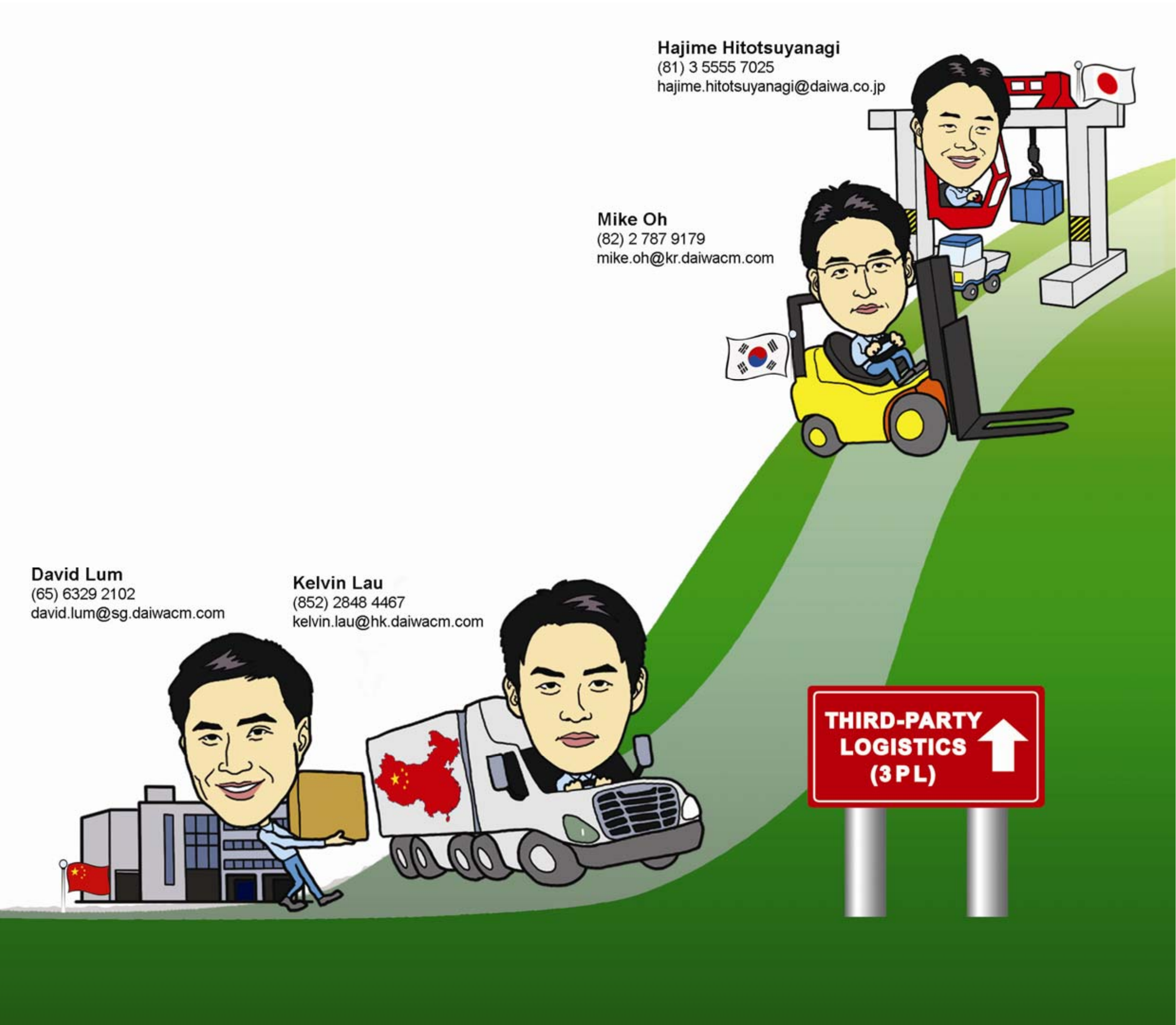
The 10-second briefing

Initiation: ready to move up in the world

- We see the development of China's logistics industry in the next decade following the path established by the US, Japan and Korea
- Given a growing need for cost savings, emerging 3PL services and a demand boost from e-commerce should be major sector drivers
- Positive rating; top pick Sinotrans; also recommend SZI, CIMC

China Logistics Sector

- Positive (initiation)
- Neutral
- Negative



Daiwa Capital Markets

Sector

Industrials / China
16 December 2013

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■ Investment case

We see strong demand-growth potential in the China Logistics Sector over the next decade, as companies will have to find ways to reduce costs to counter the impact of a slowdown in economic growth. In addition, we expect new demand to emerge from e-commerce, continuing industry migration inland, and rising domestic consumption. We initiate coverage of the sector with a Positive rating.

■ Catalysts

With reference to the development of the logistics industries in Japan, Korea, and the US, we expect to see the following trends in China.

Emergence of third-party logistics (3PL) services. We believe 3PL services will be a trend in China in the next decade, as Daiwa expects top-line growth for most China companies to slow and cost inflation, especially for labour, to continue. Thus, we believe more companies will outsource logistics management to maintain their margins.

E-commerce should spur demand. The increasing popularity of e-commerce, especially in the business-to-consumer (B2C) segment, has created new demand for logistic services. We believe the bottleneck in developing countries such as China is in the logistics flow from order to delivery.

Large integrators likely to be established. Big integrators like DHL, Fedex and UPS dominate logistics in the US, while Nippon Express and Yamato are the big players in Japan. We believe a few large integrators are poised to emerge in China.

■ What we recommend

We recommend that investors capitalise on China's logistics growth wave that we believe has just begun, and invest in the sector to benefit from a likely long-term rerating.

Our top pick is **Sinotrans** (598 HK) and we initiate coverage with a Buy (1) rating and six-month target price of HKD3.30. The company is the leading freight forwarder in China and we expect it to be rerated on the back of rising 3PL services demand.

We also like **Shenzhen International (SZI)** (152 HK) given its plan to develop several integrated logistics hubs, and initiate coverage with a Buy (1) call and target price of HKD1.30. We initiate coverage on logistics equipment provider **China International Marine Containers (CIMC)** (2039 HK) with a Buy (1) call and six-month target price of HKD20. SZI and CIMC should benefit from their landbanks in Qianhai, which we estimate are worth HKD0.6/share and HKD6.6/share to their respective NAVs.

We reaffirm our Buy call on **SITC International,** and our Outperform on **Global Logistic Properties.**

■ Risks

The main risk would be manufacturers moving from China to ASEAN, followed by competition from foreign logistics players in China, and weaker-than-expected economic growth in China.

Key stock calls

	New	Prev.
Sinotrans (598 HK)		
Rating	Buy	
Target	3.30	
Upside	▲ 38.7%	
SITC International (1308 HK)		
Rating	Buy	Buy
Target	4.00	3.20
Upside	▲ 25%	
Shenzhen International (152 HK)		
Rating	Buy	
Target	1.30	
Upside	▲ 35.4%	
Global Logistic Properties (GLP SP)		
Rating	Outperform	Outperform
Target	3.320	3.320
Upside	▲ 14.9%	
China International Marine Containers (2039 HK)		
Rating	Buy	
Target	20.00	
Upside	▲ 33.5%	

Source: Daiwa forecasts.

Sector stocks: key indicators

		Share	Rating		Target price (local curr.)			EPS (local curr.) FY1			EPS (local curr.) FY2		
Company Name	Stock code	Price	New	Prev.	New	Prev.	% chg	New	Prev.	% chg	New	Prev.	% chg
China International Marine Containers	2039 HK	14.98	Buy		20.00			0.674			0.918		
China Merchants Holding International	144 HK	28.10	Buy	Buy	31.00	31.00	0.0%	1.564	1.564	0.0%	1.879	1.879	0.0%
Global Logistic Properties	GLP SP	2.890	Outperform	Outperform	3.320	3.320	0.0%	0.121	0.121	0.0%	0.130	0.130	0.0%
Orient Overseas International	316 HK	38.95	Outperform	Outperform	52.00	52.00	0.0%	0.300	0.300	0.0%	0.420	0.420	0.0%
Shenzhen International	152 HK	0.96	Buy		1.30			0.126			0.148		
Sinotrans	598 HK	2.38	Buy		3.30			0.185			0.225		
SITC International	1308 HK	3.20	Buy	Buy	4.00	3.20	25.0%	0.043	0.041	4.3%	0.062	0.060	4.0%

Source: Daiwa forecasts

Contents

Company Section

Rising need for better logistics services in China

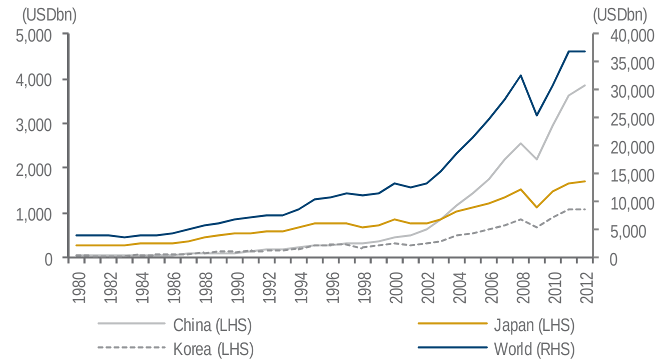
There will have to be an improvement in logistics-management efficiency to compensate for a slowdown in top-line growth and rising labour costs in China, in our view.

Efficiency has not been a focus

Strong trade-volume growth since 1980s

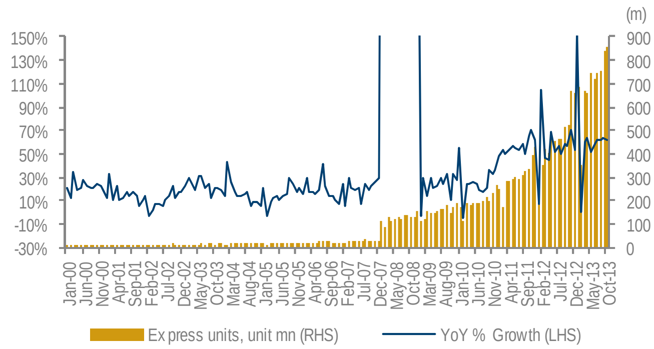
China became the factory of the world in the 1980s. The country's trade volume has increased substantially since then, and this has led to increased demand for logistics services. However, from 1980-90 the services provided focused on transportation rather than logistics management. The demand for efficient logistics services, such as courier and express services, was not high during this period of the economic boom in China, but has been increasing since 2000.

■ Trade volume by country (1980-2012)



Source: WTO, Daiwa

■ China: express volume (1999-present)

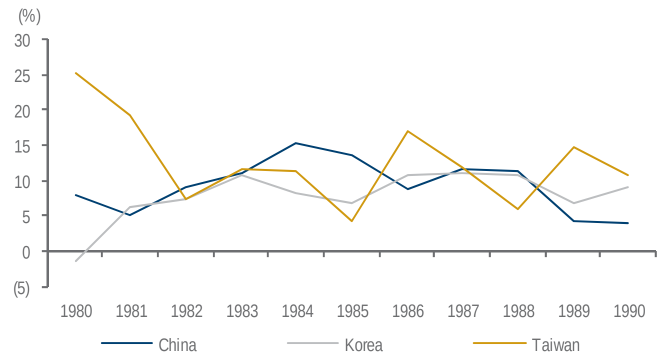


Source: CEIC
Note: The calculation method was changed in 2008

Profit driven by strong demand growth

As mentioned, reducing logistics costs by improving efficiency was not a major focus from 1980-90. The high net-profit growth generated by China manufacturers was driven by the country's strong economic growth, due partly to robust exports. China's better manufacturing net-profit margins at that time compared with other Western countries was driven mainly by cheap labour rather than industry automation or the efficient use of resources, in our view.

■ China: GDP growth (1980-90)



Source: CEIC

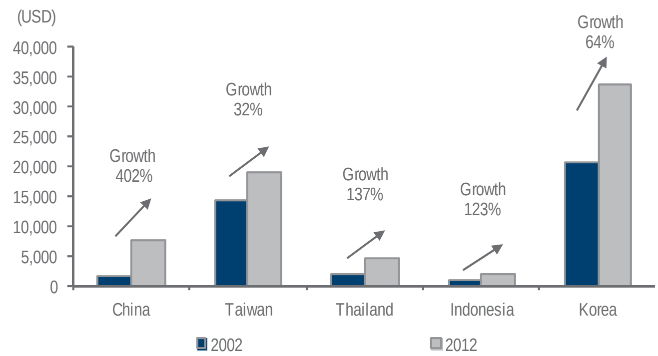
The need for efficient logistics support in order to reduce operating costs was not a high priority in China from 1980-90, as corporate earnings were driven mainly by strong top-line growth and labour was abundant and cheap.

Increasing demand due to structural economic changes

Industry migration inland is leading to strong demand for logistics services

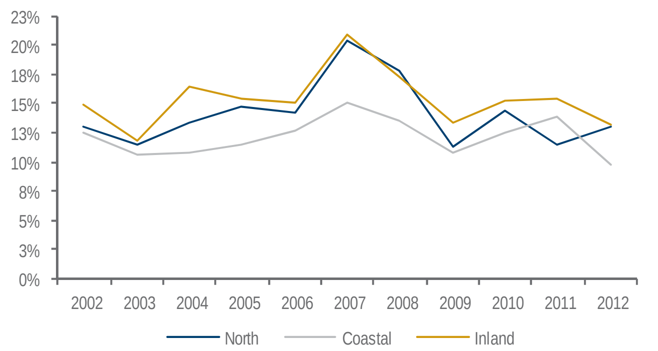
Due to rising labour costs in the coastal areas, China's manufacturing base has gradually been moving inland since early 2000, as well as to other countries in Southeast Asia (such as Vietnam, Malaysia, Thailand and Indonesia). The continuing shift of China's manufacturing base inland has created new opportunities for logistics companies, as finished goods still need to be transported back to the coastal ports to be exported. Also, the establishment of assembly lines in other Asian countries has created more demand for intra-Asia logistics services to support the transportation of components and finished goods.

■ Average annual salary per person in manufacturing sector



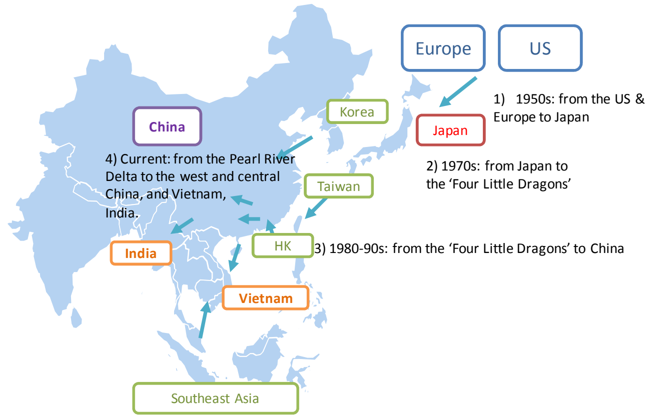
Source: CEIC

■ China: north, coastal and inland annual wage growth



Source: CEIC

■ Shifts in manufacturing base within Asia



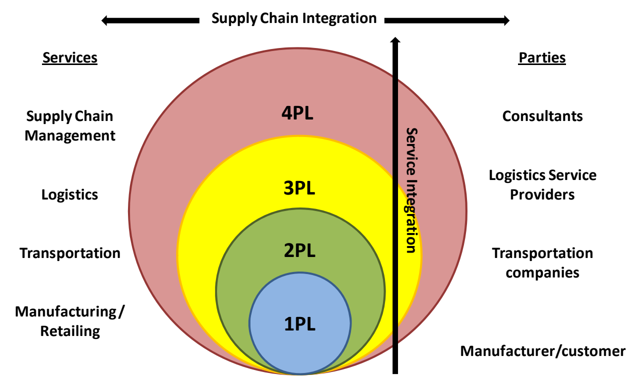
Source: Daiwa

Increasing demand for outsourcing to achieve better efficiency

In the past many China companies, especially state-owned enterprises (SOE), believed that owning a logistics network would allow them to reduce operating costs. However, many of these companies had poor management and limited economies of scale, and as such were not able to generate synergies, which led to high logistics costs in China.

The gap in the market for efficient logistics services led to room for the development of China's 3PL service segment over the past decade. (3PL is the provision of services that allow customers to outsource the entire logistics-management function, and we believe it should lead to better cost savings for companies in China that use this service.)

■ Layers of logistics services

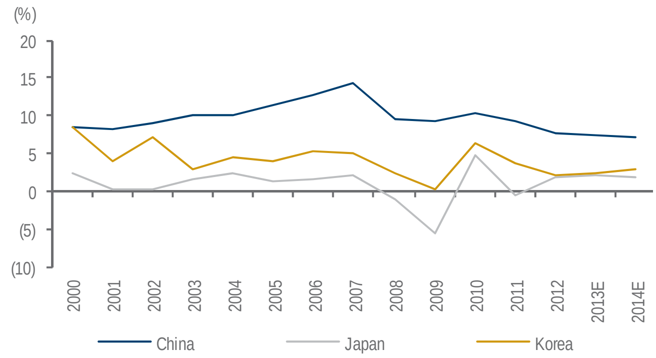


Source: Daiwa

There is growing demand for logistics-management services as a result of the ongoing migration of manufacturing from coastal to inland China, as well as the cost savings that outsourcing can bring. In our view, the emphasis on cost savings will become more important in the next decade, given Daiwa's outlook for future economic growth in China and Asia to slow. Daiwa's economics team forecasts economic growth in the likes of China, Japan and Korea to moderate in the next few years compared with the growth seen over the past decade.

