FY07, FY08 and FY09 EPS growth > 15%
2341.HK	Ecogreen Fine Chemicals	21.8	35.3	16.2	36.2	
2314.HK	Lee & Man Paper	42.9	61.8	27.8	41.7	
2689.HK	Nine Dragons Paper	N/A	17.7	17.0	31.7	
2366.HK	Qin Jia Yuan Media	6.4	51.9	24.3	40.0	
590.HK	Luk Fook	(24.5)	104.6	24.8	23.3	
8108.HK	Fava	N/A	1650.9	30.3	33.1	
330.HK	Esprit	15.3	36.6	26.4	21.1	
321.HK	Texwinca	4.0	30.1	25.3	23.6	
999.HK	I.T	0.0	33.3	20.6	21.2	
210.HK	Prime Success	13.2	31.9	27.4	24.4	
3389.HK	Xinyu Hengdeli	(40.0)	273.3	19.0	29.5	
868.HK	Xinyi Glass	42.2	67.1	26.3	43.2	
8058.HK	Shandong Luoxin Pharmacy	25.3	102.0	45.0	34.5	
3933.HK	United Laboratories	46.2	152.6	37.5	30.3	
359.HK	China Haisheng Juice	(55.4)	146.1	52.7	25.4	
682.HK	Chaoda Modern Agriculture	3.6	28.1	18.3	33.1	
733.HK	Hopefluent Group	11.9	35.3	20.4	27.8	
672.HK	Zhong An Real Estate	100.0	333.3	46.2	75.0	
3383.HK	Agile Property	(8.0)	58.0	39.0	32.8	
2007.HK	Country Garden	N/A	138.4	66.4	30.9	
2337.HK	Shanghai Forte Land	(19.5)	44.8	27.1	28.5	
2868.HK	Beijing Capital Land	21.5	72.4	58.9	20.0	
285.HK	BYD Electronic	1850.0	48.7	22.1	37.0	
317.HK	Guangzhou Shipyard	97.5	252.0	21.8	33.0	
1138.HK	China Shipping Development	2.5	64.8	30.3	21.9	
1211.HK	BYD Co	122.6	44.4	27.4	15.9	
3336.HK	Ju Teng	(17.5)	102.0	44.6	28.7	
299.HK	Sinocom Software	20.2	55.7	22.1	28.9	
3888.HK	Kingsoft Corp	156.2	45.8	35.0	40.8	
268.HK	Kingdee International Sftwr	37.5	36.4	29.3	32.0	

Tier 3 (blue):

Stock code	Company	EPS growth (%)				Characteristics
		FY06	FY07	FY08	FY09	
581.HK	China Oriental	24.1	11.1	49.6	30.1	
148.HK	Kingboard Chemicals	365.0	(62.6)	9.2	16.8	Satisfactory EPS growth
2000.HK	SIM Tech	12.2	(35.9)	9.4	22.4	▪ FY08 EPS growth > FY07 EPS growth
919.HK	Modern Beauty Salon	11.3	13.5	13.8	17.9	
52.HK	Fairwood	98.4	11.4	24.2	22.3	▪ FY08 EPS growth > 0
2368.HK	Eagle Nice	(35.6)	0.6	31.9	29.2	
531.HK	Samson	(2.6)	(45.9)	30.0	24.6	
3322.HK	Win Hanverky	N/A	(10.8)	12.6	17.3	▪ FY09 EPS growth > 15%
8271.HK	Global Digital Creations	N/A	N/A	251.9	110.5	
8149.HK	TSC Offshore	35.2	(91.3)	2327.2	48.0	
3900.HK	Greentown China	75.8	(42.2)	53.7	41.1	
337.HK	SPG Land	N/A	0.2	10.2	43.4	
3377.HK	Sino-Ocean Land	N/A	N/A	4.5	28.6	
3399.HK	Guangdong Nan Yue Logistic	(14.0)	2.7	31.3	20.8	
628.HK	Dore	N/A	N/A	906.5	34.8	
1882.HK	Haitian	N/A	(2.7)	13.5	22.3	
1888.HK	Kingboard Laminates	45.1	5.4	11.4	19.9	
3313.HK	Meadville	N/A	(19.0)	90.0	24.8	
2018.HK	AAC	47.2	(2.9)	32.1	25.9	
3339.HK	CIMH	87.5	(1.7)	14.9	27.1	

* Note: Data used at this stage of filtering is based on consensus figures. We use our own fundamental forecasts for companies listed in the appendix.
Sources: Bloomberg and Sun Hung Kai Financial

Stage 2: Scoring – Who ranks higher?

Methodology

- Of the stocks that are left following the above-mentioned screening, we then employed a scoring system (maximum 150 points) based on five parameters (listed in order of weighting from high to low).
 1. ROE
 2. 12-month rolling forward P/E
 3. Free-cash-flow yield
 4. Net debt (net cash) / share
 5. Dividend yield
- We gave these stocks five scores according to their 12-month forward rolling P/Es, ROEs, FCF yields, net debt per price, and dividend yields. By adding these five scores together, a maximum of 150 total points can be attained by a company. Results are shown in figure 6 below.



Stage 2 Results: Overview

Figure 6: Results from stage 2 scoring

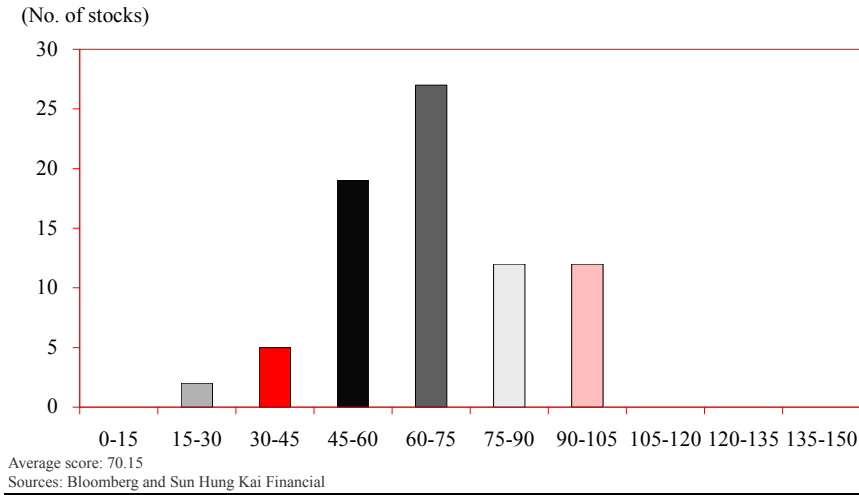
Stock code	Company	Dividend yield (%)	Net debt/price (HK\$)	FCF yield (%)	12M rolling forward P/E (X)	ROE (%)	Total score (max. 150 pts)
919.HK	Modern Beauty Salon	6.7	(0.8)	2.5	7.8	61.6	102
590.HK	Luk Fook	4.9	(0.4)	7.9	6.5	28.8	101
755.HK	Shanghai Zendai	0.0	0.1	14.4	2.3	26.0	100
3336.HK	Ju Teng	0.0	0.4	8.4	4.8	26.0	99
2000.HK	SIM Tech	6.7	(0.4)	10.1	4.2	19.8	98
8108.HK	Fava	0.0	(0.1)	(2.5)	3.8	44.9	98
52.HK	Fairwood	5.1	(0.8)	8.4	7.5	29.6	96
856.HK	VST	0.0	(0.1)	(1.3)	2.3	57.9	92
2368.HK	Eagle Nice	8.1	(0.6)	8.9	4.5	15.2	91
299.HK	Sinocom Software	4.1	(0.4)	8.6	9.2	24.9	91
733.HK	Hopefluent Group	4.1	(0.8)	0.0	5.8	22.1	90
3399.HK	Guangdong Nan Yue Logistic	4.7	(2.3)	28.3	4.3	15.9	90
330.HK	Esprit	2.2	(4.3)	4.4	13.3	49.5	87
8058.HK	Shandong Luoxin Pharmacy	0.6	(0.2)	5.0	9.3	35.4	85
3889.HK	Global Sweeteners	0.0	(0.4)	8.8	5.3	19.5	83
2889.HK	China Nickel Resources	3.5	0.5	0.0	3.4	20.0	81
752.HK	Pico Far East	6.0	(0.4)	5.6	6.7	21.0	81
3989.HK	Hembly	3.9	0.9	(16.2)	3.5	29.2	80
285.HK	BYD Electronic	3.2	(1.0)	(2.0)	5.7	28.5	79
317.HK	Guangzhou Shipyard	2.7	(10.8)	(7.3)	6.8	42.1	79
628.HK	Dore	17.0	0.3	(21.4)	0.4	22.4	78
319.HK	China Metal	4.3	0.0	4.1	5.3	18.2	76
838.HK	Eva Precision Industrial	2.9	(0.0)	0.2	6.1	21.7	76
408.HK	Yip's Chemical	4.2	0.3	9.8	7.5	22.5	75
581.HK	China Oriental Group	2.3	0.3	1.4	6.6	24.8	74
1882.HK	Haitian	5.4	(0.6)	0.8	6.8	22.7	74
8313.HK	International Elite	0.0	(0.4)	4.8	4.5	18.5	73
3933.HK	United Laboratories	3.5	1.0	(9.3)	6.4	26.8	73
1171.HK	Yanzhou Coal	1.4	(1.2)	2.5	10.0	23.5	73
819.HK	Tianneng Power	4.1	(0.0)	(24.7)	4.5	24.1	73
1888.HK	Kingboard Laminates	6.5	0.8	1.1	6.4	24.0	73
321.HK	Texwinca	5.0	0.7	0.5	8.9	23.5	72
359.HK	China Haisheng Juice	1.5	1.4	(18.1)	5.8	31.6	72
2341.HK	Ecogreen Fine Chemicals	1.8	(0.2)	(5.6)	6.0	20.6	71
543.HK	Pacific Online	5.2	(0.8)	3.5	8.3	19.4	70
1883.HK	CITIC 1616	1.9	(0.4)	6.7	10.7	26.3	70
531.HK	Samson	0.0	(0.4)	12.2	5.5	15.2	70
767.HK	Pacific Plywood	0.0	0.4	(3.1)	1.3	20.0	70
8149.HK	TSC Offshore Group	0.0	(0.9)	2.9	5.8	16.6	69
999.HK	I.T	5.3	(0.4)	6.1	9.6	19.3	68
3322.HK	Win Hanverky	5.5	(0.4)	(6.4)	4.3	18.2	68
672.HK	Zhong An Real Estate	0.0	(1.0)	(11.7)	5.2	18.4	68
3888.HK	Kingsoft Corp	2.5	(1.3)	9.0	11.8	19.7	67
210.HK	Prime Success	1.1	0.0	0.5	13.2	31.8	66
3383.HK	Agile Property	2.9	1.6	(10.4)	7.0	28.3	65
3313.HK	Meadville	3.2	1.3	(4.4)	5.2	21.9	65
268.HK	Kingdee International Sftwr	1.3	(0.3)	6.3	12.5	26.0	63
682.HK	Chaoda Modern Agriculture	0.6	0.7	(3.1)	7.5	20.7	62
2018.HK	AAC	0.0	(0.7)	0.0	9.2	23.9	61
2314.HK	Lee & Man Paper	3.2	1.9	(6.7)	5.2	20.4	60
1138.HK	China Shipping Development	2.5	1.6	(3.7)	9.7	33.5	60
2038.HK	Foxconn	0.0	(0.6)	(0.8)	8.6	23.6	58
8271.HK	Global Digital Creations	0.0	(0.1)	(6.9)	4.4	18.3	57
1169.HK	Haier Electronics	0.0	(0.1)	1.2	9.4	20.0	56
3883.HK	China Aoyuan	3.1	(0.7)	(15.0)	3.2	16.1	56
2007.HK	Country Garden	2.0	(0.1)	(7.0)	8.6	31.2	56
3311.HK	China State Construction	2.7	(2.5)	(7.3)	10.4	23.4	56
425.HK	Minth Group	2.0	(1.7)	(0.2)	8.4	16.6	55
3389.HK	Xinyu Hengdeli	2.1	0.1	(1.5)	11.9	23.5	54
839.HK	Anhui Tianda Oil Pipe	3.1	(0.3)	(3.7)	5.1	19.3	54
3339.HK	CIMH	3.3	1.8	(3.2)	8.4	23.1	54
175.HK	Geely Automobile	1.5	(0.1)	6.3	7.7	19.0	53
2337.HK	Shanghai Forte Land	0.0	2.2	0.9	5.0	15.6	52
3900.HK	Greentown China	5.0	6.5	(59.4)	4.8	20.7	52
337.HK	Spg Land	4.3	1.3	(2.7)	5.0	16.0	52
1868.HK	Neo-Neon	3.4	(0.9)	(1.6)	5.3	15.8	52
1205.HK	CITIC Resources	0.0	1.9	0.6	10.3	20.7	51
3303.HK	Jutal Offshore Oil Services	4.4	(0.3)	(0.5)	5.5	15.4	51
868.HK	Xinyi Glass	3.2	0.2	(7.3)	9.2	20.7	46
2868.HK	Beijing Capital Land	6.1	1.8	(19.5)	4.3	15.8	44
2366.HK	Qin Jia Yuan Media	1.4	(0.1)	(1.7)	11.1	19.4	43
304.HK	Peace Mark	1.8	0.6	(6.4)	8.1	20.7	42
2689.HK	Nine Dragons Paper	2.0	1.3	(6.5)	7.4	19.3	33
1211.HK	BYD Co	3.6	1.4	(14.6)	8.5	18.3	33
148.HK	Kingboard Chemicals	2.9	5.5	(2.8)	8.8	16.3	28
3377.HK	Sino-Ocean Land	2.3	0.7	(28.5)	7.5	16.0	25

Sources: Bloomberg and Sun Hung Kai Financial

A Closer Look at the Stage 2 Results – Scores

To get a general idea of what constitutes a high, medium or low score, Figure 7 shows a distribution of the scores across all 76 firms.

Figure 7: Distribution of scores across 76 firms



- The average score across all stocks was 70.15; 34 of the 76 firms scored higher than this. The lowest score was 25 and the highest 102. Stocks with high scores are better candidates as value plays. Of the 76 stocks, the following table lists those with above-average scores.

Figure 8: Firms with above-average scores

Stock code	Company	Dividend yield (%)	Net debt/price (HK\$)	FCF yield (%)	12M rolling forward P/E (X)	ROE (%)	Total score (max. 150 pts)
919.HK	Modern Beauty Salon	6.7	(0.8)	2.5	7.8	61.6	102
590.HK	Luk Fook	4.9	(0.4)	7.9	6.5	28.8	101
755.HK	Shanghai Zendai	0.0	0.1	14.4	2.3	26.0	100
3336.HK	Ju Teng	0.0	0.4	8.4	4.8	26.0	99
2000.HK	SIM Tech	6.7	(0.4)	10.1	4.2	19.8	98
8108.HK	Fava	0.0	(0.1)	(2.5)	3.8	44.9	98
52.HK	Fairwood	5.1	(0.8)	8.4	7.5	29.6	96
856.HK	VST	0.0	(0.1)	(1.3)	2.3	57.9	92
2368.HK	Eagle Nice	8.1	(0.6)	8.9	4.5	15.2	91
299.HK	Sinocom Software	4.1	(0.4)	8.6	9.2	24.9	91
733.HK	Hopefluent Group	4.1	(0.8)	0.0	5.8	22.1	90
3399.HK	Guangdong Nan Yue Logistic	4.7	(2.3)	28.3	4.3	15.9	90
330.HK	Esprit	2.2	(4.3)	4.4	13.3	49.5	87
8058.HK	Shandong Luoxin Pharmacy	0.6	(0.2)	5.0	9.3	35.4	85
3889.HK	Global Sweeteners	0.0	(0.4)	8.8	5.3	19.5	83
2889.HK	China Nickel Resources	3.5	0.5	0.0	3.4	20.0	81
752.HK	Pico Far East	6.0	(0.4)	5.6	6.7	21.0	81
3989.HK	Hembly	3.9	0.9	(16.2)	3.5	29.2	80
285.HK	BYD Electronic	3.2	(1.0)	(2.0)	5.7	28.5	79
317.HK	Guangzhou Shipyard	2.7	(10.8)	(7.3)	6.8	42.1	79
628.HK	Dore	17.0	0.3	(21.4)	0.4	22.4	78
319.HK	China Metal	4.3	0.0	4.1	5.3	18.2	76
838.HK	Eva Precision Industrial	2.9	(0.0)	0.2	6.1	21.7	76
408.HK	Yip's Chemical	4.2	0.3	9.8	7.5	22.5	75
581.HK	China Oriental Group	2.3	0.3	1.4	6.6	24.8	74
1882.HK	Haitian	5.4	(0.6)	0.8	6.8	22.7	74
8313.HK	International Elite	0.0	(0.4)	4.8	4.5	18.5	73
3933.HK	United Laboratories	3.5	1.0	(9.3)	6.4	26.8	73
1171.HK	Yanzhou Coal	1.4	(1.2)	2.5	10.0	23.5	73
819.HK	Tianneng Power	4.1	(0.0)	(24.7)	4.5	24.1	73
1888.HK	Kingboard Laminates	6.5	0.8	1.1	6.4	24.0	73
321.HK	Texwinca	5.0	0.7	0.5	8.9	23.5	72
359.HK	China Haisheng Juice	1.5	1.4	(18.1)	5.8	31.6	72
2341.HK	Ecogreen Fine Chemicals	1.8	(0.2)	(5.6)	6.0	20.6	71

Sources: Bloomberg and Sun Hung Kai Financial

Stage 3: Qualitative analysis – looking at firms one by one

- The stock list produced from the first screening stages forms a platform for further in-depth analysis. We have complemented this screening process with a qualitative inspection by looking for stocks that, having undergone careful examination by our analysts, have received Buy ratings. These number 15 in total, which we highlight as good value stocks.

Stage 3 Results: Overview

Figure 9: 15 value stocks

Stock code	Company	EPS growth (%)			Dividend yield (%)	Net debt/price (HK\$)	FCF yield (%)	12M rolling forward P/E (X)	ROE (%)	Total score (max. 150)
		FY07	FY08	FY09						
590.HK	Luk Fook	104.6	24.3	23.2	4.9	(0.4)	7.9	6.5	28.6	101
3336.HK	Ju Teng	102.0	44.6	28.7	0.0	0.4	8.4	4.8	26.0	99
2000.HK	SIM Tech	(35.9)	9.4	22.4	6.7	(0.4)	10.1	4.2	19.8	98
1882.HK	Haitian	(2.7)	13.4	20.5	5.4	(0.6)	0.8	6.8	22.4	74
1171.HK	Yanzhou Coal	37.5	65.8	18.8	1.4	(1.2)	2.5	10.0	23.5	73
1888.HK	Kingboard Laminates	5.4	10.3	15.6	6.5	0.8	1.1	6.4	26.0	73
3383.HK	Agile China	58.0	35.3	34.4	2.9	1.6	(10.4)	7.0	27.5	65
3313.HK	Meadville	(19.0)	90.6	22.8	3.2	1.3	(4.4)	5.2	22.7	65
2018.HK	AAC	(2.9)	32.1	25.9	0.0	(0.7)	0.0	9.2	24.0	61
2314.HK	Lee & Man Paper	61.8	27.8	41.7	3.2	1.9	(6.7)	5.2	20.4	60
1138.HK	China Shipping Development	64.8	30.6	21.9	2.5	1.6	(3.7)	9.7	33.5	60
3883.HK	Aoyuan	5.9	20.8	64.4	3.1	(0.7)	(15.0)	3.2	16.1	56
425.HK	Mint Group	25.0	36.0	31.0	2.0	(1.7)	(0.2)	8.4	16.6	55
3339.HK	CIMH	(1.7)	14.7	26.9	3.3	1.8	(3.2)	8.4	22.9	54
868.HK	Xinyi Glass	67.1	27.3	45.3	3.2	0.2	(7.3)	9.2	20.7	46

* Note: Data used in this report is based on consensus figures. We use our own fundamental forecasts for companies listed in the appendix.
Sources: Bloomberg and Sun Hung Kai Financial

- Company backgrounds, key investment positives and negatives, and financial data for these 15 stocks are in Appendix 2.

Conclusion

- Our objective here is to provide a list of value stocks that offer good investment opportunities. Through several quantitative screening steps, we have identified more than 70 possible value stocks. Then through a qualitative analysis of companies, we have highlighted 15 of these as Buys. For qualitative information on these 15 stocks, please refer to Appendix 2.
- In conclusion, despite these tumultuous times, investors need not fret. Opportunities for buying into value stocks occur regardless of the equities market outlook. Profit can be obtained by buying stocks at deflated prices not reflecting intrinsic value. By identifying good value stocks, we can effectively curtail risk by investing intelligently, and avoid concerning ourselves with market factors that can cause fluctuations in stock prices, such as inflation, interest rates and oil prices – and focus on actual companies. Given current rice and oil prices, one may not know whether to feed oneself or one's car, but good investors should know that in a time of market uncertainty, value still exists.



Appendix 1: Difference between our forecasts and the consensus

- Data used in this report is based on Bloomberg consensus figures. In the company analyses in Appendix 2, we use our own fundamental earnings forecasts. The table below shows the differences between our EPS-growth forecasts and the Bloomberg consensus for our 15 value stocks.

Figure 10: Comparison of EPS-growth forecasts and the Bloomberg consensus

Stock code	Company	Consensus EPS growth (%)			Our EPS growth forecasts (%)		Difference (our forecast minus consensus) (bps)	
		FY07	FY08F (consensus)	FY09F (consensus)	FY08F	FY09F	FY08F	FY09F
590.HK	Luk Fook	104.6	24.3	23.2	17.9	26.3	(6.4)	3.1
3336.HK	Ju Teng	102.0	44.6	28.7	40.9	28.2	(3.7)	(0.4)
2000.HK	SIM Tech	(35.9)	9.4	22.4	15.4	14.9	6.0	(7.5)
1882.HK	Haitian	(2.7)	13.4	20.5	11.1	25.0	(2.3)	4.5
1171.HK	Yanzhou Coal	37.5	65.8	18.8	62.0	14.6	(3.8)	(4.2)
1888.HK	Kingboard Laminates	5.4	10.3	15.6	11.9	22.0	1.7	6.4
3383.HK	Agile	58.0	35.3	34.4	39.0	52.5	3.7	18.1
3313.HK	Meadville	(19.0)	90.6	22.8	8.1	22.0	(82.5)	(0.8)
2018.HK	AAC	(2.9)	32.1	25.9	23.2	26.3	(8.9)	0.4
2314.HK	Lee & Man Paper	61.8	27.8	41.7	23.1	43.5	(4.7)	1.8
1138.HK	China Shipping Dev	64.8	30.6	21.9	24.6	25.2	(6.0)	3.3
3883.HK	China Aoyuan	5.9	20.8	64.4	50.0	44.4	29.2	(19.9)
425.HK	Mint Group	25.0	36.0	31.0	28.4	36.5	(7.6)	5.5
3339.HK	CIMH	(1.7)	14.7	26.9	25.4	22.3	10.7	(4.6)
868.HK	Xinyi Glass	67.1	27.3	45.3	36.3	39.3	9.0	(6.0)

Sources: Bloomberg and Sun Hung Kai Financial

Appendix 2: Company backgrounds, key investment positives and negatives and financial data

AAC (2018.HK)

Analyst: Eva Yip
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AAC Acoustic designs and manufactures miniature acoustic components. These include receivers, speakers and microphones used in mobile phones, games consoles, notebooks, MP3 players, digital-still cameras and other consumer-electronic devices. Each component sells at US\$1.50-3.00 per unit, and ASPs for order renewal are around 8-10% lower than for the first batch. Motorola and its ODM are the largest customers, making up around 35% of FY07 sales. After qualification as Nokia's supplier, Nokia makes up 10% of revenue, possibly rising to 25% this year and replacing Motorola as the largest customer. AAC accounts for 0.06% of Nokia's COGS and 0.12% of Motorola's COGS. It has a 20-25% global market share in receivers, 15-20% in speakers and single digits in microphones. As Motorola is AAC's largest customer, sales have suffered from Motorola's continued market-share loss. However, efforts to bring in new customers and increase penetration among existing customers should maintain sales momentum in FY08 and FY09.

Handset-market growth is set slow to a 7% CAGR for 2006-11 vs. c. 22% in 2006. Despite an industry slowdown, AAC is set to achieve 26% sales growth p.a. in FY08 and FY09, driven by the rollout of new customers, more sales to existing customers and new product launches. AAC will expand capacity 40% in FY08, which should help it meet rising customer demand. Domestic acoustic-component peers could find it difficult to gain share due to the stringent quality requirements of top-tier customers (the fault rate needs to be as low as 5%). Qualification periods are also typically long; it took AAC two years to penetrate Nokia's supply chain.

AAC collaborates with Nanjing University, which has the best acoustics department in China; this gives it stronger R&D than local competitors. It has a leading 40% market share in China's acoustics market. Key competitors are mainly component makers based in Europe or Japan, such as Hosiden and Philips. As AAC is based in China, its production-labor costs are lower and it also has lower operating expenses/sales of 16% on average vs. Japan-based Pioneer's 24%. Another advantage is that its semi-automated production lines can ramp up capacity rapidly (2-3 months faster than its peers) while maintaining cost advantages; Japanese peers have lower profitability (single-digit net margins), which offers no room to cut prices.

As 80% of sales are from the handset segment, any abrupt slowdown in global handset demand could cut sales. The increasing risk of global recession could also cut high-end handset demand (as indicated by Sony Ericsson's profit warning at the beginning of the year). With 35-40% of AAC's components for high-end models, this could be a key risk dampening sales growth. Nonetheless, with the diversification of handset customers, any market-share reshuffle among top-tier customers should have a minimal impact on sales. Increasing market share from non-handset makers that are not current customers could also help maintain sales.

Figure 11: AAC - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – RMBm	197.7	332.9	570.3	551.1	678.8	857.2
Net-profit growth - %	42.7	68.4	71.3	(3.4)	23.2	26.3
EPS –RMB fen	20.7	31.1	45.7	44.4	54.7	69.0
EPS growth – %	42.7	50.1	47.2	(2.9)	23.2	26.3
P/E – X	29.4	19.6	13.3	13.7	11.1	8.8
DPS –RMB fen	0.0	0.0	0.0	0.0	0.0	0.0
Dividend yield – %	0.0	0.0	0.0	0.0	0.0	0.0
BVPS –RMB	N/A	1.4	1.7	2.1	2.6	3.1
P/B – X	N/A	4.2	3.6	2.9	2.3	1.9
Oper. cash flow per share – RMB fen	N/A	34.3	37.0	30.1	26.4	58.9
FCF/share –RMB fen	N/A	6.3	12.4	0.7	(5.8)	34.8
Free cash flow yield – %	N/A	1.0	2.0	0.1	(1.0)	5.7
Net debt per share –RMB fen	N/A	(87.9)	(80.6)	(69.9)	(73.5)	(102.4)
Net debt/ price – %	N/A	(14.5)	(13.3)	(11.5)	(12.1)	(16.9)
Issued shares – millions	N/A	1,072.0	1,248.0	1,242.0	1,242.0	1,242.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 12: Investment Highlights for AAC



 Key investment positive	 Key investment negatives
<ul style="list-style-type: none"> ■ AAC is still on a growth track despite the maturing handset market (set for a 7% sales CAGR for 2006-11). This is due to continued efforts to bring in new customers and increasing penetration of existing customers. ■ Sales momentum to resume in FY08 and FY09 after the trough in 1H07 caused by weak Motorola business (35% of sales). Sales are set to grow 34% in FY08 and 20% in FY09, following 10% in FY07. ■ Growth will be driven by ramping up product platforms from new customers (Nokia, Apple and RIM). ■ Strong China handset-market growth from new-product launches. The China handset market makes up 15% of total sales and is estimated to grow 35% in FY07. ■ Growth driven by increasing penetration of new customers' supply chains. AAC has further penetrated to supply other components to new customers (non-headset components to RIM include speakers and receiver platforms). ■ Market share should improve following Nokia qualification. It has a 20-25% global market share in receivers, 15-20% in speakers and single digits in microphones. Nokia had a global market share of c. 40% in 2007. It targets to achieve 20% of Nokia's component supply. ■ Positive impact from gaining Nokia as a customer. Large order sizes mean economies of scale. ■ Supplying parts for low-end Nokia phones does not necessarily mean lower margins, as AAC can bundle these with other components. ■ Margins are stabilizing (47.3% in FY07) on more new products despite ASP erosion for handsets, as AAC's products are priced based on technology. ■ Lack of competition. Major competitors are from Europe and Japan, but AAC can offer lower costs, flexibility and scalability. ■ Low R&D costs. Japanese suppliers are losing money or with single digit net margin and unable to adopt a price-cut strategy. ■ Flexibility: AAC has semi-automated and vertically integrated production lines that can expand capacity within two months vs. its peers' six months, responding quicker to customer requests. ■ Competitive advantages: 1. Comprehensive product range covering all acoustic components, 2. Able to provide stability, a key concern of international vendors. ■ Strong R&D vs. local competitors, with a 40% market share in China's acoustics market. AAC collaborates with Nanjing University, which has the best acoustics department in China. ■ Capacity expansion to meet increase demand (up 40% in FY08). New production facilities are scheduled to enter production in November, with a new production plant next year. ■ Minimal impact from Motorola's bearish guidance. Motorola will increase outsourcing to its ODM (also AAC's customer) from 40% in 2007 to 50% in 2008. 35% of total sales are from Motorola and its ODM. ■ Threat from the Hon Hai group in the handset-acoustics segment should be immaterial over the next 6-12 months, given that it takes at least 1-2 years to gain customer qualification. ■ Share buybacks provide share-price support and enhance ROE. The company will renew its share-buyback program. It has bought back 16.5 million shares since 2007 (about US\$14.8m at HK\$6.00-7.50 per share). 	<ul style="list-style-type: none"> ■ Motorola's spin off and Sony Ericsson's profit warning in 1Q08 could affect sales. Motorola made up 35% of total sales and Sony Ericsson 15% in 2007. ■ Relies on handset market (80% of total sales). ■ Increase in effective tax rate (8% in FY07) due to tax unification (to 25%), could erode its bottom line. ■ 8-12% increase in operating expenses due to new labor laws (labor makes up 20% of COGS).