We consider it reasonable to assume that slower economic growth would translate into weaker growth in demand for products and services in China, thereby putting pressure on the top-line growth of China-based companies and operations. At the same time, however, inflation and rising labour costs in China are likely to underline the importance of controlling logistics costs. As such, we think the stage is set for the further development of 3PL services in Asia, mirroring the experience seen in developed countries such as the US, Japan and Korea.

■ **GDP growth comparison: China, Japan and Korea**



Source: CEIC, Daiwa forecast

The logistics market in China

Highly fragmented, with no major integrators

The logistics industry in China currently comprises many players and lacks any major integrators. Customers have to liaise with individual companies, including trucking companies and freight forwarders, in order to ensure the logistics process runs smoothly. Not surprisingly, miscommunication among the various parties often results in service disruptions.

While some 3PL companies have been established in recent years, they are limited in scale. The major nationwide players are Sinotrans (598 HK, HKD2.38, Buy [1]), which is involved in freight forwarding and 3PL, and Shunfeng and China Postal Express and Logistics, which focus on parcel delivery.

The lack of large-scale integrators in China may explain why some companies, such as Amazon, JD.com and Vancl, have established their own logistics platforms to support their B2C distribution. In the long run, however, we believe outsourcing logistics operations will be the most cost-efficient way for many companies to handle sales and distribution.

Partially open market to stimulate local development

The lack of major integrators in China has prompted the China Government to partially open up the market to large global operators. In 2012, the government permitted Fedex to operate domestic delivery services in Shanghai, Guangzhou, Shenzhen, Hangzhou, Tianjin, Dalian, Zhengzhou and Chengdu, and UPS to carry out domestic delivery services in Shanghai, Guangzhou, Shenzhen, Tianjin and Xi'an (both companies were already conducting international delivery services in the country).

Although we have seen a modest opening-up of the domestic delivery market in China, we believe the government is unlikely to open up the market fully to international players given the ramifications for domestic operators. Rather, we believe the government's existing policy is designed to spur the development of domestic players. By allowing the global logistics companies to participate in some parts of the market, the government targets to speed up the development of the logistics network in inland China (such as Zhengzhou, Chengdu and Xian), in our view.

Although the government's policy has opened the door to increased competition in some cities, we believe the domestic players will not be adversely affected to any great extent, as the global players lack the nationwide networks that the domestic companies have. Going forward, we expect the government to open up the market at a measured pace, ie, depending on the readiness of domestic players to face competition.

In sum, we do not expect the international players to garner large market shares in China in the foreseeable future.

Under-developed infrastructure in inland provinces

The development of China's road network to date has centred on the coastal provinces. Toll roads, for example, are largely concentrated in the coastal provinces. We see ample scope for further road construction in the coming decade.

■ **China's highway density: inland vs. coastal areas (1Q12)**

	Inland			Coastal		
	Anhui	Henan	Sichuan	Guangdong	Jiangsu	Zhejiang
Highway (km)	2,969	5,196	3,000	5,049	4,120	3,500
Km/10,000 (km sq)	213	311	62	281	402	344

Source: Provincial government statistics
Note: highway density is the length of highways relative to the size of a province

Meanwhile, China's railway network is still used mostly to transport passengers rather than cargo. Although there are some railway networks in northern China dedicated to the transportation of commodities like coal, such as the Daqin railway and Shenhua railway, there is limited available capacity for the transportation of general cargo.

In the long term, the China Government intends to shift passenger traffic to the country's fledgling high-speed railway system, which would free up more rail capacity for cargo transportation. However, tickets for the high-speed railway are currently too expensive for the general public, and the number of railway passengers continues to rise fairly fast (up 5-10% YoY over 2010-12). As it stands, there is insufficient spare capacity for cargo, even with the country's high-speed rail network now up and running.

In order to encourage more passengers to take high-speed trains, the former Ministry of Railways (MOR) (now China Railway Corporation) had reduced ticket fares on some train services that had low load factors. However, as the difference in fares between high-speed trains and regular train services remains significant, we believe it will take time for passenger numbers to be boosted on high-speed trains.

■ **China: high-speed railway network (2012)**

Source: China Discovery

Supportive policy from government to rectify the situation

In 2011, the government announced several policies to support the development of the logistics industry in China. Some of the major initiatives included lowering the tax burden, improving land policy to favour logistics companies, reducing toll rates through a toll-by-weight policy, and encouraging greater integration of logistics companies via mergers and acquisitions.

These policies were augmented by further policy support announced by individual provinces, including the setting up of free-trade zones in Qianhai and Shanghai. We believe the Qianhai free-trade zone will be slightly more focused on future logistics development, while the one in Shanghai will focus more on serving as a platform for financial reforms.

■ **Supportive policies for logistics companies (announced in 2011)**

Lessen the tax burden on logistics enterprises	Relevant departments should coordinate on tax support and expand the scope of support. Combine the VAT reform and solve the problems on tax discrepancies in warehousing, distribution and freight forwarding transportation links. Improve commodity-storage facilities land-use tax policy.
Enhance support on logistics land use	Increase the land support policy on storage facilities, distribution centres, transit centres and logistics parks. Set priorities for logistics land usage and establish a timetable for such arrangements. Logistics supply of government land for construction should be included in the annual land supply plan, according to tender, auction or listing, or other ways to sell. Actively support the use of the old factories, warehouses and inventory of land resources. Establish a land compensation policy for the transfer of land use for the construction of logistics facilities or the provision of logistics services.
Promote logistics vehicle access	Reduce bridge tolls. Gradual phasing out of government-funded class 2 highway tolls, reducing the number of ordinary highway toll stations, control the scale of toll roads, optimise the toll roads' structure. Increase highway toll supervision, merge unnecessary toll stations, gradually reduce highway tolls. Amend as soon as possible the "Toll Road Management Regulations". Actively promote a toll-collection system, improve the efficiency of vehicular traffic. Pay close attention to revising and improving road transport, management methods for large objects and overloaded vehicles, travelling road regulations, codes, road-traffic management and non-compliance to government practices.
Encourage more integration of logistics companies	Support the creation of large logistics enterprises through mergers and acquisitions, and of decentralised logistics facilities to integrate resources; encourage small and medium-sized logistics enterprises to strengthen alliances. Support the development of joint distribution by trade and business enterprises, reduce distribution costs, improve distribution efficiency. Provide support for logistics firms to strengthen co-operation with manufacturers, that are fully involved in manufacturing enterprise supply chain management, or manufacturing companies jointly established with third-party logistics enterprises. Establish policies for manufacturing companies and business logistics firms to enjoy tax benefits, dispose of assets, and relocate personnel. Actively guide enterprises in the area of logistics outsourcing, expand logistics demand, promote regional logistics infrastructure and share a common information platform.

Source: Guo Fa (2011) no. 38

■ Policies for Shanghai free-trade zone (announced in 2013)

	Sector	Policy
1	Bank	1) Allow foreign financial institutions to establish banks in the zone, and allow domestic private companies to establish Sino-foreign banks with foreign financial institutions. Allow trials for banks with restricted licences. 2) Allow qualified domestic banks to operate offshore business.
2	Insurance	Allow trials to establish foreign-funded healthcare insurance companies.
3	Diversified financials	Remove the minimum restriction on registered capital for single aircraft and ship-leasing companies. Allow leasing companies to engage in factoring businesses.
4	Shipping	1) Relax the ceiling on foreign holdings in Sino-foreign JVs. 2) Allow Chinese-owned but non-Chinese registered vessels to operate domestic container routes between Shanghai and other cities.
5	Vessel management	Allow foreign vessel management companies to operate in the zone.
6	Value-added telecommunication services	Allow foreign entities to operate some value-added telecommunication services.
7	Console games	Allow foreign companies to produce and sell video game consoles.
8	Legal services	Explore cooperation between domestic and foreign (including Hong Kong and Macau) agents that provide legal services.
9	Investment credit investigation	Allow foreign-funded companies for investment credit investigation to be established.
10	Travel agencies	Allow Sino-foreign joint travel agencies registered in the zone to operate outbound travel businesses (except in Taiwan).
11	Human resources	1) Allow the establishment of Sino-foreign HR agencies, with foreign-owned holdings of below 70%. Allow Hong Kong and Macau agencies to set up wholly owned subsidiaries. 2) Reduce the minimum registered capital requirement from USD300,000 to USD125,000 for foreign agencies.
12	Investment management	Allow the establishment of foreign-funded joint-stock investment companies.
13	Engineering design	Remove the performance requirement for first-time qualification applications for engineering-design companies that provide services to the zone.
14	Construction	Remove the share restrictions on foreign investment for foreign-funded construction companies that provide services in the zone.
15	Talent agencies	Allow foreign agencies to enter the market to serve Shanghai.
16	Entertainment	Allow the establishment of foreign-funded entertainment venues.
17	Education and vocational training	Allow the establishment of Sino-foreign joint institutions engaged in education and vocational training.
18	Medical services	Allow the establishment of foreign-funded medical institutions.

Source: The Central People's Government of the People's Republic of China, Daiwa

■ Qianhai free-trade zone: policies to establish a modern logistics industry (announced in 2010)

1	Encourage organisations to build regional production hubs and international supply chain management centres. Former bonded logistics ports are permitted to engage in international practices, and actively explore new customs supervision policy and institutional innovation. Improve the market access mechanism and policy support mechanisms, focusing on developing financing advisory services, financing guarantees, settlement, customs clearance, information management and related value-added services within supply-chain management.
2	Encourage the introduction of e-commerce transactions to provide logistics and related value-added services for integrated service-oriented enterprises. Support Shenzhen Port's vehicle import pier to be become more popular, and the development of automotive logistics services. Encourage local enterprises to undertake procurement, sales and other related outsourcing services; build international procurement and distribution facilities and compete on global distribution management platform.
3	Actively support the development of port and shipping services. Take advantage of the international shipping centre in Hong Kong and promote Shenzhen to expand its port services.
4	Actively introduce a shipping business management centre, document management centre, settlement centre, shipping agency and other sea-front establishments or businesses. Promote the development of financial innovation for the maritime sector, support the formation of the marine development fund, shipping-finance leasing companies, shipping insurance institutions, the promotion of civil aircraft and aviation-equipment financial leasing businesses. Permit operations and businesses with good credit records with the domestic banks to open special accounts or special offshore accounts. Support shipping-finance leasing companies to enter the inter-bank lending market and raise funds including via bond issuance.
5	Support the development of the aviation market, carry out aircraft-material leasing, material transactions, civil-aircraft financing, and other innovative services.

Source: Shenzhen Qianhai Modern Service Industry Cooperation Zone Authority

China, the next boom logistics market in Asia

We expect the trends that emerged in the US, Japan, and Korea to develop in China, such as the development of 3PL businesses, increase in e-commerce, and the emergence of large integrators.

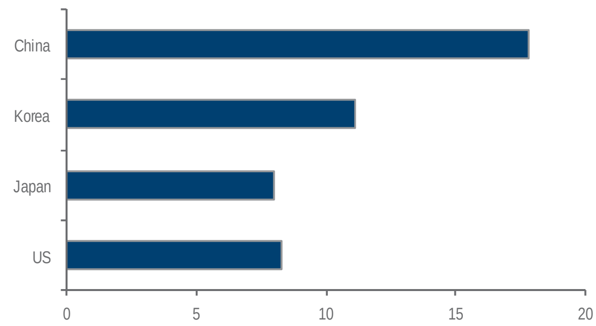
Considerable room to cut logistics costs

Logistics costs in China are high

Comparing logistics costs as a percentage of GDP (and based on the data available), China had the highest costs at 18% for 2010 (also 18% in 2012), which was much higher than 8.5% in the US (same in 2012), 8% in Japan (2012: 8.5%), and 11% in Korea (2012 data for Korea is not available) according to the data provided by Daiwa analysts Mike Oh and Hajime Hitotsuyanagi.

In terms of the cost-structure composition, transportation costs in China accounted for about 10% of the country's total GDP for 2010, higher than the levels for the US (5.3%), Japan (5.0%), and Korea (8.1%). In China, storage costs amounted to about 6% of GDP (3pp higher than in the US, Japan, and Korea), and management costs were about 2% of GDP (0.2% in the US, 0.3% in Japan and 0.5% in Korea).

■ Logistics costs as a % of GDP (2010)



Source: CSCMP, JILS, Statistics Korea, CFLP

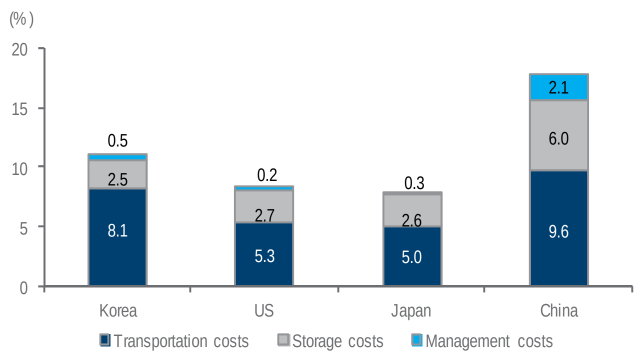
The high transportation and management costs in China reflect partly inefficient logistics management. For example, many trucks are often loaded on one leg of their trip but are empty on the return journey. According to the management of one logistics company we spoke with recently, 40% of all the trucks in China are either empty or are only part-loaded. This results in high transportation charges in order to offset the cost of the empty return trip. This situation is a result of a lack of integrated logistics facilities in the country, especially in inland regions. In other countries, arrangements on transportation logistics are better, as trucks have tracking systems that make it easier to pick up cargo on a return journey.

Also, the toll-road systems in developed countries are more open to private capital. In these countries, the government's role tends to be focused on setting safety standards rather than on regulating prices, as in China. This increases competition and thus helps to reduce toll tariffs in developed countries (as these countries can attract investors to build alternative routes, thereby diverting some traffic to these roads and helping to keep toll-road returns stable).

Part of the movement of cargo in China is related to the system of tax rebates for exports and imports; some provinces offer tax rebates on exports, and this attracts cargo movements to and from those provinces in order to benefit from these rebates. For example, goods produced in a logistics park in Shenzhen can receive a tax rebate as export goods if they are shipped to Hong Kong and then simply returned. This leads to additional transportation costs for the manufacturer, but is justified by the tax savings received.

In terms of storage costs, better inventory control by manufacturers in the US, Japan, and Korea is the main reason why their costs tend to be lower compared with manufacturers in developing countries like China. However, we believe the logistics industry in China to be able to reduce its costs on potentially better inventory control at manufacturers in the future.

■ Comparison of logistics costs breakdown as % of GDP (2010)



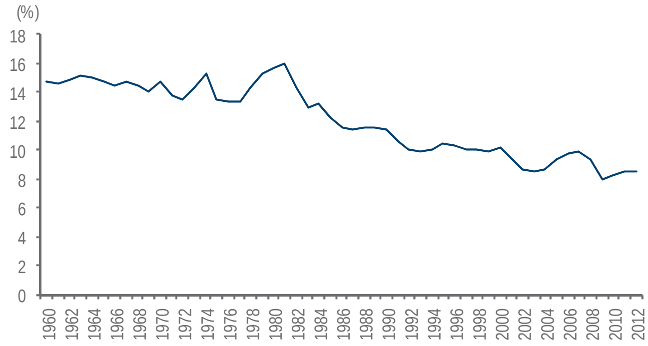
Source: CSCMP, JILS, Statistics Korea, CFLP

Reforms in the logistics industry are needed

Deregulation leads to lower transportation costs

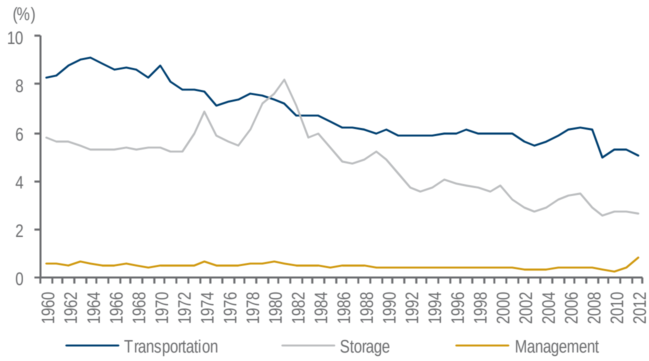
Logistics costs in the US as a percentage of GDP averaged 15% over 1960-70 and had declined to 10% by 1992. They ranged from 8-9% over 2002-11. By comparing the cost components, we can see that savings came from reduced transportation costs in the early stage of the industry's development, and later from reduced storage costs. Management costs ranged from 0.4-0.5% over 1960-2011. The level rose to 0.8% for 2012 as some of the data was reclassified.

■ US: logistics costs as a % of GDP



Source: CSCMP

■ US: breakdown of logistics costs as a % of GDP



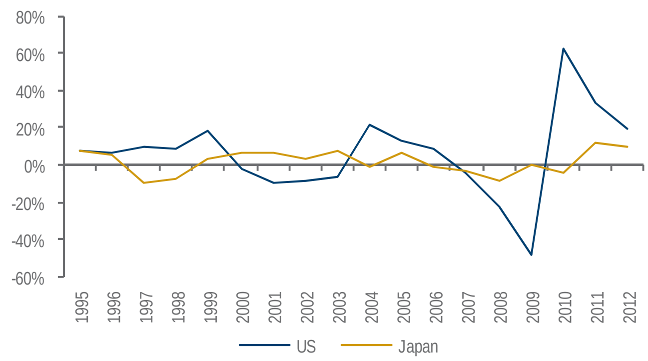
Source: CSCMP

We believe the reduction in transportation costs was related to the deregulation of the US transportation industry in the 1970s and 1980s, which opened the market to more private investors and thus more competition. Also, government control over toll-road tariffs was relaxed during the period. Road tariffs became more dependent on market forces and continued to decline as more companies entered the market. Since then, the US Government has focused increasingly on safety and environmental protection with respect to toll roads. The trigger for deregulation was strong demand for reduced transportation costs, which was supported by consumer organisations, economists, and environmental organisations.

A similar situation has been developing recently in China, with trucking companies, drivers, and economists calling for lower toll-road tariffs. We believe this was the reason for the year-long nationwide investigation into illegal charges on toll roads, and was also underpinned by the importance the government places on the logistics sector. The restructuring of the former MOR into China Railway Corporation earlier this year points to the potential for the deregulation of the railway sector (given the aim to separate the operation and regulation of the railway sector). We believe this should pave the way for more private capital to enter the market, as was seen in the US and Japan in past.

As has occurred in the US and Japan, the opening-up of the transportation system to private capital enabled the efficient development of transportation infrastructures, driven by market forces. The burden of financing these projects fell more to private capital rather than the government. This brought about a more efficient use of capital and enabled government bureaucracy to be avoided.

■ Transportation FAI: YoY % change (1995-2012)



Source: CEIC

■ **Reforms in the US transportation system**

Deregulation act	Description
Railroad Revitalisation and Regulatory Reform Act of 1976	Reduced federal regulation of railroads and authorised implementation details for Conrail, the newly created northeast railroad system
Airline Deregulation Act of 1978	Removed government control over fares, routes, and the market entry of new airlines from commercial aviation
Staggers Rail Act of 1980	Greatly reduced federal regulatory control over virtually every aspect of rail freight operations
Motor Carrier Act of 1980	Deregulated the trucking market to permit much more flexible pricing and service arrangements.
Bus Regulatory Reform Act of 1982	Liberalised the regulations governing US inter-city bus transport. Considered to be beneficial in improving the economic efficiency of carriers.
Surface Freight Forwarder Deregulation Act of 1986	Eliminated federal regulation of prices, services and opened freight forwarders to general commodities.
Federal Aviation Administration Authorization Act of 1994	Forbade states from enacting or enforcing a law related to the price, route, or service of any motor carrier
Ocean Shipping Act of 1984	Permitted independent rate-making by conference participants
Ocean Shipping Reform Act of 1998	Permitted secret contract rates, which tend to undercut collective carrier pricing

Source: Daiwa

Improved inventory control helps to save on storage costs

As well as the reduction in transportation costs, the savings on storage costs in the US since the 1980s was due in part to the growing popularity of better inventory control, which is often referred to as just-in-time (JIT) inventory management. JIT means producing goods and services exactly when they are required, and thus reduces the need to keep inventory and raw materials. The concept was first developed in Japan and is now used widely around the world.

The well-developed transportation infrastructures in Japan and the US helped companies to achieve JIT. Also, better information and tracking systems facilitated companies' inventory controls. This helped to eliminate unnecessary inventory storage and led to further savings on warehouse-storage costs. The role of logistics service providers has increased since the 1980s: many have been transformed from transportation service providers (2PL) to logistics management companies (3PL). Demand for their services was given a further boost in Japan and the US from the increased popularity of e-commerce in the 1990s.

3PL services should be the future in China

These services also reduce costs

If we compare the 3PL service penetration level (defined as 3PL service revenue divided by the total logistics revenue) with the logistics costs as a percentage of GDP for the US, Japan, China, and Korea, we see that the lower the 3PL service penetration rate in logistics, the higher the logistics costs as a percentage of GDP. We believe this is due to the advantage that 3PL services bring to logistics management, of helping companies to reduce operational costs. As such, a higher 3PL services penetration rate generally leads to lower logistics costs, and vice versa.

According to a recent study by Capgemini Consulting, using 3PL services can help to reduce logistics costs by 11%, inventory costs by 6%, and warehousing costs by 23%, compared with just using 2PL services. Given the benefits, we see significant potential for the development of 3PL services in China, as many companies are likely to look to cut costs over the coming years to offset the impact of a potential economic slowdown.

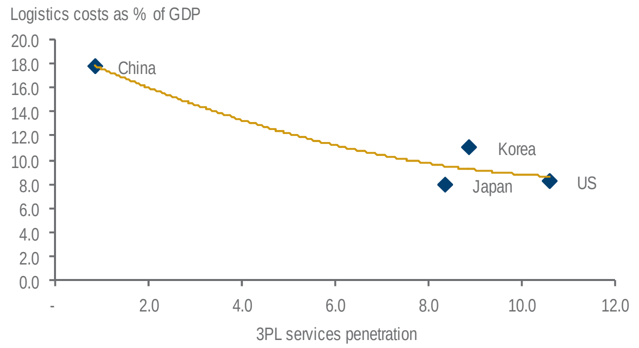
This situation occurred in Japan between FY90 and FY00. For example, the proportion of companies with in-house logistics facilities in total truck transportation (tonne basis) in Japan fell from 60% for FY90 to 49% for FY00 and 32% for FY10, as more companies have outsourced logistics operations by using 3PL services. We believe this illustrates well the scope for growth in 3PL services in China.

■ **Cost-savings from 3PL services**

Results	2013 study	2014 study
Logistics cost reduction	15%	11%
Inventory cost reduction	8%	6%
Logistics fixed asset reduction	26%	23%

Source: Capgemini Consulting

■ **The higher 3PL services penetration, the lower the logistics costs (2010)**



Source: Armstrong & Associates, Daiwa

Increasing need for 3PL services

Daiwa expects China's economic growth to slow over 2013-15 (as noted earlier in this report). This, together with a rise in labour costs, should increase demand for more cost-efficient logistics support for manufacturers, in our view.

We expect more companies to shift from having their own logistics networks and distribution centres to outsourcing their logistics needs. This should lead to increased efficiency and reduced operating costs, as logistics firms providing 3PL services can generate economies of scale and often have expertise in logistics management given many have evolved from being long-established 2PL service providers. We believe companies' in-house handling of their logistics needs will be phased out gradually in China and more 3PL service providers will develop in the coming decade.

In addition, we expect more consolidation within the logistics industry, which should result in the emergence of major China logistics companies over the coming decade. Furthermore, the growing use of e-commerce should provide additional demand for 3PL services, especially in the B2C segment, as we go on to discuss.

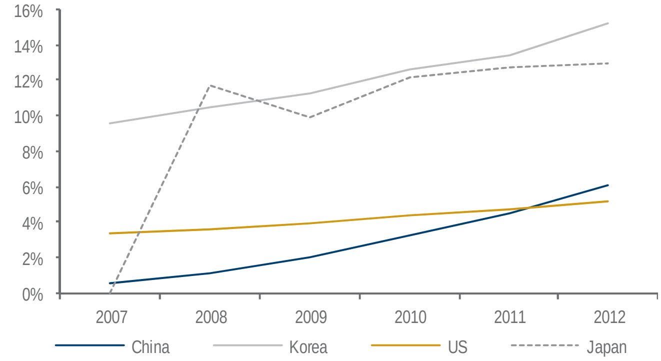
E-commerce should provide a strong demand boost

High potential demand from online sales

One of the drivers of logistics demand in Japan and Korea over recent years has been the increasing popularity of e-commerce, especially online shopping, and we expect the same to happen in China in the next few years. Comparing online sales as a percentage of total retail sales, in Korea and Japan it stood at 12-14% for 2012, while for China it was 6% for 2012 (up from 0.3% for 2007). In terms of online sales per person, China is still far behind Japan, as the popularity of online shopping in China does not extend to people in rural areas or third-tier cities.

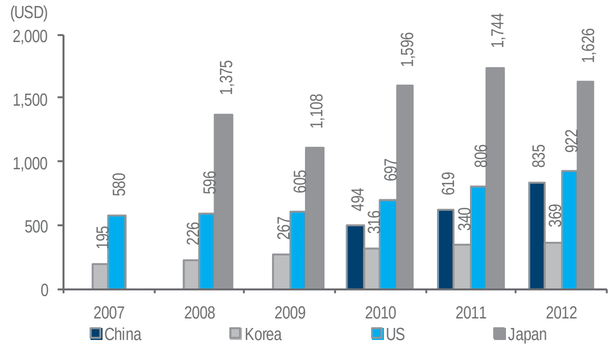
Based on the data for 2012, China has a younger population, with a higher percentage of the population in the 15-64 year age bracket than Japan, and our research shows that young consumers are more likely to shop online than the elderly. This provides opportunities for the existing logistics service providers in China and may even attract new entrants to the market. For example, Alibaba and a number of express-service companies, such as Shunfeng, Shentong, and Yuantong, have set up a company called Cainiao to focus on developing logistics services to support Alibaba's e-commerce platform.

■ Comparison of online sales as a % of total retail sales



Source: CEIC, Shinsegae Retail Research Institute

■ Comparison of online sales per person (2007-12)



Source: CEIC, Shinsegae Retail Research Institute

■ Asia: age profile, population, and per-capita income (2012)

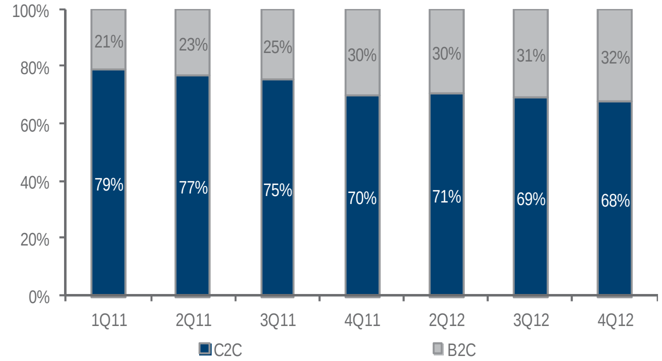
Country	Age profile (%) 0-14	15-64 (30-49)	65 and above	Population (m people)	Income per capita (USD)
Australia	19	68	13	22	38,708
China	19	72	8	1,338	3,746
Hong Kong SAR, China	12	76 (34)	13	7	28,134
India	31	64	5	1,225	1,207
Indonesia	27	67	6	240	2,372
Japan	13	64 (28)	23	127	37,986
Korea	16	72 (34)	11	49	18,077
Malaysia	30	65 (26)	5	28	6,545
Philippines	35	61	4	93	1,889
Singapore	17	74 (25)	9	5	33,902
Taiwan*	16	74 (33)	11	23	16,413
Thailand	21	71	9	69	3,805

*Source: World Bank, * Taiwan National Statistics*

Emerging B2C business should increase demand for 3PL services

More than 85% of the total transaction amount in China's e-commerce industry is B2B-related currently, so we believe online shopping by consumers has strong potential in the country. In the online-shopping market, the C2C segment, which accounts for close to 70% of online-shopping revenue, has been declining over the past few years. We believe the business opportunity for logistics companies comes mainly from B2C online shopping, which would benefit the 3PL service providers as it involves more than just parcel deliveries (the focus of the C2C market).

■ China: online shopping breakdown (1Q11-4Q12)



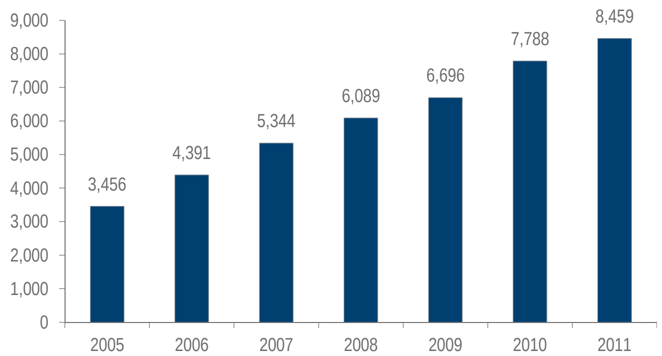
Source: Iresearch Global Inc

Referencing B2C e-commerce growth in Japan, the strong growth in China's e-commerce revenue should continue for a number of years. In Japan, B2C e-commerce revenue amounted to almost JPY8.5bn for 2011, up from JPY3.5bn for 2005 and representing a CAGR of 16% over the period.

In China, where the wave in online shopping only started recently, we believe B2C e-commerce revenue growth could be more than 20% YoY and continue for a decade, given its larger population and much lower level of online sales as a percentage of total retail sales in China vs. Japan and Korea. With the emergence of a large number of B2C platforms in China, the demand for better B2C logistics services looks set to accelerate over the next decade.

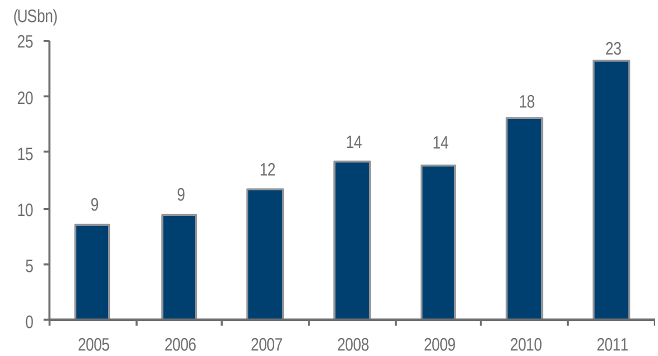
For example, 3PL service revenue rose at a CAGR of 10% over 2005-11, while B2C revenue increased at a CAGR of 16% over the same period. This suggests that the greater demand for B2C would lead to greater demand for 3PL, as we believe many e-commerce players would be unable to afford to invest in their logistics facilities. The lower increase for 3PL service revenue was due in part to the financial crisis from 2008-09.

■ Japan: market size of B2C e-commerce (JPYbn)



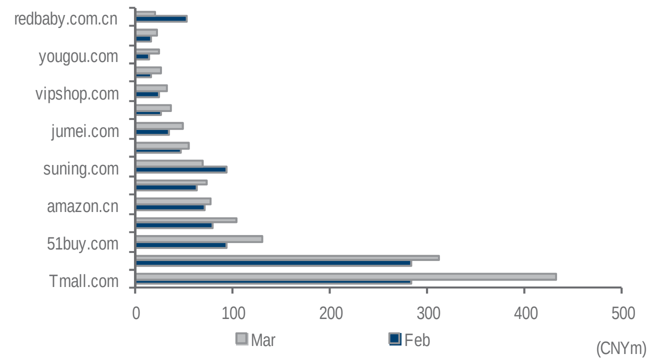
Source: Ministry of Economy, Trade and Industry 'e-commerce market survey'

■ Japan: 3PL market (JPYbn)



Source: Logi-Biz (Logistics Business, September 2012 issue), China Logistics Year Book

■ Top-15 China B2C websites by visits, February and March 2013



Source: China Internet Watch

Large integrators dominate

In the US, large integrators such as UPS and Fedex, emerged on the back of the development of the logistics industry in the country, while the major logistics companies in Japan are Nippon Express (9602 JP, JPY508, Neutral [3]) and Yamato Express (9064 JP, JPY2100, Neutral [3]).

These integrators provide services covering all areas of logistics, including trucking, warehousing, and customs clearance. This allows them to provide 3PL or even 4PL services (which not only help the customer with its logistics management, but also help them solve their logistics needs in the whole supply chain) to customers.

The advantage of these integrators is the economies of scale and efficiency they provide, as they are involved in every step of the logistics chain. This provides a more cost-efficient way for its customers to handle their logistics.

Before the emergence of these integrators, the logistics market in the US was fragmented, with many players involved in different segments, as is the case now in China. For example, some companies in China focus only on trucking, while others only establish warehouses. Over the next decade, we expect a number of major integrators to emerge in China, based on the trends followed in Japan and the US.

■ Top-10 global 3PL companies for 2012 (by turnover)

1	DHL Supply Chain & Global Forwarding
2	Kuehne + Nagel
3	Nippon Express
4	DB Schenker Logistics
5	C.H. Robinson Worldwide
6	Hyundai GLOVIS
7	CEVA Logistics
8	UPS Supply Chain Solutions
9	DSV
10	Sinotrans

Source: Armstrong & Associates

Common features of the dominant players

A strong operational network is crucial for the large integrators to maintain their market positions. This applies not only to their domestic markets, but also globally. For example, DHL has a presence in 220 countries and territories, while UPS is present in more than 200 countries and territories.

In addition, all the large integrators have strong IT infrastructures to support their operations. A cargo-tracking system has become a basic service for their customers. In order to provide accurate tracking, many of the warehouses owned by the large US and Japanese integrators are equipped with systems that electronically monitor the progress of the products being shipped in their warehouses.

Similar facilities are being built in China by SZI, Global Logistic Properties (GLP) (GLP SP, SGD2.89, Outperform [2]), SITC International (SITC) (1308 HK, HKD3.2, Buy [1]), and Sinotrans.

Meanwhile, the execution ability managements is crucial as logistics management often involves a large team and a large global network. For example, DHL has 285,000 employees, while Fedex has more than 300,000 staff in 220 countries and territories. In addition, management's ability to build a strong brand is important in attracting more outsourcing business from customers and developing a company's 3PL services, rather than continuing to offer only 2PL services.

Structural changes in China

Apart from the trends evident in the US, Japan and Korea, we are also seeing structural economic changes in China, which are supporting demand for logistics services.

Shift to inland provinces should continue

As we have already mentioned, over the past decade land and labour costs in coastal provinces have increased substantially, to a level that is now too expensive for many factories to set up there. This has resulted in a continuous move inland by companies setting up factories, leading to higher GDP growth on manufacturing (a secondary industry) in inland provinces than for the whole country since 2000.

As finished goods ready for export still need to be transported to coastal ports, demand for good logistics services, especially cross-province transportation, looks set to continue to rise for the next decade. This trend will also benefit the ports along the Yangtze River, as more manufacturers use the waterways as a cheap means of transport to move goods around the country.