Figure 13: AAC Acoustic – Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	626.8	1,073.7	1,773.4	1,952.2	2,621.5	3,145.9	46.7
COGS	(315.7)	(546.0)	(902.1)	(1,028.8)	(1,441.8)	(1,714.5)	51.8
Gross profit	311.1	527.7	871.3	923.5	1,179.7	1,431.4	41.8
Operating expenses	(24.7)	(62.4)	(113.4)	(117.3)	(157.3)	(157.3)	63.3
Other operating income	8.4	19.0	46.3	32.4	16.5	20.0	39.1
Operating profit	294.8	484.3	804.2	838.6	776.8	979.5	39.7
Finance expenses	(6.0)	(7.6)	(0.6)	(6.6)	(5.4)	(5.4)	27.7
PBT	288.8	476.7	803.5	832.0	771.4	974.1	39.8
Tax	(29.5)	(20.3)	(31.5)	(49.9)	(92.6)	(116.9)	23.7
Net profit	197.7	332.9	570.3	551.1	678.8	857.2	41.2
EPS – RMB fen	20.7	31.1	45.7	44.4	54.7	69.0	32.3

Sources: The Company and Sun Hung Kai Financial

Figure 14: AAC Acoustic – Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	250.5	957.8	1,015.9	1,050.8	1,093.2	1,452.3	74.7
Accounts receivable	253.5	347.6	553.9	762.2	1,005.5	1,206.6	47.4
Inventory	80.5	116.2	188.5	271.0	646.4	775.7	42.0
Other current assets	2.7	1.0	10.0	13.7	13.7	13.7	(17.6)
Total current assets	587.2	1,422.6	1,768.3	2,097.8	2,758.9	3,448.3	54.2
Net fixed assets	224.5	349.9	626.8	869.8	975.7	1,091.4	56.8
Other long-term assets	13.6	19.4	147.1	244.1	244.1	244.1	126.9
Total assets	825.3	1,791.9	2,542.2	3,211.7	3,978.7	4,783.9	57.4
Short-term debt	82.7	15.0	10.0	182.3	180.0	180.0	24.3
Accounts payable	112.3	219.3	374.0	414.9	553.0	657.6	39.2
Other current liabilities	150.7	19.2	33.2	26.5	26.5	26.5	(4.6)
Total current liabilities	345.8	253.5	417.2	623.8	759.6	864.1	29.9
Long-term debt	0.0	0.0	0.0	0.0	0.0	0.0	N/A
Other long-term liabilities	0.0	0.0	0.0	0.0	0.0	0.0	N/A
Total liabilities	345.8	253.5	417.2	623.8	759.6	864.1	29.9
Shareholders equity	256.8	1,538.4	2,111.1	2,577.3	3,209.1	3,909.7	75.4
Minorities	3.0	0.0	13.9	10.6	10.0	10.0	(24.4)
Total equity and liabilities	602.6	1,791.9	2,528.3	3,201.1	3,968.7	4,773.9	59.8

Sources: The Company and Sun Hung Kai Financial

Figure 15: AAC Acoustic – Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	48.5	71.3	65.2	10.1	34.3	20.0	46.7
EBIT growth – %	33.8	64.3	66.0	4.3	(7.4)	26.1	39.7
Net-profit growth – %	42.7	68.4	71.3	(3.4)	23.2	26.3	41.2
EPS growth – %	42.7	50.1	47.2	(2.9)	23.2	26.3	32.3
Profitability ratios							
Gross margin – %	49.6	49.1	49.1	47.3	45.0	45.5	48.8
Operating margin – %	47.0	45.1	45.3	43.0	29.6	31.1	45.1
Net margin – %	31.5	31.0	32.2	28.2	25.9	27.2	30.7
ROAA – %	29.3	25.4	26.3	19.2	18.9	19.6	25.1
ROAE – %	74.7	37.1	31.3	23.5	23.5	24.1	41.6
Other ratios							
Capex/sales – %	17.3	27.9	17.3	18.7	15.3	9.5	20.3
Capex/depreciation – %	466.4	956.2	638.0	474.5	474.5	474.5	633.8
Operating expense/ sales – %	(3.9)	(5.8)	(6.4)	(6.0)	(6.0)	(5.0)	(5.5)
Net debt/equity (net cash) – %	(65.3)	(61.3)	(47.6)	(33.7)	(28.5)	(32.5)	(52.0)
Inventory/sales – %	12.8	10.8	10.6	13.9	24.7	24.7	12.0
Effective tax rate – %	10.2	4.3	3.9	6.0	12.0	12.0	6.1
ROAA component analysis							
Revenue/average assets – %	92.9	82.1	81.8	67.9	72.9	71.8	81.2
COGS/average assets – %	(46.8)	(41.7)	(41.6)	(35.8)	(40.1)	(39.1)	(41.5)
Gross profit/average assets – %	46.1	40.3	40.2	32.1	32.8	32.7	39.7
Operating expenses/average assets – %	(3.7)	(4.8)	(5.2)	(4.1)	(4.4)	(3.6)	(4.4)
Other operating income/average assets – %	1.3	1.4	2.1	1.1	0.5	0.5	1.5
Operating profit/average assets – %	43.7	37.0	37.1	29.1	21.6	22.4	36.7
Finance expenses/average assets – %	(0.9)	(0.6)	(0.0)	(0.2)	(0.2)	(0.1)	(0.4)
PBT/average assets – %	42.8	36.4	37.1	28.9	21.5	22.2	36.3
Tax/average assets – %	(4.4)	(1.5)	(1.5)	(1.7)	(2.6)	(2.7)	(2.3)
Net profit/average assets – %	29.3	25.4	26.3	19.2	18.9	19.6	25.1
ROAE component analysis							
Revenue/average equity – %	236.9	119.6	97.2	83.3	90.6	88.4	134.3
COGS/average equity – %	(119.3)	(60.8)	(49.4)	(43.9)	(49.8)	(48.2)	(68.4)
Gross profit/average equity – %	117.6	58.8	47.7	39.4	40.8	40.2	65.9
Operating expenses/average equity – %	(9.3)	(7.0)	(6.2)	(5.0)	(5.4)	(4.4)	(6.9)
Other operating income/average equity – %	3.2	2.1	2.5	1.4	0.6	0.6	2.3
Operating profit/average equity – %	111.4	54.0	44.1	35.8	26.8	27.5	61.3
Finance expenses/average equity – %	(2.3)	(0.8)	(0.0)	(0.3)	(0.2)	(0.2)	(0.9)
PBT/average equity – %	109.2	53.1	44.0	35.5	26.7	27.4	60.5
Tax/average equity – %	(11.1)	(2.3)	(1.7)	(2.1)	(3.2)	(3.3)	(4.3)
Net profit/average equity – %	74.7	37.1	31.3	23.5	23.5	24.1	41.6

Sources: The Company and Sun Hung Kai Financial

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Agile is a property developer that focuses on building large-scale community property. In 2007, the company maintained rapid growth and outstanding performance, and expanded its business nationwide. The stock is one of our top picks in the sector.

Agile has one of the largest and most diverse land banks among the top five developers. It has 28.4 million sq m of GFA across 20 cities, sufficient for eight years of development. That should help dilute policy risk from any single market.

Agile increased its net gearing significantly to 60.2% in FY07 to buy 9.5 million sq m of land bank for RMB8.8bn. It has paid 82% of the land cost, leaving only RMB1.6bn in land premiums for 2008. However, with no further land-bank expansion plan in 2008, and strong contract sales expected, we estimate net gearing to improve to 45% in FY08 and 40% in FY09. We see this as a sustainable zone for large property developers.

Moreover, Agile benefits from large economies of scale, which have helped improved margins. The gross margin surged 7.7 pts to 50.5% in FY07, one of the highest in the sector, while the net margin improved 1.8 pts to 20.4%. We expect these high margins to persist over FY08-10.

The company launched 22 projects in 2007, up 57% from 2006. It expanded into four new cities, and completed a total of 1.53 million sq m of GFA. Despite more project launches and GFA completion, selling, marketing and administration expenses stayed at only 5.5% of revenue. This indicates Agile's economies of scale have helped keep costs under control.

Another reason for Agile's improving profitability is its low land costs, at only 7.5% of ASPs in 2006 and 7.6% in 2007. We expect low land costs to ASPs to persist for the next 4-5 years.

Agile's current land-bank cost is as low as RMB619/sq m, only 7.7% its estimated FY08 ASP. This should provide solid downside protection for profit growth.

Figure 16: Agile - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
EPS –RMB fen	9.1	38.6	35.5	56.1	78.0	119.0
EPS growth – %	N/A	324.2	(8.0)	58.0	39.0	52.5
P/E – X	78.0	18.4	20.0	11.8	8.5	5.4
DPS –RMB fen	0.0	2.9	12.0	19.0	26.5	40.3
Dividend yield – %	0.0	0.4	1.7	2.7	3.7	5.7
BVPS –RMB	N/A	1.3	2.0	2.4	3.0	3.9
P/B – X	N/A	5.5	3.6	2.8	2.2	1.7
Net debt per share –RMB fen	N/A	(84.3)	4.4	145.2	133.2	154.8
Net debt/ price – %	N/A	(11.9)	0.6	20.5	18.8	21.8
Issued shares – millions	N/A	3,465.3	3,745.7	3,745.7	3,745.7	3,745.7

Sources: Bloomberg and Sun Hung Kai Financial

Figure 17: Investment Highlights for Agile



	
Key investment positives	Key investment negatives
<ul style="list-style-type: none"> ■ Economies of scales: Agile launched 22 projects in 2007, up 57% from 2006. It expanded into four new cities, and completed 1.53 million sq m of GFA. Despite more project launches and GFA completion, selling, marketing and administration expenses stayed at only 5.5% of revenue. That suggests Agile's economies of scale helped it keep costs under control. ■ Greater economies of scale also boosted margins, with the gross margin surging 7.7 ppts to 50.5% in FY07, one of the highest in the sector. The net margin also increased 1.8 ppts to 20.4%. We expected high margins to continue over FY08-10. ■ One-quarter of our FY08 sales estimate has already been locked in: by end-1Q08, Agile had pre-sold 370,000 sq m of GFA or RMB3.2bn revenue, which represents about 22.4% of our FY08 sales target has been locked-in. ■ Agile's current land-bank cost is as little as RMB619/sq m, only 7.7% of its estimated FY08 ASP. This should provide solid downside protection for profit growth. ■ Large land bank: Agile has one of the largest and most diverse land banks among the top five developers. It has 28.4 million sq m of GFA across 20 cities, sufficient for eight years of development. That should help dilute policy risk from any single market. ■ Solid earnings growth: net income forecast to rise at a 46% three-year CAGR to about RMB3bn by FY08. ■ Development completion accelerating: GFA of 1.6 million, 2.5 million and 3.1 million sq m will be completed in 2007-09 (vs. 1.1 million in 2006), representing a 41% three-year CAGR. ■ Agile increased net gearing significantly to 60.2% in FY07, as it bought 9.5 million sq m of land for RMB8.8bn. It has paid 82% of the land cost, leaving only RMB1.6bn of land premiums for 2008. However, with no further land-bank expansion in 2008, and strong contract sales expected, we estimate net gearing to improve to 45% in FY08 and 40% in FY09. In our view that is a sustainable level for large property developers. ■ Operational strengths: 1) strong execution, 2) expertise in the Guangzhou property market, and 3) high-quality products (large-scale community projects). ■ Benefits from accelerating industry consolidation: recent austerity measures (including credit tightening, restricted land supply and the 70%, 90 sq m requirement) may accelerate industry consolidation. Large property developers would benefit. ■ Expansion to other markets: Agile has expanded to other provinces, helping it increase brand awareness. ■ Strong brand image: Agile has firmly established its brand name as a master community developer and is also well recognized by the market for its high-quality products and related property-management services. ■ Expansion into non-residential property: Agile has started to expand its product range. It is building a five-star hotel in Shanghai and complex buildings, which will generate sustainable long-term profit. 	<ul style="list-style-type: none"> ■ Policy risks: More unexpected tightening policies targeting the property sector (e.g. faster-than-expected rate hikes, policies to curb presales, implementation of LAT), may dampen sentiment and slow property sales. ■ The gross margin normalizing after 2009: the gross margin is set to fall to about 25% after 2009 (vs. 30% in 2007-09) as low-cost land bank (acquired pre-2007) gradually runs out. ■ Potential oversupply: as cheap land bank runs out, developers need to roll out projects more aggressively to maintain profit growth. This plus the 70%, 90 sq m rule (effectively increasing the number of property units supplied) could lead to property oversupply after 2009. ■ Expansion into unfamiliar markets: more time is required to understand new markets, which could slow property sales and increase operating risk. ■ The possibility of increased competition in Guangdong. ■ A potential slowdown in Guangdong: the Guangdong property market is more mature than other provinces, and demand for residential property may rise slower.

Figure 18: Agile - Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR (%)
Revenue	2,548.9	5,370.6	6,675.2	10,312.3	14,282.1	22,184.0	42.6
COGS	(1,901.4)	(3,631.9)	(4,375.3)	(5,105.3)	(7,141.0)	(11,092.0)	32.2
Gross profit	647.5	1,738.7	2,299.9	5,207.0	7,141.0	11,092.0	58.9
Operating expenses	(287.7)	(267.4)	(376.7)	(617.0)	(912.1)	(1,613.6)	56.7
Other operating income	6.5	8.4	24.6	40.0	44.0	48.4	54.9
Operating profit	366.0	1,422.6	2,372.1	4,417.7	6,273.0	9,526.9	60.9
Finance expenses	(17.1)	(9.9)	(48.5)	(63.2)	(98.5)	(101.4)	79.0
PBT	349.6	1,458.1	2,423.9	4,454.5	6,111.4	9,320.4	59.0
Tax	119.4	475.1	1,173.4	2,343.7	3,178.0	4,846.6	78.7
Net profit exclude fair value gain	74.4	52.6	49.6	967.0	2,043.8	2,691.0	167.4
EPS – RMB fen	9.1	38.6	35.5	56.1	78.0	119.0	32.5

Sources: The Company and Sun Hung Kai Financial

Figure 19: Agile - Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR (%)
Cash and securities	172.6	4,205.2	5,194.5	2,582.5	3,971.9	4,270.6	0.4
Accounts receivable	47.1	278.9	591.3	1,056.9	1,571.0	2,662.1	75.8
Inventory	2,697.5	2,971.3	3,619.3	6,401.7	9,283.3	13,754.1	46.7
Other current assets	1,697.8	1,275.0	4,584.2	13,116.3	9,311.5	12,647.4	77.5
Total current assets	4,615.0	8,730.4	13,989.3	23,157.4	24,137.7	33,334.2	39.8
Net fixed assets	1,443.3	871.8	3,462.4	5,384.4	6,730.5	7,403.6	70.7
Other long-term assets	71.1	18.2	32.1	164.1	180.2	194.2	80.8
Total assets	6,129.4	9,620.3	17,483.8	28,705.9	31,048.4	40,932.0	43.6
Short-term debt	318.5	507.5	651.2	1,375.1	1,650.1	1,732.6	35.9
Accounts payable	1,441.2	1,751.5	2,089.6	3,647.6	4,298.9	6,211.5	37.2
Other current liabilities	2,478.1	1,761.4	2,070.9	7,168.9	5,412.9	8,208.1	46.9
Total current liabilities	4,237.8	4,020.4	4,811.6	12,191.6	11,361.9	16,152.2	41.6
Long-term debt	1,098.2	778.2	4,708.4	6,647.3	7,312.0	8,335.7	80.9
Other long-term liabilities	65.0	311.6	579.5	833.3	1,285.4	1,996.6	59.1
Total liabilities	5,401.0	5,110.2	10,099.6	19,672.2	19,959.3	26,484.5	50.9
Shareholders equity	728.4	4,510.1	7,384.2	9,033.7	11,089.0	14,447.5	33.8
Minorities	5.6	5.9	14.7	18.8	20.7	23.8	41.6
Total equity and liabilities	6,129.4	9,620.3	17,483.8	28,705.9	31,048.3	40,932.0	43.6

Sources: The Company and Sun Hung Kai Financial

Figure 20: Agile - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR/ average (%)
Growth ratios							
Revenue growth – %	32.0	110.7	24.3	54.5	38.5	55.3	54.1
EBIT growth – %	162.8	288.7	66.8	86.2	42.0	51.9	91.9
Net-profit growth – %	216.3	330.0	27.0	69.2	38.9	52.5	81.3
EPS growth – %	N/A	324.2	(8.0)	58.0	39.0	52.5	67.2
Profitability ratios							
Gross margin – %	25.4	32.4	34.5	50.5	50.0	50.0	43.5
Operating margin – %	14.4	26.5	35.5	42.8	43.9	42.9	38.3
Net margin – %	2.9	1.0	0.7	9.4	14.3	12.1	7.5
ROAA – %	1.2	0.7	0.4	4.2	6.8	7.5	3.9
ROAE – %	12.8	2.0	0.8	11.8	20.3	21.1	11.2
Other ratios							
Operating expense/sales – %	11.3	5.0	5.6	6.0	6.4	7.3	6.1
Net debt/equity (net cash) – %	169.9	(64.7)	2.2	60.2	45.0	40.1	16.6
Inventory/sales – %	105.8	55.3	54.2	62.1	65.0	62.0	59.7
Effective tax rate – %	34.1	32.6	48.4	52.6	52.0	52.0	47.5
ROAA component analysis							
Revenue/average assets – %	41.8	68.2	49.3	44.7	47.8	61.6	54.3
COGS/average assets – %	(31.2)	(46.1)	(32.3)	(22.1)	(23.9)	(30.8)	(31.0)
Gross profit/average assets – %	10.6	22.1	17.0	22.5	23.9	30.8	23.3
Operating expenses/average assets – %	(4.7)	(3.4)	(2.8)	(2.7)	(3.1)	(4.5)	(3.3)
Other operating income/average assets – %	0.1	0.1	0.2	0.2	0.1	0.1	0.1
Operating profit/average assets – %	6.0	18.1	17.5	19.1	21.0	26.5	20.4
Finance expenses/average assets – %	(0.3)	(0.1)	(0.4)	(0.3)	(0.3)	(0.3)	(0.3)
PBT/average assets – %	5.7	18.5	17.9	19.3	20.5	25.9	20.4
Tax/average assets – %	2.0	6.0	8.7	10.1	10.6	13.5	9.8
Net profit/average assets – %	1.2	0.7	0.4	4.2	6.8	7.5	3.9
ROAE component analysis							
Revenue/average equity – %	438.0	205.0	112.2	125.6	141.9	173.7	151.7
COGS/average equity – %	(326.7)	(138.7)	(73.6)	(62.2)	(71.0)	(86.9)	(86.5)
Gross profit/average equity – %	111.3	66.4	38.7	63.4	71.0	86.9	65.3
Operating expenses/average equity – %	(49.4)	(10.2)	(6.3)	(7.5)	(9.1)	(12.6)	(9.2)
Other operating income/average equity – %	1.1	0.3	0.4	0.5	0.4	0.4	0.4
Operating profit/average equity – %	62.9	54.3	39.9	53.8	62.3	74.6	57.0
Finance expenses/average equity – %	(2.9)	(0.4)	(0.8)	(0.8)	(1.0)	(0.8)	(0.7)
PBT/average equity – %	60.1	55.7	40.8	54.3	60.7	73.0	56.9
Tax/average equity – %	20.5	18.1	19.7	28.6	31.6	38.0	27.2
Net profit/average equity – %	12.8	2.0	0.8	11.8	20.3	21.1	11.2

Sources: The Company and Sun Hung Kai Financial

China Aoyuan (3883.HK)**Analyst: Christina Ngai**
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China Aoyuan Property (Aoyuan) is a regional property developer in China, mainly focusing on Guangdong province. Aoyuan was established in 1999 and has built a strong brand name over the past 7-8 years in Guangdong. In 2005, Aoyuan was named one of the “Top Ten Guangdong Real Estate Enterprises with Development Potential & Prospects” by the Guangdong Association of Enterprises.

Last year’s IPO helped improve Aoyuan’s balance sheet dramatically to a net-cash position of about HK\$0.70 per share, or 30.6% of the current stock price. We expect the strong finances to reduce operating risk and any impact from further credit tightening, helping it through a rough 2008.

Currently, Aoyuan has 12 projects on hand and GFA has reached 5.8 million sq m, which should be enough for 4-5 years of development. Half the land bank is outside Guangdong and in second-tier cities/provinces, such as Jiangxi, Guangxi, Chongqing and Shenyang. This geographic diversification should lower the negative impact from tightening measures in any single market.

Aoyuan’s FY07 earnings came in 11% higher than the estimate given in its IPO prospectus, mainly due to a 141% rise in GFA delivery. We estimate a 99% two-year CAGR in GFA delivery to drive 92% p.a. earnings growth.

Aoyuan also maintained a high gross margin in FY07 at 52.9%, which is mainly due to its low land costs. This helped keep the net margin high at 24%, vs. the 20% sector average. As it has enough land bank for 4-5 years of development, we expect margins to remain high in FY08-10.

Based on the current weaker market sentiment and our expectation that there will be no further land-bank additions in 2008, we believe Aoyuan’s land should be valued more conservatively, and estimate an FY08 NAV of HKD6.18/share.

Aoyuan trades at 5.7X FY08F earnings, and about a 65% discount to our FY08F NAV forecast, a huge discount to its regional peers. We see the undemanding valuation as an excellent entry point to accumulate a stock with strong fundamentals, high potential growth and limited downside risk.

Figure 21: China Aoyuan - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
EPS –RMB fen	N/A	N/A	10.0	24.0	36.0	52.0
EPS growth – %	N/A	N/A	N/A	140.0	50.0	44.4
P/E – X	N/A	N/A	20.3	7.9	5.3	3.5
DPS –RMB fen	N/A	N/A	0.0	0.0	10.1	15.0
Dividend yield – %	N/A	N/A	0.0	0.0	5.0	7.4
BVPS –RMB	N/A	N/A	N/A	2.3	2.6	3.0
P/B – X	N/A	N/A	N/A	0.8	0.7	0.6
Net debt per share –RMB fen	N/A	N/A	N/A	(65.2)	(59.8)	2.8
Net debt/ price – %	N/A	N/A	N/A	(32.1)	(29.5)	1.4
Issued shares – millions	N/A	N/A	N/A	2,252.5	2,252.5	2,252.5

Sources: Bloomberg and Sun Hung Kai Financial

Figure 22: Investment Highlights for China Aoyuan



 Key investment positives	 Key investment negatives
<ul style="list-style-type: none"> ■ Strong balance sheet: The company is in a strong net-cash position due to the funds raised in its recent IPO. ■ Diverse locations: About 40% of land is in second-tier locations, e.g. Chongqing and in Guangxi. This should lower the impact from tightening measures, which have not yet affected the property market in second-tier cities ■ Accelerated earnings growth: Aoyuan is set to post an earnings CAGR of 92% in FY07-09, mainly driven by accelerating GFA sales, from 400,000 sq m in 2007 to 1.3 million sq m by 2009. ■ Undemanding valuation: The stock trades at a 65% discount to NAV and 5.7X FY08F earnings, significantly below its peers' average of 10X. ■ Low-cost land bank: Aoyuan's strategy is to acquire land in up-and-coming cities, which results in a high gross margin (50% vs. its peers' 40%) from the low land cost and high selling prices. 	<ul style="list-style-type: none"> ■ Policy risks: More unexpected tightening policies targeting the property sector (e.g. faster-than-expected rate hikes, policies to curb presales, higher interest rates) may dampen sentiment and slow property sales. ■ Failure to increase its land bank would limit sustainable growth: Aoyuan has 5.8 million sq m of land bank. If it fails to increase this, long-term sustainable growth in future (after four years) may be constrained. ■ Increased competition: more rivals in Guangdong. ■ Guangdong growth potential: The Guangdong property market is more mature than elsewhere in China, and demand growth may be slower than in other cities.

Figure 23: China Aoyuan - Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR (%)
Revenue	214.7	854.9	883.7	2,501.4	2,811.9	4,038.4	47.4
COGS	(158.9)	(615.4)	(429.0)	(1,177.0)	(1,349.7)	(1,938.4)	33.2
Gross profit	55.7	239.5	454.8	1,324.4	1,462.2	2,100.0	72.1
Operating expenses	(70.7)	(38.1)	(56.1)	(208.9)	(253.1)	(363.5)	75.7
Other operating income	2.9	8.2	0.0	0.0	0.0	0.0	(100.0)
Operating profit	18.7	280.7	529.3	1,211.9	1,213.3	1,756.7	58.2
Finance expenses	(5.5)	(1.5)	(2.1)	(30.6)	(42.2)	(60.6)	153.5
PBT	9.2	275.4	526.7	1,204.0	1,213.3	1,756.7	58.9
Tax	17.0	85.8	227.4	601.6	400.4	579.7	61.2
Net profit exclude fair value gain	74.4	52.6	49.6	967.0	2,043.8	2,691.0	167.4
EPS – RMB fen	N/A	N/A	10.0	24.0	36.0	52.0	N/A

Sources: The Company and Sun Hung Kai Financial

Figure 24: China Aoyuan - Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR (%)
Cash and securities	71.0	49.5	308.9	2,658.2	2,537.4	1,128.1	118.5
Accounts receivable	7.1	7.1	96.2	1,371.5	1,687.1	2,826.9	347.2
Inventory	1,385.7	980.1	1,036.3	2,593.1	3,514.9	5,048.0	50.6
Other current assets	836.5	835.3	471.7	1,169.3	269.7	349.4	(19.6)
Total current assets	2,300.4	1,872.0	1,913.0	7,792.1	8,009.1	9,352.4	49.5
Net fixed assets	399.9	453.3	234.0	442.6	503.3	743.1	13.2
Other long-term assets	149.1	33.7	42.1	5.9	288.2	413.9	87.1
Total assets	2,849.4	2,359.1	2,189.1	8,240.7	8,800.6	10,509.4	45.3
Short-term debt	123.2	204.6	216.9	74.9	74.9	74.9	(22.2)
Accounts payable	300.8	294.3	200.5	500.6	742.3	999.5	35.8
Other current liabilities	1,722.4	1,103.1	736.6	1,279.6	867.2	1,321.2	4.6
Total current liabilities	2,146.4	1,602.1	1,153.9	1,855.1	1,684.4	2,395.6	10.6
Long-term debt	438.0	254.0	114.0	1,115.3	1,115.3	1,115.3	44.8
Other long-term liabilities	0.0	25.4	92.9	226.2	160.2	231.9	73.9
Total liabilities	2,584.4	1,881.4	1,360.8	3,196.6	2,959.9	3,742.8	18.8
Shareholders equity	265.1	477.6	1,274.9	5,044.1	5,840.8	6,766.6	94.0
Minorities	14.5	21.6	0.4	0.0	0.0	0.0	(100.0)
Total equity and liabilities	2,849.4	2,359.1	2,635.7	8,240.7	8,800.7	10,509.4	45.3

Sources: The Company and Sun Hung Kai Financial

Figure 25: China Aoyuan - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR/ average (%)
Growth ratios							
Revenue growth – %	N/A	298.2	3.4	183.0	12.4	43.6	79.8
EBIT growth – %	N/A	1,401.1	88.6	129.0	0.1	44.8	148.1
Net-profit growth – %	N/A	N/A	58.9	101.1	34.9	44.8	N/A
EPS growth – %	N/A	N/A	N/A	140.0	50.0	44.4	N/A
Profitability ratios							
Gross margin – %	26.0	28.0	51.5	52.9	52.0	52.0	47.3
Operating margin – %	8.7	32.8	59.9	48.4	43.1	43.5	45.6
Net margin – %	34.7	6.2	5.6	38.7	72.7	66.6	37.9
ROAA – %	2.6	2.0	2.2	18.5	24.0	27.9	14.9
ROAE – %	28.1	14.2	5.7	30.6	37.6	42.7	26.1
Other ratios							
Capex/sales – %	2.5	0.6	0.2	0.3	0.0	0.0	0.2
Operating expenses/sales – %	32.9	4.5	6.3	8.4	9.0	9.0	7.4
Net debt/equity (net cash) – %	184.9	85.6	1.7	(29.1)	(23.1)	0.9	7.2
Inventory/sales – %	645.5	114.6	117.3	103.7	125.0	125.0	117.1
Effective tax rate – %	185.8	31.2	43.2	50.0	33.0	33.0	38.1
ROAA component analysis							
Revenue/average assets – %	7.5	32.8	38.9	48.0	33.0	41.8	38.9
COGS/average assets – %	(5.6)	(23.6)	(18.9)	(22.6)	(15.8)	(20.1)	(20.2)
Gross profit/average assets – %	2.0	9.2	20.0	25.4	17.2	21.8	18.7
Operating expenses/average assets – %	(2.5)	(1.5)	(2.5)	(4.0)	(3.0)	(3.8)	(2.9)
Other operating income/average assets – %	0.1	0.3	0.0	0.0	0.0	0.0	0.1
Operating profit/average assets – %	0.7	10.8	23.3	23.2	14.2	18.2	17.9
Finance expenses/average assets – %	(0.2)	(0.1)	(0.1)	(0.6)	(0.5)	(0.6)	(0.4)
PBT/average assets – %	0.3	10.6	23.2	23.1	14.2	18.2	17.9
Tax/average assets – %	0.6	3.3	10.0	11.5	4.7	6.0	7.1
Net profit/average assets – %	2.6	2.0	2.2	18.5	24.0	27.9	14.9
ROAE component analysis							
Revenue/average equity – %	81.0	230.2	100.9	79.2	51.7	64.1	105.2
COGS/average equity – %	(60.0)	(165.7)	(49.0)	(37.3)	(24.8)	(30.8)	(61.5)
Gross profit/average equity – %	21.0	64.5	51.9	41.9	26.9	33.3	43.7
Operating expenses/average equity – %	(26.7)	(10.3)	(6.4)	(6.6)	(4.7)	(5.8)	(6.7)
Other operating income/average equity – %	1.1	2.2	0.0	0.0	0.0	0.0	0.4
Operating profit/average equity – %	7.1	75.6	60.4	38.4	22.3	27.9	44.9
Finance expenses/average equity – %	(2.1)	(0.4)	(0.2)	(1.0)	(0.8)	(1.0)	(0.7)
PBT/average equity – %	3.5	74.2	60.1	38.1	22.3	27.9	44.5
Tax/average equity – %	6.4	23.1	26.0	19.0	7.4	9.2	16.9
Net profit/average equity – %	28.1	14.2	5.7	30.6	37.6	42.7	26.1

Sources: The Company and Sun Hung Kai Financial

China Shipping Development (1138.HK)**Analyst: Eva Yip**
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China Shipping Development's (CSD's) main business is cargo shipping, largely oil and dry-bulk cargo (primarily coal) along the PRC coast. Most dry bulk in China is transported by sea. 43% of CSD's revenue is from coal shipments, 40% from oil shipments and the remainder from other dry bulk. Domestic transport made up 70% of FY07 revenue, while international transport made up 30%. Fuel is the major operating cost, accounting for 41% of costs. Its customers include China refiners and IPPs. It has over a 70% market share in domestic crude shipments and over a 30% share in coal shipments. By December 2007, CSD owned a fleet of 185 vessels with an aggregate 7.8 million deadweight tonnes (dwt). Its net profit grew 65% yoy, driven by the purchase of 42 dry-bulk cargo ships from its parent in late 2006. This increased its dry-bulk fleet capacity 35% and made a full-year contribution in FY07.

We expect the company to maintain strong sales growth after posting 35% in FY07, driven by freight-rate increases and volume growth. In 2008, aggregate freight volume under COA contracts will reach 89.4 million tonnes (up 7% yoy) and the average standard freight rate will increase c. 40%. Dry bulk accounted for 60% of sales in FY07. As one of the largest dry-bulk carriers in China, CSD can benefit from the geographic imbalance in natural resources. China's coal reserves are concentrated in north and west China, but south and east China consume more energy due to booming economic activity.

CSD's earnings are less volatile than its peers, which may suffer from industry cycles. The company's focus on dry bulk makes it defensive against a U.S. economic slowdown and weak China exports. This is because coal and oil demand are stable as China continues to experience high GDP growth. CSD has also signed long-term COA contracts (50-60% of sales) that mitigate downside risk from falling spot freight rates.

Cash flows are predictable, with the company generating about a 30% gross margin from its freight rates for domestic coal and oil transport, with a fuel-surcharge mechanism that can pass through 80-90% of oil-price hikes. Finances are also healthy, with 20% net gearing at end-FY07 and net cash inflows from operating activities at RMB5.6bn for FY07. The company aims to lower finance costs by increasing the percentage of USD debt (from 55% to target 75% by 2011).

As utilization is high (over 90%), CSD is constructing 59 vessels of 8.69 million dwt, all scheduled for delivery by end-2012. Total capex of RMB23.4bn is expected in the next five years, which may lead to negative free cash flow and cuts in the dividend payout (37% in FY07).

International coal shipments may suffer from government limits on coal exports due to domestic shortages. About 10% of revenue is from international coal shipments.

Oil-shipping freight rates are also falling, due to high crude prices that may reduce demand, and increasing international capacities. The international crude composite freight-rate indicator fell 13% from 2006. 24% of revenue is from international oil shipments.

Figure 26: China Shipping Development - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – RMBm	1,844.5	2,691.2	2,758.5	4,546.4	5,832.7	7,303.1
Net-profit growth - %	53.2	45.9	2.5	64.8	28.3	25.2
EPS –RMB fen	55.5	80.9	82.9	136.7	170.3	213.2
EPS growth – %	80.2	45.9	2.5	64.8	24.6	25.2
P/E – X	34.8	23.9	23.3	14.1	11.3	9.1
DPS –RMB fen	15.0	30.0	30.0	50.0	60.0	70.0
Dividend yield – %	0.8	1.6	1.6	2.6	3.1	3.6
BVPS –RMB	2.6	3.3	3.8	4.8	5.7	7.1
P/B – X	7.4	5.9	5.1	4.0	3.4	2.7
Oper. cash flow per share – RMB fen	85.7	110.6	95.3	168.4	196.1	250.4
FCF/share –RMB fen	10.6	31.3	(46.7)	(65.5)	64.7	63.6
Free cash flow yield – %	0.6	1.6	(2.4)	(3.4)	3.4	3.3
Net debt per share –RMB fen	30.7	16.8	80.0	152.4	72.8	68.1
Net debt/ price – %	1.6	0.9	4.1	7.9	3.8	3.5
Issued shares – millions	3,326.0	3,326.0	3,326.0	3,326.0	3,425.1	3,425.1

Sources: Bloomberg and Sun Hung Kai Financial

Figure 27: Investment Highlights for China Shipping Development



	
Key investment positive	Key investment negatives
<ul style="list-style-type: none"> ■ Sales growth driven by freight-rate increases and volume growth. In 2008, aggregate freight volume under the COA contracts will reach 89.4 million tonnes (up 7% yoy) and the average standard freight rate will increase c. 40%. Dry bulk accounted for 60% of sales in FY07. ■ Benefits from geographic imbalance in natural resources. China's coal reserves are concentrated in north and west China, but south and east China consume more energy due to booming economic activity. 80% of coal is borne by sea routes. ■ Defensive shipping company against a U.S. economic slowdown and weak China exports. It mainly focuses on dry-bulk cargo transport. Coal and oil demand is stable (and trending upwards) as China continues to experience high GDP growth. ■ Long term COA contracts also account for 50-60% of total sales, mitigating downside risk from falling spot freight rates. ■ China's government aims to increase the market shares of Chinese carriers in various dry-bulk categories. Its policy aims are to have 50% of dry-bulk cargo handled by domestic carriers. For example, domestic carriers currently handle only 30% of imported iron ore. ■ Capacity expansion will be met by secured crude shipments. CSD entered a 10-year shipping contract with Sinopec, the country's top refiner, in July 2006 to transport imported crude into the mainland. Under the deal, starting 1 July 2006, shipment volume will range from 3.5 to 4.5 million tonnes in 2006 and 2007, rising to 12 million tonnes in 2010. This represents growth of 12-15% p.a. 40% of revenue is from oil shipments. ■ Market leadership. CSD has dominant market positions (over 30% and 70% market shares for domestic coal and oil shipping respectively). This gives it pricing power to pass through oil-price hikes. ■ Oil-price hikes should have less impact on margins (gross margin 41% in FY07, up 5 ppts). The oil pass-through mechanism can pass on 80-90% of oil price hikes. Fuel costs make up 40% of COGS. ■ Rise in NAV from appreciation of vessels. Further tight shipping capacity can drive up vessel value. ■ Long-term and predictable cash flows. Freight rates in domestic coal and oil transport give CSD about a 30% gross margin, with the fuel-surcharge mechanism. ■ High barriers to entry. China's domestic waters are not open to foreign competition. ■ Healthy finances (20% net gearing at end-FY07 and net cash inflows from operating activities at RMB5.6bn in FY07). ■ Lower financing costs from increasing the percentage of USD debt (from 55% to a target of 75% by 2011). 	<ul style="list-style-type: none"> ■ Heavy capex investment of RMB23.4bn in 2008-12 to double the fleet size (the group has 59 vessels of 8.69 million dwt under construction). The dividend payout may not rise (37% in FY07). ■ An abrupt economic slowdown would lower coal demand (43% of revenue is from coal shipments). ■ International coal shipments may suffer from government limits on coal exports due to domestic coal shortages. About 10% of revenue is from international coal shipments. ■ Downward trend in oil-shipping freight rates. High crude prices and increased international capacities are exerting downward pressure on international freight rates. 24% of revenue is from international oil shipments. ■ High utilization and tight capacity to ease in FY09. New vessels will only be delivered by FY09 and capacity was only boosted 7% in FY08.

Figure 28: China Shipping Development - Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	6,452.5	8,515.2	9,203.6	12,394.7	17,480.8	21,672.1	26.2
COGS	(4,017.3)	(5,155.3)	(5,916.7)	(7,329.3)	(10,258.9)	(12,493.2)	21.0
Gross profit	2,435.2	3,359.9	3,286.8	5,065.4	7,221.9	9,178.9	36.4
Operating expenses	(387.8)	(344.0)	(259.9)	(273.0)	(332.1)	(411.8)	(5.3)
Other operating income	212.9	266.2	311.3	542.9	570.1	570.1	42.8
Operating profit	2,260.3	3,282.1	3,413.3	5,501.2	7,659.9	9,547.2	44.1
Finance expenses	(106.0)	(135.6)	(120.5)	(173.1)	(130.0)	(120.0)	16.0
PBT	2,154.3	3,146.5	3,292.8	5,328.0	7,529.9	9,427.2	45.8
Tax	(308.7)	(452.6)	(531.3)	(781.7)	(1,694.2)	(2,121.1)	50.0
Net profit	1,844.5	2,691.2	2,758.5	4,546.4	5,832.7	7,303.1	39.4
EPS – RMB fen	55.5	80.9	82.9	136.7	170.3	213.2	45.2

Sources: The Company and Sun Hung Kai Financial

Figure 29: China Shipping Development - Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	1,312.6	1,177.9	475.3	1,079.8	3,132.1	5,213.1	(1.1)
Accounts receivable	157.2	227.9	400.3	559.4	766.3	950.0	26.3
Inventory	146.3	266.7	192.6	285.6	393.5	479.2	26.2
Other current assets	270.1	163.8	1,244.6	512.9	610.3	690.6	16.3
Total current assets	1,886.2	1,836.3	2,312.8	2,437.7	4,902.1	7,332.9	8.8
Net fixed assets	9,738.0	11,468.1	13,725.1	20,002.1	21,002.2	25,202.7	26.8
Other long-term assets	94.4	82.9	962.2	1,167.3	1,167.3	1,167.3	48.1
Total assets	11,718.6	13,387.4	17,000.2	23,607.1	27,071.6	33,702.9	24.8
Short-term debt	410.1	295.6	1,475.5	721.8	1,126.8	1,702.8	28.1
Accounts payable	165.0	216.9	216.2	462.1	646.4	684.6	35.2
Other current liabilities	547.9	560.7	961.8	582.2	781.3	940.4	16.6
Total current liabilities	1,123.0	1,073.3	2,653.5	1,766.2	2,554.6	3,327.8	25.1
Long-term debt	1,924.3	1,440.4	1,661.4	3,554.8	4,499.8	5,843.8	22.6
Other long-term liabilities	0.0	0.0	80.1	2,116.5	245.1	245.1	107.8
Total liabilities	3,047.2	2,513.7	4,394.9	7,437.6	7,299.5	9,416.8	32.6
Shareholders equity	8,659.1	10,848.7	12,605.3	16,071.5	19,674.1	24,188.1	21.8
Minorities	12.3	25.0	0.0	98.0	98.0	98.0	99.4
Total equity and liabilities	11,706.3	13,362.4	17,000.2	23,509.1	26,973.6	33,604.9	24.7

Sources: The Company and Sun Hung Kai Financial

Figure 30: China Shipping Development - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	32.1	32.0	8.1	34.7	41.0	24.0	26.2
EBIT growth – %	77.3	45.2	4.0	61.2	39.2	24.6	44.1
Net-profit growth – %	53.2	45.9	2.5	64.8	28.3	25.2	39.4
EPS growth – %	80.2	45.9	2.5	64.8	24.6	25.2	45.2
Profitability ratios							
Gross margin – %	37.7	39.5	35.7	40.9	41.3	42.4	38.4
Operating margin – %	35.0	38.5	37.1	44.4	43.8	44.1	38.8
Net margin – %	28.6	31.6	30.0	36.7	33.4	33.7	31.7
ROAA – %	17.2	21.4	18.2	22.4	23.0	24.0	19.8
ROAE – %	23.1	27.6	23.5	31.7	32.6	33.3	26.5
Other ratios							
Capex/sales – %	38.7	31.0	51.3	62.8	25.7	29.5	45.9
Capex/depreciation – %	320.8	285.9	483.6	777.4	313.3	341.5	466.9
Operating expense/ sales - %	(6.0)	(4.0)	(2.8)	(2.2)	(1.9)	(1.9)	(3.8)
Net debt/equity (net cash) – %	11.8	5.1	21.1	31.5	12.7	9.6	17.4
Inventory/sales – %	2.3	3.1	2.1	2.3	2.3	2.2	2.4
Effective tax rate – %	14.3	14.4	16.1	14.7	22.5	22.5	14.9
ROAA component analysis							
Revenue/average assets – %	60.2	67.8	60.6	61.0	69.0	71.3	62.4
COGS/average assets – %	(37.5)	(41.1)	(38.9)	(36.1)	(40.5)	(41.1)	(38.4)
Gross profit/average assets – %	22.7	26.8	21.6	24.9	28.5	30.2	24.0
Operating expenses/average assets – %	(3.6)	(2.7)	(1.7)	(1.3)	(1.3)	(1.4)	(2.4)
Other operating income/average assets – %	2.0	2.1	2.0	2.7	2.2	1.9	2.2
Operating profit/average assets – %	21.1	26.1	22.5	27.1	30.2	31.4	24.2
Finance expenses/average assets – %	(1.0)	(1.1)	(0.8)	(0.9)	(0.5)	(0.4)	(0.9)
PBT/average assets – %	20.1	25.1	21.7	26.2	29.7	31.0	23.3
Tax/average assets – %	(2.9)	(3.6)	(3.5)	(3.8)	(6.7)	(7.0)	(3.5)
Net profit/average assets – %	17.2	21.4	18.2	22.4	23.0	24.0	19.8
ROAE component analysis							
Revenue/average equity – %	80.8	87.3	78.5	86.4	97.8	98.8	83.3
COGS/average equity – %	(50.3)	(52.9)	(50.5)	(51.1)	(57.4)	(57.0)	(51.2)
Gross profit/average equity – %	30.5	34.4	28.0	35.3	40.4	41.9	32.1
Operating expenses/average equity – %	(4.9)	(3.5)	(2.2)	(1.9)	(1.9)	(1.9)	(3.1)
Other operating income/average equity – %	2.7	2.7	2.7	3.8	3.2	2.6	3.0
Operating profit/average equity – %	28.3	33.6	29.1	38.4	42.9	43.5	32.4
Finance expenses/average equity – %	(1.3)	(1.4)	(1.0)	(1.2)	(0.7)	(0.5)	(1.2)
PBT/average equity – %	27.0	32.3	28.1	37.2	42.1	43.0	31.1
Tax/average equity – %	(3.9)	(4.6)	(4.5)	(5.5)	(9.5)	(9.7)	(4.6)
Net profit/average equity – %	23.1	27.6	23.5	31.7	32.6	33.3	26.5

Sources: The Company and Sun Hung Kai Financial

China Infrastructure Machinery Holdings (3339.HK)**Analyst: Desmond Chan**
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China Infrastructure Machinery Holdings Limited (CIMH), established in 1993, is one of the leading wheel-loader manufacturers in PRC and the only listed Chinese player in Hong Kong, with more than 16% domestic market share as of 2006. Although CIMH is relatively young compared with major competitors like Guangxi Liugong, its market share has risen from 8.7% in 2001 to 16% in 2006, thanks to its 1) vertical business model, 2) high quality products, 3) competitive pricing strategy, 4) efficient sales distribution channel, and 5) efficient cost control system.

In recent years, CIMH has expanded its product mix by launching forklift, road rollers and excavator to the market to diversify from its single-product business model. Excavator sales were weak in FY07 at only 50 units, since the company's excavator technology still lags imported machines. However, the company expect excavator sales to increase to over 600 given CIMH has improved its product stability.

Exports will be another major catalyst, as CIMH began exporting its products from 2006. The company's products are around 60% cheaper than its foreign competitors, while export margins are at least 6% higher than for domestic sales.

The major threat is skyrocketing steel prices, since more than 50% of COGS are directly or indirectly related to steel. China's FAI also has a significant impact on profit. However, as 80% of products are sold to infrastructure and mining projects, the company has become less susceptible to FAI than its local competitors.

Figure 31: China Infrastructure Machinery Holdings - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – RMBm	131.9	235.9	624.2	629.6	805.7	985.8
Net-profit growth - %	11.1	78.8	164.6	0.9	28.0	22.4
EPS –RMB fen	19.0	32.0	60.0	59.0	74.0	90.5
EPS growth – %	11.8	68.4	87.5	(1.7)	25.4	22.3
P/E – X	35.5	21.1	11.2	11.4	9.1	7.5
DPS –RMB fen	N/A	N/A	22.0	22.6	24.6	30.1
Dividend yield – %	N/A	N/A	3.3	3.4	3.6	4.5
BVPS –RMB	N/A	1.1	1.7	2.6	3.1	3.6
P/B – X	N/A	N/A	3.9	2.6	2.2	1.9
Oper. cash flow per share – RMB fen	N/A	7.2	29.9	5.9	45.3	50.0
FCF/share –RMB fen	N/A	(11.4)	(5.6)	(35.8)	(10.0)	13.1
Free cash flow yield – %	N/A	(1.7)	(0.8)	(5.3)	(1.5)	1.9
Net debt per share –RMB fen	N/A	4.2	35.1	161.0	131.3	123.1
Net debt/ price – %	N/A	0.6	5.2	23.9	19.5	18.2
Issued shares – millions	N/A	1,037.1	1,037.1	1,089.1	1,085.0	1,085.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 32: Investment Highlights for China Infrastructure Machinery Holdings



 Key investment positive	 Key investment negatives
<ul style="list-style-type: none"> ■ Bigger wheel loader pie: CIMH benefits from the growing wheel-loader industry, as industry sales have increased from 45,000 units in 2002 to 120,000 in 2006 (21.6% CAGR), and are expected to increase to 231,000 in 2010, for a 13.9% CAGR in the next four years. ■ Demand will be driven by strong FAI growth, especially in infrastructure (like railways and expressways) and mining (like coal mining), with each contributing about 40% of sales. ■ According to the 11th Five Year Plan, China is expected to invest more than RMB100bn in construction machinery during 2006-10. Spending on railway projects in the same period is expected to quadruple from the previous five years, reaching to RMB1.5tn. Increasing concerns about rural roads and highway maintenance as well as a regular product-replacement cycle of 3-4 years should also supports steady demand for wheel loaders. ■ Seizing market share from small competitors. CIMH increased its domestic wheel-loader market share from 8.5% in 2001 to 14% in 2004 and 18% in 2006, and is expected to reach 23% in 2010. ■ CIMH has established a nationwide network of over 130 independent sales dealers covering 22 provinces; 80% of them selling CIMH products only. ■ Strong pricing power. Gross margin has improved from 20.6% to 25.7% thanks to CIMH's vertically integrated business model implemented in FY06, where more than 50% of components by COGS are manufactured in-house. However, margins declined to 22.4% in FY07 as steel prices in China increased 15%. To defend margins in FY08, CIMH raised wheel-loader prices 10% during 5M08. This makes it less likely margins will be squeezed again in FY08. We believe its track record of steadily increasing ASPs indicates strong pricing power. ■ Tremendous export growth: CIMH exported more than 300 units of wheel loaders to emerging economies (such as the Middle East and Russia) in the first four months of the year and we expects a total of 1,100 units will be shipped for the full year for 350% yoy growth, driven by CIMH's lower prices (60% cheaper than foreign competitors) but proven quality. China's wheel-loader exports rose over 150% in 2007, and exports should be a major growth driver for CIMH in the coming three years. ■ Increasing revenue from diversified product mix: CIMH is diversifying into road rollers, forklifts, excavators and agricultural machinery to enlarge its revenue base. According to management, demand for forklifts is strong, with demand for 110,000 units in FY07, having risen at over a 30% CAGR for the previous five years, driven by strong growth in the department-store and retail businesses in China. 	<ul style="list-style-type: none"> ■ Further steel-price hikes. We estimate every 1% rise in steel price rises (above our 10% expectation) will cut profit 2.4%. CIMH's earning is highly sensitive to steel prices as over 50% of COGS are directly or indirectly from steel. ■ Potential mergers among the top five players: According to CCMIA, the top five wheel-loader players accounts for over 70% of domestic sales, while market-share differences between the top three players are less than 4%. Therefore, any mergers might trigger another price war and cut into CIMH's margins. ■ Currency risk due to RMB appreciation, as CIMH's exports are set to increase to 20% of revenue by 2010. The company may need to hedge its currency risk. We estimate every 10% RMB appreciation would drive down EPS 1.1%. ■ Keen competition in the wheel-loader industry. Although the top five players account for over 70% of sales, the remainder comes from hundreds of smaller players. Although smaller players provide much worse product quality and after-sales service, competition may intensify if supply increases sharply. ■ Lackluster excavator sales. CIMH aims to tap the excavator market, as excavator sales in China posted a 45% CAGR over 2001-06 with much higher margins than wheel loaders. However, imports make up over 75% of the market, as excavators require much more advanced technology. CIMH introduced its excavators in 2007, but sales are expected to come in at less than 50 units. If the company does not improve its technology in the next two years, growth could be significantly affected, as we believe the wheel-loader market may mature from 2013.

Figure 33: China Infrastructure Machinery Holdings - Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	2,108.6	2,678.5	3,717.9	5,308.6	7,209.0	9,172.9	37.3
COGS	(1,688.6)	(2,125.9)	(2,760.9)	(4,117.1)	(5,608.4)	(7,164.0)	36.1
Gross profit	420.0	552.6	957.1	1,191.6	1,600.6	2,008.9	41.9
Operating expenses	(204.2)	(282.9)	(332.1)	(545.6)	(749.8)	(972.3)	40.8
Other operating income	17.7	17.3	14.0	29.0	35.0	40.0	31.8
Operating profit	233.5	286.9	639.0	675.0	901.1	1,137.4	42.3
Finance expenses	(20.9)	(30.8)	(20.3)	(111.6)	(111.6)	(111.6)	77.2
PBT	213.9	265.8	616.1	684.1	926.1	1,187.1	45.4
Tax	(82.0)	(29.1)	(9.3)	(54.7)	(120.4)	(201.9)	12.4
Net profit	131.9	235.9	624.2	629.6	805.7	985.8	51.8
EPS – RMB fen	19.0	32.0	60.0	59.0	74.0	90.5	36.5

Sources: The Company and Sun Hung Kai Financial

Figure 34: China Infrastructure Machinery Holdings - Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	158.9	408.0	129.4	478.1	419.6	508.6	99.7
Accounts receivable	300.5	350.1	679.8	872.5	1,167.8	1,476.8	37.3
Inventory	619.3	704.0	952.8	1,491.3	1,996.8	2,503.9	34.3
Other current assets	147.3	78.5	208.8	2,258.4	1,952.5	1,674.7	90.3
Total current assets	1,226.0	1,540.6	1,970.8	5,100.3	5,536.7	6,164.0	54.0
Net fixed assets	326.7	533.7	846.3	1,319.2	1,843.5	2,285.5	59.0
Other long-term assets	7.5	0.0	24.7	100.9	120.3	132.7	9.4
Total assets	1,560.2	2,074.3	2,841.8	6,520.4	7,500.5	8,582.2	53.2
Short-term debt	547.7	465.9	493.9	387.9	520.3	636.5	(0.0)
Accounts payable	317.2	280.0	332.4	697.5	929.8	1,159.8	27.8
Other current liabilities	182.4	174.0	237.5	751.4	858.4	971.3	39.5
Total current liabilities	1,047.4	919.8	1,063.8	1,836.8	2,308.5	2,767.6	21.3
Long-term debt	0.0	0.0	0.0	1,843.9	1,843.9	1,843.9	N/A
Other long-term liabilities	0.0	0.0	0.0	22.2	29.1	37.5	N/A
Total liabilities	1,047.4	919.8	1,063.8	3,702.9	4,181.5	4,649.0	44.6
Shareholders equity	512.9	1,154.5	1,778.0	2,817.4	3,319.0	3,933.2	70.3
Minorities	0.0	1.7	1.1	1.0	2.0	3.0	N/A
Total equity and liabilities	1,560.2	2,074.3	2,841.8	6,520.4	7,500.5	8,582.2	53.2

Sources: The Company and Sun Hung Kai Financial

Figure 35: China Infrastructure Machinery Holdings - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	41.3	27.0	38.8	42.8	35.8	27.2	37.3
EBIT growth – %	41.8	22.9	122.7	5.6	33.5	26.2	42.3
Net-profit growth – %	11.1	78.8	164.6	0.9	28.0	22.4	51.8
EPS growth – %	11.8	68.4	87.5	(1.7)	25.4	22.3	36.5
Profitability ratios							
Gross margin – %	19.9	20.6	25.7	22.4	22.2	21.9	22.2
Operating margin – %	11.1	10.7	17.2	12.7	12.5	12.4	12.9
Net margin – %	6.3	8.8	16.8	11.9	11.2	10.7	10.9
ROAA – %	9.6	13.0	25.4	13.5	11.5	12.3	15.4
ROAE – %	31.1	28.3	42.6	27.4	26.3	27.2	32.3
Other ratios							
Capex/sales – %	4.6	7.2	9.9	8.6	8.3	4.9	7.6
Capex/depreciation – %	498.0	704.6	1,022.0	695.0	806.9	1,071.4	729.9
Net debt/equity (net cash) – %	69.0	3.8	20.5	62.2	42.9	33.9	38.9
Inventory/sales – %	29.4	26.3	25.6	28.1	27.7	27.3	27.3
Effective tax rate – %	38.3	11.0	1.5	8.0	13.0	17.0	14.7
ROAA component analysis							
Revenue/average assets – %	153.7	147.4	151.3	113.4	102.8	114.1	141.4
COGS/average assets – %	(123.1)	(117.0)	(112.3)	(88.0)	(80.0)	(89.1)	(110.1)
Gross profit/average assets – %	30.6	30.4	38.9	25.5	22.8	25.0	31.4
Operating expenses/average assets – %	(14.9)	(15.6)	(13.5)	(11.7)	(10.7)	(12.1)	(13.9)
Other operating income/average assets – %	1.3	1.0	0.6	0.6	0.5	0.5	0.9
Operating profit/average assets – %	17.0	15.8	26.0	14.4	12.9	14.1	18.3
Finance expenses/average assets – %	(1.5)	(1.7)	(0.8)	(2.4)	(1.6)	(1.4)	(1.6)
PBT/average assets – %	15.6	14.6	25.1	14.6	13.2	14.8	17.5
Tax/average assets – %	(6.0)	(1.6)	(0.4)	(1.2)	(1.7)	(2.5)	(2.3)
Net profit/average assets – %	9.6	13.0	25.4	13.5	11.5	12.3	15.4
ROAE component analysis							
Revenue/average equity – %	497.4	321.3	253.6	231.0	235.0	253.0	325.8
COGS/average equity – %	(398.3)	(255.0)	(188.3)	(179.2)	(182.8)	(197.6)	(255.2)
Gross profit/average equity – %	99.1	66.3	65.3	51.9	52.2	55.4	70.6
Operating expenses/average equity – %	(48.2)	(33.9)	(22.6)	(23.7)	(24.4)	(26.8)	(32.1)
Other operating income/average equity – %	4.2	2.1	1.0	1.3	1.1	1.1	2.1
Operating profit/average equity – %	55.1	34.4	43.6	29.4	29.4	31.4	40.6
Finance expenses/average equity – %	(4.9)	(3.7)	(1.4)	(4.9)	(3.6)	(3.1)	(3.7)
PBT/average equity – %	50.5	31.9	42.0	29.8	30.2	32.7	38.5
Tax/average equity – %	(19.3)	(3.5)	(0.6)	(2.4)	(3.9)	(5.6)	(6.5)
Net profit/average equity – %	31.1	28.3	42.6	27.4	26.3	27.2	32.3

Sources: The Company and Sun Hung Kai Financial

Haitian (1882.HK)**Analyst: Desmond Chan**
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Haitian International is the largest plastic-injection-molding-machinery (PIMM) producer in the world by volume, and the fifth largest by revenue. In 2006, Haitian produced around 17,000 PIMMs, accounting for 32% of the market by volume. 70% of sales are to the domestic market, with the remainder for export.