■ Land cost comparison (CNY/sq m)

Average land cost	Inland	Costal
2005	403	604
2012	584	721

Source: Wind

■ Average monthly salary for manufacturing workers (CNY)

Average	Inland	Costal
2005	373	548
2012	887	1,122

Source: Wind

■ Secondary industry: GDP growth in inland provinces

Source: Wind

Domestic consumption looks set to boost demand

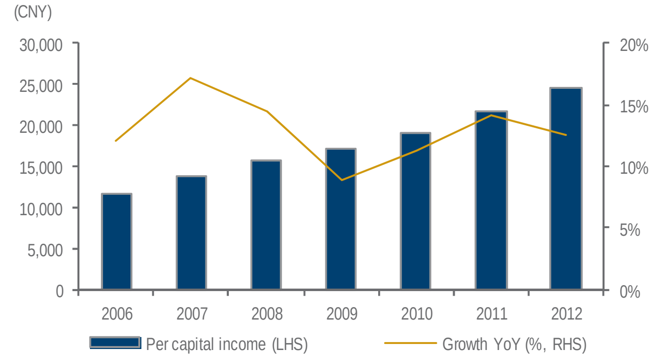
Urbanisation to drive consumption

Since 2006, disposable incomes in China have doubled. At the end of 2012, the urban population was 51% of the total, and we expect it to continue to rise to 70% by 2030. China's National Bureau of Statistics estimates that more than 10m people migrate to urban areas annually. As the government has targeted urbanisation as an objective under the 12th Five-Year Plan (2011-15), we would expect the rising disposable-income trend to continue.

Although boosting disposable incomes is a must, we believe it is more important for the PRC Government to ensure better income equality between inland and coastal provinces, which would also result in better political stability for the whole country. A significant increase in the whole population's income would lead to greater demand for goods, especially in the inland provinces where economic growth is faster. This would increase demand for logistics, to transport imported goods from coastal to inland provinces, and domestically produced goods across the country.

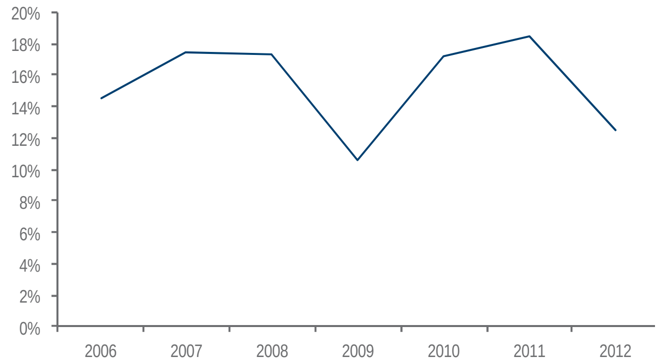
To facilitate this trend, there is likely to be increased demand for logistics services as most of the inland infrastructure is not well developed. Also, we often see a lot of miscommunication between warehouses, trucking companies and freight forwarders, which should create more room for the 3PL players or distribution centres to set up and gain market share.

■ China: disposal income per capita



Source: CEIC

■ China: domestic consumption growth



Source: CEIC

■ Gini index vs. urbanisation rate

2012	China	US	Japan	Korea	Brazil	Malaysia	Indonesia
Urbanisation rate (%)	*51.8*	*82.6*	*91.7*	*83.5*	*84.9*	*73.4*	*51.4*
Gini Index (point)	47.4	N/A	N/A	41.9	50.8	46.2	38.1

Source: World Bank, World Factbook

Better logistics facilities needed

Growth in the number of logistics parks

As mentioned before, infrastructure and facilities in inland provinces are not well established. In order to cope with the increase in logistics demand going forward, a huge improvement in logistics facilities would be needed, especially in inland areas. Currently, the lack of efficient distribution centres and logistic parks has led to a wastage of manpower, such as low utilisation of trucks, in China, especially in inland areas.

We believe demand for warehouse/storage facilities in China will continue to increase. The per capita income for China's coastal areas has reached an inflection point of USD5,000 (according to the government), which has triggered increased demand for automobiles and other durable goods over the past five years.

For example, according to GLP, about 80% of its leased space in China is used by tenants for domestic consumption-related businesses (such as local car dealerships), while 20% is used for import-export-related activities.

On a per-capita basis, China's total warehouse stock (of both modern and non-modern facilities) is only 0.38sq m versus 5.16sq m in the US (according to GLP, from data obtained from the China Association of Warehouses and Storage, CBRE estimates, and the CIA's *The World Factbook*).

In China, many of the management teams of logistics parks we spoke with recently estimate that 75% of warehouses do not provide modern logistics requirements (such as wide-column spacing [sufficient space in between piles of goods], large floor areas (at least 10,000 sq m), high ceilings (at least 5.5m), modern loading docks, enhanced safety systems or other value-added features), and some warehouses could be demolished given the rapid pace of urbanisation.

Key stock calls

Sinotrans is our top pick, followed by SZI and CIMC as alternative ways to invest in the sector.

Theme 1: buy the logistics operators

Top pick: Sinotrans (598 HK, HKD2.38, Buy [1])

We believe Sinotrans is the best-positioned stock within our coverage to benefit from the increasing demand for logistics services in China, as it has the largest operational network in the country and strong management expertise in terms of freight-forwarding in China. The company's continuous investment in its IT infrastructure should also help it become a dominant logistics company in the country.

Sinotrans is now the largest freight forwarder by sea freight and the second-largest by air freight in China (both in terms of revenue). Its ongoing focus on developing its 3PL services, which accounted for about 26% of the 1H13 operating profit (under PRC GAAP), should be a bright spot in the future, and one that we will monitor closely.

The increasing demand that we are seeing for efficient courier services should also benefit the company, as its subsidiary, SinoAir, has a joint venture with DHL to develop courier services in China. For 2012, the joint venture accounted for 77% of Sinotrans' net profit. We believe this segment of the business has a more stable net-profit profile compared with the company's sea-freight forwarding business.

We see Sinotrans' 2014E PER of 8x as undemanding compared with its past-5-year-average PER of 12x. We expect the stock to be rerated as the company develops its 3PL services and international courier business.

SITC International (1308 HK, HKD3.2, Buy [1])

In terms of benefiting from increasing demand for logistics services, SITC is another good investment vehicle, in our view, especially when it comes to the B2B segment. The shift of manufacturing plants inland by more companies is already stimulating logistics demand in terms of transporting raw materials, components, and finished goods between the inland provinces and coastal ports.

The company is focusing on developing its B2B logistics business, and is also considering expanding further into the 3PL arena as well. The greater demand for logistics services should boost the company's profitability, as the logistics business offers a higher gross margin (at an average of about 15% for the past five years according to SITC) than shipping (average of 5-10% for the past five years, according to SITC). We forecast a logistics-revenue CAGR of 15% YoY for 2012-14, which should push up the gross margin from 12% for 2011 to 16% for 2014E.

We think the stock's PER of 6.6x, dividend yield of 6.5%, and ROE of 19% for 2014E are undemanding, especially considering the strong potential for its logistics business, which we forecast to post stable top-line growth of 14% YoY for 2014-15.

Prefer Sinotrans to SITC

We prefer Sinotrans as a pure logistics player and believe its leading position in the sector and strong logistics network will enable it to benefit from forthcoming opportunities as China's logistics business develops. Investors looking for exposure only to China's logistics industry might be put off by SITC's shipping business.

On valuation, Sinotrans is trading at a higher PER than SITC, but both are only at about 10x 2013E PER, which we see as undemanding for both companies. We believe Sinotrans deserves to trade at a premium to SITC due to its focus on the logistics business, a growth area in China in the future, while SITC's exposure to shipping could lead to more earnings volatility for the company.

Theme 2: buy the logistics-park operators

Shenzhen International (152 HK, HKD0.96, Buy [1])

About 68% of SZI's adjusted EBIT comes from its toll-road business (through its stake in Shenzhen Expressway (548 HK, HKD3.51, Buy [1]), 7% comes from its 49% stake in Shenzhen Airlines, which is also 51% owned by Air China (753 HK, HKD5.68, Buy [1]). However, we believe the company's future earnings growth lies in the development of integrated logistic hubs, which it has started to build and plan in Shenyang and Tianjin, respectively. The company aims to have up to 30 integrated logistics hubs in China in the long term.

Unlike the old logistics parks, which place an emphasis on offering tax rebates but no value-added service inside the park, the aim of integrated logistics hubs is to offer a platform for small- and medium-sized logistics companies, including trucking, freight-forwarding, financing and even front-line sales, to work together. This should offer greater rental income potential for SZI as the operator.

Companies (especially e-commerce companies) can set up their offices inside the logistics hub, and then benefit from the support provided by logistics service providers.

We are currently seeing strong demand for such platforms in China, as we think small- and medium-sized logistics companies often find it difficult to coordinate functions with other companies in the supply chain. Also, many cannot afford their own facilities such as warehouses, IT infrastructure and trucking companies, which they can benefit from within integrated logistics hubs. For example, the occupancy for the SZI logistics parks are all currently above 90%.

We also like SZI's landbank in Qianhai, which we estimate is worth about HKD0.6/share, and which we believe should provide good share-price support over our six-month investment horizon.

The stock is trading at a 2014E PER of 7x, which is in line with its past-5-year average. However, with its clear strategy to accelerate the development of its logistics hubs in 2014-15, we believe the stock could be rerated over the next 6 months.

Global Logistic Properties (GLP SP, SGD2.89, Outperform [2])

GLP manages and develops modern logistics facilities and has leading positions in its three markets: China (59% of NAV as at 30 September 2013), Japan (29% of NAV) and Brazil (5% of NAV; the remaining 7% of the group's NAV consists of net cash in Singapore). In each of these markets, GLP has the largest network (of properties owned, managed through joint ventures or REITs, and under development) by area.

In China, it owns 6.3m sq m of logistics space, well ahead of the second-largest competitor, which owns only 0.9m sq m. In Japan, its network consists of 3.7m sq m versus 2.4m sq m for the second-largest player, while in Brazil, its network consists of 2.0m sq m versus 1.2m sq m for the second-largest player. (All comparisons are as at 30 September 2013.)

We believe GLP should be viewed as a play on the growing logistics industry, mostly in China and Japan, regardless of who is the major market player in the future, as they would still need GLP's support in terms of facilities.

Many of GLP's tenants in China are top-tier 3PLs and e-commerce retailers. If some of these players lose competitiveness, or if the retailing or 3PL industries undergo consolidation, GLP's tenants might change, but the need for modern logistics facilities would still exist, in our opinion, to support the burgeoning market.

■ GLP: top-10 tenants in China (September 2013)

		Industry	Area leased from third party
1	Amazon*	Retailer	5.3%
2	Deppon	3PL	4.5%
3	Nice Talent	3PL	2.2%
4	Vipshop*	Retailer	2.1%
5	DHL	3PL	1.8%
6	Toll Warehouse	3PL	1.8%
7	Schenker	3PL	1.7%
8	VANCL*	Retailer	1.5%
9	JD.com (360buy)*	Retailer	1.2%
10	PGL	3PL	1.2%
	Total		23.3%

Source: GLP
**E-commerce customer*

We believe GLP's logistics-development business is an inherently high ROE and IRR business, helped by a relatively short development cycle (typically two years or less) for its logistics facilities. According to GLP, its properties have a cash-conversion cycle of 1.5 years, from investment to achieving a stable cash flow. We estimate that the unlevered IRR for its development business in China (assuming a two-year cash-conversion cycle and a 5-year investment period before divestment) is 21.5% during the current growth phase, and 18% during the mature phase.

The stock is trading at a 35% premium to its tangible book value (of SGD2.14), so does not look cheap compared with the typical property developers or landlords. However, we believe this stock is worth considering given its dominant market positions, development-growth opportunities, and inherently attractive business model.

We prefer SZI to GLP on valuation grounds

We are more positive on the share price upside potential for SZI than GLP over the next six months, as we believe SZI's high land value per share will provide share-price support, and foresee more good news to come on SZI's development of several integrated logistics hubs.

From our SOTP valuation for SZI, we derive a six-month target price of HKD1.30, implying 35% upside potential from the current share price, whereas our target price of SGD3.32 for GLP implies much more moderate 15% upside potential. For GLP, as mentioned, we believe the current share price does not look cheap, even though it is likely to maintain its dominant market position.

Theme 3: buy equipment players

China International Marine Containers (CIMC) (2039 HK, HKD14.98, Buy [1])

We believe the increase in demand for logistics services will lead to increased demand for CIMC's transportation equipment, including trucks and trailers. Also, a rise in demand for better food quality (based on the country's rising income levels) could increase the demand for CIMC's reefers.

We expect the profitability of CIMC's core business, container manufacturing, to improve on a YoY basis for 2014, as we forecast its vessel production capacity to increase by 7% YoY, and accumulated replacement demand for the past three years. We believe the profitability of the container-shipping companies will continue to improve over the next few years, as we expect more of the shipping companies to start to order new container boxes for replacement.

We estimate the value of the company's landbank in Qianhai is worth HKD6.6/share, which we believe should provide good share-price support and limit the downside risk.

The stock is trading currently at a 2014E PER of 13x, higher than its major peer, Singamas Container Holdings Limited (Not rated), which traded at around a 10x (Bloomberg consensus forecasts) for the same period PER of 10x. We consider the premium between the two to be justified as CIMC has the largest share of the container-manufacturing business (around 50% vs. 20-30% for Singamas), while its Qianhai development also provides extra comfort.

Risks to our call

Our positive calls on the companies in our coverage universe are related mostly to our positive view on the sector. Therefore, we see the downside risks to our forecasts as being sector-related, and outline these below.

Manufacturers moving to ASEAN countries

While some manufacturers are moving to locations inland in China, many others have moved production bases to ASEAN member countries. The major reason for this is the high cost of labour in China and the poor infrastructure in the country's inland areas. If more manufacturers decide to move to ASEAN countries rather than inland in China, this would affect the demand for logistics service in those areas. We see this risk as the biggest for the sector.

Competition from overseas players

China recently allowed foreign logistics service providers, such as Fedex and UPS, to enter the markets of a number of cities. Although we expect the opening of the logistics market to take place gradually and in a controlled manner, there would be downside risk to our expectations for the sector if the government were to open the market faster than we expect.

Slower-than-expected economic growth

Daiwa's Deputy Head of Regional Economics, Kevin Lai, forecasts China's GDP growth to slow to 7.5% YoY for 2014, from 7.6% YoY for 2013. Our earnings forecasts would be at risk if GDP growth was slower next year than we expect, as a result of the new reform policy on individual sectors affecting the profitability of the state-owned enterprises.

Appendix

■Industry comparables

Company (Hong Kong & China)		Bloomberg code	Share price currency	Share price 12-Dec-13	Rating	6M target price	Total market cap (USDm)	PER (x) FY13E	PER (x) FY14E	Dividend yield (%) FY13E	Dividend yield (%) FY14E	EV/EBITDA (x) FY13E	EV/EBITDA (x) FY14E	ROE (%) FY13E	ROE (%) FY14E
Logistics															
Sitc International Holdings	*	1308 HK	HKD	3.2	Buy	4.00	1,067	9.7	6.6	4.6	6.5	7.2	5.3	14.9	19.4
Sinotrans Limited-H	*	598 HK	HKD	2.38	Buy	3.30	1,304	10.1	8.3	1.6	1.6	5.8	4.8	7.4	8.4
Shenzhen Intl Holdings	*	152 HK	HKD	0.96	Buy	1.30	2,051	7.6	6.5	3.9	3.9	8.6	7.9	15.5	16.3
China International Marine-H	*	2039 HK	HKD	14.98	Buy	20.00	5,630	17.4	12.8	2.0	2.0	10.0	8.2	8.7	10.6
China South City Holdings		1668 HK	HKD	1.91	NR	NR	1,523	4.2	3.0	8.9	11.2	2.4	1.9	21.8	20.3
Wuhu Port Storage&Transpor-A		600575 CH	CNY	3.54	NR	NR	1,420	n.a.	n.a.	n.a	n.a	n.a.	n.a.	n.a.	n.a.
Shenzhen Chiwan Petroleum-B		200053 CH	CNY	15.57	NR	NR	463	n.a.	n.a.	n.a	n.a	n.a.	n.a.	n.a.	n.a.
Fujian Xiamen Xiangyu Co L-A		600057 CH	CNY	6.81	NR	NR	964	n.a.	n.a.	n.a	n.a	n.a.	n.a.	n.a.	n.a.
Cts International Logistii-A		603128 CH	CNY	11.6	NR	NR	764	n.a.	n.a.	n.a	n.a	n.a.	n.a.	n.a.	n.a.
Orient International Enter-A		600278 CH	CNY	12.5	NR	NR	1,075	n.a.	n.a.	n.a	n.a	n.a.	n.a.	n.a.	n.a.
Jiangsu Feiliks Internatio-A		300240 CH	CNY	10.06	NR	NR	277	18.5	14.6	n.a	n.a	n.a.	n.a.	11.2	11.2
Global Logistic Properties#	*	GLP SP	SGD	2.89	Outperform	3.32	10,960	19.0	17.7	1.4	1.5	34.2	30.7	6.7	6.8
Shipping															
Orient Overseas International Ltd.	*	316 HK	HKD	38.95	Outperform	52	3,144	16.8	12.0	1.5	2.1	9.7	8.6	4.1	5.6
China Shipping Container Lines	*	2866 HK	HKD	2.01	Buy	2.4	4,448	n.a.	14.5	0.0	0.0	23.9	7.7	0.0	4.8
China COSCO Holdings	*	1919 HK	HKD	3.81	Buy	5.40	5,696	n.a.	11.7	0.0	0.0	45.6	10.7	0.0	11.4
Aviation															
Air China Ltd.	*	753 HK	HKD	5.68	Buy	6	9,056	15.7	9.7	0.0	1.0	5.7	4.7	6.7	9.9
China Southern Airlines Co.	*	1055 HK	HKD	3.07	Outperform	3.2	4,415	35.0	12.9	0.4	1.6	6.7	5.3	2.2	5.7
China Eastern Airlines Co.	*	670 HK	HKD	2.91	Buy	3.4	5,639	14.9	7.2	0.0	0.0	6.9	6.2	7.1	12.9
Cathay Pacific Airways	*	293 HK	HKD	16.1	Buy	17.3	8,169	27.9	16.0	1.3	1.9	5.3	4.3	3.9	6.5
Beijing Capital International Airport	*	694 HK	HKD	6.58	Hold	5.2	3,675	16.7	14.9	1.8	2.0	8.9	8.4	8.5	8.9
AviChina Industry & Technology	*	2357 HK	HKD	4.43	Buy	5.2	3,128	26.4	21.7	0.6	0.7	11.2	8.2	7.6	7.8
Expressways															
Jiangsu Express Co. Ltd.	*	177 HK	HKD	9.38	Outperform	9.5	5,042	12.9	11.7	5.1	4.9	8.1	7.4	15.1	16.1
Zhejiang Expressway Co.	*	576 HK	HKD	6.89	Hold	6.8	3,859	13.0	12.7	5.8	5.9	7.3	6.4	11.4	11.4
Shenzhen Expressway Co.	*	548 HK	HKD	3.51	Buy	4	1,243	7.5	6.6	5.3	6.0	5.6	4.8	8.2	8.8
YuexiuTransport Infrastructure	*	1052 HK	HKD	3.99	Buy	5	861	9.6	7.5	7.8	8.8	8.0	6.7	6.5	7.9
Ports															
China Merchants Holdings International	*	144 HK	HKD	28.1	Buy	31	9,157	18.0	15.0	2.4	2.7	15.4	14.9	8.3	9.4
COSCO Pacific Ltd.	*	1199 HK	HKD	10.76	Outperform	12.2	4,042	11.3	12.1	7.4	3.1	8.6	8.4	7.9	6.7