The company mainly designs, develops, manufacturers, sells and supports PIMMs and related parts for end users across various industries, mainly in autos, construction materials, healthcare, logistics, packaging, IT, household appliances, electronics and other consumer products.

Compared with peers like **Chen Hsong (57 HK)**, Haitian has stronger competitive advantages and presence in the domestic large-tonnage PIMMs market (around one-third of revenue). This market will be driven by the auto, logistics and household-appliances sectors (more than 20% yoy unit growth in 2007 in China) and the company will continue to benefit most in the industry given its technological strengths and expertise in large-tonnage PIMMs. Competition in ultra-large PIMMs is relatively low. As such, Haitian should maintain its pricing power and gross margins of 28-29% in the next three years.

Haitian has a clear strategy to focus on the high-tech market, where entry barriers are higher. Its new energy-saving PIMMs (Mars J5 series) was well received by the market and has been named as the key promotional energy-saving product in Ningbo. Its sales reached RMB430m, accounted for around 11% of the company's turnover in FY07 and expected to rise to over 15% in FY09. Besides, Haitian acquired Zhafir in August 2007, a German-based PIMMs manufacturer, to enhance its R&D capability and help to upgrade its HTD series (increase stability, reliability and cost efficiency). It is expected that the HTD series will account for over 6% of the company's turnover in FY09. We believe strong R&D capability is critical for long-term success in the Chinese PIMMs industry.

Expanding international sales (RMB1.25bn in FY07 and 33% of turnover, from 30% in FY06) will be another long-term growth strategy for Haitian. Growth has been driven by rising disposable incomes and steady FAI growth in emerging economies, while the company has successfully penetrated new markets like India, Brazil, Poland and North America.

Rising steel costs remains the major concern for Haitian, given that steel directly or indirectly accounts for 60% of COGS. Steel costs surged 15% in FY07, and we estimate a 1% increase in prices would cut earnings 1.3%. Steel costs have already surged 20% in 1H08, and Haitian increased its ASP 5% in 1Q08, though it increase prices again to defend margins.

Figure 36: Haitian - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – RMBm	262.3	306.9	450.9	568.4	641.8	805.4
Net-profit growth - %	(13.6)	17.0	46.9	26.1	12.9	25.5
EPS –RMB fen	N/A	N/A	37.0	36.0	40.0	50.0
EPS growth – %	N/A	N/A	N/A	(2.7)	11.1	25.0
P/E – X	N/A	N/A	10.8	11.0	9.9	8.0
DPS –RMB fen	0.0	0.0	0.0	9.0	13.0	17.0
Dividend yield – %	0.0	0.0	0.0	2.3	3.3	4.3
BVPS –RMB	N/A	N/A	1.5	1.8	1.9	2.3
P/B – X	N/A	N/A	2.7	2.3	2.1	1.8
Oper. cash flow per share – RMB fen	N/A	N/A	37.5	22.7	34.7	52.5
FCF/share –RMB fen	N/A	N/A	26.3	4.2	13.2	35.2
Free cash flow yield – %	N/A	N/A	6.6	1.0	3.3	8.8
Net debt per share –RMB fen	N/A	N/A	(64.3)	(49.0)	(93.7)	(118.1)
Net debt/ price – %	N/A	N/A	(16.2)	(12.3)	(23.6)	(29.7)
Issued shares – millions	N/A	N/A	1,596.0	1,596.0	1,596.0	1,596.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 37: Investment Highlights for Haitian

 Key investment positives	 Key investment negatives
<ul style="list-style-type: none"> ▪ Demand for PIMMs is positively correlated to demand for plastic products, and continues to grow steadily. Since these products are relatively durable, less expensive than timber and steel and have wider applications in the electronics, recycling and automobile businesses, demand for PIMMs is estimated to reach 276,000 units, or RMB117.5bn, by 2010, for a CAGR of 6.1%. ▪ Less affected by any U.S. slowdown than many other manufacturers, which means more stable earnings in a volatile market, as 70% of Haitian's sales are domestic, with the rest mainly shipped to emerging economies. Growing use of plastic in PRC manufacturing provides stable and less seasonal demand for PIMMs, while the rapid recent growth in mainland domestic consumption should bolster growth in mainland manufacturing industries. ▪ Strong expertise in mid- to large-tonnage PIMMs. This should help drive demand from key industries, such as auto parts, logistics and environmental services and household appliances. Haitian has around 35% of sales from mid-to-large tonnage PIMMs; its dominant position (60% market share by volume) provides pricing power and make it less susceptible to a U.S. slowdown. ▪ Higher-margin new products are the major long-term growth driver. Haitian's new environmentally friendly machines were well received by the market in 1H07 and another new product, full-electric machines, could become a long-term growth driver. The two new products are expected to increase margins due to their good quality and uniqueness. ▪ The international market is increasingly important to Haitian, surging from 17% of FY03 turnover to 30% in FY06 and expected to further increase to 36% in FY09. The gross margin for international sales is generally higher than for domestic sales. ▪ Strengthening R&D capability. Haitian recently acquired a German-based company, Zhafir Plastics, which has very strong, fully functional R&D capability for plastic machine components. This acquisition was acquired from its three key shareholders, which might reflect a tendency to reduce connected transactions in future. ▪ Size is critical in the PIMM industry. Since Haitian is the largest manufacturer in China and ranks fifth in the world, it has stronger bargaining power than its Chinese competitors. ▪ Nationwide distribution channels with sales network covering 24 provinces in China and 80 countries. ▪ Management and employees hold 75% of the company through direct holdings. ▪ Dividend-payout ratio of 50%, higher than its IPO commitment of 33%. ▪ Gross margin has risen from 28.2% to 29.1% and the net margin from 14.5% to 15.2%, driven by higher sales volumes and better cost control (SG&A dropped by 1.2 ppt). 	<ul style="list-style-type: none"> ▪ Strong and volatile crude prices have had a strong negative effect on group revenue. As crude prices increase, so will prices of plastic resin, lowering demand for PIMMs as manufacturers become more conservative in expanding production capacity. ▪ To stabilize economic growth, China's government has launched regular austerity measures and credit-tightening policies, adversely affecting demand from many SME customers. Haitian is not immune to this, despite its dominant position in the medium- to large-tonnage segment, which is mostly made up of large customers with strong liquidity that are less subject to changes in credit-tightening policies. 60% of sales are still from small-tonnage PIMMs, and many clients in this segment would be strongly affected by credit-tightening policies, though Haitian should fare better in this regard than Chen Hsong. ▪ Steel accounts for around 40% of Haitian's COGS, and any price increase would put pressure on its gross margin. ▪ Cuts in export-VAT rebates. Although the 13% export-VAT rebate for PIMMS has not been cut, it could be in future, which might affect earnings. ▪ Slowdowns in the auto and household-appliance sectors could hit demand for PIMMs, since auto parts and household appliances account for 46% of sales. ▪ Progress depends on the growth outlook for global markets, and the ability of manufacturers to deploy their capex plans. ▪ Exchange-rate risk, as 30% of turnover is from international sales, mainly denominated in U.S. dollars (the remainder is domestic sales denominated in RMB), while only around 25% of costs are in U.S. dollars. This risk could widen as international sales are expected to gradually increase to over 35% in the long term, while the company has not adopted any currency hedging. We estimate a 1% RMB appreciation would cut earnings 0.5% in FY08.

Figure 38: Haitian - Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07F	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	2,594.1	2,577.6	3,175.7	3,842.1	4,558.7	5,460.6	17.5
COGS	(1,903.8)	(1,868.2)	(2,282.1)	(2,714.6)	(3,246.3)	(3,833.2)	17.0
Gross profit	690.3	709.4	893.7	1,127.5	1,312.4	1,627.4	18.6
Operating expenses	(413.8)	(352.3)	(444.3)	(534.1)	(620.0)	(729.0)	20.3
Other operating income	27.1	16.5	28.6	0.0	0.0	9.5	(8.4)
Operating profit	303.6	373.6	478.0	691.5	808.7	1,035.0	15.2
Finance expenses	(4.0)	(6.4)	(15.5)	(19.5)	(9.3)	(11.7)	26.3
PBT	312.6	351.4	483.6	619.7	706.8	910.1	15.2
Tax	(22.4)	(22.1)	(21.9)	(46.5)	(65.0)	(104.7)	33.0
Net profit	262.3	306.9	450.9	573.2	641.8	805.4	17.0
EPS – RMB fen	N/A	N/A	37.0	36.0	40.0	50.0	N/A

Sources: The Company and Sun Hung Kai Financial

Figure 39: Haitian - Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07F	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	589.4	591.5	1,712.1	1,629.4	1,684.1	2,073.1	47.6
Accounts receivable	747.8	806.2	878.6	1,056.6	1,299.2	1,529.0	13.5
Inventory	506.6	589.5	651.6	754.7	915.5	1,069.5	35.9
Other current assets	199.2	222.1	99.4	116.4	146.0	166.1	(20.0)
Total current assets	2,043.0	2,209.3	3,341.8	3,557.0	4,044.8	4,837.6	23.8
Net fixed assets	819.2	1,038.4	802.4	1,073.3	1,305.7	1,445.7	15.1
Other long-term assets	44.9	16.6	11.1	97.9	106.0	120.7	25.8
Total assets	2,907.2	3,264.3	4,155.3	4,728.1	5,456.4	6,404.0	21.6
Short-term debt	495.2	665.9	563.4	188.9	188.9	188.9	26.1
Accounts payable	480.6	467.4	629.7	733.3	865.0	1,030.1	15.1
Other current liabilities	582.1	578.1	441.8	1,151.1	1,315.4	1,569.7	2.5
Total current liabilities	1,557.8	1,711.5	1,634.9	2,073.2	2,369.3	2,788.8	13.6
Long-term debt	100.0	0.0	150.0	0.0	0.0	0.0	N/A
Other long-term liabilities	0.0	0.0	0.0	0.1	0.1	0.1	N/A
Total liabilities	1,657.8	1,711.5	1,784.9	2,073.3	2,369.4	2,788.9	13.6
Shareholders equity	1,249.3	1,552.8	2,370.4	2,654.8	3,087.2	3,615.2	29.5
Minorities	83.4	102.8	1.3	1.5	0.0	0.0	(63.9)
Total equity and liabilities	2,907.2	3,264.3	4,155.3	4,728.2	5,456.6	6,404.1	21.6

Sources: The Company and Sun Hung Kai Financial

Figure 40: Haitian - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07F	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	29.3	(0.6)	23.2	20.4	19.2	19.8	17.5
EBIT growth – %	(9.4)	23.1	28.0	23.3	37.2	28.0	15.2
Net-profit growth – %	(13.6)	17.0	46.9	26.1	12.9	25.5	17.0
EPS growth – %	N/A	N/A	N/A	(2.7)	11.1	25.0	N/A
Profitability ratios							
Gross margin – %	26.6	27.5	28.1	29.3	28.8	29.8	27.9
Operating margin – %	11.7	14.5	15.1	15.4	17.7	19.0	14.2
Net margin – %	10.1	11.9	14.2	14.9	14.1	14.7	12.8
ROAA – %	10.3	9.9	12.2	12.7	12.5	13.6	11.3
ROAE – %	23.4	21.9	23.0	22.0	21.8	24.0	22.6
Other ratios							
Capex/sales – %	N/A	N/A	5.6	N/A	7.5	5.1	5.6
Capex/depreciation – %	N/A	N/A	232.7	N/A	309.0	202.5	232.7
Net debt/equity (net cash) – %	(3.6)	2.9	(43.3)	(28.0)	(48.4)	(52.1)	(18.0)
Inventory/sales – %	19.5	22.9	20.5	25.9	20.1	19.6	22.2
Effective tax rate – %	7.2	6.3	4.5	5.3	9.2	11.5	5.8
ROAA component analysis							
Revenue/average assets – %	101.6	83.5	85.6	85.4	88.9	92.1	89.0
COGS/average assets – %	(74.6)	(60.5)	(61.5)	(60.4)	(63.3)	(64.6)	(64.2)
Gross profit/average assets – %	27.0	23.0	24.1	25.0	25.6	27.4	24.8
Operating expenses/average assets – %	(16.2)	(11.4)	(12.0)	(12.4)	(12.1)	(12.3)	(13.0)
Other operating income/average assets – %	1.1	0.5	0.8	0.5	0.0	0.2	0.7
Operating profit/average assets – %	11.9	12.1	12.9	13.2	15.8	17.5	12.5
Finance expenses/average assets – %	(0.2)	(0.2)	(0.4)	(0.2)	(0.2)	(0.2)	(0.2)
PBT/average assets – %	12.2	11.4	13.0	13.4	13.8	15.3	12.5
Tax/average assets – %	(0.9)	(0.7)	(0.6)	(0.7)	(1.3)	(1.8)	(0.7)
Net profit/average assets – %	10.3	9.9	12.2	12.7	12.5	13.6	11.3
ROAE component analysis							
Revenue/average equity – %	231.3	184.0	161.9	148.1	155.0	162.9	181.3
COGS/average equity – %	(169.8)	(133.3)	(116.3)	(104.7)	(110.3)	(114.4)	(131.0)
Gross profit/average equity – %	61.6	50.6	45.6	43.4	44.6	48.6	50.3
Operating expenses/average equity – %	(36.9)	(25.1)	(22.6)	(21.5)	(21.1)	(21.8)	(26.6)
Other operating income/average equity – %	2.4	1.2	1.5	0.9	0.0	0.3	1.5
Operating profit/average equity – %	27.1	26.7	24.4	22.8	27.5	30.9	25.2
Finance expenses/average equity – %	(0.4)	(0.5)	(0.8)	(0.3)	(0.3)	(0.3)	(0.5)
PBT/average equity – %	27.9	25.1	24.7	23.2	24.0	27.2	25.2
Tax/average equity – %	(2.0)	(1.6)	(1.1)	(1.2)	(2.2)	(3.1)	(1.5)
Net profit/average equity – %	23.4	21.9	23.0	22.0	21.8	24.0	22.6

Sources: The Company and Sun Hung Kai Financial

Ju Teng (3336.HK)**Analyst: Eva Yip**
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Ju Teng was formed in 2000, and manufactures and sells notebook-computer casings. It is the largest maker of plastic notebook casings in the world, with a c. 30% market share by shipments. The company serves most Taiwan notebook OEMs, including Arima, ASUS, Compal, FIC, Wistron and Quanta. All its customers are OEMs and ODMs of electronic consumer products for leading international brands like Dell, Toshiba and Lenovo. Ju Teng makes semi-finished consumer goods and delivers these to its customers' PRC production plants for further processing, before marketing and sale to end users. The company considers a number of factors in determining prices, including supply and demand, competitor prices, costs of production and technical specifications. ASPs for NB casings are currently around US\$23. Ju Teng's main competitors are Hon Hai and Huan Hsin, both listed on the Taiwan stock exchange.

The NB-casing business is growing rapidly, driven by soaring demand for NBs against a backdrop of desktop-to-notebook replacement. In June, IDC upgraded its global NB shipment-growth forecast for 2008 from 26.2% to 34.5%, despite the economic slowdown (vs. single-digit growth for desktops). Ju Teng has a technological edge, with advanced surface-treatment technology such as in-mold-decoration injection molding that creates three-dimensional visual effects. There is rising trend for top NB vendors to adopt IMD casing for their products, which could contribute 40-50% of Ju Teng's sales this year, from 6% in FY06. This technology also generates higher ASPs and margins, which can expand overall margins (the overall gross margin increased to 15.1% in FY07, from 14.2% in 2006). Staying ahead of rivals in terms of technology can help prevent margin erosion and increase market share. The company plans to increase capacity 20% in 2008, which should help meet rising demand (utilization was c. 80% in 2007).

While stellar NB industry growth provides promising prospects, Ju Teng is still active in seeking other growth drivers. In 1H08, it acquired a factory that makes desktop computer casings, hard disks and printers, which it will convert into an LCD-TV casing plant, aiming to start production in 2009. LCD-TV casings should have strong prospects, with global LCD-TV shipments estimated to reach 133 million in 2010, a 20% CAGR for 2007-10, based on Display Search findings. There is also an increasing trend for outsourcing LCD-TV assembly, due to competition intensifying and increasing price pressure for TV makers. Ju Teng faces little risk in expanding into LCD-TV casings due to its strong relationship with Wistron, which lists world No. 2 LCD-TV firm Sony as a key customer. Ju Teng has built a solid relationship with Wistron, which is its second largest customer. Its LCD-TV casing plants are close to Wistron's LCD-TV plant in Zhongshan, and it already makes casings for Sony NBs. Ju Teng also has a 70/30 JV with Wistron. Diversifying into other applications can reduce reliance on the NB market, which currently makes up almost all revenue.

The key concern for the company is NB price erosion. NB prices are estimated to fall 7% p.a. to 2010 and rising low-end NB contributions could drag down ASPs. Low-end NB-casing ASPs are US\$15-17 vs. c. US\$23 overall (low-end NBs are set to make up 20% of sales, vs. only a small portion in 2007). But we think the shift in sales mix toward high-end products can improve margins and more than offset the negative impact of price erosion. Another key risk is spikes in oil price that could lead to margin pressure. 40% of COGS are plastics and paints (oil-related items). However, strong bargaining power – due to tight industry capacity and customers tending to appoint specific suppliers – can help mitigate rising costs. Ju Teng also has a concentrated customer base, with the three largest customers, Quanta, Wistron and Compal, making up c. 70% of FY07 sales. Any customer loss could have a significant impact on sales. Nonetheless, the company's technological edge means it is well placed to capture more customer orders and could see some market-share expansion.

Figure 41: Ju Teng - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – HK\$m	241.4	192.1	202.9	410.0	577.7	740.8
Net-profit growth - %	46.5	(20.4)	5.6	102.0	40.9	28.2
EPS –HK cents	32.6	24.6	20.3	41.0	57.8	74.1
EPS growth – %	46.2	(24.5)	(17.5)	102.0	40.9	28.2
P/E – X	10.0	13.3	16.1	8.0	5.6	4.4
DPS –HK cents	0.0	0.0	0.0	0.0	0.0	0.0
Dividend yield – %	0.0	0.0	0.0	0.0	0.0	0.0
BVPS –HK\$	0.9	1.6	1.6	2.1	2.5	3.4
P/B – X	3.4	2.1	2.1	1.5	1.3	1.0
Oper. cash flow per share – HK cents	(41.4)	22.6	47.2	41.4	75.3	94.0
FCF/share –HK cents	(96.7)	(21.7)	9.7	19.7	44.1	74.0
Free cash flow yield – %	(29.7)	(6.7)	3.0	6.0	13.5	22.7
Net debt per share –HK cents	4.1	103.8	66.1	35.1	1.8	(72.2)
Net debt/ price – %	1.3	31.9	20.3	10.8	0.6	(22.2)
Issued shares – millions	740.0	782.0	1,000.0	1,000.0	1,000.0	1,000.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 42: Investment Highlights for Ju Teng



	
Key investment positive	Key investment negatives
<ul style="list-style-type: none"> ▪ Increasing demand for notebook computers and in turn notebook casings, driven by desktop-to-notebook replacement. In June, IDC upgraded its global NB shipment-growth forecast for 2008 from 26.2% to 34.5%, despite the economic slowdown (vs. single-digit growth for desktop PCs). ▪ Strong order book from increasing in-mold-decoration (IMD) casing demand. Ju Teng believes it is one year ahead its rivals in IDM technology, which can bring strong casing orders to the company. Top NB brands are increasingly adopting IMD casings for their products. ▪ Market-share expansion. With its leading technology edge, it can capture more market share on IMD product casing demand. Ju Teng already accounts for a 29% global market share in NB casings. ▪ No sign of a slowdown. Its three key customers reported stellar revenue growth in 1Q08, indicating no slowdown in the global notebook market. ▪ Margin expansion due to increasing contributions from higher-margin products. Management expects higher-margin in-mold decoration (IMD) products to account for 40-50% of sales this year from 9% in FY06. IMD products offer 20%-plus gross margins vs. the 15% average. ▪ Margins can also be driven by the increasing popularity of fancy NB casings, which generate higher ASPs and margins. ▪ Expansion into high-growth LCD-TV casings. Global LCD-TV shipments are estimated to reach 133 million in 2010. ▪ Outsourcing is also increasing, as LCD-TV competition is intensifying and pricing pressure forces TV makers to outsource assembly. ▪ Ample growth in TV outsourcing, as outsourcing by major Japanese and Korean manufacturers remains low. In contrast, key notebook players are US-based companies that favor outsourcing. ▪ Low investment risk in expanding the LCD-TV casing business, due to a strong relationship with Wistron (Ju Teng has a 70/30 JV with Wistron), which lists the world's No. 2 LCD-TV firm Sony as a key customer. Ju Teng's LCD-TV casing plants are close to Wistron's LCD-TV plant in Zhongshan, and it already makes casings for Sony NBs. ▪ Diversifying into other applications can reduce reliance on the NB market (almost all revenue is from NBs). ▪ Rising pricing power as tight casing capacity can lead to tight supply. Ju Teng's ASP was flat last year despite ASP erosion in NBs. ▪ The company plans to increase capacity 20% in 2008, which should help meet rising demand (utilization was c. 80% in 2007). ▪ Technology leadership. Ju Teng's IMD technology is superior to that of its competitors, giving it greater bargaining power and helping it maintain margins for its high-end products given the lack of competition. ▪ Ju Teng offers one-stop services including plastic-injection molding, dust-free spray painting, metal tooling and stamping and assembly of notebook-computer casings. This vertically integrates lengthy and complex production processes, lowering production costs and enhancing efficiency and mass-production capacity. ▪ May pay out a dividend. Due to business expansion, the company has not declared any dividend since listing in 2005. 	<ul style="list-style-type: none"> ▪ ASP erosion from falling NB prices (down 7% p.a. to 2010) and rising low-end NB contributions. Low-end NB-casing ASPs are US\$15-17 vs. c. US\$23 overall (low-end NBs are set to make up 20% of sales vs. only a small portion in 2007). ▪ Rising operating expenses due to soaring labor costs (up 15-20% in FY08 and making up c. 10% of COGS). ▪ Spikes in oil price could lead to margin pressure. 40% of COGS are plastics and paints (oil-related items). ▪ High customer concentration. Sales to the five largest customers accounted for 87% of FY07 sales, and the largest customer made up 32%. ▪ CPU shortages could raise costs for low-end NBs and cut demand. In early 2008, there was a shortage of 45nm E8000 series CPUs, spurring a price increase of over 20% and prompting many consumers to delay purchases.

Figure 43: Ju Teng - Profit and Loss Statement

Year ended 31 Dec, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	1,561.1	2,671.8	3,558.3	5,275.8	6,837.3	8,528.3	56.2
COGS	(1,159.3)	(2,229.7)	(3,053.2)	(4,479.7)	(5,743.3)	(7,127.9)	61.5
Gross profit	401.8	442.1	505.1	796.2	1,094.0	1,400.4	36.7
Operating expenses	(148.1)	(218.8)	(263.0)	(308.3)	(396.6)	(494.6)	51.4
Other operating income	21.5	45.8	84.8	95.0	99.7	104.7	42.8
Operating profit	275.3	269.0	330.9	584.1	798.6	1,012.0	32.0
Finance expenses	(12.6)	(59.9)	(99.1)	(99.9)	(99.0)	(99.0)	111.9
PBT	262.8	209.1	231.8	484.2	699.6	913.0	26.8
Tax	(21.4)	(17.0)	(30.7)	(57.3)	(104.9)	(155.2)	26.3
Net profit	241.4	192.1	202.9	410.0	577.7	740.8	25.6
EPS – HK cents	32.6	24.6	20.3	41.0	57.8	74.1	16.4

Sources: The Company and Sun Hung Kai Financial

Figure 44: Ju Teng - Balance Sheet

Year ended 31 Dec, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	145.3	226.7	179.5	406.0	781.9	1,522.2	36.8
Accounts receivable	747.6	797.5	942.8	1,582.7	1,873.2	2,102.9	47.0
Inventory	415.5	765.0	654.6	727.8	944.1	1,171.7	46.2
Other current assets	120.2	601.9	765.6	691.5	691.5	691.5	80.0
Total current assets	1,428.6	2,391.1	2,542.5	3,408.0	4,290.8	5,488.3	49.6
Net fixed assets	855.7	1,159.7	1,478.9	1,662.3	1,745.4	1,832.7	40.0
Other long-term assets	55.0	53.3	53.6	154.0	153.3	153.3	93.8
Total assets	2,339.3	3,604.2	4,075.0	5,224.3	6,189.6	7,474.4	46.8
Short-term debt	0.0	512.5	838.0	757.2	800.0	800.0	34.9
Accounts payable	433.6	630.0	819.8	1,398.4	1,888.2	2,343.4	47.0
Other current liabilities	1,027.6	696.0	830.4	858.7	858.7	858.7	36.1
Total current liabilities	1,461.1	1,838.4	2,488.3	3,014.3	3,546.9	4,002.2	40.3
Long-term debt	175.5	526.3	2.1	0.0	0.0	0.0	N/A
Other long-term liabilities	0.0	0.0	0.0	25.6	25.6	25.6	N/A
Total liabilities	1,636.7	2,364.7	2,490.3	3,039.9	3,572.6	4,027.8	39.0
Shareholders equity	702.6	1,239.5	1,551.0	2,111.1	2,542.0	3,371.6	61.7
Minorities	0.0	0.0	33.7	73.2	75.0	75.0	N/A
Total equity and liabilities	2,339.3	3,604.2	4,041.3	5,151.1	6,114.6	7,399.4	46.3

Sources: The Company and Sun Hung Kai Financial

Figure 45: Ju Teng - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	75.9	71.1	33.2	48.3	29.6	24.7	56.2
EBIT growth – %	43.2	(2.3)	23.0	76.5	36.7	26.7	32.0
Net-profit growth – %	46.5	(20.4)	5.6	102.0	40.9	28.2	25.6
EPS growth – %	46.2	(24.5)	(17.5)	102.0	40.9	28.2	16.4
Profitability ratios							
Gross margin – %	25.7	16.5	14.2	15.1	16.0	16.4	17.9
Operating margin – %	17.6	10.1	9.3	11.1	11.7	11.9	12.0
Net margin – %	15.5	7.2	5.7	7.8	8.4	8.7	9.0
ROAA – %	13.9	6.5	5.3	8.8	10.1	10.8	8.6
ROAE – %	47.7	19.8	14.5	22.4	24.8	25.1	26.1
Other ratios							
Capex/sales – %	26.2	13.0	10.6	4.1	4.6	2.3	13.5
Capex/depreciation – %	846.6	378.3	289.9	129.1	176.7	107.9	411.0
Operating expense/ sales - %	(9.5)	(8.2)	(7.4)	(5.8)	(5.8)	(5.8)	(7.7)
Net debt/equity (net cash) – %	4.3	65.5	42.6	16.6	0.7	(21.4)	32.3
Inventory/sales – %	26.6	28.6	18.4	13.8	13.8	13.7	21.9
Effective tax rate – %	8.1	8.1	13.2	11.8	15.0	17.0	10.3
ROAA component analysis							
Revenue/average assets – %	90.2	89.9	92.7	113.5	119.8	124.8	96.6
COGS/average assets – %	(67.0)	(75.0)	(79.5)	(96.3)	(100.6)	(104.3)	(79.5)
Gross profit/average assets – %	23.2	14.9	13.2	17.1	19.2	20.5	17.1
Operating expenses/average assets – %	(8.6)	(7.4)	(6.8)	(6.6)	(6.9)	(7.2)	(7.3)
Other operating income/average assets – %	1.2	1.5	2.2	2.0	1.7	1.5	1.8
Operating profit/average assets – %	15.9	9.1	8.6	12.6	14.0	14.8	11.5
Finance expenses/average assets – %	(0.7)	(2.0)	(2.6)	(2.1)	(1.7)	(1.4)	(1.9)
PBT/average assets – %	15.2	7.0	6.0	10.4	12.3	13.4	9.7
Tax/average assets – %	(1.2)	(0.6)	(0.8)	(1.2)	(1.8)	(2.3)	(1.0)
Net profit/average assets – %	13.9	6.5	5.3	8.8	10.1	10.8	8.6
ROAE component analysis							
Revenue/average equity – %	308.6	275.1	255.0	288.1	293.9	288.4	281.7
COGS/average equity – %	(229.2)	(229.6)	(218.8)	(244.6)	(246.9)	(241.1)	(230.6)
Gross profit/average equity – %	79.4	45.5	36.2	43.5	47.0	47.4	51.2
Operating expenses/average equity – %	(29.3)	(22.5)	(18.8)	(16.8)	(17.0)	(16.7)	(21.9)
Other operating income/average equity – %	4.3	4.7	6.1	5.2	4.3	3.5	5.1
Operating profit/average equity – %	54.4	27.7	23.7	31.9	34.3	34.2	34.4
Finance expenses/average equity – %	(2.5)	(6.2)	(7.1)	(5.5)	(4.3)	(3.3)	(5.3)
PBT/average equity – %	52.0	21.5	16.6	26.4	30.1	30.9	29.1
Tax/average equity – %	(4.2)	(1.7)	(2.2)	(3.1)	(4.5)	(5.2)	(2.8)
Net profit/average equity – %	47.7	19.8	14.5	22.4	24.8	25.1	26.1

Sources: The Company and Sun Hung Kai Financial

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Kingboard Laminates is the largest laminate producer in the world by revenue (11.5% global market share). It produces three types of laminates: glass-epoxy laminates, paper laminates and composite-epoxy-material laminates. Laminates are used to produce PCBs, which are in turn used in a wide variety of electronic products like computers and mobile phones. Over 90% of sales are domestic.