*Source: Bloomberg, *Daiwa forecasts, #FY13=year ended 31 March 2014*

The 10-second briefing

Sinotrans
598 HK

Target (HKD): **3.30**
Upside: **38.7%**
12 Dec price (HKD): **2.38**

Initiation: ready to deliver on the promise of 3PL

- Already a leading player in logistics in China, Sinotrans looks well-placed to become one of only a few major integrators
- 3PL and international courier services should be growth areas for the company. Asset injections could be share-price catalysts
- Initiating with a Buy (1) call and a six-month target of HKD3.30. Sinotrans is our top pick in the China Logistics Sector

1 Buy (initiation)
2 Outperform
3 Hold
4 Underperform
5 Sell

How do we justify our view?

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■ Investment case

We believe Sinotrans will be a major beneficiary of the ongoing growth in demand for logistics services in China, particularly the increasing need for third-party logistics services (3PL). Backed by its established network and management expertise, Sinotrans looks on track to become one of only a few major integrators in China, which we believe would lead to a rerating of the stock.

■ Catalysts

Sinotrans currently derives most of its profits from the sea-freight freight forwarding business. However, we expect its provision of 3PL services, which currently account for 26% of its operating profit, to grow in importance. Its international courier service, operated through its subsidiary's (SinoAir) joint venture with DHL, should be another earnings growth driver in the coming three years, in our view. International courier services are underdeveloped in China, and we believe many domestic and international companies will increasingly need to secure a reliable partner for such services in China.

We highlight asset restructuring as a possible share-price catalyst. In our view, the market would recognise the value of moves by the company to: 1) spin off its marine transportation business, which has long been loss-making, and 2) receive asset injections from its parent (Sinotrans & CSC Holdings) of more logistics operations, such as auto transportation and freight-forwarding for its railway service.

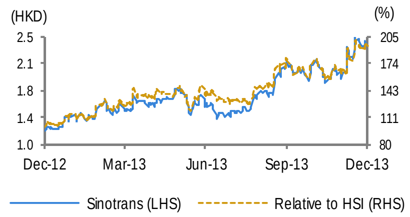
■ Valuation

We see Sinotrans' 2014E PER of 8x as undemanding and we expect the stock to be rerated as the company develops its 3PL services and international courier business, and sharpens its focus on logistics by spinning off the marine transportation business. We initiate with a Buy (1) call and a six-month target price of HKD3.30, set at 12x our 2014 EPS forecast, in line with the stock's past-five-year average PER multiple. Sinotrans is our top pick in the China Logistics sector.

■ Risks

The main risk would be lower-than-expected demand for freight-forwarding and 3PL. Another risk would be higher-than-expected freight rates charged by shipping companies.

Share price performance



12-month range	1.21-2.50
Market cap (USDbn)	1.30
3m avg daily turnover (USDm)	2.75
Shares outstanding (m)	4,249
Major shareholder	Sinotrans & CSC Hldg (57.9%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	49,650	54,522	59,925
Operating profit (m)	803	1,116	1,472
Net profit (m)	787	956	1,142
Core EPS (fully-diluted)	0.185	0.225	0.269
EPS change (%)	20.0	21.5	19.4
Daiwa vs Cons. EPS (%)	15.8	18.5	22.1
PER (x)	10.1	8.3	6.9
Dividend yield (%)	1.6	1.6	1.6
DPS	0.030	0.030	0.030
PBR (x)	0.7	0.7	0.6
EV/EBITDA (x)	5.8	4.8	3.9
ROE (%)	7.4	8.4	9.2

Source: FactSet, Daiwa forecasts

1 Buy (initiation)
2 Outperform
3 Hold
4 Underperform
5 Sell

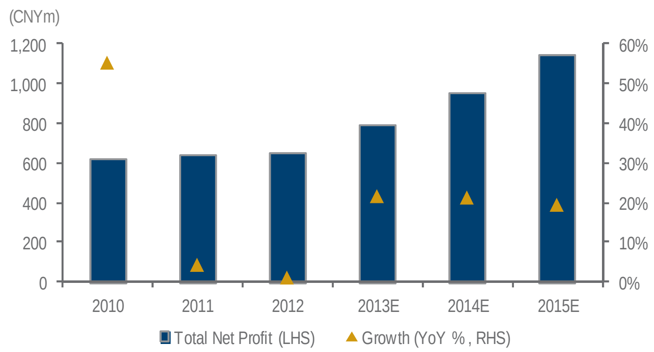
How do we justify our view?

- Growth outlook ✔✔✔✔✔
- Valuation ✔✔✔✔
- Earnings revisions ✔✔✔✔

Growth outlook ✔✔✔✔✔

We forecast Sinotrans to have a net profit CAGR of 20% for 2013-15, given ongoing growth in demand for logistics in China, which we expect to spur demand for 3PL services. In addition, we believe the company's international courier service will continue to deliver strong earnings growth over the same time frame.

Sinotrans: net profit and net profit growth

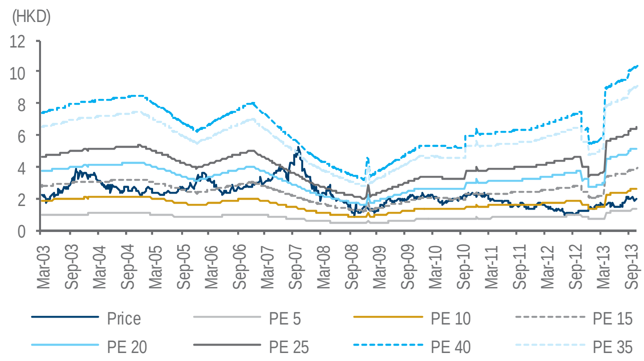


Source: Company

Valuation ✔✔✔✔

On our forecasts, the stock is trading at 8x 2014E PER, well below its past-five-year average PER of 12x. We believe its discounted valuation is a hangover from the market's concern in 2H12 over the economic recovery in Europe and, by extension, Sinotrans' shipping-related exposure. But, in our view, prevailing valuations do not capture the long-term positives for the logistics business in China. We look for the stock to be rerated if, as we expect, the company becomes a major integrator in China.

Sinotrans: forward PER

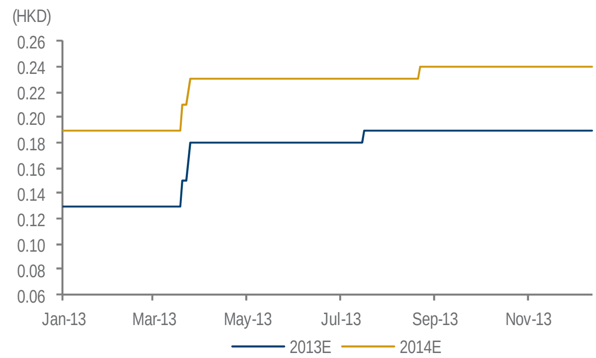


Source: Thomson Reuters, Daiwa forecasts

Earnings revisions ✔✔✔✔

The stock is covered by only four analysts. Compared with the Bloomberg consensus, we are likely more optimistic on Sinotrans' 3PL services, which we expect to be a major driver of its earnings over our forecast horizon, as well as the earnings contribution from its subsidiary's JV with DHL.

Sinotrans: revisions to consensus earnings forecasts (2013-14E)



Source: Bloomberg, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sea-freight forwarding volume growth (%)	n.a.	n.a.	n.a.	n.a.	3.2	6.0	4.0	4.0
Air-freight forwarding volume growth (%)	0.0	n.a.	n.a.	n.a.	5.0	(5.0)	7.0	8.0
3PL service revenue growth	0.0	0.0	0.0	0.0	0.0	15.0	15.0	15.0
Vessel calls (times)	0.0	n.a.	n.a.	n.a.	0.2	(1.0)	0.0	0.0
Freight rate increase (%)	0.0	n.a.	n.a.	n.a.	0.0	(5.0)	5.0	5.0

■ Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Freight forwarding	28,991	22,337	35,588	36,211	39,449	41,515	45,831	50,630
Shipping agency	675	556	632	669	1,018	1,008	1,008	1,008
Other Revenue	5,410	4,742	6,327	6,867	7,015	7,128	7,683	8,287
Total Revenue	35,076	27,635	42,547	43,747	47,482	49,650	54,522	59,925
Other income	346	334	249	196	148	148	148	148
COGS	(29,135)	(22,253)	(35,755)	(36,414)	(39,892)	(41,714)	(45,807)	(50,347)
SG&A	(4,797)	(4,415)	(5,421)	(5,780)	(6,002)	(6,165)	(6,548)	(6,971)
Other op.expenses	(741)	(801)	(843)	(883)	(1,053)	(1,116)	(1,199)	(1,284)
Operating profit	749	500	777	866	683	803	1,116	1,472
Net-interest inc./(exp.)	25	(64)	(83)	(117)	(194)	(240)	(240)	(240)
Assoc/forex/extraord./others	412	319	363	431	744	839	930	1,023
Pre-tax profit	1,186	755	1,056	1,180	1,233	1,402	1,807	2,255
Tax	(348)	(228)	(224)	(308)	(322)	(295)	(465)	(653)
Min. int./pref. div./others	(270)	(130)	(216)	(229)	(262)	(318)	(386)	(460)
Net profit (reported)	569	397	616	643	649	789	956	1,142
Net profit (adjusted)	463	355	744	676	656	787	956	1,142
EPS (reported)(CNY)	0.134	0.093	0.145	0.151	0.153	0.186	0.225	0.269
EPS (adjusted)(CNY)	0.109	0.084	0.175	0.159	0.154	0.185	0.225	0.269
EPS (adjusted fully-diluted)(CNY)	0.109	0.084	0.175	0.159	0.154	0.185	0.225	0.269
DPS (CNY)	0.050	0.020	0.040	0.030	0.030	0.030	0.030	0.030
EBIT	948	602	562	800	662	807	1,116	1,472
EBITDA	1,079	894	1,191	1,307	1,158	1,313	1,679	2,087

■ Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	1,186	755	1,056	1,180	1,233	1,402	1,807	2,255
Depreciation and amortisation	330	412	434	460	494	529	581	634
Tax paid	(348)	(273)	(232)	(363)	(309)	(295)	(465)	(653)
Change in working capital	(656)	(23)	(3)	(130)	(1,590)	(774)	(1,193)	(1,487)
Other operational CF items	333	(88)	(297)	(29)	554	154	446	634
Cash flow from operations	844	782	958	1,118	381	1,016	1,176	1,383
Capex	(999)	(473)	(992)	(1,341)	(1,316)	(1,500)	(1,500)	(1,500)
Net (acquisitions)/disposals	(23,887)	(650)	(403)	(505)	(46)	(312)	0	0
Other investing CF items	23,593	91	508	326	172	520	796	867
Cash flow from investing	(1,293)	(1,031)	(887)	(1,520)	(1,190)	(1,292)	(704)	(633)
Change in debt	831	(1,583)	1,267	2,466	1,473	368	200	0
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(342)	(113)	(246)	(366)	(152)	(127)	(127)	(127)
Other financing CF items	(28)	2,390	(53)	(1,339)	(431)	(359)	(320)	(320)
Cash flow from financing	461	694	968	761	890	(119)	(248)	(448)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	12	445	1,038	359	81	(394)	223	302
Free cash flow	(155)	309	(34)	(223)	(935)	(484)	(324)	(117)

Source: FactSet, Daiwa forecasts

Financial summary continued ...

Balance sheet (CNYm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	4,918	4,713	5,522	5,940	6,174	5,983	6,207	6,509
Inventory	30	31	36	83	53	105	105	105
Accounts receivable	4,580	5,489	6,421	6,708	8,019	9,028	9,914	10,896
Other current assets	876	832	1,103	1,841	1,271	1,369	1,369	1,369
Total current assets	10,405	11,065	13,082	14,572	15,518	16,486	17,595	18,879
Fixed assets	4,213	4,364	4,752	5,622	6,367	7,382	8,282	9,144
Goodwill & intangibles	1,033	1,733	2,087	2,251	2,450	2,456	2,456	2,456
Other non-current assets	3,570	4,557	5,174	4,357	4,953	5,418	5,868	6,318
Total assets	19,221	21,719	25,095	26,802	29,288	31,741	34,201	36,797
Short-term debt	2,044	436	3,110	4,465	2,832	2,800	2,800	2,800
Accounts payable	5,489	5,192	5,596	6,126	7,619	8,542	9,337	10,217
Other current liabilities	1,439	1,924	2,777	3,277	2,862	3,083	3,333	3,575
Total current liabilities	8,973	7,552	11,484	13,867	13,313	14,425	15,470	16,592
Long-term debt	27	2,552	1,144	748	2,845	3,245	3,445	3,445
Other non-current liabilities	384	394	426	202	402	364	364	364
Total liabilities	9,384	10,497	13,055	14,817	16,561	18,034	19,279	20,400
Share capital	4,249	4,249	4,249	4,249	4,249	4,249	4,249	4,249
Reserves/R.E./others	3,740	4,915	5,510	5,536	6,113	6,775	7,604	8,618
Shareholders' equity	7,989	9,164	9,759	9,785	10,362	11,024	11,853	12,867
Minority interests	1,847	2,058	2,281	2,200	2,365	2,684	3,069	3,530
Total equity & liabilities	19,221	21,719	25,095	26,802	29,288	31,741	34,201	36,797
EV	4,372	5,626	6,189	6,609	6,439	7,679	8,042	8,200
Net debt/(cash)	(2,847)	(1,725)	(1,267)	(727)	(497)	62	38	(264)
BVPS (CNY)	1.880	2.157	2.297	2.303	2.439	2.594	2.790	3.028

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	(12.6)	(21.2)	54.0	2.8	8.5	4.6	9.8	9.9
EBITDA (YoY)	(36.9)	(17.2)	33.2	9.7	(11.4)	13.4	27.8	24.3
Operating profit (YoY)	(21.6)	(36.5)	(6.7)	42.4	(17.2)	21.9	38.3	31.8
Net profit (YoY)	(30.1)	(23.3)	109.8	(9.2)	(2.9)	20.0	21.5	19.4
Core EPS (fully-diluted) (YoY)	(30.1)	(23.4)	109.8	(9.2)	(2.9)	20.0	21.5	19.4
Gross-profit margin	16.9	19.5	16.0	16.8	16.0	16.0	16.0	16.0
EBITDA margin	3.1	3.2	2.8	3.0	2.4	2.6	3.1	3.5
Operating-profit margin	2.7	2.2	1.3	1.8	1.4	1.6	2.0	2.5
Net profit margin	1.3	1.3	1.7	1.5	1.4	1.6	1.8	1.9
ROAE	5.3	4.1	7.9	6.9	6.5	7.4	8.4	9.2
ROAA	2.3	1.7	3.2	2.6	2.3	2.6	2.9	3.2
ROCE	7.6	4.6	3.7	4.8	3.7	4.2	5.5	6.7
ROIC	7.0	4.2	6.0	5.8	4.3	4.9	5.8	6.7
Net debt to equity	net cash	net cash	net cash	net cash	net cash	0.6	0.3	net cash
Effective tax rate	29.3	30.2	21.2	26.1	26.1	21.0	25.7	29.0
Accounts receivable (days)	57.2	66.5	51.1	54.8	56.6	62.7	63.4	63.4
Current ratio (x)	1.2	1.5	1.1	1.1	1.2	1.1	1.1	1.1
Net interest cover (x)	n.a.	9.4	6.7	6.8	3.4	3.4	4.7	6.1
Net dividend payout	37.4	21.4	27.6	19.8	19.6	16.2	13.3	11.2
Free cash flow yield	n.a.	3.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: FactSet, Daiwa forecasts

Company profile

Sinotrans is a leading China-based shipping logistics company which provides integrated logistics services with core service of sea, air, rail and road freight forwarding, express services and shipping agency services. The Company also provides support services of storage and terminal services, trucking and marine transportation services.

Ready to deliver on the promise of 3PL

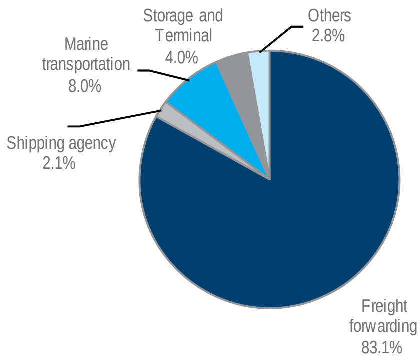
Within the China Logistics Sector, we believe Sinotrans is the most likely stock to be rerated, given the company's dominance in logistics and potential to become one of only a few major integrators.

Ready to leverage its leading position in logistics

Sinotrans is the largest freight-forwarder, in both air and sea freight, in China, and currently has the most extensive logistics network in the country.

In recent years the company has been developing its 3PL service offerings, which in 1H13 contributed 11.5% of its revenue and 26.4% of its operating profit. We forecast growth in its revenue from 3PL to exceed 15% pa in the coming three years, and expect 3PL to contribute more than 30% of its net profit from freight forwarding by 2016.

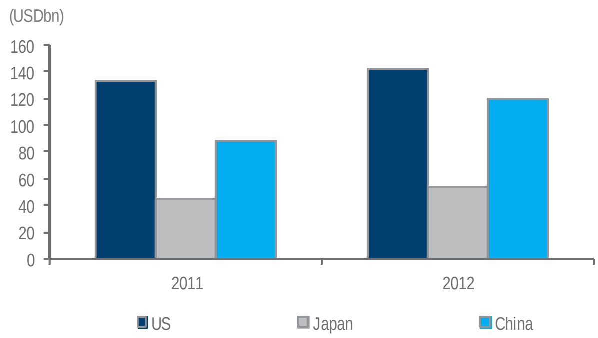
■ **Sinotrans: revenue breakdown (2012)**



Source: Company

We believe ongoing growth in the logistics industry in China will spur the further development of the company's 3PL service. Demand for 3PL is increasing in China as such services can significantly reduce manufacturers' costs, and in this respect we expect China to follow in the footsteps of the US and Japan, where 3PL services are more established and widely used.

■ **Market comparison: 3PL revenue (2011-12)**



Source: Armstrong & Associates

Sinotrans' established network, which covers many of China's tier-2 cities and tier-3, as well as the major cities, gives it a clear advantage over new entrants to the logistics market in China, in our opinion. We note that e-commerce giant Alibaba recently began using Sinotrans' logistics services, though shipment volumes are currently small.

We expect a few major integrators to emerge in China in the coming years, mirroring the way the US and Japan markets have developed, and we believe Sinotrans is the leading candidate in China to make this transformation. If the company can do so, we believe the shares would merit a long-term rerating.

■ **China: top-10 freight forwarders (by 2011 revenue)**

1	Sinotrans & CSC Holdings Co. Ltd
2	COSCO International Freight Group Limited
3	China National Materials Storage and Transportation Corporation
4	DHL Global Forwarding (China) Co., Ltd.
5	Sinosteel Shipping & Forwarding Co. Ltd
6	JC Trans Group
7	China Railway International Freight Forwarding Dalian Co,.Ltd
8	C&D Logistics Group Co., Ltd.
9	Kerry EAS Logistics Network Limited
10	Zhenghua Logistics Group

Source: China Logistics Year Book

Express service to be a major contributor

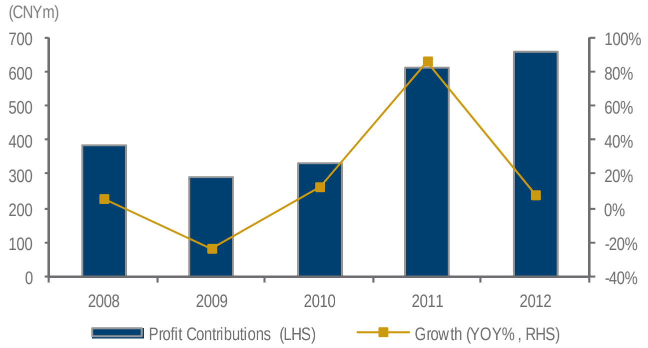
In 1986, Sinotrans' wholly-owned subsidiary, Sinotrans Air Transportation Development (SinoAir), formed a 50/50 joint venture, Sinotrans-DHL, with DHL, a leading international provider of global express services, to operate an international courier service in China.

We believe this long-established venture has positioned Sinotrans to win market share from other courier services in China, particularly in growing market segments such as e-commerce, where domestic and international players are keen to secure reliable service providers in logistics.

At the same time, the venture has given Sinotrans an opportunity to learn from DHL, which we think will help it to hone the skills to meet the logistics needs of the emerging e-commerce market in China.

Freight-forwarding for sea freight has been weak in recent years owing to subdued economic growth globally. As a result, the Sinoair-DHL venture contributed 30% of Sinotrans' pre-tax profit in 2012, a large proportion relative to previous years.

■ Sinoair-DHL joint venture: net profit (2008-12)



Source: SinoAir

Asset restructuring is a potential share-price catalyst

Possible spin-off of marine transportation business

Sinotrans' marine transportation business has been loss-making for the past three years, mainly because of losses incurred on old freight-rate contracts that the company remains committed to. According to management, although the marine transportation operation's net loss is expected to decline YoY in 2013, the company is considering spinning off the business and concentrating on logistics.

There is also a possibility of net asset injections by its parent company, Sinotrans & CSC Holdings, according to management. The parent company is an industrial conglomerate with interests in logistics, transportation and shipyards.

Potential asset injections

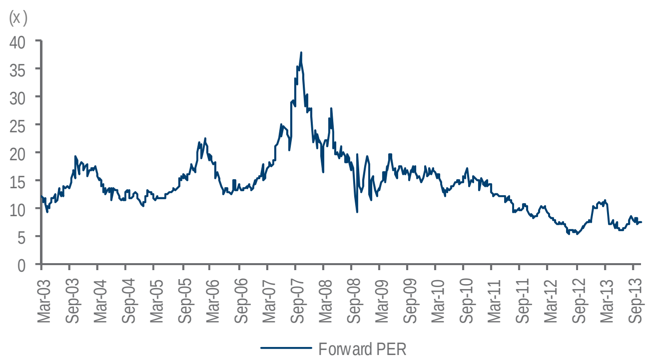
Management expects to further restructure the company in the coming 2 to 3 years. We believe Sinotrans will sharpen its focus on logistics by establishing a presence in auto transportation logistics and railway freight forwarding. In our opinion, auto transportation logistics is an area with high growth potential, while railway freight forwarding offers good synergies with Sinotrans' existing business.

Valuation and recommendation

We initiate coverage of Sinotrans with a Buy (1) rating and a six-month target price of HKD3.30 (potential upside of 39%). The company is the closest thing China has to a pure logistics player, and we believe the stock will be rerated if, as we expect, the company transforms itself into a major integrator. Sinotrans is our top pick in the China Logistics Sector.

Our target price is based on a 2014E PER of 12x, in line with the stock's past-five-year average PER multiple. We believe our target PER is conservative given continued expansion in China's logistics industry and the limited range of listed companies offering exposure to this segment. Moreover, the stock market will likely look favourably upon the company's intention to sharpen its focus on logistics, as in the past it arguably has lacked a clear business strategy.

■ Sinotrans: forward PER



Source: Thomson Reuters, Daiwa forecasts

Risks to our view

The main risk to our call on Sinotrans would be weaker-than-expected global economic growth, which would affect demand for global trade and hence the company's freight-forwarding business.

Another risk is the outlook for 3PL, which is still a new concept in China. Many manufacturers and e-commerce companies in the country currently handle their own logistics requirements. Although we expect 3PL to rise in prominence in China, its pace of development is uncertain, as is its contribution to the company's revenue and net profits.

Finally, Sinotrans' net-profit margin is highly dependent on how much the company charges its customers, and how much the company is charged by shipping companies. A hike in shipping companies' rates would be negative for Sinotrans if the company were unable to pass on the costs to its customers.

Company background

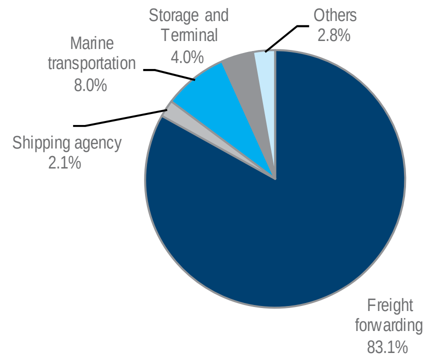
Sinotrans was listed in Hong Kong in 2003. Its major shareholder is Sinotrans & CSC Holdings, which has a 58% stake.

Sinotrans is the largest freight forwarder (both air and sea freight) and the second-largest shipping agency in China (the largest player, China Ocean Shipping Agency, is part of the COSCO Group).

Its major businesses include freight forwarding, shipping agency, storage and terminal services, marine transportation, and other ancillary services (including trucking and express services).

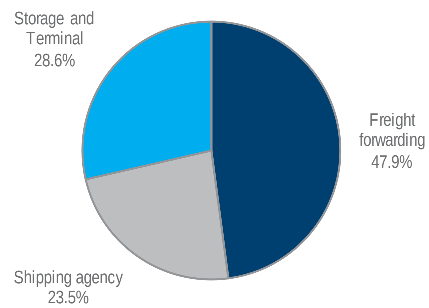
Sinotrans' major profit contributor is currently the sea-freight-forwarding business. However, we believe 3PL and international courier services will make increasing contributions to the company's net profit in the coming years.

■ Sinotrans: revenue breakdown (2012)



Source: Company

■ Sinotrans: gross-profit breakdown (2012)



Source: Company

The 10-second briefing

SITC International
1308 HK

Target (HKD): **3.20 → 4.00**
Upside: **25.0%**
12 Dec price (HKD): **3.20**

Integrated-logistics model a valuable asset

- SITC's integrated logistics model should be a good fit to accommodate the growth of 3PL services in China
- Its planned acquisition of dry-bulk vessels is a slight concern, but the share-price impact should be limited
- Switching to an SOTP valuation; raising 2013-15 earnings forecasts by 4-20%; reiterating Buy (1) rating

1 Buy (unchanged)
2 Outperform
3 Hold
4 Underperform
5 Sell

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■ What's new

We have some reservations about SITC International's planned acquisition of five dry-bulk vessels, as this may put off some investors looking for pure logistics plays. But, we remain positive on the stock because we think the capex will be relatively small and the impact on investor sentiment short-lived.

■ What's the impact

SITC is the first logistics company in the Mainland to provide integrated logistics services, and the company calls itself the UPS of the China shipping industry. We believe its business model will allow it to develop 3PL services in the future. SITC's plan to buy dry-bulk vessels could dilute its perception among investors that it is a strong logistics play. However, as the incurred capex is likely to be small (USD51m), and given that management is committed to growing its logistics business, we believe the impact on sentiment will be limited.

■ What we recommend

We reiterate our Buy (1) call and are raising our SOTP-based six-month target price to HKD4.00 (from HKD3.20). We are lifting 2013-15E earnings by 4-20% to incorporate management's recent guidance. We now value SITC using SOTP (previously a target PBR of 1.4x), as we believe separate valuations for its shipping and logistics businesses better reflect the structure of the company and allow meaningful comparison with its logistics peers.

To derive our target price, we apply a PBR of 1.0x (a 10% premium to its peers, which we think is justified given SITC's intra-Asia focus) for the shipping business and a PER of 12x (in line with that for the other logistics companies) for its logistics business for 2014E. We think the stock's PER of 6.6x, dividend yield of 6.5%, and ROE of 19% for 2014E limit the potential share-price downside. The main risk to our call would be a slower-than-expected expansion of SITC's logistics business.

■ How we differ

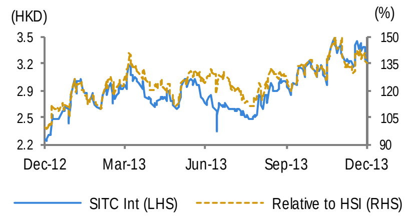
We are more optimistic than the market on the shipping industry outlook for 2014, as we expect capacity discipline to continue.

Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	(2.6)	(2.6)	(2.6)
Net profit change	4.3	4.0	19.7
Core EPS (FD) change	4.3	4.0	19.7

Source: Daiwa forecasts

Share price performance



12-month range	2.25-3.49
Market cap (USDbn)	1.07
3m avg daily turnover (USDm)	0.66
Shares outstanding (m)	2,587
Major shareholder	Resourceful Link (55.1%)

Financial summary (USD)

Year to 31 Dec	13E	14E	15E
Revenue (m)	1,287	1,466	1,669
Operating profit (m)	109	157	209
Net profit (m)	110	161	213
Core EPS (fully-diluted)	0.043	0.062	0.082
EPS change (%)	17.7	46.6	32.2
Daiwa vs Cons. EPS (%)	11.9	27.2	42.1
PER (x)	9.7	6.6	5.0
Dividend yield (%)	4.6	6.5	8.5
DPS	0.019	0.027	0.035
PBR (x)	1.4	1.2	1.0
EV/EBITDA (x)	7.2	5.3	4.1
ROE (%)	14.9	19.4	22.2

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Avg freight rate (USD/TEU)	0.0	450.0	506.0	543.0	539.0	485.1	485.1	485.1
Lifting volume ('000 TEU)	0.0	1,186.8	1,373.2	1,546.3	1,774.1	1,991.6	2,230.6	2,498.2
Bunker price (USD/ton)	0.0	386.0	495.0	669.0	664.0	610.0	600.0	600.0
Avg freight rate growth (%)	0.0	(16.2)	12.4	7.3	(0.7)	(10.0)	0.0	0.0
Lifting volume growth (%)	0.0	9.9	15.7	12.6	14.7	12.3	12.0	12.0
Bunker price growth (%)	0.0	24.3	39.5	2.2	(8.1)	(1.6)	0.0	0.0
Vessel capacity growth (%)	0.0	5.3	22.5	8.2	13.0	10.0	10.0	10.0

Profit and loss (USDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sea freight logistics Revenues	0	430	434	407	488	492	551	617
Land based logistics Revenues	0	264	458	653	716	795	915	1,052
Other Revenue	0	0	0	0	0	0	0	(0)
Total Revenue	0	694	892	1,060	1,205	1,287	1,466	1,669
Other income	0	4	3	34	14	17	17	17
COGS	0	(616)	(711)	(945)	(1,057)	(1,115)	(1,233)	(1,372)
SG&A	0	(37)	(52)	(52)	(61)	(63)	(70)	(77)
Other op.expenses	0	(10)	(15)	(5)	(10)	(16)	(22)	(28)
Operating profit	0	36	117	93	91	109	157	209
Net-interest inc./(exp.)	0	(1)	(0)	9	5	7	7	7
Assoc/forex/extraord./others	0	(1)	(1)	(5)	0	0	1	2
Pre-tax profit	0	34	115	96	96	117	165	218
Tax	0	(1)	(3)	(2)	(2)	(2)	(3)	(5)
Min. int./pref. div./others	0	(0)	(0)	(1)	(0)	(0)	(1)	(1)
Net profit (reported)	0	32	112	94	93	114	161	213
Net profit (adjusted)	0	31	112	75	93	110	161	213
EPS (reported)(USD)	n.a.	0.012	0.043	0.036	0.036	0.044	0.062	0.082
EPS (adjusted)(USD)	n.a.	0.012	0.043	0.029	0.036	0.043	0.062	0.082
EPS (adjusted fully-diluted)(USD)	n.a.	0.012	0.043	0.029	0.036	0.043	0.062	0.082
DPS (USD)	0.000	0.000	0.015	0.015	0.015	0.019	0.027	0.035
EBIT	0	36	117	93	91	109	157	209
EBITDA	0	44	126	93	100	125	178	236

Cash flow (USDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	0	34	115	96	96	117	165	218
Depreciation and amortisation	0	9	11	11	16	25	31	36
Tax paid	0	(2)	(2)	(2)	(2)	(2)	(3)	(5)
Change in working capital	0	3	31	(14)	(8)	(7)	(9)	(10)
Other operational CF items	0	2	2	2	2	2	3	6
Cash flow from operations	0	46	157	94	104	134	187	246
Capex	0	(14)	(39)	(95)	(196)	(172)	(172)	(172)
Net (acquisitions)/disposals	0	0	1	1	(2)	(2)	(2)	(2)
Other investing CF items	0	6	(0)	2	(30)	(30)	(30)	(30)
Cash flow from investing	0	(8)	(38)	(91)	(228)	(203)	(203)	(203)
Change in debt	0	(21)	(18)	(42)	96	35	35	35
Net share issues/(repurchases)	0	0	401	(2)	(1)	0	0	0
Dividends paid	0	0	(40)	(40)	(40)	(40)	(49)	(69)
Other financing CF items	0	(1)	(15)	0	(9)	19	19	19
Cash flow from financing	0	(23)	327	(84)	45	14	5	(15)
Forex effect/others	0	(0)	4	14	22	(1)	(1)	(1)
Change in cash	0	15	449	(68)	(57)	(56)	(12)	27
Free cash flow	0	32	118	(1)	(92)	(37)	16	74