The company targets to achieve 15% sales growth p.a. for the next three years from market-share gains, steady consumer-electronics demand and customer expansion. Management has a track record of meeting its sales targets. Market share is set to expand from acquiring more customers (estimated to rise 1-2 pts in 2007), as lower costs (30-40% cheaper than Japanese peers) attract more cost-conscious customers during economic downcycles. The migration of electronics production to China also supports domestic PCB (and hence laminate) demand. Kingboard Laminates has strong pricing power due to concentrate industry and it can pass through rising raw material prices to customers.

KBL has a vertically integrated business model that also produces copper foil, glass yarn and fabric, which gives it better profitability (gross margin 30%-plus vs. peers' 20%). It has not suffered from raw-material shortages, and operation will not be disrupted in upcycles, whereas its peers would face sales caps.

Its profitable model is difficult to mimic by its peers. Superior profitability (average gross margin of 26% and a high ROE of 30%-plus, vs. the sector averages of 19% and 22%) is due to large scale (twice the production volume of its closest peer). Bottlenecks in upstream materials make it difficult for domestic laminate producers to expand capacity to that scale.

Rising free cash flow (due to capex peaking in 2007) and a healthy balance sheet (turning to net cash in FY09) could lead to a rise in dividend payout, from 50% in FY07. This translates to a 6-7% forward yield.

After achieving explosive growth from strong PCB demand, sales growth is decelerating. Core organic growth hinges on volume growth and ASP hikes. Its past growth (37% CAGR in 2003-2007) was driven by strong demand and capacity expansion. There may not be further M&A growth drivers given the company's 30% ROE, which makes it difficult to find lucrative investment opportunities that would match or improve on this. Also, KBL has the same management as its parent company, which tends to emphasize new chemical projects. It is unlikely to seek new project for the spin-off company. Stringent pollution controls on high-emissions sectors such as PCBs could speed up market consolidation and lower industry pricing power.

Figure 46: Kingboard Laminates - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – HK\$m	1,036.7	1,078.2	1,638.1	1,813.3	2,028.5	885.3
Net-profit growth - %	166.9	4.0	51.9	10.7	11.9	22.0
EPS –HK cents	41.6	39.5	57.3	60.4	67.6	71.3
EPS growth – %	119.7	(5.1)	45.1	5.4	11.9	22.0
P/E – X	11.1	11.7	8.1	7.6	6.8	9.2
DPS –HK cents	0.0	0.0	0.0	30.0	33.8	0.0
Dividend yield – %	0.0	0.0	0.0	6.5	7.3	0.0
BVPS –HK\$	N/A	N/A	2.0	2.5	3.0	3.2
P/B – X	N/A	N/A	2.3	1.8	1.5	2.0
Oper. cash flow per share – HK cents	N/A	N/A	78.2	55.0	92.8	62.4
FCF/share –HK cents	N/A	N/A	52.7	10.8	59.5	38.2
Free cash flow yield – %	N/A	N/A	11.4	2.3	12.9	5.8
Net debt per share –HK cents	N/A	N/A	47.6	57.9	28.7	(109.1)
Net debt/ price – %	N/A	N/A	10.3	12.5	6.2	(16.7)
Issued shares – millions	N/A	N/A	2,859.9	3,000.0	3,000.0	1,242.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 47: Investment Highlights for Kingboard Laminates



 Key investment positive	 Key investment negatives
<ul style="list-style-type: none"> ▪ The company targets to achieve 15% sales growth p.a. for the next three years from market-share gains, steady consumer-electronics demand and customer expansion. Management has a track record of meeting its sales targets. ▪ Market-share expansion from acquiring more customers (up 1.5 ppts in 2006). Lower costs (30-40% cheaper than Japanese peers) attracts more customers during economic downturns to cut costs. ▪ The migration of electronics production to China also supports domestic PCB (and hence laminate) demand. China's electronic-product export value grew 28% p.a. in 2006 and 2007. ▪ Demand for electronic products (80% of total PCB demand) should remain steady amid global economic growth. Shortening product lifecycles for electronics have triggered steady growth. ▪ Valuable pricing power under an inflationary environment. The laminate industry is concentrated among the top five producers, which account for 46% of global production value. Meanwhile, the PCB industry is highly fragmented (the top five make up 13% of production) and no single customer contributes more than 2% of total sales. KBL has raised ASPs twice year-to-date. This pricing power allows the company to generate stable earnings. ▪ Its vertically integrated supply chain allows for sufficient raw material supply to meet rising demand, and raising ASPs to more than offset raw-material price hikes during upcycles. In 2004, its ASP rose 40% and gross margin increased 10 ppts, vs. its peers' 5ppts. ▪ Less likely to suffer during an economic slowdown than its peers. It focuses on laminates for mass-market products such as PCs and notebooks (lower price, but large volume). Its peers focus on niche products. ▪ Paper-laminate profitability could rise. Major international laminate makers have exited the paper-laminate segment, but these are still widely used in low-end applications (26% of revenue is from paper laminates, and the company still has a 50% market share in China). ▪ Its profitable model is difficult to mimic. Superior profitability (average gross margin of 26% and high ROE of 30%-plus, vs. the sector averages of 19% and 22%) is due to large scale (twice the production volume of its closest peer). Bottlenecks in upstream materials make it difficult for domestic laminate producers to expand capacity to that scale. ▪ Operations are less likely to be disrupted, as it has sufficient upstream materials due to in-house production. ▪ Largest customer E&E (18-20% of annual sales) is locked in, as it is 70%-owned by Kingboard Chemicals. E&E is the second largest producer of rigid PCBs in China. ▪ Close proximity to customers. KBL's production plants are in east and south China, close to key PCB production plants, lowering logistics costs and allowing for fast delivery. ▪ KBL's 50% dividend payout (the company targets no less than 30%) may reflect management's confidence in the FY08 business outlook and its solid balance sheet. ▪ Healthy balance sheet, with 23% net gearing at end-2007. This should support M&A opportunities and a high dividend payout (50% in FY07). ▪ Falling capex in FY08 (HK\$1.4bn in 2007 vs. HK\$1bn in 2008) should raise FCF and hence dividend payouts. ▪ New players will also need some time to become qualified by customers. KBL already has over 1,000 customers. 	<ul style="list-style-type: none"> ▪ Slowing sales growth. Core organic growth hinges on volume growth and ASP increases. Past strong sales growth (37% CAGR over 2003-07) was partly driven by capacity expansion (total capacity rose at a 20% CAGR over the same period), whereas capacity will only grow 10% in 2008. ▪ Earnings growth could be threatened by technology change. There has been a shift toward the use of flexible PCBs in consumer electronics. KBL currently only produces rigid laminates and does not service the flexible-PCB market. ▪ Unable to find lucrative investment opportunities to enhance ROE. It is not easy to find M&A targets or new businesses that generate ROEs higher than its own (average of 32% for 2003-07). ▪ KBL shares the same management as its parent, which devotes many resources to new chemical businesses. It is therefore unlikely to find new lucrative businesses for KBL. ▪ PCB industry consolidation could weak laminate producers' bargaining power. The government may strengthen the implementation of pollution controls for the PCB industry, which could lead to rapid industry consolidation. ▪ The rising effective tax rate could cut profitability (6.3% in FY07).

Figure 48: Kingboard Laminates -Profit and Loss Statement

Year ended 31 Dec, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	4,660.2	6,131.2	8,472.4	10,426.8	11,807.2	13,310.1	36.8
COGS	(3,119.2)	(4,397.5)	(6,058.4)	(7,671.5)	(8,666.5)	(9,743.0)	35.7
Gross profit	1,540.9	1,733.7	2,414.0	2,755.2	3,140.7	3,567.1	40.3
Operating expenses	(341.9)	(474.6)	(532.0)	(601.9)	(684.8)	(785.3)	29.9
Other operating income	39.9	75.0	77.5	69.6	97.1	101.2	28.1
Operating profit	1,238.9	1,334.2	1,959.6	2,223.0	2,553.0	2,883.1	43.5
Finance expenses	(98.6)	(100.3)	(73.1)	(168.1)	(155.3)	(159.3)	26.9
PBT	1,140.3	1,233.1	1,887.3	2,054.8	2,397.7	2,723.8	45.4
Tax	(60.7)	(91.0)	(145.8)	(129.2)	(239.8)	(272.4)	32.1
Net profit	1,036.7	1,078.2	1,638.1	1,813.3	2,028.5	2,304.3	47.0
EPS – HK cents	41.6	39.5	57.3	60.4	67.6	76.8	33.7

Sources: The Company and Sun Hung Kai Financial

Figure 49: Kingboard Laminates -Balance Sheet

Year ended 31 Dec, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	499.8	685.0	1,713.3	1,471.7	2,138.6	3,065.6	39.4
Accounts receivable	1,738.1	2,372.5	2,710.3	3,510.0	3,881.8	4,375.9	27.0
Inventory	935.4	889.8	1,339.5	1,510.6	1,662.1	1,735.1	30.2
Other current assets	3,783.1	4,964.1	181.2	409.7	409.7	409.7	(30.3)
Total current assets	6,956.4	8,911.5	5,944.2	6,902.1	8,092.2	9,586.2	14.6
Net fixed assets	3,712.4	3,995.1	4,105.5	5,192.7	5,707.9	5,991.3	18.0
Other long-term assets	427.6	335.4	196.1	436.4	436.4	436.4	20.0
Total assets	11,096.4	13,242.0	10,245.9	12,531.2	14,236.5	16,014.0	16.1
Short-term debt	508.7	1,008.8	540.7	636.6	600.0	600.0	38.1
Accounts payable	612.2	647.5	729.9	892.3	1,187.2	1,201.2	21.1
Other current liabilities	4,886.4	6,163.9	800.7	834.4	922.1	1,007.6	(20.9)
Total current liabilities	6,007.3	7,820.1	2,071.2	2,363.3	2,709.2	2,808.8	(3.5)
Long-term debt	874.3	360.9	2,535.0	2,573.5	2,400.0	2,300.0	40.2
Other long-term liabilities	154.0	12.7	0.5	0.0	0.0	0.0	N/A
Total liabilities	7,035.6	8,193.7	4,606.8	4,936.8	5,109.2	5,108.8	5.6
Shareholders equity	4,060.8	5,048.2	5,639.1	7,594.4	9,127.3	10,905.2	27.0
Minorities	551.6	600.3	700.9	854.7	967.0	1,096.5	13.2
Total equity and liabilities	11,096.4	13,242.0	10,245.9	12,531.2	14,236.5	16,014.0	16.1

Sources: The Company and Sun Hung Kai Financial

Figure 50: Kingboard Laminates - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	56.8	31.6	38.2	23.1	13.2	12.7	36.8
EBIT growth – %	136.1	7.7	46.9	13.4	14.8	12.9	43.5
Net-profit growth – %	166.9	4.0	51.9	10.7	11.9	13.6	47.0
EPS growth – %	119.7	(5.1)	45.1	5.4	11.9	13.6	33.7
Profitability ratios							
Gross margin – %	33.1	28.3	28.5	26.4	26.6	26.8	29.1
Operating margin – %	26.6	21.8	23.1	21.3	21.6	21.7	23.2
Net margin – %	22.2	17.6	19.3	17.4	17.2	17.3	19.1
ROAA – %	11.5	8.9	13.9	15.9	15.2	15.2	12.6
ROAE – %	29.7	23.7	30.7	27.4	24.3	23.0	27.9
Other ratios							
Capex/sales – %	22.1	10.6	8.6	12.7	8.5	4.5	13.5
Capex/depreciation – %	334.2	170.8	159.1	234.7	194.1	105.9	224.7
Operating expense/ sales - %	(7.3)	(7.7)	(6.3)	(5.8)	(5.8)	(5.9)	(6.8)
Net debt/equity (net cash) – %	21.7	13.6	24.2	22.9	9.4	(1.5)	20.6
Inventory/sales – %	20.1	14.5	15.8	14.5	14.1	13.0	16.2
Effective tax rate – %	5.3	7.4	7.7	6.3	10.0	10.0	6.7
ROAA component analysis							
Revenue/average assets – %	51.8	50.4	72.1	91.6	88.2	88.0	66.5
COGS/average assets – %	(34.7)	(36.1)	(51.6)	(67.4)	(64.8)	(64.4)	(47.4)
Gross profit/average assets – %	17.1	14.2	20.6	24.2	23.5	23.6	19.0
Operating expenses/average assets – %	(3.8)	(3.9)	(4.5)	(5.3)	(5.1)	(5.2)	(4.4)
Other operating income/average assets – %	0.4	0.6	0.7	0.6	0.7	0.7	0.6
Operating profit/average assets – %	13.8	11.0	16.7	19.5	19.1	19.1	15.2
Finance expenses/average assets – %	(1.1)	(0.8)	(0.6)	(1.5)	(1.2)	(1.1)	(1.0)
PBT/average assets – %	12.7	10.1	16.1	18.0	17.9	18.0	14.2
Tax/average assets – %	(0.7)	(0.7)	(1.2)	(1.1)	(1.8)	(1.8)	(0.9)
Net profit/average assets – %	11.5	8.9	13.9	15.9	15.2	15.2	12.6
ROAE component analysis							
Revenue/average equity – %	133.5	134.6	158.6	157.6	141.2	132.9	146.1
COGS/average equity – %	(89.4)	(96.6)	(113.4)	(115.9)	(103.7)	(97.3)	(103.8)
Gross profit/average equity – %	44.1	38.1	45.2	41.6	37.6	35.6	42.3
Operating expenses/average equity – %	(9.8)	(10.4)	(10.0)	(9.1)	(8.2)	(7.8)	(9.8)
Other operating income/average equity – %	1.1	1.6	1.5	1.1	1.2	1.0	1.3
Operating profit/average equity – %	35.5	29.3	36.7	33.6	30.5	28.8	33.8
Finance expenses/average equity – %	(2.8)	(2.2)	(1.4)	(2.5)	(1.9)	(1.6)	(2.2)
PBT/average equity – %	32.7	27.1	35.3	31.1	28.7	27.2	31.5
Tax/average equity – %	(1.7)	(2.0)	(2.7)	(2.0)	(2.9)	(2.7)	(2.1)
Net profit/average equity – %	29.7	23.7	30.7	27.4	24.3	23.0	27.9

Sources: The Company and Sun Hung Kai Financial

Lee & Man Paper (2314.HK)**Analyst: Desmond Chan**
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Lee & Man manufactures of linerboard, corrugated medium and pulp. Linerboard and corrugated medium are divided into a range of grades with different specifications, customized for different industrial-packaging purposes. Lee & Man has eight production machines, with an annual capacity of 3.1 million tons. It aims to increase this to 14 production machines and capacity of 3.9 million tons by 2008.

Recovered paper is major raw material used in containerboard production (around 50% of COGS); the price of waste paper in the PRC has gone up 15% in the past few months. L&M passed part its cost hikes on to customers during December 2007 to January 2008. The containerboard ASP was HK\$3,150-3,200 per ton in January, vs. an average of HK\$3,067 in 1H08, with plans to increase prices to HK\$3,400 per ton by end-March. Market believe margin pressure should be temporary and are confident in the long-term ability to pass on raising costs.

Although the market expects a U.S. economic slowdown to cut worldwide demand for containerboard, China should buck this trend, with the PRC is a net importer of containerboard. According to NDRC estimates, China's paper and containerboard consumption rose 7.5% p.a. over 2005-10, from 59.3 million tons to 90 million tons. This strong demand indicates a robust industry outlook and solid growth prospects on the mainland. Lee & Man has expanded into the pulp business in Vietnam, and expects to produce 500,000 tons of bleached pulp p.a. once it starts up in early 2009. In the long term, pulp is set to account for 40-50% of Lee & Man's revenue and become the major growth driver.

The NDRC has recently introduced regulation changes: 1) Shutting down smaller plants to eliminate 6.5 million tons of outdated papermaking capacity, 2) Restricting new capacity among the big players, with no single company allowed to account for over 20% of overall paper and paperboard consumption or more than 35% of production in any single domestic paper-product segment, 3) New paper-industry entrants must meet new requirements.

We believe these should be positive to L&M, as: 1) Eliminating smaller paper producers could create opportunities for the company to expand market share; 2) Higher entry barriers could decrease price competition; 3) China's paper and paperboard capacity is currently 56 million tons, compared with consumption of 59.3 million tons, according to the NDRC. Lee & Man has 3.1 million tons of capacity, set to expand to 4.9 million tons in FY09 (8.3% of national capacity), giving the company plenty of room to grow. We do not see any impact from the new regulations over the next 2-3 years.

Chinese containerboard producers depend heavily on imported recovered paper. Any unexpected increase in pulp prices together with delays in passing cost hikes on to end customers would hurt Lee & Man's earnings visibility. Stretched management capacity from accelerated capacity expansion could lower efficiency and hence equipment utilization.

Figure 51: Lee & Man Paper - Earnings Summary

Year ending 31 Mar	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – HK\$m	284.9	417.7	600.0	1,010.2	1,409.3	2,028.0
Net-profit growth - %	33.7	46.6	43.6	68.4	39.5	43.9
EPS –HK cents	40.7	43.5	62.2	100.7	124.0	178.0
EPS growth – %	7.4	7.0	42.9	61.8	23.1	43.5
P/E – X	29.0	27.1	19.0	11.7	9.5	6.6
DPS –HK cents	10.0	18.0	24.0	36.0	50.0	71.0
Dividend yield – %	0.8	1.5	2.0	4.7	5.6	7.2
BVPS –HK\$	2.3	3.2	3.7	5.9	6.4	7.5
P/B – X	5.2	3.7	3.2	2.0	1.8	1.6
Oper. cash flow per share –HK cents	(9.2)	21.7	31.9	62.8	88.1	129.9
FCF/share –HK cents	(96.4)	(34.9)	(76.8)	(110.9)	(204.1)	(43.2)
Free cash flow yield – %	(8.2)	(2.9)	(6.5)	(9.4)	(17.3)	(3.7)
Net debt per share –HK cents	63.8	71.4	172.9	185.0	444.3	588.1
Net debt/ price – %	5.4	6.0	14.6	15.6	37.6	49.8
Issued shares – millions	840.5	963.4	967.6	1,119.5	1,137.0	1,137.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 52: Investment Highlights for Lee & Man Paper



 Key investment positives	 Key investment negatives
<ul style="list-style-type: none"> ▪ Able to pass costs on to customers. Planned to increase prices to HK\$3,400/ton by end-March. We believe margin pressure should be temporary and are confident in the company's long-term ability to pass on rising costs. ▪ The market expects a U.S. economic slowdown to cut worldwide demand for containerboard, but China should buck this trend. The PRC is a net importer of containerboard and is estimated to remain so until 2011. ▪ The NDRC estimates 7.5% p.a. growth for China's paper and containerboard consumption, from 59.3 million tons in 2005 to 90 million tons in 2010. This strong demand indicates a robust industry outlook and solid growth prospects on the mainland. ▪ A decline in overall demand for containerboard would drag down prices of recovered paper, a raw material used by Lee & Man. ▪ The NDRC recently changed regulations: 1) Shutting down smaller plants to eliminate 6.5 million tons of outdated papermaking capacity, 2) Restricting new capacity among the big players, with no single company allowed to account for over 20% of overall paper and paperboard consumption or more than 35% of production in any single domestic paper-product segment, 3) New paper industry entrants must meet new requirements. ▪ We see the above regulations as positive to Lee & Man, as: 1) Eliminating smaller paper producers could create opportunities for the company to expand market share.; 2) Higher entry barriers could decrease price competition.; 3) China's paper and paperboard capacity is currently 56 million tons, compared with consumption of 59.3 million tons, according to the NDRC. Lee & Man has 3.1 million tons of capacity, set to expand to 4.9 million tons in FY09 (8.3% of national capacity), giving the company plenty of room to grow. We do not see any impact from the new regulations over the next 2-3 years. ▪ The company has announced entering a strategic cooperation to procure mulberry trees from forestry company China Grand Forestry. This could lead to a stable source of low-cost raw material and potentially higher-quality pulp than that produced from bamboo. ▪ Expansion into the pulp business in Vietnam could increase earnings, the firm expects to produce 500,000 tons of bleached pulp once it starts up in early 2009. 	<ul style="list-style-type: none"> ▪ Recovered paper is the major raw material used in containerboard production (around 50% of COGS); the price of waste paper in the PRC has gone up 15% in the past few months. Lee & Man was unable to pass on all the cost hikes to customers during December 2007 to January 2008. The containerboard ASP was HK\$3,150-3,200 per ton in January vs. an average of HK\$3,067 in 1H08. ▪ Rising coal prices, which accounted for 8-10% of Lee & Man's COGS. We estimate every 1% rise in coal prices would cut earnings around 0.5%. ▪ Lee & Man has invested aggressively in Vietnam, with a new capacity of 430,000 tonnes for corrugated paper and 150,000 tonnes for pulp to start in 2009. According to the company, the first phase of operations in Vietnam requires around HK\$2bn of capex and the company has currently invested around 10% of this amount. 70-80% of the investment will be for purchasing new machineries, with the remainder for land and construction. The company is confident about its Vietnam project, as: <ol style="list-style-type: none"> 1. Half its products from this plant are for exports denominated in USD or Euros. 2. Local sales will be priced in USD, so there will be no exchange rate risk from depreciation in the Vietnamese Dong. 3. There is a local demand/supply gap for containerboard in Vietnam, which has to bring in USD-denominated imports. This could give Lee & Man a costs advantage over peers in the U.S. and Europe given its lower local labor costs and closer proximity to local customers. 4. The group plans to build a deep-water port next to its production facilities, further strengthening its cost advantages, as water transport is cheaper than land transport. 5. Lee & Man expects demand for containerboard in Vietnam to grow 10-15% p.a. ▪ Despite management's confidence in the Vietnam project, we factor in a worst-case scenario that the project fails and generates no profit for the company. We estimate this could lower FY09 profit by HK\$360m, or 10-15% of the consensus estimate (i.e. FY10 EPS growth would fall from 31% to 13% if this is the case)

Figure 53: Lee & Man Paper - Profit and Loss Statement

Year ended 31 Mar, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	1,701.1	2,771.4	3,778.1	5,160.6	8,762.8	13,024.8	49.7
COGS	(1,322.7)	(2,198.0)	(2,903.9)	(3,799.1)	(6,766.6)	(10,057.8)	49.7
Gross profit	378.4	573.4	874.2	1,361.5	1,996.2	2,967.1	49.5
Operating expenses	(88.5)	(159.4)	(332.5)	(461.1)	(740.5)	(1,053.1)	72.2
Other operating income	15.2	27.2	93.2	143.2	219.1	260.5	96.8
Operating profit	305.0	441.2	634.9	1,043.5	1,474.8	2,174.5	46.0
Finance expenses	(15.0)	(11.4)	(69.2)	(80.1)	0.0	0.0	51.4
PBT	290.1	423.4	625.6	1,041.0	1,507.2	2,216.4	48.3
Tax	(5.3)	(5.7)	(25.6)	(30.9)	(98.0)	(188.4)	98.2
Net profit	284.9	417.7	600.0	1,010.2	1,409.3	2,028.0	47.6
EPS – HK cents	40.7	43.5	62.2	100.7	124.0	178.0	27.7

Sources: The Company and Sun Hung Kai Financial

Figure 54: Lee & Man Paper - Balance Sheet

Year ended 31 Mar, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	351.7	81.6	110.3	215.0	343.8	206.4	74.4
Accounts receivable	287.7	599.6	807.1	1,080.6	1,752.6	2,591.9	62.2
Inventory	469.1	548.4	774.3	1,379.2	2,131.5	3,067.6	52.1
Other current assets	161.7	143.1	154.7	365.1	578.9	838.9	105.0
Total current assets	1,270.2	1,372.7	1,846.4	3,039.8	4,806.7	6,704.8	60.5
Net fixed assets	2,025.6	2,582.4	3,751.4	5,841.5	9,083.6	10,947.9	42.0
Other long-term assets	113.4	158.4	176.2	963.9	510.6	299.9	127.6
Total assets	3,409.1	4,113.4	5,774.0	9,845.2	14,400.8	17,952.5	50.3
Short-term debt	578.2	618.5	782.6	824.8	989.7	1,187.7	16.9
Accounts payable	120.6	97.8	169.7	510.5	920.1	1,367.6	68.8
Other current liabilities	139.7	195.8	196.0	412.9	719.8	1,067.6	34.3
Total current liabilities	838.5	912.1	1,148.3	1,748.1	2,629.6	3,622.9	29.0
Long-term debt	309.8	150.7	1,001.0	1,461.0	4,405.4	5,705.4	N/A
Other long-term liabilities	357.5	9.2	47.7	65.5	90.4	134.8	(46.6)
Total liabilities	1,505.7	1,071.9	2,197.0	3,274.5	7,125.4	9,463.1	22.9
Shareholders equity	1,903.4	3,041.5	3,577.0	6,570.7	7,275.4	8,489.4	90.9
Minorities	0.0	0.0	0.0	(0.1)	0.0	0.0	N/A
Total equity and liabilities	3,409.1	4,113.4	5,774.0	9,845.2	14,400.8	17,952.5	50.3

Sources: The Company and Sun Hung Kai Financial

Figure 55: Lee & Man Paper - Key Ratios

Year ended 31 Mar	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	65.4	62.9	36.3	36.6	69.8	48.6	(97.9)
EBIT growth – %	32.7	44.6	43.9	64.4	41.3	47.4	(95.7)
Net-profit growth – %	33.7	46.6	43.6	68.4	39.5	43.9	(95.4)
EPS growth – %	7.4	7.0	42.9	61.8	23.1	43.5	150.6
Profitability ratios							
Gross margin – %	22.2	20.7	23.1	26.4	22.8	22.8	52.4
Operating margin – %	17.9	15.9	16.8	20.2	16.8	16.7	33.7
Net margin – %	16.7	15.1	15.9	19.6	16.1	15.6	33.6
ROAA – %	10.7	11.1	12.1	12.9	11.6	12.5	1.0
ROAE – %	23.8	16.9	18.1	19.9	20.4	25.7	2.1
Other ratios							
Capex/sales – %	43.1	19.7	27.8	37.7	37.9	15.1	4.4
Capex/depreciation – %	N/A	652.1	1,032.9	1,256.2	1,142.0	545.6	400.0
Net debt/equity (net cash) – %	28.2	22.6	46.8	31.5	69.4	78.8	(24.7)
Inventory/sales – %	27.6	19.8	20.5	26.7	24.3	23.6	0.0
Effective tax rate – %	1.8	1.3	4.1	3.0	6.5	8.5	2.5
ROAA component analysis							
Revenue/average assets – %	63.7	73.7	76.4	66.1	72.3	80.5	3.0
COGS/average assets – %	(49.5)	(58.4)	(58.7)	(48.6)	(55.8)	(62.2)	(1.4)
Gross profit/average assets – %	14.2	15.2	17.7	17.4	16.5	18.3	1.6
Operating expenses/average assets – %	(3.3)	(4.2)	(6.7)	(5.9)	(6.1)	(6.5)	(0.6)
Other operating income/average assets – %	0.6	0.7	1.9	1.8	1.8	1.6	0.0
Operating profit/average assets – %	11.4	11.7	12.8	13.4	12.2	13.4	1.0
Finance expenses/average assets – %	(0.6)	(0.3)	(1.4)	(1.0)	0.0	0.0	0.0
PBT/average assets – %	10.9	11.3	12.7	13.3	12.4	13.7	1.0
Tax/average assets – %	(0.2)	(0.2)	(0.5)	(0.4)	(0.8)	(1.2)	(0.0)
Net profit/average assets – %	10.7	11.1	12.1	12.9	11.6	12.5	1.0
ROAE component analysis							
Revenue/average equity – %	141.9	112.1	114.2	101.7	126.6	165.2	6.2
COGS/average equity – %	(110.3)	(88.9)	(87.8)	(74.9)	(97.7)	(127.6)	(3.0)
Gross profit/average equity – %	31.6	23.2	26.4	26.8	28.8	37.6	3.3
Operating expenses/average equity – %	(7.4)	(6.4)	(10.0)	(9.1)	(10.7)	(13.4)	(1.2)
Other operating income/average equity – %	1.3	1.1	2.8	2.8	3.2	3.3	0.0
Operating profit/average equity – %	25.4	17.8	19.2	20.6	21.3	27.6	2.1
Finance expenses/average equity – %	(1.3)	(0.5)	(2.1)	(1.6)	0.0	0.0	0.0
PBT/average equity – %	24.2	17.1	18.9	20.5	21.8	28.1	2.1
Tax/average equity – %	(0.4)	(0.2)	(0.8)	(0.6)	(1.4)	(2.4)	(0.1)
Net profit/average equity – %	23.8	16.9	18.1	19.9	20.4	25.7	2.1

Sources: The Company and Sun Hung Kai Financial

Luk Fook (590.HK)**Analyst: Fiona Wong**
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Luk Fook is a jeweler and goldsmith established in 1991. The company mainly sources and retails gold jewelry and ornaments, gem-set jewelry, gemstones and other accessories. It has 304 self-owned and franchise shops in China, Hong Kong, Macau and Canada.

Revenue grew 33.8% in FY07 due to strong retail growth of 29.4% and manufacturing sales rising 42.8%. Hong Kong remained the biggest market with 94.2% of sales, but according to management half of Hong Kong sales are to mainland tourists. Hong Kong same-store sales (SSS) grew 20% yoy in March this year. The gross margin for gold products was 12-17% and jewelry around 36%. Gold products accounted for 45% of revenue and jewelry the remainder.

We believe Chinese consumers like gold and jewelry as status symbols and also as an alternative investment in the face of weak A-share and property markets. According to government figures, Hong Kong retail sales increased only 12.8% in 2007 (2006: 7.3%) but gold and jewelry sales rose 24.5% (2006: 15.2%). China retail sales grew 16.8% in 2007, while gold and jewelry sales increased 41.7%. We believe Luk Fook benefit from continued growth.

Hong Kong jewelry retailers have a competitive advantage when selling to PRC tourists, and report that half their Hong Kong retail sales are to mainland visitors. They prefer Hong Kong brands for their: 1) reputation and quality; 2) trendy designs; and 3) no VAT (17% in China) and sales tax (5%) imposed. PRC gold and jewelry operators will find it difficult to compete against these advantages over the next five years.

Luk Fook has expanded rapidly in the PRC as it has focused on a franchise model rather than self-owned stores. It expects to reach 429 points of sale by FY09, vs. just 224 for Chow Sang Sang. We estimate Luk Fook's EPS growth at 17.9% in FY08 and 26.3% in FY09 (vs. Chow Sang Sang's 1.7% and 12.7%).

Hong Kong jewelry retailers operate a cost-plus pricing model to maintain stable margins, and typically keep two months of gold inventory. In general, fine-gold products account for 40-45% of revenue and jewelry the remainder. On average, the jewelry gross margin is 10-15 pts higher than for fine gold.

Selling and administrative expenses remained stable at 13.2-15.7% of sales in FY04-07. Rentals accounted 5.1% of total sales, according to management, and will increase slightly when they renew contracts this year. We believe the operating margin will climb to 9% in FY08, from 8.3% last year.

Another benefit of opening stores through franchisees is lower capex. This helped Luk Fook generate free cash flow (FCF) of HK\$110m in FY07 (for an FCF yield of 4.4%), compared with Chow Sang Sang's projected negative FCF. Luk Fook also generates better ROAs and ROEs.

Management budgets around HK\$30-40m of capex for new stores and renovation. We believe the company has sufficient fund as it has almost no long-term debt and HK\$100m of net cash on hand. The company targets to increase its shop portfolio around 20% through franchises in the PRC. Franchising offers faster store expansion than self-opening, but brand management and quality may prove hard to control. Mistakes by franchisees may destroy the brand reputation in China.

Figure 56: Luk Fook - Earnings Summary

Year ending 31 Mar	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – HK\$m	78.1	127.2	96.5	199.0	235.0	296.6
Net-profit growth - %	64.9	62.9	(24.1)	106.1	18.1	26.2
EPS –HK cents	15.8	25.8	19.5	40.3	47.5	60.0
EPS growth – %	58.0	63.3	(24.4)	106.7	17.9	26.3
P/E – X	27.2	16.7	22.1	10.7	9.1	7.2
DPS –HK cents	7.0	10.0	10.0	18.0	21.5	27.1
Dividend yield – %	1.6	2.3	2.3	4.2	5.0	6.3
BVPS –HK\$	1.2	1.4	1.5	1.7	2.0	2.3
P/B – X	3.5	3.1	2.9	2.5	2.2	1.9
Oper. cash flow per share –HK cents	10.7	14.8	16.6	28.0	35.5	56.9
FCF/share –HK cents	1.3	(2.1)	9.6	22.3	28.1	48.9
Free cash flow yield – %	0.3	(0.5)	2.2	5.2	6.5	11.4
Net debt per share –HK cents	(15.3)	(22.8)	(22.3)	(35.5)	(42.3)	(64.5)
Net debt/ price – %	(3.6)	(5.3)	(5.2)	(8.3)	(9.8)	(15.0)
Issued shares – millions	478.4	482.6	486.7	491.6	492.5	492.5

Sources: Bloomberg and Sun Hung Kai Financial

Figure 57: Investment Highlights for Luk Fook



	
Key investment positive	Key investment negatives
<ul style="list-style-type: none"> ▪ Revenue grew 33.8% in FY07 due to strong retail growth of 29.4% and manufacturing sales rising 42.8%. Hong Kong remained the biggest market with 94.2% of sales, but according to management half of Hong Kong sales are to mainland tourists. ▪ According to government figures, Hong Kong retail sales increased only 12.8% in 2007 (2006: 7.3%) but gold and jewelry sales rose 24.5% (2006: 15.2%). China retail sales grew 16.8% in 2007, while gold and jewelry sales increased 41.7%. ▪ We believe Chinese consumers like gold and jewelry as status symbols and also as an alternative investment in the face of weak A-share and property markets. ▪ According to management, Hong Kong same-store sales (SSS) grew 20% yoy in March this year. The gross margin for gold products was 12-17% and jewelry around 36%. Gold products accounted for 45% of revenue and jewelry the remainder. ▪ Hong Kong jewelry retailers can leverage their strong brand names to aggressively expand their PRC store networks, either through the self-owned or franchise models. Based on our discussions with the management teams of Hong Kong jewelry retailers, we estimate per ticket sales in China have increased from HK\$1,000-1,500 in 2005 to HK\$2,200 now. We expect mainland per ticket sales to grow around 20% p.a. in the next few years and become the next earnings driver. ▪ Hong Kong jewelry retailers have a competitive advantage when selling to PRC tourists, and report that half their Hong Kong retail sales are to mainland visitors. They prefer Hong Kong brands for their: 1) reputation and quality; 2) trendy designs; and 3) no VAT (17% in China) and sales tax (5%) imposed. PRC gold and jewelry operators will find it difficult to compete against these advantages over the next five years. ▪ Luk Fook has expanded rapidly in the PRC as it has focused on a franchise model rather than self-owned stores. It expects to reach 429 points of sale by FY09, vs. just 224 for Chow Sang Sang. We estimate Luk Fook's EPS growth at 17.9% in FY08 and 26.3% in FY09 (vs. Chow Sang Sang's 1.7% and 12.7%). ▪ Hong Kong jewelry retailers operate a cost-plus pricing model to maintain stable margins, and typically keep two months of gold inventory. In general, fine-gold products account for 40-45% of revenue and jewelry the remainder. On average, the jewelry gross margin is 10-15 ppts higher than for fine gold. ▪ Selling and administrative expenses remained stable at 13.2-15.7% of sales in FY04-07. Rentals accounted 5.1% of total sales, according to management, and will increase slightly when they renew contracts this year. We believe the operating margin will climb to 9% in FY08, from 8.3% last year. ▪ Another benefit of opening stores through franchisees is lower capex. This helped Luk Fook generate free cash flow (FCF) of HK\$110m in FY07 (for an FCF yield of 4.4%), compared with Chow Sang Sang's projected negative FCF. Luk Fook also generates better ROAs and ROEs. ▪ Management budgets around HK\$30-40m of capex for new stores and renovation. We believe the company has sufficient fund as it has almost no long-term debt and HK\$100m of net cash on hand. ▪ The company targets to increase its shop portfolio around 20% through franchises in the PRC. 	<ul style="list-style-type: none"> ▪ The company may suffer from gold-price volatility as it only hedges around 30-40% of its gold needs. To mitigate losses from volatile gold prices, the company only keeps two months of inventory.

Figure 58: Luk Fook - Profit and Loss Statement

Year ended 31 Mar, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR (%)
Revenue	1,598.1	1,961.7	2,126.3	2,845.1	3,146.7	3,649.1	46.7
COGS	(1,252.2)	(1,545.7)	(1,666.6)	(2,257.3)	(2,485.9)	(2,871.9)	51.8
Gross profit	345.9	416.0	459.7	587.8	660.8	777.3	41.8
Operating expenses	(273.3)	(311.8)	(376.2)	(421.4)	(452.8)	(507.1)	53.1
Other operating income	20.2	23.1	25.4	49.7	67.5	84.1	39.1
Operating profit	92.9	152.7	113.7	234.9	283.6	362.2	36.7
Finance expenses	(0.0)	(0.4)	(1.3)	(0.2)	(0.5)	(0.6)	27.7
PBT	92.9	152.3	112.4	234.7	283.1	361.6	36.9
Tax	(14.8)	(25.1)	(15.9)	(35.7)	(48.1)	(65.1)	23.7
Net profit	78.1	127.2	96.5	199.0	235.0	296.6	41.2
EPS – HK cents	15.8	25.8	19.5	40.3	47.5	60.0	32.3

Sources: The Company and Sun Hung Kai Financial

Figure 59: Luk Fook - Balance Sheet

Year ended 31 Mar, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR (%)
Cash and securities	73.1	131.4	108.7	174.5	308.5	467.4	74.7
Accounts receivable	27.0	26.3	32.5	51.9	56.0	61.0	47.4
Inventory	488.1	544.8	612.0	751.9	864.6	951.1	42.0
Other current assets	0.0	0.0	0.8	0.0	0.0	0.0	(17.6)
Total current assets	588.2	702.6	754.1	978.3	1,229.2	1,479.5	54.2
Net fixed assets	101.9	112.4	117.9	111.3	122.1	133.8	56.8
Other long-term assets	21.3	27.1	26.9	30.5	32.0	34.0	126.9
Total assets	711.4	842.1	898.9	1,120.0	1,383.2	1,647.4	57.4
Short-term debt	0.0	21.4	0.0	0.0	100.0	150.0	24.3
Accounts payable	112.4	121.5	161.6	227.3	260.0	310.0	39.2
Other current liabilities	7.9	13.9	8.5	29.7	32.0	34.0	(4.6)
Total current liabilities	120.3	156.8	170.1	257.0	392.0	494.0	29.9
Long-term debt	0.0	0.0	0.0	0.0	0.0	0.0	N/A
Other long-term liabilities	(120.2)	(154.9)	(169.5)	(256.9)	(391.9)	(493.9)	N/A
Total liabilities	0.1	1.9	0.6	0.1	0.1	0.1	29.9
Shareholders equity	583.2	674.0	715.2	850.1	978.3	1,140.4	75.4
Minorities	7.8	9.2	13.0	12.8	12.8	12.8	(24.4)
Total equity and liabilities	583.3	676.0	715.8	850.2	978.5	1,140.6	59.8

Sources: The Company and Sun Hung Kai Financial

Figure 60: Luk Fook - Key Ratios

Year ended 31 Mar	FY04	FY05	FY06	FY07	FY08F	FY09F	FY05-09 CAGR/ average (%)
Growth ratios							
Revenue Growth – %	9.3	22.8	8.4	33.8	10.6	16.0	18.0
EBIT Growth – %	54.3	64.4	(25.5)	106.5	20.7	27.7	31.3
Net Profit Growth – %	64.9	62.9	(24.1)	106.1	18.1	26.2	30.6
EPS Growth – %	58.0	63.3	(24.4)	106.7	17.9	26.3	30.6
Profitability ratios							
Gross Margin – %	21.6	21.2	21.6	20.7	21.0	21.3	21.2
Operating Margin – %	5.8	7.8	5.3	8.3	9.0	9.9	8.1
Net Margin – %	4.9	6.5	4.5	7.0	7.5	8.1	6.7
ROAA – %	11.6	16.4	11.1	19.7	18.8	19.6	17.1
ROAE – %	14.0	20.2	13.9	25.4	25.7	28.0	22.6
Other ratios							
Capex/Sales – %	2.8	4.2	1.6	1.0	1.2	1.1	1.8
Capex/Depreciation – %	365.9	647.2	179.3	110.9	133.0	134.4	240.9
Net Debt/Equity – %	(12.5)	(16.3)	(15.2)	(20.5)	(21.3)	(27.8)	(20.2)
Inventory/Sales – %	30.5	27.8	28.8	26.4	27.5	26.1	27.3
Effective tax rate – %	15.9	16.5	14.1	15.2	17.0	18.0	16.2
ROAA component analysis							
Revenue/Average Asset – %	237.6	252.6	244.3	281.8	251.4	240.8	254.2
COGS/Average Asset – %	(186.2)	(199.0)	(191.5)	(223.6)	(198.6)	(189.5)	(200.4)
Gross Profit/Average Asset – %	51.4	53.6	52.8	58.2	52.8	51.3	53.7
Operating Expense/Average Asset – %	(40.6)	(40.1)	(43.2)	(41.7)	(36.2)	(33.5)	(38.9)
Other Operating Income/Average Asset – %	3.0	3.0	2.9	4.9	5.4	5.5	4.4
Operating Profit/Average Asset – %	13.8	19.7	13.1	23.3	22.7	23.9	20.5
Finance Expense/Average Asset – %	(0.0)	(0.1)	(0.2)	(0.0)	(0.0)	(0.0)	(0.1)
PBT/Average Asset – %	13.8	19.6	12.9	23.2	22.6	23.9	20.5
Tax/Average Asset – %	(2.2)	(3.2)	(1.8)	(3.5)	(3.8)	(4.3)	(3.3)
Net profit/Average Asset – %	11.6	16.4	11.1	19.7	18.8	19.6	17.1
ROAE component analysis							
Revenue/Average Equity – %	285.7	312.1	306.1	363.5	344.2	344.5	334.1
COGS/Average Equity – %	(223.9)	(245.9)	(239.9)	(288.4)	(271.9)	(271.1)	(263.5)
Gross Profit/Average Equity – %	61.8	66.2	66.2	75.1	72.3	73.4	70.6
Operating Expense/Average Equity – %	(48.9)	(49.6)	(54.2)	(53.8)	(49.5)	(47.9)	(51.0)
Other Operating Income/Average Equity – %	3.6	3.7	3.7	6.3	7.4	7.9	5.8
Operating Profit/Average Equity – %	16.6	24.3	16.4	30.0	31.0	34.2	27.2
Finance Expense/Average Equity – %	(0.0)	(0.1)	(0.2)	(0.0)	(0.1)	(0.1)	(0.1)
PBT/Average Equity – %	16.6	24.2	16.2	30.0	31.0	34.1	27.1
Tax/Average Equity – %	(2.6)	(4.0)	(2.3)	(4.6)	(5.3)	(6.1)	(4.5)
Net profit/Average Equity – %	14.0	20.2	13.9	25.4	25.7	28.0	22.6

Sources: The Company and Sun Hung Kai Financial

Meadville (3313.HK)**Analyst: Eva Yip**
eva.yip@shkf.com

Meadville is the fifth largest PCB maker in China by sales, but is on track to become the second largest within the next year. Its PCB products are mainly for high-end applications such as communications and cell phones (55% of sales). It has very strong product and geographical themes, riding the ongoing boom in handset demand in China, and the upcoming capex boom for telecom equipment upon China's 3G implementation. During slow global PCB sales of 2004-07, when global annual PCB sales growth declined from 15% to 4%, Meadville managed to post accelerating revenue growth, averaging 30-40% p.a.

Meadville is ZTE's largest supplier (the largest telecom-equipment manufacturer in China), supplying 50% of ZTE's PCB requirements, and is one of only a few China-based PCB makers that can supply the country's key communications companies. It mainly sells to reputable OEMs and brand owners such as ZTE, Huawei, IBM and Sony. It also acquired Finnish PCB-maker Aspocom in late 2007, which helped it penetrate Nokia's handset supply chain.

China's low- to mid-end PCB producers have little pricing power, and demand for their products is cyclical. Profit margins are hit hard by increasing labor costs and the rising RMB. Meadville is different – half its revenue is denominated in RMB, and there is little or no earnings impact from RMB appreciation. It also has a history of passing on cost increases to customers. Meadville raised ASPs every year during 2005-07, but still posted an ASP CAGR of 11%. Copper, laminates, and other raw materials account for 48% of COGS, but despite copper prices quadrupling and laminate costs rising 40-50% over 2003-07, the gross margin was stable at 20%-plus due to increasing ASPs. Although the company provides 50% of ZTE's PCB requirements, it only accounts for 2-3% of ZTE's COGS, so cost increases are easily passed on.

However, Meadville may need to raise funds for capacity expansion. Production utilization is running at 90%, with high estimated sales growth (25% p.a. over the next two years). Capex is budgeted at HK\$2.6bn, equivalent to 70% of its market cap, for the next two years. Meanwhile, the cash-conversion cycle is positive, and free-cash flow is projected to be negative until next year. Even though it might make more sense to borrow to expand, given the cost of debt vs. equity and rising inflation, gearing is already high at 80%.

The stock trades at almost half the P/E of its Taiwanese peers, based on 17% p.a. two-year core EPS growth. Meadville also owns a 22% stake in A-share Guangdong Shengyi Scitech (600183), worth HK\$1.4bn and equal to 35% of Meadville's market cap. Subtracting the earnings contribution from this company and the corresponding market value, the rest of Meadville trades at sub-4X prospective earnings.

Figure 61: Meadville - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – HK\$m	170.9	210.8	372.0	596.0	649.7	885.3
Net-profit growth - %	246.9	23.4	76.5	60.2	9.0	22.0
EPS –HK cents	N/A	N/A	24.8	30.5	32.9	71.3
EPS growth – %	N/A	N/A	N/A	22.9	8.1	22.0
P/E – X	N/A	N/A	7.5	6.1	5.7	9.2
DPS –HK cents	N/A	N/A	0.0	6.0	6.5	0.0
Dividend yield – %	N/A	N/A	0.0	3.2	3.5	0.0
BVPS –HK\$	N/A	N/A	0.6	1.4	1.5	3.2
P/B – X	N/A	N/A	3.0	1.3	1.3	2.0
Oper. cash flow per share – HK cents	N/A	N/A	25.8	60.2	54.2	62.4
FCF/share –HK cents	N/A	N/A	(19.9)	(10.7)	(17.4)	38.2
Free cash flow yield – %	N/A	N/A	(10.7)	(5.7)	(9.3)	5.8
Net debt per share –HK cents	N/A	N/A	104.3	116.8	140.7	(109.1)
Net debt/ price – %	N/A	N/A	55.8	62.5	75.2	(16.7)
Issued shares – millions	N/A	N/A	1,500.0	1,956.2	1,956.2	1,242.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 62: Investment Highlights for Meadville



 Key investment positive	 Key investment negatives
<ul style="list-style-type: none"> ▪ PCBs are the 'heart' of electronic products and demand remains strong due to shorter electronic-product lifecycles. Its customers' industries are characterized by rapidly changing customer preferences and aggressive market competition. PCBs make up 92% of revenue. Despite fewer new innovative electronic products than in recent years, BPA Consulting estimates a 7.5% CAGR for the global PCB market over 2005-10. ▪ The migration of electronics production and PCB outsourcing to China supports local PCB demand. PRC electronic-product exports grew 28% p.a. in 2006 and 2007 by value. Mainland PCB demand is set to post a 12% CAGR for 2005-10, the highest rate in the world. 35% of global PCBs will be from China in 2010 vs. 28% in 2005. ▪ Unique exposure to high-growth segment. China is moving toward higher-value-added electronic products, leading to greater high-end PCB demands. The high-end PCB business is expected to outpace the low-end market. Meadville is the only company that can produce high-end PCBs in China. These made up 31% of FY07 sales. ▪ Exposure to high-growth segment. The company focuses on the telecommunications/handset segment (55% of PCB sales). Demand from China and emerging markets is set to post a 7.9% CAGR for 2005-10, much higher than for other PCB applications. ▪ Rising ASPs support revenue growth. Thanks to the shifting sales mix toward high-end products, the ASP rose at a 10% CAGR for 2004-07. ▪ Less pricing pressure vs. low-end PCB makers. The lack of high-end PCB suppliers in China means Meadville can pass through rising raw-material prices despite being the largest supplier of its main customers. The company does not compete on cost and volume bases, but rather in terms of technology. ▪ Products include conventional PCBs, niche PCBs, quick-turn PCBs and lead- and halogen-free PCBs. ▪ Greater demand can be met by capacity expansion, set to rise 26% in FY08 and 37% in FY09. ▪ Homegrown 3G services will be rolled out by 2009. The telecommunications sector contributed 55% of sales and the company plans to focus on the segment to leverage 3G business opportunities. ▪ The company holds a 22.18% stake in Guangdong Shengyi Science Tech Co, worth RMB1.8bn (c. 50% of Meadville's market cap). ▪ The acquisition of Finnish PCB maker Aspocomp could help Meadville penetrate the world's largest handset maker, Nokia, and expand its sales network in northern Europe. 7% of 2007 sales were to Europe. ▪ The company's partnership with Japanese PCB manufacturers has helped it enter the Japanese market. 11% of revenue was from Asia in 2007. ▪ First-mover advantage. It is not easy for small peers to capture market share. Most customers are reputable, large OEMs such as Huawei and ZTE. It could take 2-3 years for small peers to qualify as suppliers. ▪ Large customers have strong growth prospects. Meadville is the largest supplier of Huawei (30% of its requirements) and ZTE (50%). Both have strong demand for high-end PCBs due to rapid overseas expansion. High-end PCBs can only be sourced from Meadville in China. ▪ Diverse customer base. The top five customers make up 36% of revenue and the top customer makes up 11-12%. ▪ High entry barriers protect margins. The company serves mainly OEMs and brand owners that have stringent criteria for suppliers. ▪ RMB appreciation should not result in margin pressure. Most sales are domestic and denominated in RMB (40% of sales in RMB with 50-60% of costs in RMB). 	<ul style="list-style-type: none"> ▪ Needs continued R&D to maintain competitiveness. Not coping with rapid technology change to meet customer requirements could hurt the business. ▪ Net gearing is set to rise to fund heavy capex (HK\$1.44bn and HK\$1.2bn in FY08 and FY09) for capacity expansion (capacity up 26% in FY08 and 37% in FY09). Net gearing of 81% as at end-2007, and estimated to rise to 94% in FY08. ▪ Share placements to fund capex or lower net gearing could lead to EPS dilution. ▪ Not attracting new customers or customers pulling back orders could lead to underutilization, which coupled with high fixed costs might mean margin erosion. The company operates at 100% utilization (average fixed-asset turnover is 1.5-1.6X for the PCB industry, and high utilization is key to maintaining profitability). ▪ Expansion into new business segments. The company plans to invest in new product lines (flexible and/or rigid-flexible PCBs) and PCBs used in aerospace products. Despite helping to diversify products, this could mean uncertain product demand and growth and lengthy qualification periods for new customers. ▪ RMB appreciation could cut cost competitiveness by causing electronics plants to shift to other Asian countries and cutting into PCB demand. ▪ Easing cross-strait tensions between Taiwan and China could encourage Taiwanese PCB makers to increase investment in the mainland to lower production costs. This would increase competition.