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (USDm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	0	66	504	437	379	323	311	338
Inventory	0	8	12	16	19	20	23	25
Accounts receivable	0	35	49	79	73	78	89	101
Other current assets	0	66	16	28	40	42	48	54
Total current assets	0	175	581	559	510	464	470	517
Fixed assets	0	167	189	264	444	591	732	867
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	0	5	17	28	46	64	83	102
Total assets	0	346	787	852	1,001	1,119	1,285	1,487
Short-term debt	0	17	13	31	17	52	86	121
Accounts payable	0	72	86	141	138	146	162	181
Other current liabilities	0	81	26	20	24	26	28	31
Total current liabilities	0	170	125	192	180	224	277	333
Long-term debt	0	73	66	6	115	115	115	115
Other non-current liabilities	0	3	1	0	1	1	1	1
Total liabilities	0	247	191	198	296	340	393	450
Share capital	0	0	34	33	33	33	33	33
Reserves/R.E./others	0	98	560	617	670	743	856	1,000
Shareholders' equity	0	98	594	650	703	777	889	1,033
Minority interests	0	2	3	3	2	2	3	4
Total equity & liabilities	0	346	787	852	1,001	1,119	1,285	1,487
EV	1,068	1,092	642	662	814	905	951	960
Net debt/(cash)	0	24	(426)	(400)	(246)	(156)	(110)	(102)
BVPS (USD)	n.a.	0.038	0.228	0.250	0.272	0.300	0.344	0.399

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	n.a.	n.a.	28.4	18.9	13.6	6.9	13.9	13.9
EBITDA (YoY)	n.a.	n.a.	186.2	(25.8)	7.7	24.4	42.9	32.6
Operating profit (YoY)	n.a.	n.a.	227.1	(20.6)	(1.7)	20.2	43.5	33.2
Net profit (YoY)	n.a.	n.a.	261.9	(32.9)	24.4	17.7	46.6	32.2
Core EPS (fully-diluted) (YoY)	n.a.	n.a.	261.9	(32.6)	25.0	17.7	46.6	32.2
Gross-profit margin	n.a.	11.3	20.3	10.9	12.3	13.4	15.8	17.8
EBITDA margin	n.a.	6.3	14.1	8.8	8.3	9.7	12.2	14.2
Operating-profit margin	n.a.	5.1	13.1	8.7	7.6	8.5	10.7	12.5
Net profit margin	n.a.	4.5	12.6	7.1	7.8	8.5	11.0	12.8
ROAE	n.a.	63.1	32.4	12.1	13.8	14.9	19.4	22.2
ROAA	n.a.	17.9	19.8	9.2	10.1	10.4	13.4	15.4
ROCE	n.a.	37.4	26.9	13.6	11.9	12.3	15.4	17.7
ROIC	n.a.	54.9	77.3	42.7	24.9	19.8	21.9	23.9
Net debt to equity	net cash	24.7	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	n.a.	4.4	2.3	2.1	2.4	2.1	2.1	2.1
Accounts receivable (days)	n.a.	9.3	17.3	22.0	22.9	21.3	20.7	20.7
Current ratio (x)	n.a.	1.0	4.7	2.9	2.8	2.1	1.7	1.6
Net interest cover (x)	n.a.	35.6	600.8	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	n.a.	0.0	35.8	42.8	42.8	42.8	42.8	42.8
Free cash flow yield	0.0	3.0	11.0	n.a.	n.a.	n.a.	1.5	7.0

Source: FactSet, Daiwa forecasts

Company profile

SITC International Holdings (SITC) is a leading China-based shipping logistics company with an operating capacity of 50,360 TEUs (average vessel age of about 7.7 years). It is the third-largest overall and the largest non-state-owned China-based container shipping company in terms of 2010 shipping capacity. SITC focuses extensively on the intra-Asia market.

The 10-second briefing

Shenzhen International
152 HK

Target (HKD): **1.30**
Upside: **35.4%**
12 Dec price (HKD): **0.96**

Initiation: good grounds for a rerating

- SZI's development of integrated logistics hubs should be its main bright spot and drive a rerating
- We believe its landbank in Qianhai has substantial value, which should also provide share-price support
- Initiating with a Buy (1) rating and SOTP-derived target price of HKD1.30, implying 35% upside potential

1 Buy (initiation)
2 Outperform
3 Hold
4 Underperform
5 Sell

How do we justify our view?

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Investment case

Shenzhen International (SZI) is a conglomerate with businesses in logistics, toll roads and air travel. It is developing a new type of integrated logistics hub which we believe is a crucial breakthrough that should alter investors' perception of SZI from being a holding company to a logistics operator, and thus drive a rerating of the stock in the coming months. Also, we see considerable value to unlock from SZI's landbank in Qianhai. We initiate coverage with a Buy (1) rating.

Catalysts

SZI's logistics business only contributed about 8% of its adjusted EBIT for 1H13. However, as management targets to sign agreements for, and start building, 30 integrated logistics hubs by 2015, it expects the earnings contribution to rise to 30% in the long term, and we see this business as SZI's main earnings-growth and value driver. Currently, we estimate the occupancy rate for all the logistics parks at above 90%.

In our view, another major rerating catalyst lies in SZI's landbank in Qianhai, which we estimate is worth HKD0.6/share assuming SZI would be required to pay a land conversion premium of CNY10,000/sq m.

We forecast SZI's toll-road business to record improved EPS growth of 13% YoY for 2014 and 2015, driven mainly by a turnaround from losses to breakeven at Qinglian expressway.

We expect subsidiary Shenzhen Airlines' domestic passenger yield to recover in 2014 on likely greater capacity discipline, and see another potential catalyst if SZI decides to sell its 49% stake in the airline and focus on its logistics business.

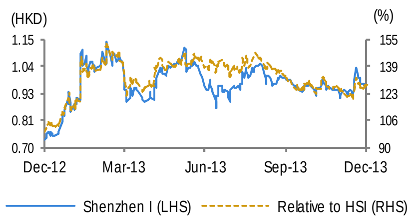
Valuation

We have a six-month target price of HKD1.30 derived from our SOTP valuation, which we consider the most appropriate method given SZI's profile as a conglomerate. We believe its current share price does not reflect fully its logistics business potential and land value in Qianhai.

Risks

The main risk to our call on SZI would be lower-than-expected toll-road traffic and revenue growth. Other risks include a lower-than-expected land value being realised.

Share price performance



12-month range	0.74-1.14
Market cap (USDbn)	2.05
3m avg daily turnover (USDm)	6.82
Shares outstanding (m)	16,542
Major shareholder	Shenzhen Investment Hldg (48.1%)

Financial summary (HKD)

Year to 31 Dec	13E	14E	15E
Revenue (m)	6,234	6,888	7,686
Operating profit (m)	2,981	3,246	3,959
Net profit (m)	2,077	2,453	3,065
Core EPS (fully-diluted)	0.126	0.148	0.185
EPS change (%)	10.1	17.5	24.9
Daiwa vs Cons. EPS (%)	(3.0)	5.8	23.4
PER (x)	7.6	6.5	5.2
Dividend yield (%)	3.9	3.9	3.9
DPS	0.037	0.037	0.037
PBR (x)	1.1	1.0	0.9
EV/EBITDA (x)	8.6	7.9	6.6
ROE (%)	15.5	16.3	17.8

Source: FactSet, Daiwa forecasts

1 Buy (initiation)
2 Outperform
3 Hold
4 Underperform
5 Sell

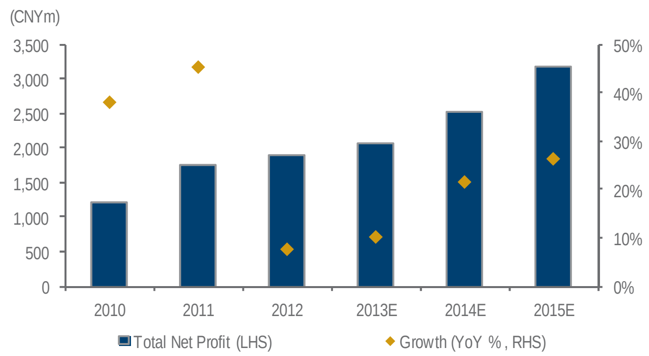
How do we justify our view?

- Growth outlook ✔✔✔✔✔
- Valuation ✔✔✔✔✔
- Earnings revisions ✔✔✔✔✔

Growth outlook ✔✔✔✔✔

We expect SZI's net profit growth to accelerate from 2014 onwards, on the back of an earnings rebound for its toll-road business due to a recovery in truck traffic, and a turnaround to breakeven for Qinglian expressway in 2014 (from net losses over 2007-13E). In addition, we expect the company's new logistics hubs that it is developing to start contributing to its net profit from 2015 onwards.

SZI: net profit and net profit growth (2010-15E)

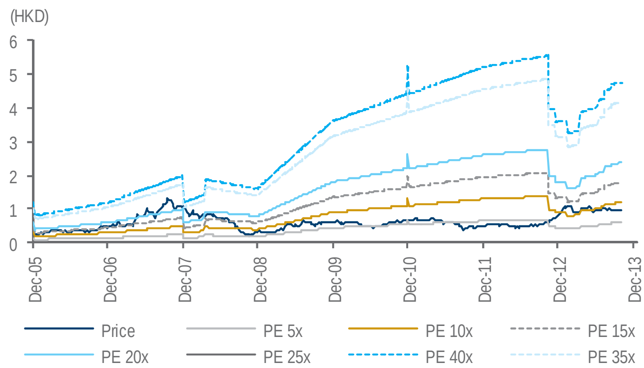


Source: Company

Valuation ✔✔✔✔✔

SZI's share price rallied sharply in late-2012 due to the government's development of the Qianhai area, which has improved investor sentiment on the company as it is one of the three main land owners in Qianhai. In recent months, investors have started focusing on how SZI will develop its logistics hubs in China. Even after its rerating since late-2012, we believe SZI's current 2014E PER of 6.5x based on our EPS is undemanding given the good growth potential we see for its integrated logistics hubs. Also, we believe the market has not yet fully factored in the value of its landbank in Qianhai, which we estimate is worth HKD0.6/share, and which should limit the downside share-price risk.

SZI: 12-month forward PER



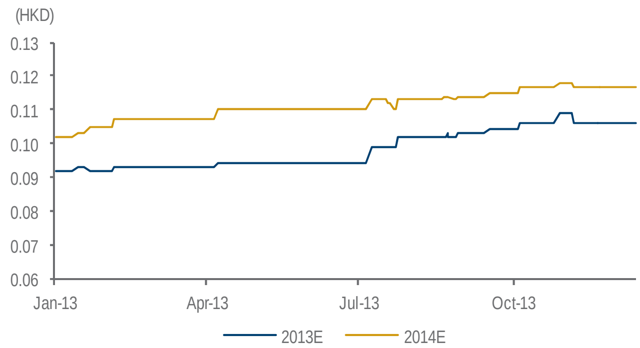
Source: Thomson Reuters, Daiwa forecasts

Earnings revisions ✔✔✔✔✔

The Bloomberg consensus EPS forecasts have been steadily revised up in 2013, likely due to positive developments in the logistics industry and new investment by SZI.

Our 2014 and 2015 EPS forecasts are 6% and 24%, respectively, above the consensus forecasts, as we are more optimistic than the consensus on an earnings recovery for SZI's toll-road business and believe its new logistics hubs will start contributing positively to its bottom line in 2015.

SZI: revisions to consensus 2013E and 2014E EPS



Source: Bloomberg, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Toll road revenue growth	n.a.	n.a.	23.9	3.4	0.9	7.8	5.3	5.3
Logistics busines revenue growth	n.a.	n.a.	39.4	63.0	14.3	16.3	16.7	21.9

■ Profit and loss (HKDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Toll road revenue	0	3,725	4,617	4,774	4,817	5,161	5,636	6,158
Logistics business revenue	0	355	495	807	922	1,073	1,252	1,527
Other Revenue	5,952	1	0	0	0	0	0	0
Total Revenue	5,952	4,081	5,112	5,581	5,740	6,234	6,888	7,686
Other income	263	467	573	484	80	308	0	0
COGS	(4,665)	(2,636)	(2,994)	(2,839)	(3,102)	(3,164)	(3,227)	(3,292)
SG&A	(22)	(23)	(27)	(35)	(43)	(43)	(44)	(45)
Other op.expenses	(214)	(202)	(244)	(330)	(337)	(354)	(371)	(390)
Operating profit	1,314	1,688	2,419	2,861	2,339	2,981	3,246	3,959
Net-interest inc./(exp.)	(384)	(541)	(632)	(644)	(855)	(730)	(767)	(805)
Assoc/forex/extraord./others	227	297	358	586	1,291	818	1,145	1,373
Pre-tax profit	1,157	1,444	2,145	2,803	2,775	3,068	3,624	4,528
Tax	(190)	(267)	(453)	(540)	(479)	(530)	(626)	(782)
Min. int./pref. div./others	(392)	(307)	(491)	(518)	(417)	(461)	(545)	(681)
Net profit (reported)	575	870	1,201	1,745	1,878	2,077	2,453	3,065
Net profit (adjusted)	533	841	1,190	1,176	1,875	2,077	2,453	3,065
EPS (reported)(HKD)	0.041	0.614	0.086	0.107	0.115	0.126	0.148	0.185
EPS (adjusted)(HKD)	0.038	0.594	0.085	0.072	0.115	0.126	0.148	0.185
EPS (adjusted fully-diluted)(HKD)	0.038	0.594	0.085	0.072	0.115	0.126	0.148	0.185
DPS (HKD)	0.014	0.217	0.035	0.033	0.037	0.037	0.037	0.037
EBIT	1,314	1,688	2,419	2,861	2,339	2,981	3,246	3,959
EBITDA	1,724	2,249	3,374	3,930	3,496	4,196	4,522	5,299

■ Cash flow (HKDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	1,157	1,444	2,145	2,803	2,775	3,068	3,624	4,528
Depreciation and amortisation	410	562	955	1,069	1,157	1,215	1,276	1,340
Tax paid	(295)	(374)	(442)	(590)	(642)	(530)	(626)	(782)
Change in working capital	2,306	(129)	(121)	(299)	(131)	(59)	(90)	(118)
Other operational CF items	(2,458)	(200)	(480)	(1,129)	(1,230)	(1,207)	(1,231)	(1,464)
Cash flow from operations	1,121	1,303	2,056	1,853	1,929	2,487	2,953	3,503
Capex	(3,177)	(2,078)	(1,806)	(1,578)	(1,318)	(1,500)	(1,500)	(1,500)
Net (acquisitions)/disposals	(1,053)	(2,342)	24	(484)	36	0	0	0
Other investing CF items	384	529	198	257	136	235	239	243
Cash flow from investing	(3,846)	(3,891)	(1,585)	(1,806)	(1,147)	(1,265)	(1,261)	(1,257)
Change in debt	6,543	6,475	4,755	7,893	3,424	3,000	3,000	3,000
Net share issues/(repurchases)	2	32	4	0	0	0	0	0
Dividends paid	(655)	(374)	(479)	(723)	(782)	(612)	(612)	(612)
Other financing CF items	(4,658)	(4,319)	(4,152)	(5,230)	(2,283)	(3,898)	(3,500)	(3,500)
Cash flow from financing	1,232	1,813	129	1,939	360	(1,510)	(1,112)	(1,112)
Forex effect/others	75	(0)	4	7	0	(33)	(32)	(31)
Change in cash	(1,419)	(775)	603	1,994	1,143	(321)	547	1,102
Free cash flow	(2,057)	(775)	250	275	611	987	1,453	2,003

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (HKDm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	2,061	1,683	2,079	3,733	4,868	4,545	5,091	6,194
Inventory	0	0	0	8	9	9	9	9
Accounts receivable	574	412	623	917	1,165	1,265	1,398	1,560
Other current assets	1,306	2,326	3,451	1,501	1,647	1,647	1,647	1,647
Total current assets	3,941	4,422	6,153	6,160	7,689	7,466	8,145	9,409
Fixed assets	1,636	2,281	3,226	4,025	3,829	4,809	5,720	6,563
Goodwill & intangibles	18,126	22,464	23,447	24,386	24,189	23,502	22,770	21,990
Other non-current assets	3,211	3,282	3,970	5,330	6,677	7,677	8,746	10,096
Total assets	26,915	32,448	36,796	39,901	42,383	43,453	45,381	48,057
Short-term debt	1,942	3,863	2,141	1,413	3,898	3,500	3,500	3,500
Accounts payable	3,234	2,085	2,308	2,245	2,082	2,124	2,166	2,210
Other current liabilities	160	175	328	751	516	516	516	516
Total current liabilities	5,336	6,123	4,777	4,409	6,496	6,140	6,182	6,226
Long-term debt	10,369	11,031	11,809	15,321	14,072	13,572	13,072	12,572
Other non-current liabilities	1,327	2,574	3,187	2,022	1,827	1,827	1,827	1,827
Total liabilities	17,032	19,728	19,773	21,753	22,395	21,539	21,082	20,625
Share capital	2,941	2,974	4,920	4,937	4,952	4,952	4,952	4,952
Reserves/R.E./others	1,969	4,051	5,924	6,277	7,693	9,157	10,998	13,450
Shareholders' equity	4,910	7,025	10,844	11,214	12,645	14,110	15,950	18,403
Minority interests	4,973	5,695	6,179	6,934	7,343	7,804	8,349	9,030
Total equity & liabilities	26,915	32,448	36,796	39,901	42,383	43,453	45,381	48,057
EV	31,103	34,785	33,930	35,815	36,325	36,212	35,710	34,789
Net debt/(cash)	10,250	13,210	11,871	13,001	13,101	12,527	11,481	9,878
BVPS (HKD)	0.347	4.960	0.773	0.685	0.772	0.853	0.964	1.112

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	19.4	(31.4)	25.3	9.2	2.8	8.6	10.5	11.6
EBITDA (YoY)	(49.8)	30.5	50.0	16.5	(11.0)	20.0	7.8	17.2
Operating profit (YoY)	(57.6)	28.5	43.3	18.3	(18.2)	27.5	8.9	22.0
Net profit (YoY)	(74.4)	57.8	41.6	(1.2)	59.5	10.8	18.1	24.9
Core EPS (fully-diluted) (YoY)	(75.5)	1,476.9	(85.7)	(15.3)	59.5	10.1	17.5	24.9
Gross-profit margin	21.6	35.4	41.4	49.1	46.0	49.2	53.2	57.2
EBITDA margin	29.0	55.1	66.0	70.4	60.9	67.3	65.6	68.9
Operating-profit margin	22.1	41.4	47.3	51.3	40.7	47.8	47.1	51.5
Net profit margin	9.0	20.6	23.3	21.1	32.7	33.3	35.6	39.9
ROAE	9.0	14.1	13.3	10.7	15.7	15.5	16.3	17.8
ROAA	2.1	2.8	3.4	3.1	4.6	4.8	5.5	6.6
ROCE	6.1	6.8	8.3	8.7	6.4	7.7	8.1	9.4
ROIC	5.8	6.0	7.0	7.7	6.0	7.3	7.6	9.0
Net debt to equity	208.8	188.0	109.5	115.9	103.6	88.8	72.0	53.7
Effective tax rate	16.4	18.5	21.1	19.3	17.3	17.3	17.3	17.3
Accounts receivable (days)	30.4	44.1	37.0	50.4	66.2	71.2	70.6	70.2
Current ratio (x)	0.7	0.7	1.3	1.4	1.2	1.2	1.3	1.5
Net interest cover (x)	3.4	3.1	3.8	4.4	2.7	4.1	4.2	4.9
Net dividend payout	35.4	35.3	40.9	31.0	32.6	29.5	25.0	20.0
Free cash flow yield	n.a.	n.a.	1.6	1.7	3.8	6.2	9.1	12.6

Source: FactSet, Daiwa forecasts

Company profile

Shenzhen International Holdings Limited (SZI) is a conglomerate engaged in the investment, construction, and operation of logistics infrastructure facilities in China, and provides logistics services. The company also owns 51% of the toll-road operator Shenzhen Expressway, 49% of Shenzhen Airlines, and a 380,000 sq km landbank in the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone.