Figure 63: Meadville - Profit and Loss Statement

Year ended 31 Dec, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	1,643.9	2,216.9	3,140.4	4,490.3	5,554.9	6,894.8	39.7
COGS	(1,279.3)	(1,792.6)	(2,486.6)	(3,430.2)	(4,216.2)	(5,198.7)	38.9
Gross profit	364.5	424.3	653.8	1,060.0	1,338.7	1,696.1	42.7
Operating expenses	(206.0)	(232.6)	(280.8)	(485.3)	(572.2)	(717.1)	33.0
Other operating income	14.8	62.6	97.1	177.1	111.1	137.9	128.6
Operating profit	173.3	254.3	470.2	497.3	860.5	1,099.8	42.0
Finance expenses	(33.4)	(56.9)	(88.2)	(109.7)	(84.9)	(106.6)	48.7
PBT	204.4	258.2	433.6	522.7	908.0	1,163.3	36.7
Tax	(19.9)	(18.3)	(48.7)	(72.1)	(127.1)	(162.9)	53.5
Net profit	170.9	210.8	372.0	596.0	649.7	827.5	51.6
EPS – HK cents	0.0	0.0	24.8	30.5	32.9	42.0	N/A

Sources: The Company and Sun Hung Kai Financial

Figure 64: Meadville - Balance Sheet

Year ended 31 Dec, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	103.4	174.3	211.2	414.3	208.8	101.7	58.7
Accounts receivable	616.2	974.9	1,241.7	1,597.0	1,902.4	2,266.8	37.3
Inventory	219.4	259.2	373.5	498.0	577.6	712.1	31.4
Other current assets	35.9	36.2	2.2	45.1	45.1	45.1	7.9
Total current assets	974.9	1,444.5	1,828.5	2,554.5	2,733.9	3,125.8	37.8
Net fixed assets	1,175.1	1,536.0	2,030.8	4,121.4	4,533.5	4,760.2	51.9
Other long-term assets	421.4	496.9	578.5	938.1	938.1	938.1	30.5
Total assets	2,571.3	3,477.4	4,437.8	7,613.9	8,205.5	8,824.1	43.5
Short-term debt	829.7	863.3	1,026.2	961.1	961.1	961.1	5.0
Accounts payable	468.5	600.4	800.0	1,428.3	1,732.7	2,136.4	44.9
Other current liabilities	67.4	188.0	910.6	206.0	205.4	205.4	45.1
Total current liabilities	1,365.6	1,651.7	2,736.8	2,595.4	2,899.2	3,302.9	23.8
Long-term debt	78.0	532.8	749.1	1,738.1	2,000.0	2,000.0	181.1
Other long-term liabilities	8.9	13.6	14.2	461.5	381.5	381.5	272.0
Total liabilities	1,452.5	2,198.1	3,500.1	4,795.0	5,280.6	5,684.4	48.8
Shareholders equity	1,118.8	1,279.3	937.7	2,822.8	2,924.8	3,139.6	36.1
Minorities	145.3	152.5	203.9	359.3	468.2	616.6	35.2
Total equity and liabilities	2,571.3	3,477.4	4,437.8	7,617.8	8,205.5	8,824.1	43.6

Sources: The Company and Sun Hung Kai Financial

Figure 65: Meadville - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	30.3	34.9	41.7	43.0	23.7	24.1	39.7
EBIT growth – %	183.4	46.7	84.9	5.8	73.0	27.8	42.0
Net-profit growth – %	246.9	23.4	76.5	60.2	9.0	27.4	51.6
EPS growth – %	N/A	N/A	N/A	22.9	8.1	27.6	N/A
Profitability ratios							
Gross margin – %	22.2	19.1	20.8	23.6	24.1	24.6	21.2
Operating margin – %	10.5	11.5	15.0	11.1	15.5	16.0	12.5
Net margin – %	10.4	9.5	11.8	13.3	11.7	12.0	11.5
ROAA – %	7.3	7.0	9.4	9.9	8.2	9.7	8.8
ROAE – %	16.2	17.6	33.6	31.7	22.6	27.3	27.6
Other ratios							
Capex/sales – %	21.5	23.8	21.8	30.9	25.2	17.4	25.5
Capex/depreciation – %	350.6	331.1	328.2	475.5	400.0	333.3	378.3
Operating expense/ sales - %	(12.5)	(10.5)	(8.9)	(10.8)	(10.3)	(10.4)	(10.1)
Net debt/equity (net cash) – %	71.9	95.5	166.8	80.9	94.1	91.1	114.4
Inventory/sales – %	13.3	11.7	11.9	11.1	10.4	10.3	11.6
Effective tax rate – %	9.7	7.1	11.2	13.8	14.0	14.0	10.7
ROAA component analysis							
Revenue/average assets – %	70.2	73.3	79.4	74.5	70.2	81.0	75.7
COGS/average assets – %	(54.6)	(59.3)	(62.8)	(56.9)	(53.3)	(61.1)	(59.7)
Gross profit/average assets – %	15.6	14.0	16.5	17.6	16.9	19.9	16.0
Operating expenses/average assets – %	(8.8)	(7.7)	(7.1)	(8.1)	(7.2)	(8.4)	(7.6)
Other operating income/average assets – %	0.6	2.1	2.5	2.9	1.4	1.6	2.5
Operating profit/average assets – %	7.4	8.4	11.9	8.3	10.9	12.9	9.5
Finance expenses/average assets – %	(1.4)	(1.9)	(2.2)	(1.8)	(1.1)	(1.3)	(2.0)
PBT/average assets – %	8.7	8.5	11.0	8.7	11.5	13.7	9.4
Tax/average assets – %	(0.9)	(0.6)	(1.2)	(1.2)	(1.6)	(1.9)	(1.0)
Net profit/average assets – %	7.3	7.0	9.4	9.9	8.2	9.7	8.8
ROAE component analysis							
Revenue/average equity – %	155.8	184.9	283.3	238.8	193.3	227.4	235.7
COGS/average equity – %	(121.3)	(149.5)	(224.3)	(182.4)	(146.7)	(171.4)	(185.4)
Gross profit/average equity – %	34.6	35.4	59.0	56.4	46.6	55.9	50.2
Operating expenses/average equity – %	(19.5)	(19.4)	(25.3)	(25.8)	(19.9)	(23.6)	(23.5)
Other operating income/average equity – %	1.4	5.2	8.8	9.4	3.9	4.5	7.8
Operating profit/average equity – %	16.4	21.2	42.4	26.4	29.9	36.3	30.0
Finance expenses/average equity – %	(3.2)	(4.7)	(8.0)	(5.8)	(3.0)	(3.5)	(6.2)
PBT/average equity – %	19.4	21.5	39.1	27.8	31.6	38.4	29.5
Tax/average equity – %	(1.9)	(1.5)	(4.4)	(3.8)	(4.4)	(5.4)	(3.3)
Net profit/average equity – %	16.2	17.6	33.6	31.7	22.6	27.3	27.6

Sources: The Company and Sun Hung Kai Financial

Minth Group (425.HK)**Analyst: Vivien Chan**
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Minth is one of the top exterior auto-body parts suppliers in China, and has a global footprint. It mainly designs, manufactures and sells body-structure parts (42% of sales), decorative parts (23.2%) and trims (23.3%) for passenger cars. Other products include doorframes, seat tracks, bumper frames, front windshield moldings, grilles, license plates and wheel covers. Minth's exceptional product quality, low cost and R&D capability have enabled the company to qualify as a supplier to most of the top 15 passenger-vehicle assemblers in China. With more than 10 manufacturing plants nationwide, Minth's domestic and export sales accounted for 87% and 13%, respectively, in 2007. Japanese automakers were easily the company's biggest clients last year at 68% of total sales, followed by the U.S. (13%), Europe (8%) and China (7%).

With 80-85% of sales over 2008-09 still from China, Minth is essentially a direct and defensive play on car sales volume. The company benefits from Chinese auto companies launching new models. Around 100 new car models were launched in 2007, and this trend is expected to continue, with new-model selling prices and margins higher than for older models. The company also benefits from rising outsourcing demand from the rest of the world. Management is confident the company can sustain annual growth of over 30% over the next few years.

The company has economies of scale from its having large capacity, and low procurement costs through more in-house raw material production. These give a high operating margin (25% in FY07 vs. the global average of 6.2%). Besides sustainable organic growth, management expects more competitors, suppliers and module assemblers to close given the difficult operating conditions. It expects quickening industry consolidation and many attractively priced M&A targets, particularly in Japan, but also in the U.S. and Europe. It targets exports to make up 25% of sales in 2010, from 13% in 2007. This would help Minth to establish global footprint more quickly, lowering costs by shifting production to China and limiting direct exposure to the U.S. economy.

Downside risks include: 1) unexpected pressure on product pricing from increasing competition among auto assemblers in China (we estimate 5-7% ASP cuts over their product lifecycles), 2) failure to secure future orders on new car models. Exports represented only 13% of Minth's sales in FY07, and only 25% of that was direct exports to the U.S. Therefore RMB appreciation should not be a major threat, as the company's raw-material import costs are largely offset by its export revenue.

Figure 66: Minth Group - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – RMBm	123.1	195.1	268.7	359.9	500.8	661.4
Net-profit growth - %	24.7	58.5	37.7	33.9	39.2	32.1
EPS –RMB fen	20.5	31.5	32.4	40.5	52.0	71.0
EPS growth – %	24.2	53.7	2.9	25.0	28.4	36.5
P/E – X	26.1	17.0	16.5	13.2	10.3	7.5
DPS –RMB fen	0.0	N/A	N/A	10.9	15.0	21.0
Dividend yield – %	0.0	N/A	N/A	2.0	2.8	3.9
BVPS –RMB	0.7	1.2	1.5	3.1	3.0	3.4
P/B – X	7.5	N/A	N/A	1.7	1.8	1.6
Oper. cash flow per share – RMB fen	7.7	27.1	29.9	32.5	68.1	74.0
FCF/share –RMB fen	(8.9)	8.8	8.3	(1.6)	41.9	47.8
Free cash flow yield – %	(1.7)	1.6	1.5	(0.3)	7.8	8.9
Net debt per share –RMB fen	12.4	(24.6)	(21.2)	(147.8)	103.5	99.3
Net debt/ price – %	2.3	(4.6)	(4.0)	(27.6)	19.3	18.5
Issued shares – millions	600.0	830.0	830.0	954.5	955.0	955.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 67: Investment Highlights for Minth Group



 Key investment positive	 Key investment negatives
<ul style="list-style-type: none"> ▪ Broad customer base of Japanese OEMs (68% revenue in FY07) and enjoy higher margin; est. Japanese OEM auto sales in China (30% CAGR sales) will outperform the average passenger car sales in China (15%). ▪ Strong order book in FY08-09; orders already guaranteed from key new models such as Toyota's Carmy; Nissan's Bluebird Sylphy which expected strong sales in China. ▪ In 2007, China's auto industry launched its largest number of new models and the trend is expected to continue. New-model selling prices and margins are higher than for older models. ▪ Low cost structure and hence higher operating margin (28% in FY07 vs. global average of 6.2%); economies of scale from large capacity, and lower procurement costs from more in-house raw-material production. ▪ Can pass 30% of raw-material cost changes on to customers (protected by customer agreement). ▪ Benefits from growing outsourcing trend; most auto OEMs prefer sourcing to in-house production. ▪ Provides value-added services such as electroplating and coating; can help maintain margins (FY07 net margin: 26% vs. peers' single digits). ▪ Has alliances with tier-1 Japanese suppliers such as Sankei Giken (suppliers to Honda), Tokai Kogyo (suppliers to Honda, Toyota); can secure orders and technology. ▪ Overseas market opportunities from global outsourcing demand (export grew 75% CAGR between FY07-09). ▪ Able to maintain strong earnings growth through volume gains. HK\$160-220m from IPO was used to expand capacity. ▪ Commitment to R&D (R&D/sales raised from 0.4% in FY02 to 3.8% in FY07) helps maintain competitiveness. ▪ Auto-parts market consolidation can help the company capture market share from small players. ▪ Products are not related to safety, minimizing product-liability risk. 	<ul style="list-style-type: none"> ▪ Unexpectedly large pressure on product pricing due to increasing competition among auto assemblers in China. We estimate average cuts in selling prices of 5-7% over their product lifecycles. ▪ Prices for new models have fallen 6-10% p.a. over the past three years. ▪ Pricing pressure from customers; auto overcapacity will worsen as buyers are waiting for auto price cuts. ▪ Introduction of consumption tax and fuel-price increases are likely hurt vehicle-sales growth, lowering demand for auto body parts. ▪ Weak bargaining power over upstream and downstream players due to the many players in the exterior-parts industry (the top five make up less than 35% of the market). ▪ Need to strengthen R&D to stay competitive. Auto parts have short product life cycle. ▪ Relies on Japanese peers for R&D; lacks the ability to design and develop exterior parts. ▪ Relies on Japanese auto-component suppliers for some product designs, moldings and some materials. ▪ Further capex needs (more than RMB200m p.a. over 2006-07) for capacity expansion and investment in R&D. ▪ Large exposure to the China market (over 90% of revenue in FY05); lack of market diversification. ▪ Profit growth may be hampered by possible China tax unification (likely to be unified to 24% after 2008 vs. 6% effective tax in FY05). ▪ RMB appreciation would likely to hurt Minth's exports.

Figure 68: Minth Group - Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	464.2	678.6	956.2	1,408.7	1,983.3	2,674.0	47.4
COGS	(277.6)	(406.6)	(579.8)	(858.3)	(1,211.4)	(1,652.5)	46.7
Gross profit	186.5	272.0	376.4	550.4	771.9	1,021.5	48.5
Operating expenses	(58.0)	(95.7)	(139.5)	(216.5)	(288.6)	(375.2)	45.1
Other operating income	20.7	23.5	28.4	58.2	25.0	32.0	8.2
Operating profit	149.2	199.8	265.3	392.2	501.7	657.8	38.4
Finance expenses	(2.1)	(9.1)	(2.8)	(6.9)	(7.6)	(9.5)	31.1
PBT	151.0	210.3	289.6	394.0	550.0	739.0	39.1
Tax	(6.3)	(12.2)	(14.5)	(28.2)	(42.0)	(63.7)	71.2
Net profit	123.1	195.1	268.7	359.9	500.8	661.4	38.2
EPS – RMB fen	20.5	31.5	32.4	40.5	52.0	71.0	25.2

Sources: The Company and Sun Hung Kai Financial

Figure 69: Minth Group - Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	86.4	465.5	232.1	933.1	1,105.7	1,064.9	98.3
Accounts receivable	174.6	172.8	218.4	365.7	587.3	773.2	37.5
Inventory	111.6	175.9	219.5	279.5	466.8	652.7	30.8
Other current assets	73.9	35.7	34.3	749.4	115.0	105.0	57.8
Total current assets	446.5	850.0	704.3	2,327.7	2,274.8	2,595.8	57.4
Net fixed assets	380.9	506.7	654.8	944.0	1,020.5	1,183.3	33.5
Other long-term assets	7.6	50.5	131.7	141.0	121.4	265.2	89.3
Total assets	834.9	1,407.1	1,490.9	3,412.7	3,416.7	4,044.3	49.3
Short-term debt	160.6	145.8	56.1	128.1	117.0	117.0	(5.6)
Accounts payable	74.0	81.6	101.3	154.5	426.8	651.0	21.1
Other current liabilities	169.6	91.3	116.3	132.1	(23.3)	(60.9)	1.3
Total current liabilities	404.1	318.8	273.7	414.7	520.5	707.1	3.7
Long-term debt	0.0	115.6	0.0	0.0	0.0	0.0	N/A
Other long-term liabilities	0.0	0.0	0.0	1.4	29.5	64.4	(47.4)
Total liabilities	404.1	434.3	273.7	416.1	550.0	771.5	2.5
Shareholders equity	430.8	972.8	1,217.2	2,996.6	2,866.7	3,272.8	76.3
Minorities	40.1	25.2	34.5	39.1	45.0	53.0	32.7
Total equity and liabilities	834.9	1,407.1	1,490.9	3,412.7	3,416.7	4,044.3	49.3

Sources: The Company and Sun Hung Kai Financial

Figure 70: Minth Group - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	55.4	46.2	40.9	47.3	40.8	34.8	47.4
EBIT growth – %	39.6	33.9	32.8	47.8	27.9	31.1	38.4
Net-profit growth – %	24.7	58.5	37.7	33.9	39.2	32.1	38.2
EPS growth – %	24.2	53.7	2.9	25.0	28.4	36.5	25.2
Profitability ratios							
Gross margin – %	40.2	40.1	39.4	39.1	38.9	38.2	39.7
Operating margin – %	32.1	29.4	27.7	27.8	25.3	24.6	29.3
Net margin – %	26.5	28.7	28.1	25.5	25.3	24.7	27.2
ROAA – %	16.2	17.4	18.5	14.7	14.7	17.7	16.7
ROAE – %	33.2	27.8	24.5	17.1	17.1	21.5	25.7
Other ratios							
Capex/sales – %	21.4	22.4	18.8	23.1	12.6	9.3	21.4
Capex/depreciation – %	407.5	516.3	501.6	569.5	301.1	231.6	498.7
Net debt/equity (net cash) – %	17.2	(21.0)	(14.5)	(47.1)	34.5	29.0	(16.3)
Inventory/sales – %	24.0	25.9	23.0	19.8	23.5	24.4	23.2
Effective tax rate – %	4.1	5.8	5.0	7.2	7.6	8.6	5.5
ROAA component analysis							
Revenue/average assets – %	61.0	60.5	66.0	57.5	58.1	71.7	61.2
COGS/average assets – %	(36.5)	(36.3)	(40.0)	(35.0)	(35.5)	(44.3)	(36.9)
Gross profit/average assets – %	24.5	24.3	26.0	22.4	22.6	27.4	24.3
Operating expenses/average assets – %	(7.6)	(8.5)	(9.6)	(8.8)	(8.5)	(10.1)	(8.7)
Other operating income/average assets – %	2.7	2.1	2.0	2.4	0.7	0.9	2.3
Operating profit/average assets – %	19.6	17.8	18.3	16.0	14.7	17.6	17.9
Finance expenses/average assets – %	(0.3)	(0.8)	(0.2)	(0.3)	(0.2)	(0.3)	(0.4)
PBT/average assets – %	19.8	18.8	20.0	16.1	16.1	19.8	18.7
Tax/average assets – %	(0.8)	(1.1)	(1.0)	(1.2)	(1.2)	(1.7)	(1.0)
Net profit/average assets – %	16.2	17.4	18.5	14.7	14.7	17.7	16.7
ROAE component analysis							
Revenue/average equity – %	125.3	96.7	87.3	66.9	67.7	87.1	94.0
COGS/average equity – %	(74.9)	(57.9)	(53.0)	(40.7)	(41.3)	(53.8)	(56.6)
Gross profit/average equity – %	50.3	38.8	34.4	26.1	26.3	33.3	37.4
Operating expenses/average equity – %	(15.7)	(13.6)	(12.7)	(10.3)	(9.8)	(12.2)	(13.1)
Other operating income/average equity – %	5.6	3.4	2.6	2.8	0.9	1.0	3.6
Operating profit/average equity – %	40.3	28.5	24.2	18.6	17.1	21.4	27.9
Finance expenses/average equity – %	(0.6)	(1.3)	(0.3)	(0.3)	(0.3)	(0.3)	(0.6)
PBT/average equity – %	40.8	30.0	26.4	18.7	18.8	24.1	29.0
Tax/average equity – %	(1.7)	(1.7)	(1.3)	(1.3)	(1.4)	(2.1)	(1.5)
Net profit/average equity – %	33.2	27.8	24.5	17.1	17.1	21.5	25.7

Sources: The Company and Sun Hung Kai Financial

SIM Tech (2000.HK)**Analyst: Eva Yip**
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SIM Tech develops mobile handsets and wireless-communications modules and manufactures LCD modules. Handset design made up 62% of FY07 sales, wireless communications 22% and LCD modules 16%. It is the largest independent design house (IDH) in China by revenue. There is an increasing trend for brand owners to outsource handset design to IDHs to cut costs. SIM Tech uses a one-to-many approach to develop motherboards for handsets, i.e. one motherboard platform is standardized to develop 10-15 handset models with similar content, with each model differentiated mostly through branding, settings, style and casing. This can lower R&D expenses almost 90% and shorten the time to market, as a complete phone design can be ready within 12 weeks. The company charges customers around half the market price, so industry ASP erosion could dilute its margins too.

Ningbo Bird, Lenovo and China King are among SIM Tech's top customers in China. It is expanding its customer base of international telecom operators and currently ships to three of these. Competitors include Longcheer and China Techfaith.

Handset-design outsourcing is increasing due to shortening handset lifecycles, rapid technology change and the need for more niche products to cater for different demographics. Upcoming mainland implementation of 3G could create opportunities for SIM Tech. Its customers are suppliers of China Mobile's TD-SCDMA handsets, and it also already has expertise in developing 3G PRC handsets. The start of 3G services nationwide could stimulate demand for 3G handsets. Despite continued delays in 3G, the rising popularity of high-functionality handsets has helped the company post steady shipment growth (up 44% in FY07). There is also an increasing trend for non-traditional handset makers such as telecom operators and brand owners like Prada to enter the market.

Even though it can achieve strong volume growth, sales may be offset by margin erosion in the handset industry due to falling ASPs. Margins fell from 16% in FY05 to 13.3% in 2H06 due to ASP erosion. To counter margin pressure, the company has expanded overseas (10% of sales in FY07, from 5% in FY06). Smaller peers could face difficulty penetrating overseas due to long qualification periods.

Profitability is highly dependent on new product rollouts, as these can generate higher ASPs. Sudden technology changes can affect sales, and it may need to write off obsolete inventory, including stockpiles of electronic components. Entry barriers for the industry are also low, though maintaining R&D is key for survival.

Figure 71: SIM- Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – HK\$m	155.5	295.1	372.9	240.7	277.9	319.4
Net-profit growth - %	399.5	89.7	26.4	(35.4)	15.4	14.9
EPS –HK cents	13.8	22.4	24.8	15.9	18.4	21.1
EPS growth – %	399.3	62.2	10.4	(35.8)	15.4	14.9
P/E – X	5.9	3.7	3.3	5.2	4.5	3.9
DPS –HK cents	0.0	14.0	17.0	5.5	6.4	7.4
Dividend yield – %	0.0	17.1	20.7	6.7	7.8	9.0
BVPS –HK\$	0.2	0.8	0.7	0.8	0.9	1.1
P/B – X	4.7	1.1	1.1	1.0	0.9	0.7
Oper. cash flow per share – HK cents	19.4	16.5	50.0	25.8	31.8	39.2
FCF/share –HK cents	13.1	13.5	45.2	18.2	18.6	52.5
Free cash flow yield – %	16.0	16.4	55.2	22.2	22.7	64.0
Net debt per share –HK cents	(9.4)	(43.4)	(54.7)	(41.0)	(53.1)	(71.8)
Net debt/ price – %	(11.5)	(52.9)	(66.7)	(50.0)	(64.8)	(87.5)
Issued shares – millions	1,125.0	1,315.1	1,504.9	1,514.2	1,514.2	1,514.2

Sources: Bloomberg and Sun Hung Kai Financial

Figure 72: Investment Highlights for SIM



	
Key investment positive	Key investment negatives
<ul style="list-style-type: none"> ■ Benefits from outsourcing trend. Its one-to-many solutions offer customizable handset solutions at competitive prices with small order batches and a time-to-market advantage. It can offer up to 90% savings in product development for handset makers. Handset-solution sales made up 62% of FY07 revenue. ■ Leading PRC handset makers outsource design to IDHs to keep their content in line with the top brands, as product lifecycles are getting shorter. ■ International handset vendors also outsource design to cut R&D costs and offer a wide range of products catering for many niche segments. ■ Benefits from structural changes in the handset market. New non-traditional handset makers entering the market with their own handsets, such as Prada and Disney, rely on large-scale IDHs for product co-development. ■ With more customized features from co-development with other non-handset makers, ASPs could improve. The overall ASP only dropped 5% hoh in 1H07, vs. 42% yoy in FY06. ■ Margins edging up on a revamped sales mix. SIM Tech has trimmed its low-margin orders and focuses on higher-margin, high-end solution designs such as smart phones, mobile TV and GPS (18-20% for domestic-made handset and 25-30% for overseas). Gross margins in 2H07 recovered to the FY06 level. ■ Margin improvement in the LCD-module business (16% of FY07 revenue). The company has developed touch-screen LCD modules (gross margin of 40% vs. the average of 8.5%), which can lower production costs. ■ Greater popularity of smart phones, TV phones and dual-mode phones from the gradual deployment of 3G across China could lead to strong handset sales. ■ One of the best-placed manufacturers to capitalize on China's 3G market due to its strong R&D. Five customers are suppliers for China Mobile's TD-SCDMA. It has built up expertise in developing China 3G phones and is now waiting for mass shipments to commence. ■ On the wireless-module front, it can capture market share from existing market leaders such as Wavecom and Siemens due to its low costs. This business accounts for 22% of sales. There is a prevailing trend for wireless modules for machine-to-machine communication. SIM Tech has more than a 50% of market share in China and 15% of the global market. ■ Strong engineering teams and R&D compared with small peers. ■ High entry barriers in overseas markets. SIM Tech is qualified as a supplier of European telecom operators, a process that can take other firms up to two years. ■ Exploring overseas markets can reduce reliance on the competitive China market. Overseas sales made up 10% of FY07 sales. ■ Net cash reached HK\$620m (HK\$0.41 per share), at end-2007. Capex needs are also limited (about HK\$200m for R&D). ■ The company has split its R&D team into six sub-teams diversifying into different customer bases, to avoid high customer concentration. ■ Diversifying the customer base can create cross-selling opportunities. ■ The company can source components quickly (it was previously a distributor of electronic components) which can shorten its time to market. It is also the only IDH with in-house LCD manufacturing. 	<ul style="list-style-type: none"> ■ Profitability/sales depend on the new-product rollout, as these tend to have higher ASPs. Old models face margin pressure. ■ Still relies heavily on the domestic market (90% of sales). ■ Much of its advantage is in its skilled engineers. ■ Relies on distributors to sell modules (85% of products are sold through distributors). ■ Greater working-capital needs, as international operators could ask for longer account-receivables period and lengthen the cash-conversion cycle. Greater capex due to value-accretive acquisitions may also lead to a payout-ratio cut (70% in FY06 to 35% in FY07). ■ Rising labor costs and RMB appreciation could reduce cost competitiveness.

Figure 73: SIM- Profit and Loss Statement

Year ended 31 Dec, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	1,567.1	2,719.6	3,418.9	2,897.0	3,201.8	3,565.8	22.7
COGS	(1,311.2)	(2,276.8)	(2,914.9)	(2,486.4)	(2,739.3)	(3,029.4)	23.7
Gross profit	255.9	442.7	504.0	410.6	462.5	536.4	17.1
Operating expenses	(70.0)	(197.0)	(203.1)	(255.7)	(256.1)	(296.0)	53.9
Other operating income	31.5	67.2	91.0	102.3	96.1	107.0	48.1
Operating profit	217.4	313.0	391.9	257.2	302.4	347.5	5.8
Finance expenses	(4.8)	(4.5)	(0.3)	(0.6)	(0.3)	(0.3)	(50.5)
PBT	212.7	308.5	391.6	256.6	302.1	347.2	6.5
Tax	(13.5)	(13.4)	(18.7)	(15.9)	(24.2)	(27.8)	5.7
Net profit	155.5	295.1	372.9	240.7	277.9	319.4	15.7
EPS – HK cents	13.8	22.4	24.8	15.9	18.4	21.1	4.8

Sources: The Company and Sun Hung Kai Financial

Figure 74: SIM- Balance Sheet

Year ended 31 Dec, HK\$m	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	206.5	579.9	822.7	620.4	804.3	1,086.5	44.3
Accounts receivable	290.4	314.3	256.9	224.8	280.7	332.2	(8.2)
Inventory	314.5	402.4	462.7	520.3	412.8	456.5	18.2
Other current assets	2.4	0.0	0.0	0.0	0.0	0.0	N/A
Total current assets	813.8	1,296.6	1,542.3	1,365.5	1,497.8	1,875.1	18.8
Net fixed assets	86.7	115.8	167.7	275.3	295.1	317.0	46.9
Other long-term assets	28.4	49.5	123.9	314.5	246.2	314.5	122.6
Total assets	928.9	1,461.9	1,833.9	1,955.2	2,039.1	2,506.5	28.1
Short-term debt	133.5	9.6	0.0	0.0	0.0	0.0	N/A
Accounts payable	438.6	424.3	695.8	685.3	637.9	788.5	16.0
Other current liabilities	112.8	4.8	10.3	18.4	18.5	18.4	(45.3)
Total current liabilities	684.9	438.7	706.1	703.7	656.4	806.9	0.9
Long-term debt	0.0	0.0	0.0	0.0	0.0	0.0	N/A
Other long-term liabilities	0.0	0.0	0.0	(0.0)	(0.0)	(0.0)	N/A
Total liabilities	684.9	438.7	706.1	703.7	656.4	806.9	0.9
Shareholders equity	196.0	1,019.9	1,120.1	1,245.0	1,382.8	1,699.6	85.1
Minorities	47.9	3.3	7.7	6.5	6.5	6.5	(48.6)
Total equity and liabilities	881.0	1,458.6	1,826.2	1,948.7	2,039.1	2,506.5	30.3

Sources: The Company and Sun Hung Kai Financial

Figure 75: SIM- Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	216.7	73.5	25.7	(15.3)	10.5	11.4	22.7
EBIT growth – %	389.9	44.0	25.2	(34.4)	17.6	14.9	5.8
Net-profit growth – %	399.5	89.7	26.4	(35.4)	15.4	14.9	15.7
EPS growth – %	399.3	62.2	10.4	(35.8)	15.4	14.9	4.8
Profitability ratios							
Gross margin – %	16.3	16.3	14.7	14.2	14.4	15.0	15.1
Operating margin – %	13.9	11.5	11.5	8.9	9.4	9.7	10.6
Net margin – %	9.9	10.8	10.9	8.3	8.7	9.0	10.0
ROAA – %	22.4	24.7	22.6	12.7	13.9	14.1	20.0
ROAE – %	130.2	48.5	34.8	20.4	21.2	20.7	34.6
Other ratios							
Capex/sales – %	7.6	2.7	6.2	14.5	6.2	5.6	7.8
Capex/depreciation – %	326.3	135.6	234.1	244.7	103.0	93.6	204.8
Operating expenses/sales – %	(4.5)	(7.2)	(5.9)	(8.8)	(8.0)	(8.3)	(7.3)
Net debt/equity (net cash) – %	(54.2)	(55.9)	(73.4)	(49.8)	(58.2)	(63.9)	(59.7)
Inventory/sales – %	20.1	14.8	13.5	18.0	12.9	12.8	15.4
Effective tax rate – %	6.3	4.4	4.8	6.2	8.0	8.0	5.1
ROAA component analysis							
Revenue/average assets – %	225.8	227.5	207.5	152.9	160.3	156.9	196.0
COGS/average assets – %	(189.0)	(190.5)	(176.9)	(131.2)	(137.2)	(133.3)	(166.2)
Gross profit/average assets – %	36.9	37.0	30.6	21.7	23.2	23.6	29.8
Operating expenses/average assets – %	(10.1)	(16.5)	(12.3)	(13.5)	(12.8)	(13.0)	(14.1)
Other operating income/average assets – %	4.5	5.6	5.5	5.4	4.8	4.7	5.5
Operating profit/average assets – %	31.3	26.2	23.8	13.6	15.1	15.3	21.2
Finance expenses/average assets – %	(0.7)	(0.4)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)
PBT/average assets – %	30.7	25.8	23.8	13.5	15.1	15.3	21.0
Tax/average assets – %	(1.9)	(1.1)	(1.1)	(0.8)	(1.2)	(1.2)	(1.0)
Net profit/average assets – %	22.4	24.7	22.6	12.7	13.9	14.1	20.0
ROAE component analysis							
Revenue/average equity – %	1,311.5	447.3	319.5	245.0	243.7	231.4	337.3
COGS/average equity – %	(1,097.3)	(374.5)	(272.4)	(210.3)	(208.5)	(196.6)	(285.7)
Gross profit/average equity – %	214.2	72.8	47.1	34.7	35.2	34.8	51.5
Operating expenses/average equity – %	(58.6)	(32.4)	(19.0)	(21.6)	(19.5)	(19.2)	(24.3)
Other operating income/average equity – %	26.3	11.1	8.5	8.6	7.3	6.9	9.4
Operating profit/average equity – %	181.9	51.5	36.6	21.7	23.0	22.5	36.6
Finance expenses/average equity – %	(4.0)	(0.7)	(0.0)	(0.0)	(0.0)	(0.0)	(0.3)
PBT/average equity – %	178.0	50.7	36.6	21.7	23.0	22.5	36.3
Tax/average equity – %	(11.3)	(2.2)	(1.7)	(1.3)	(1.8)	(1.8)	(1.8)
Net profit/average equity – %	130.2	48.5	34.8	20.4	21.2	20.7	34.6

Sources: The Company and Sun Hung Kai Financial

Xinyi Glass (868.HK)**Analyst: Vivien Chan**
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Xinyi is the largest auto-glass exporter in China and benefits from the global trend to outsource auto-glass production to the PRC. Most exports are of auto glass for the after-markets in the U.S., Europe, Africa etc. Customers include auto dealers and some large OEM auto-glass manufacturers that have outsourced their after-market glass production to Xinyi. Currently, auto-glass sales make up 62% of total sales, and the company has about a 15% share of the global auto-glass aftermarket and a 30% share of China's auto-glass aftermarket.

Xinyi also integrating upstream by producing float glass (18% of FY07 sales), the raw material for auto and construction glass (20% of FY07 sales) as well as other downstream glass products. This gives Xinyi in-house control over the quality and cost of raw materials. Completion of its float-glass production lines has also coincided with the bottoming of the float-glass price cycle.

Xinyi's auto glass should continue to benefit from strong growth in the overseas aftermarket and the domestic OEM and aftermarket businesses. Its Solar-X low-e auto glasses and solar-energy glass could benefit from the policy objectives outlined in China's 11th Five Year Plan. The mainland's new energy-conservation law requires that by 2010 one-third of new construction projects have to meet the 50% energy-conservation standard, with windows accounting for half the energy loss of buildings. Xinyi's low-e construction glass could benefit from this and become a major earnings contributor. Xinyi's high-margin ultra-clear photovoltaic glass started production in 3Q07, and is used in the solar-energy industry. This could also benefit from increasing awareness of environmental protection, given rising energy costs.

The auto-glass gross margin stayed flat at 41.4% in FY07, despite the tough business environment, due to effective cost controls. The construction-glass gross margin improved by a substantial 6.4 pts to 34.7%, on much higher ASPs. The float-glass business generated a gross profit of HK\$165.8m, up 233.6%, for a gross margin of 33.7% (vs. 24.1% in FY06). Xinyi's net profit rose 72.8% yoy to HK\$670.9m, with the net margin expanding 4.1 pts to 24.2%.

Major risks include high raw-material prices and RMB appreciation. Heavy oil accounts for around 1/3 of float-glass COGS and 8% of overall COGS, so a significant rise in oil prices would likely hit costs significantly. About 60% of revenue is in US dollars and 80% of costs are in RMB, so Xinyi would suffer from RMB appreciation. However, increasing its proportion of domestic sales would lessen this impact.

Figure 76: Xinyi Glass - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit –HKDm	235.8	260.1	388.2	670.9	986.6	1,345.4
Net-profit growth - %	27.2	10.3	49.3	72.8	47.1	36.4
EPS –HKD cents	21.4	17.3	24.6	41.1	56.0	78.0
EPS growth – %	29.7	(19.2)	42.2	67.1	36.3	39.3
P/E – X	29.7	33.8	23.8	14.2	10.4	7.5
DPS –HKD cents	0.0	3.0	11.0	19.0	24.0	31.0
Dividend yield – %	0.0	0.5	1.9	3.2	4.1	5.3
BVPS –HKD	N/A	1.1	1.4	2.3	2.7	3.3
P/B – X	N/A	5.4	4.2	2.5	2.2	1.8
Oper. cash flow / share –HKD cents	N/A	15.0	23.0	26.1	50.3	57.2
FCF/share –HKD cents	N/A	(32.7)	(5.4)	(52.5)	(7.7)	5.0
Free cash flow yield – %	N/A	(5.6)	(0.9)	(9.0)	(1.3)	0.8
Net debt per share –HKD cents	N/A	18.0	29.6	24.1	65.8	76.1
Net debt/ price – %	N/A	3.1	5.1	4.1	11.2	13.0
Issued shares – millions	N/A	1,542.9	1,604.7	1,723.4	1,723.4	1,723.4

Sources: Bloomberg and Sun Hung Kai Financial

Figure 77: Investment Highlights for Xinyi Glass



 Key investment positive	 Key investment negatives
<ul style="list-style-type: none"> ▪ As the largest PRC auto-glass exporter (55% of total sales), it benefits from the global trend for outsourcing production to China. ▪ 10-12% increase in product prices after the export-tax rebate cut in July 2007 demonstrates strong pricing power. ▪ More international automakers establishing PRC production facilities will expand the auto-glass market. ▪ Capacity expansion in 2008 and 2009, including float-glass lines; low-e glass lines and expanding into the auto-glass aftermarket, can increase vertical integration and help the company better capture growth opportunities. ▪ A rebound in float-glass prices would benefit the company, as a portion of its huge new capacity is aimed at sales to third parties. ▪ The increasing number of building projects in China will drive demand for its construction-glass products. ▪ The environmentally friendly and energy-saving features of its major construction-glass product, 'low-e coated glass,' are in line with the policy objectives outlined in China's 11th Five Year Plan. Solar X, another low-e glass for autos, also benefits from greater environmental-protection concerns. ▪ As a leading player in the auto-glass aftermarket, its economies of scale offer a cost advantage, with 20-30% lower product prices than its competitors. ▪ Strong R&D, distribution network and production scale can raise entry barriers. ▪ Hiring a glass specialist, Mr. J.J. Yang, as R&D head will further enhance R&D, while the launch of a high-quality auto glass, Solar X, provides a platform for Xinyi to become a technology leader in the industry. ▪ New solar-glass products could drive long-term growth as solar energy becomes more popular. ▪ Goldman Sachs' acquisition of a 10% stake in Fuyao Glass (a major PRC auto-glass maker) has triggered a re-rating in the industry. 	<ul style="list-style-type: none"> ▪ Trade barriers to PRC exports. The company has suffered anti-dumping actions three times, from the U.S., Canada and the Philippines. ▪ Aggressive capacity expansion may cause float-glass oversupply. Fuyao Glass is set to finish two float-glass production lines in Hainan with a combined capacity of 300,000 tons/year, raising total capacity 50%. ▪ Rising heavy-oil prices, which account for 30% of float-glass COGS, can reduce its gross margin. ▪ Rising PRC labor costs would have a negative effect on margins. We estimate a 1% rise in labor costs would cut its net profit 0.18% in FY07 and 0.17% in FY08. ▪ Huge capex of around RMB1,200m in 2008 may cause the company to raise funds in the market. ▪ Breaking into the OEM market a lengthy process. ▪ Heavy reliance on a few large suppliers. ▪ Xinyi's effective tax rate in FY06 was 4%, including tax exemptions. The expiration of its tax holidays, and tax unification to 25% in FY08 from the existing 15% (with a grace period of five years), would expose its bottom line to the risk of a higher tax rate. ▪ High execution risk in the new photovoltaic-glass business, where Xinyi has little experience.

Figure 78: Xinyi Glass - Profit and Loss Statement

Year ended 31 Dec, HKDm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	1,028.3	1,380.8	1,933.2	2,774.6	4,198.3	6,087.6	36.4
COGS	(654.8)	(901.7)	(1,233.0)	(1,702.3)	(2,619.9)	(3,932.6)	33.9
Gross profit	373.6	479.0	700.2	1,072.4	1,578.4	2,155.0	40.9
Operating expenses	(146.1)	(221.7)	(342.4)	(461.7)	(640.3)	(995.7)	51.6
Other operating income	25.2	18.7	29.6	71.6	69.2	66.2	72.4
Operating profit	252.6	276.1	387.4	682.2	1,013.3	1,378.3	37.2
Finance expenses	(1.5)	(2.6)	(11.5)	(33.8)	(28.1)	(29.6)	142.3
PBT	251.6	279.9	401.8	703.2	1,053.3	1,466.4	37.9
Tax	(14.7)	(19.5)	(16.0)	(30.2)	(66.7)	(121.0)	35.9
Net profit	235.8	260.1	388.2	670.9	986.6	1,345.4	37.9
EPS – RMB fen	21.4	17.3	24.6	41.1	56.0	78.0	25.6

Sources: The Company and Sun Hung Kai Financial

Figure 79: Xinyi Glass - Balance Sheet

Year ended 31 Dec, HKDm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	223.7	129.8	162.3	309.5	466.3	588.6	18.7
Accounts receivable	228.8	334.6	486.7	593.7	775.9	1,113.8	40.6
Inventory	166.0	254.4	432.3	568.2	627.7	897.6	37.7
Other current assets	72.1	52.5	107.9	87.7	147.8	265.1	(12.0)
Total current assets	690.6	771.3	1,189.3	1,559.1	2,017.7	2,865.1	26.3
Net fixed assets	756.6	1,384.1	1,918.6	3,415.8	4,184.3	5,188.5	73.9
Other long-term assets	160.7	245.6	137.2	395.6	1,160.3	1,885.5	72.9
Total assets	1,608.0	2,401.0	3,245.0	5,370.5	7,362.3	9,939.1	51.1
Short-term debt	491.9	293.0	573.4	464.7	600.0	600.0	25.4
Accounts payable	63.3	71.4	103.4	143.7	322.5	483.8	29.3
Other current liabilities	92.9	160.9	242.0	456.4	1,096.2	1,803.0	21.2
Total current liabilities	648.1	525.3	918.8	1,064.7	2,018.7	2,886.7	24.0
Long-term debt	160.3	125.6	79.9	259.9	1,000.0	1,300.0	N/A
Other long-term liabilities	0.5	0.1	0.0	0.3	(340.7)	44.5	(7.9)
Total liabilities	808.9	651.0	998.7	1,325.0	2,678.0	4,231.2	30.9
Shareholders equity	722.0	1,672.9	2,246.3	4,045.5	4,684.3	5,707.9	62.6
Minorities	2.1	2.5	(1.7)	0.4	4.0	4.0	(26.9)
Total equity and liabilities	1,530.8	2,323.9	3,245.0	5,370.5	7,362.3	9,939.1	51.1

Sources: The Company and Sun Hung Kai Financial

Figure 80: Xinyi Glass - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	28.4	34.3	40.0	43.5	51.3	45.0	36.4
EBIT growth – %	31.2	9.3	40.3	76.1	48.5	36.0	37.2
Net-profit growth – %	27.2	10.3	49.3	72.8	47.1	36.4	37.9
EPS growth – %	29.7	(19.2)	42.2	67.1	36.3	39.3	25.6
Profitability ratios							
Gross margin – %	36.3	34.7	36.2	38.6	37.6	35.4	36.5
Operating margin – %	24.6	20.0	20.0	24.6	24.1	22.6	22.3
Net margin – %	22.9	18.8	20.1	24.2	23.5	22.1	21.5
ROAA – %	17.9	13.0	13.8	15.6	15.5	15.6	15.0
ROAE – %	36.3	21.7	19.8	21.3	22.6	25.9	24.8
Other ratios							
Capex/sales – %	51.5	53.3	23.6	N/A	23.8	14.8	42.8
Capex/depreciation – %	1,497.4	1,327.3	482.6	N/A	481.7	265.4	1,102.4
Net debt/equity (net cash) – %	55.9	16.6	21.2	10.3	24.2	23.0	26.0
Inventory/sales – %	16.1	18.4	22.4	20.5	15.0	14.7	19.4
Effective tax rate – %	5.8	7.0	4.0	4.3	6.3	8.3	5.3
ROAA component analysis							
Revenue/average assets – %	78.0	68.9	68.5	64.4	65.9	70.4	69.9
COGS/average assets – %	(49.7)	(45.0)	(43.7)	(39.5)	(41.2)	(45.5)	(44.5)
Gross profit/average assets – %	28.3	23.9	24.8	24.9	24.8	24.9	25.5
Operating expenses/average assets – %	(11.1)	(11.1)	(12.1)	(10.7)	(10.1)	(11.5)	(11.2)
Other operating income/average assets – %	1.9	0.9	1.1	1.7	1.1	0.8	1.4
Operating profit/average assets – %	19.2	13.8	13.7	15.8	15.9	15.9	15.6
Finance expenses/average assets – %	(0.1)	(0.1)	(0.4)	(0.8)	(0.4)	(0.3)	(0.4)
PBT/average assets – %	19.1	14.0	14.2	16.3	16.5	17.0	15.9
Tax/average assets – %	(1.1)	(1.0)	(0.6)	(0.7)	(1.0)	(1.4)	(0.8)
Net profit/average assets – %	17.9	13.0	13.8	15.6	15.5	15.6	15.0
ROAE component analysis							
Revenue/average equity – %	158.2	115.3	98.7	88.2	96.2	117.2	115.1
COGS/average equity – %	(100.7)	(75.3)	(62.9)	(54.1)	(60.0)	(75.7)	(73.3)
Gross profit/average equity – %	57.5	40.0	35.7	34.1	36.2	41.5	41.8
Operating expenses/average equity – %	(22.5)	(18.5)	(17.5)	(14.7)	(14.7)	(19.2)	(18.3)
Other operating income/average equity – %	3.9	1.6	1.5	2.3	1.6	1.3	2.3
Operating profit/average equity – %	38.9	23.1	19.8	21.7	23.2	26.5	25.8
Finance expenses/average equity – %	(0.2)	(0.2)	(0.6)	(1.1)	(0.6)	(0.6)	(0.5)
PBT/average equity – %	38.7	23.4	20.5	22.4	24.1	28.2	26.2
Tax/average equity – %	(2.3)	(1.6)	(0.8)	(1.0)	(1.5)	(2.3)	(1.4)
Net profit/average equity – %	36.3	21.7	19.8	21.3	22.6	25.9	24.8

Sources: The Company and Sun Hung Kai Financial

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Yanzhou Coal Mining is the third largest coal producer in China.

In 2007, Yanzhou Coal produced 35.64 million tons of raw coal, 1.4% of China's production, and sold 35.11 million tonnes of coal, of which 3.16 million tonnes were exported. Yanzhou Coal is headquartered in Shandong, which is near coastal areas and where expansion prospects are limited because of higher costs of production and less abundant coal resources. The company is therefore looking elsewhere for coal-production capacity growth, such as Shanxi, Shaanxi and Australia. These expansion projects are expected to eventually increase annual coal-production capacity by 24 million tons by 2010. Yanzhou Coal's mines are close to consumers in Shanghai and Beijing and to major export ports. The company therefore benefits from a lack of local infrastructure and the bottlenecks that have limited coal sales from Shanxi and Inner Mongolia.

Yanzhou has significant coal exports, which accounted for 9% of 2007 coal sales. The company has a wider product mix than its larger peers, with 33% of coal production made up of higher-value coking coal in 2007, one reason behind its higher ASP.

Yanzhou Coal generated a gross margin of 47.8%, EBIT margin 29.4% and net margin of 21.4% for FY07. Earnings growth will be driven by spot-price increases in the domestic coal market. Improving utilization of existing coal mines is not an option because they are already producing at full capacity. In the longer term, Yanzhou's earning growth will come from new coal-mine projects and the resulting production growth. However, there are uncertainties as to how Yanzhou would assimilate new mine operations, as these are outside Shandong (in Shanxi, Shaanxi and Australia).

The China coal market is very fragmented, and the PRC government plans to consolidate the market. In addition, coal is expected to remain an important source of energy for China. As Yanzhou Coal is smaller than its peers it would be more difficult for the company to acquire new coal mines, except through asset injection from its parent company. However, given its low leverage (total assets/equity was 1.22X at end-FY07) and plenty of cash on hand (RMB5,719m at end-FY07), it would not be a surprise if Yanzhou Coal bought overseas coal mines or smaller local coal companies.

Figure 81: Yanzhou Coal - Earnings Summary

Year ending 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F
Net profit – RMBm	3,154.3	2,881.5	2,373.0	3,230.5	5,259.6	6,027.0
Net-profit growth - %	127.5	(8.7)	(17.6)	36.1	62.8	14.6
EPS –RMB fen	66.0	59.0	48.0	66.0	106.9	122.5
EPS growth – %	120.0	(10.6)	(18.6)	37.5	62.0	14.6
P/E – X	17.9	20.0	24.6	17.9	11.0	9.6
DPS –RMB fen	16.3	15.0	12.0	17.0	20.4	22.4
Dividend yield – %	1.4	1.3	1.0	1.4	1.7	1.9
BVPS –RMB	3.2	3.6	3.9	4.4	5.0	5.8
P/B – X	3.7	3.3	3.1	2.7	2.4	2.0
Oper. cash flow per share – RMB fen	89.8	80.1	76.6	92.7	118.3	151.4
FCF/share –RMB fen	74.7	53.3	12.8	36.1	44.1	95.8
Free cash flow yield – %	6.3	4.5	1.1	3.1	3.7	8.1
Net debt per share –RMB fen	(97.9)	(142.6)	(109.2)	(106.8)	(122.4)	(160.2)
Net debt/ price – %	(8.3)	(12.1)	(9.3)	(9.1)	(10.4)	(13.6)
Issued shares – millions	4,918.4	4,918.4	4,918.4	4,918.4	4,918.4	4,918.4

Sources: Bloomberg and Sun Hung Kai Financial

Figure 82: Investment Highlights for Yanzhou Coal



 Key investment positive	 Key investment negatives
<ul style="list-style-type: none"> ▪ Yanzhou Coal (YC) is the third largest coal producer in China and benefits from the national policy of coal-industry consolidation in terms of expansion opportunities. ▪ The company has a very focused business of producing and selling coal. This allows it to concentrate on these businesses. ▪ Yanzhou has a larger proportion of export sales than its peers (9% for FY07), its clientele is more internationally diverse and it has a wider product mix. ▪ The coal produced is of higher quality as 70% is thermal coal with coke content, which should command a premium. Furthermore, the high quality of its coal products should provide better growth potential. ▪ Yanzhou Coal's headquarters are in coastal Shandong with a 20% market share in the province; the company is close to its coal consumers and hence transport costs are lower and less affected by bottlenecks. ▪ About 20% of production is coking coal, prices of which have surged 55% during the 1H08. Coking coal prices have not been capped by the NDRC and there is still room for price increases as supply remains tight. ▪ 1Q08 core earnings rose 112% yoy to RMB1.49bn, due to a 51.6% jump in average coal sales prices to RMB580.3/ton. ▪ The operating margin increased from 29% to 37% due to a 52% surge in ASP and 3% rise in sales. ▪ We expect the net profit to increase 63% in FY08 as price gains should outpace cost increases. ▪ Concerns about limited growth at existing mines in Shandong have eased (60% of FY07 sales volume), as the company is expanding outside Shandong, including to Shanxi, Shaanxi and Australia. ▪ Leverage is relatively low, allowing Yanzhou Coal to expand more aggressively by gearing up its balance sheet. ▪ The company is cash rich, with cash on hand of RMB5,719m and no bank borrowings at end-FY07. ▪ Coal-sales growth exceeded raw-coal production growth in FY07, indicating Yanzhou Coal has a solid client base to absorb its production-capacity growth. ▪ The stock traded at a 33% P/E discount to its PRC coal peers in June 2008. 	<ul style="list-style-type: none"> ▪ Benefits less from strong domestic thermal-coal contract prices in 2008, as it has more spot-sales exposure. 28% of sales volume is contract sales vs. over 80% for Shenhua and China Coal. Thermal-coal contract prices could enjoy greater upside than spot prices given the large gap. ▪ Lack of asset-injection opportunities from its parent. ▪ Volume uncertainty. Slower sales from mines at its headquarters due to the need to relocate villages (90% of production volume in 2007), and from Australia due to port congestion and railway constraints (5% of production volume in 2007). ▪ Yanzhou Coal is significantly smaller than the top two coal producers in China. It is at a disadvantage when competing for coal resources vs. larger competitors. ▪ The Chinese government has become less friendly toward exporting coal, as can be seen from the cancellation of the export-tax rebate. ▪ Demand for coking coal is more cyclical than that for thermal coal. Around one-third of production is coking coal. ▪ The company does not have a coal-export license; it has to rely on other license holders. ▪ Yanzhou Coal may face difficulties expanding outside Shandong; it takes more time to assimilate new operations. ▪ Weak cost controls. Yanzhou Coal has had a hard time controlling costs in the past few years. ▪ The Chinese government's pricing constraints and halting of exports add uncertainty to Yanzhou Coal's ability to capture higher spot prices. ▪ Shorter mine life means that earnings sustainability is at risk, with the potential for lower volumes and higher costs. Existing mines have an estimated reserve life of 14.6 years vs. in excess of 40 years for its peers. ▪ Around 55-60% of Yanzhou Coal's domestic coal sales are in the spot market, making it the most leveraged play to continued spot-price rises.

Figure 83: Yanzhou Coal - Profit and Loss Statement

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Revenue	11,977.8	12,447.0	12,944.0	15,110.5	19,794.7	22,763.9	21.4
COGS	(5,954.4)	(6,218.7)	(7,126.7)	(7,881.7)	(10,273.5)	(11,837.2)	20.4
Gross profit	6,023.4	6,228.3	5,817.3	7,228.7	9,521.3	10,926.7	22.7
Operating expenses	(1,353.2)	(1,819.6)	(2,144.3)	(2,876.5)	(2,573.3)	(2,959.3)	23.4
Other operating income	40.9	38.9	65.2	88.2	92.6	97.3	16.0
Operating profit	4,711.2	4,447.6	3,738.2	4,440.4	7,040.6	8,064.6	22.0
Finance expenses	(35.9)	(24.6)	(26.3)	(27.2)	(27.8)	(28.6)	(17.9)
PBT	4,673.3	4,420.0	3,726.6	4,543.3	7,012.8	8,036.0	23.2
Tax	(1,518.8)	(1,538.0)	(1,354.7)	(1,315.5)	(1,753.2)	(2,009.0)	22.3
Net profit	3,154.3	2,881.5	2,373.0	3,230.5	5,259.6	6,027.0	23.5
EPS – RMB fen	66.0	59.0	48.0	66.0	106.9	122.5	21.8

Sources: The Company and Sun Hung Kai Financial

Figure 84: Yanzhou Coal - Balance Sheet

Year ended 31 Dec, RMBm	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR (%)
Cash and securities	5,216.7	7,211.9	5,910.5	5,719.5	6,291.5	8,178.9	29.7
Accounts receivable	1,223.8	2,224.8	2,211.9	2,753.5	3,563.0	4,097.5	22.1
Inventory	485.4	470.5	579.6	440.1	593.8	660.2	(3.2)
Other current assets	1,393.6	1,043.9	1,170.0	995.1	989.7	2,731.7	11.1
Total current assets	8,319.6	10,951.2	9,871.9	9,908.2	11,438.1	15,668.3	22.4
Net fixed assets	9,115.7	9,898.3	12,718.9	14,101.0	17,626.3	18,155.1	11.2
Other long-term assets	901.4	405.0	867.9	2,178.2	396.0	0.0	68.3
Total assets	18,336.7	21,254.4	23,458.8	26,187.4	29,460.4	33,823.3	17.1
Short-term debt	200.0	200.0	209.6	211.1	236.4	264.8	1.4
Accounts payable	478.3	497.7	586.1	518.4	622.1	696.8	4.9
Other current liabilities	1,866.8	2,731.4	3,032.4	3,370.0	3,740.7	4,189.5	17.9
Total current liabilities	2,545.1	3,429.0	3,828.0	4,099.5	4,599.2	5,151.1	14.7
Long-term debt	200.0	0.0	330.0	258.0	270.9	298.0	(10.4)
Other long-term liabilities	64.2	178.1	307.0	341.3	0.0	0.0	61.0
Total liabilities	2,809.3	3,607.1	4,465.0	4,698.8	4,870.1	5,449.1	13.6
Shareholders equity	15,527.4	17,647.3	18,993.7	21,488.6	24,590.3	28,374.2	18.0
Minorities	3.7	28.7	62.0	71.1	78.2	86.0	108.8
Total equity and liabilities	18,336.7	21,254.4	23,458.7	26,187.4	29,460.4	33,823.3	17.1

Sources: The Company and Sun Hung Kai Financial

Figure 85: Yanzhou Coal - Key Ratios

Year ended 31 Dec	FY04	FY05	FY06	FY07	FY08F	FY09F	FY04-07 CAGR/ average (%)
Growth ratios							
Revenue growth – %	72.4	3.9	4.0	16.7	31.0	15.0	21.4
EBIT growth – %	135.1	(5.6)	(16.0)	18.8	58.6	14.5	22.0
Net-profit growth – %	127.5	(8.7)	(17.6)	36.1	62.8	14.6	23.5
EPS growth – %	120.0	(10.6)	(18.6)	37.5	62.0	14.6	21.8
Profitability ratios							
Gross margin – %	50.3	50.0	44.9	47.8	48.1	48.0	48.3
Operating margin – %	39.3	35.7	28.9	29.4	35.6	35.4	33.3
Net margin – %	26.3	23.1	18.3	21.4	26.6	26.5	22.3
ROAA – %	19.6	14.6	10.6	13.0	18.9	19.0	14.4
ROAE – %	23.7	17.4	13.0	16.0	22.8	22.8	17.5
Other ratios							
Capex/sales – %	6.2	10.6	24.2	18.4	18.4	12.0	14.9
Capex/depreciation – %	76.5	136.3	291.6	222.6	253.5	172.9	181.7
Net debt/equity (net cash) – %	(31.0)	(39.7)	(28.3)	(24.4)	(24.5)	(27.8)	(30.9)
Inventory/sales – %	4.1	3.8	4.5	2.9	3.0	2.9	3.8
Effective tax rate – %	32.5	34.8	36.4	29.0	25.0	25.0	33.2
ROAA component analysis							
Revenue/average assets – %	74.3	62.9	57.9	60.9	71.1	71.9	64.0
COGS/average assets – %	(36.9)	(31.4)	(31.9)	(31.8)	(36.9)	(37.4)	(33.0)
Gross profit/average assets – %	37.4	31.5	26.0	29.1	34.2	34.5	31.0
Operating expenses/average assets – %	(8.4)	(9.2)	(9.6)	(11.6)	(9.2)	(9.4)	(9.7)
Other operating income/average assets – %	0.3	0.2	0.3	0.4	0.3	0.3	0.3
Operating profit/average assets – %	29.2	22.5	16.7	17.9	25.3	25.5	21.6
Finance expenses/average assets – %	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
PBT/average assets – %	29.0	22.3	16.7	18.3	25.2	25.4	21.6
Tax/average assets – %	(9.4)	(7.8)	(6.1)	(5.3)	(6.3)	(6.3)	(7.1)
Net profit/average assets – %	19.6	14.6	10.6	13.0	18.9	19.0	14.4
ROAE component analysis							
Revenue/average equity – %	90.0	75.0	70.7	74.7	85.9	86.0	77.6
COGS/average equity – %	(44.7)	(37.5)	(38.9)	(38.9)	(44.6)	(44.7)	(40.0)
Gross profit/average equity – %	45.3	37.5	31.8	35.7	41.3	41.3	37.6
Operating expenses/average equity – %	(10.2)	(11.0)	(11.7)	(14.2)	(11.2)	(11.2)	(11.8)
Other operating income/average equity – %	0.3	0.2	0.4	0.4	0.4	0.4	0.3
Operating profit/average equity – %	35.4	26.8	20.4	21.9	30.6	30.5	26.1
Finance expenses/average equity – %	(0.3)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)
PBT/average equity – %	35.1	26.6	20.3	22.4	30.4	30.3	26.1
Tax/average equity – %	(11.4)	(9.3)	(7.4)	(6.5)	(7.6)	(7.6)	(8.6)
Net profit/average equity – %	23.7	17.4	13.0	16.0	22.8	22.8	17.5

Sources: The Company and Sun Hung Kai Financial

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