Logistics business should be its key driver

We believe SZI's development of integrated logistics hubs should drive a near-term rerating and long-term earnings growth, and that the value of its landbank in Qianhai should also provide good share-price support.

Logistics business: developing a bright future

SZI is a conglomerate with businesses spanning logistics infrastructure facilities, toll roads (51% ownership of Shenzhen Expressway (548 HK, HKD3.51, Buy [1]), and Shenzhen Airlines (49%-owned, unlisted).

SZI is aiming to develop a new type of integrated logistics hub in China in 2014 and 2015. The concept entails providing common facilities, including warehouses, office space, IT systems to improve coordination of logistics services, and even accommodation and restaurants. We believe there is high potential demand for such services, given many small and medium-sized logistics companies in the country probably cannot afford the substantial investments required in such facilities.

In addition, SZI's objective is for its new integrated logistics hubs to serve as distribution centres for companies to communicate with each other, thereby facilitating the flow of goods and improving operational efficiency. SZI has already been running successfully a proto-type of this business model in the Shenzhen Huatongyuan (HTY) Logistics Centre since mid-2010, and plans to expand this concept to other cities.

■ HTY Logistics Centre: view of a small warehouse with drop-off and pick-up point for trucks

Source: Daiwa

■ HTY Logistics Centre: e-commerce offices, adjacent inns and logistics companies

Source: Daiwa

At present, SZI is building a logistics centre in Shenyang and has signed agreements with the local governments in Tianjin and Wuxi to build similar logistics centres in those two cities.

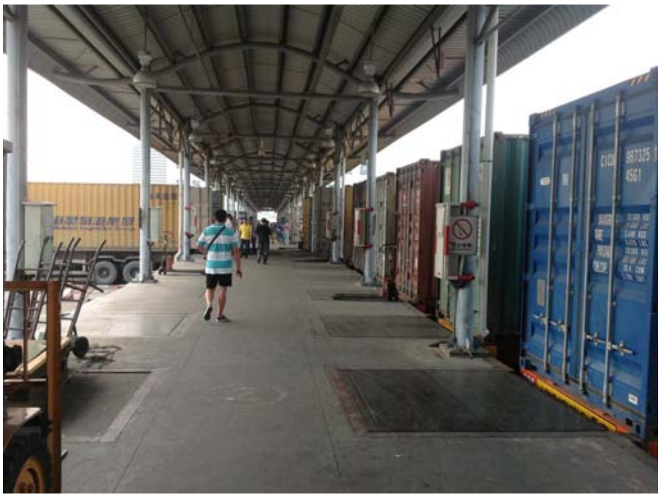
■ SZI: agreements signed for new logistics hubs

Date	Agreement	Location
26-Nov-13	Establishment of a project in Wuxi	Wuxi
8-Oct-13	China urban integrated logistics hub: development plan under way	Tianjin
11-Dec-12	Development of an integrated logistics hub	Shenyang

Source: Company

Besides, it intends to continue to develop new facilities at its existing major logistics centres, such as the South China Logistics Park, in order to sustain revenue growth in the long term.

■ South China Logistic Park: seamless transfer route between international trucks and domestic trucks



Source: Daiwa

■ South China Logistics Park: new trading area and shopping mall to be built inside the park soon

Source: Daiwa

SZI's logistics business accounted for only about 8% of its adjusted EBIT for 1H13, but management expects its development of new integrated logistics hubs (it plans 30 in total) to lift this proportion to 30% by the end of 2018.

Land conversion: an additional rerating catalyst

In 2010, the China Government started developing the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (Qianhai) with the aim of transforming Shenzhen from a low-end manufacturing centre to a high-end manufacturing and service one. The aim is to complete the project by 2015, and the land auction process started in June 2013. The average price of the land that has been auctioned so far is around CNY20,000/sq m.

SZI's land (380,000 sq m) is located in the logistics area of Qianhai. However, SZI's management has stated that it may try to convert its landbank into land for commercial use, such as office buildings, rather than just use it to build logistics facilities. Given the levels of land auction prices so far, we believe SZI's land could potentially be worth CNY15,000-20,000/sq m.

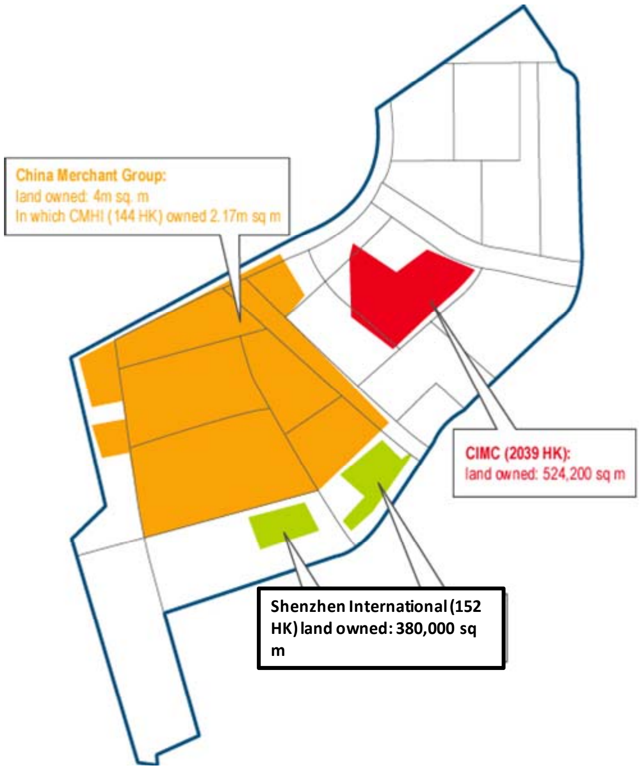
In our model, we assume that SZI will need to pay a price of CNY10,000/sq m to convert its land, assuming a plot ratio of 5x (a low plot ratio as the land falls into the logistics category), and that it would be required to return 20% of the gross floor area (GFA) to the Qianhai authority (a similar condition to that for the five latest land auctions in the area). Thus, we estimate that SZI's landbank in Qianhai is worth HKD0.60/share, and believe this should provide good share-price support in the months ahead.

■ Landbank valuation: Qianhai

Company	Shenzhen International
Stock code	152HK
Landbank (sq m)	380,000
Land price (CNY/sq m)	16,000
Land premium needed to pay (CNY/sq m)	10,000
Plot ratio (x)	5
% returned back to government	20%
No. of shares (m)	16,542
Land value per share (CNY)	0.49
Land value per share (HKD)	0.61

Source: Daiwa estimates

■ Qianhai: distribution of landbank



Source: Hong Kong Economic Times (HKET), Daiwa

■ Qianhai: land sales since June 2013

Land plot no.	T201-0077	T201-0075	T201-0078	T102-0244	T102-0245
GFA (sq m)	320,400	450,200	503,000	150,000	64,000
Base price (CNYbn)	3.5	4.7	6.72	2.42	0.998
Transaction price (CNYbn)	5.19	7.18	10.9	2.43	1.63
Difference compared with base price	48%	53%	62%	0.4%	63%
Transaction price per GFA (CNY/sq m)	16,199	15,948	21,670	16,220	25,469
Land usage (years)	40	40	40	40	40
Bidder's criteria					
Total assets (2012) (CNYbn)	> 10	> 10	n.a	n.a	n.a
Total mkt cap (as of 24-Jun-13) (HKDbn)	n.a	n.a	40	n.a	n.a
Total revenue (2012) (CNYbn)	> 10	> 10	> 20	>5	>5
Type of companies	Both domestic and international		Hong Kong listed, with assets of no less than CNY5bn	Hong Kong enterprise; must be registered in Qianhai Free Trade Zone with principal business activities in supply chain management, product exhibition and trade, industrial product design and related trade activities.	
	property company		>3 international top 500 financial institutions to invest in the project	Bidder must not bid for both T102-0245 and T102-0244 land together.	
				Parent company or holding company must be registered in Hong Kong.	

Source: Hong Kong Economic Times

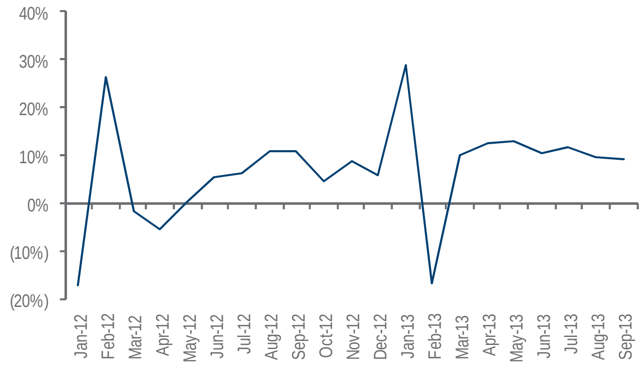
Toll-road business: profitability should improve in 2014

Regarding the toll-road business, Shenzhen Expressway's revenue and net profit came under pressure in 2H12 and 1H13 due to the alignment of toll standards in Shenzhen with those in other provinces and the implementation of a toll-free policy during national holidays.

We believe further downside to its revenue and profits arising from the toll-rate policy change is limited, as in our view the government needs more involvement from private capital in order to invest in the toll-road sector and is therefore unlikely to impose too many negative policies on toll-road operators. Indeed, we expect its profitability to improve gradually in 2014, especially as we are starting to see a consistent improvement in its truck traffic. Furthermore, the negative YoY impact of the toll-free policy during national holidays is set to diminish in 2014.

In addition, we forecast a turnaround from losses to breakeven at Qinglian expressway in 2014, which should help to improve SZI's overall profitability.

■ Shenzhen Expressway: monthly truck traffic growth, YoY (2012-September 2013)



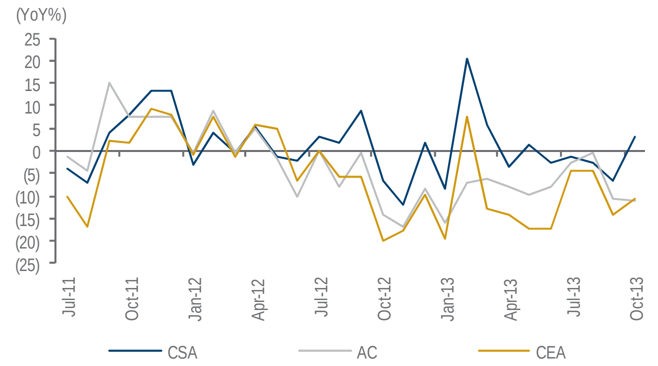
Source: Shenzhen Expressway

Shenzhen Airlines: capacity discipline should help yield recovery

SZI's airline business, which is represented by its 49% stake in Shenzhen Airlines, contributed about 7% to the company's adjusted EBIT for 1H13. Shenzhen Airlines' net profit declined sharply by 70% YoY to HKD101m for 1H13 (mirroring the trend at the big-three China airlines) due to a substantial YoY fall in its domestic passenger yield as a result of overcapacity in China's airline industry.

Starting from 3Q13, however, passenger yield declines for the China airlines have narrowed to small-single-digit YoY ones, and have even been flat YoY for some airlines. This improvement has been brought about by capacity discipline by the big-three airlines after disappointing passenger yields in 1H13. We believe this discipline has continued in 4Q13 and thus expect Shenzhen Airlines' domestic passenger yields to recover for 2H13 and 2014. Supported in part by this recovery, we expect Shenzhen Airlines' profitability to recover in tandem with the rebound we expect for the China airline industry next year.

■ **Big-3 China airlines: trend in airfares (2012-present)**



Source: Ctrip
Note: CSA = China Southern Airlines, AC = Air China, CEA = China Eastern Airlines

Valuation and recommendation

We have a six-month target price for SZI of HKD1.30, derived from our SOTP valuation. We use the SOTP method as this best captures the values of the company's different businesses and its landbank in Qianhai.

To value SZI's logistics business, we apply a target PER of 12x on our 2014E net profit for the logistics business. For the company's holding in Shenzhen Expressway, we use our six-month target price of HKD4.0.

To value the company's 49% holding in Shenzhen Airlines, we use our 2014E BVPS and assign a target PBR of 0.9x, representing the China airline industry's past-three-year average PBR. This benchmark PBR is the same as our target multiple applied to value another major domestic airline, China Southern Airlines (1055 HK, HKD3.07, Outperform [2]).

We value the company's landbank in Qianhai at HKD0.6/share, as explained earlier in this report.

Finally, we value the company's 5.89% stake in the investment company, CSG Holding (Not rated), at its current market value. SZI intends to continue reducing its stake in the medium term.

■ **SZI: summary SOTP valuation**

Asset	Methodology	Value per share (HKD)
Toll roads: holding in Shenzhen Expressway	DCF-based	0.26
Logistics business	12x 2014E PER	0.16
Holding in Shenzhen Airlines	0.9x 2014E PBR	0.21
Holding in CSG	Market value	0.08
Land value in Qianhai	CNY16,000/sq m	0.60
Total		1.30

Source: Daiwa estimates

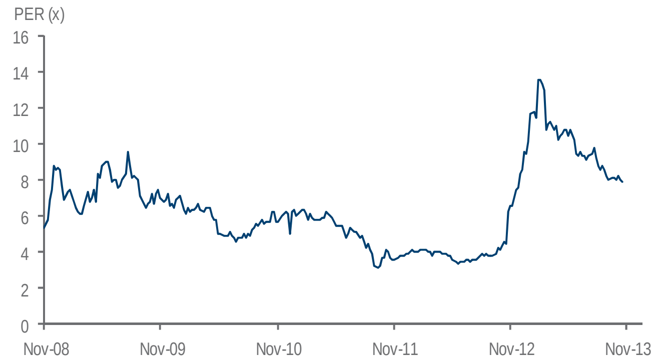
We initiate coverage on SZI with a Buy (1) rating. We foresee strong demand for SZI's integrated logistics hubs from small and medium sized e-commerce and logistics firms onwards of 2014, and expect the stock to be rerated as the market starts to recognise fully the value of its logistics business. Also, we believe the company's landbank in Qianhai has considerable value, which should provide share-price support and limit the downside risk.

Finally, SZI trades at a wide discount to Shenzhen Expressway's share price, which we expect to narrow on the back of the continuous growth in its logistics business that we forecast.

■ **SZI: share-price discount to Shenzhen Expressway (2008-present)**

Source: Thomson Reuters

■ **SZI: 12-month forward PER**



Source: Thomson Reuters, Daiwa forecasts

Risks

We see the main risk to our rating, target price and forecasts for SZI as lower-than-expected toll-road traffic and revenue growth, which could be triggered by a weaker-than-expected global economic recovery. This would also have an adverse impact on demand for services at the company's logistics centres.

Another risk would be weaker-than-expected growth in air traffic and yields for Shenzhen Airlines, which could arise from industry overcapacity if the China airlines were to deploy new capacity too aggressively in 2014.

Finally, we see downside share-price risk if the value of SZI's land in Qianhai turns out to be lower than we expect (as the land bank accounts for almost half of our SOTP valuation). Given that the development of Qianhai (and SZI's involvement in the area) was one of the major catalysts for the stock's rerating in late 2012, a lower land price compared to our expectation (for instance, below CNY15,000) could prompt a sell-off in the SZI stock.

Company background

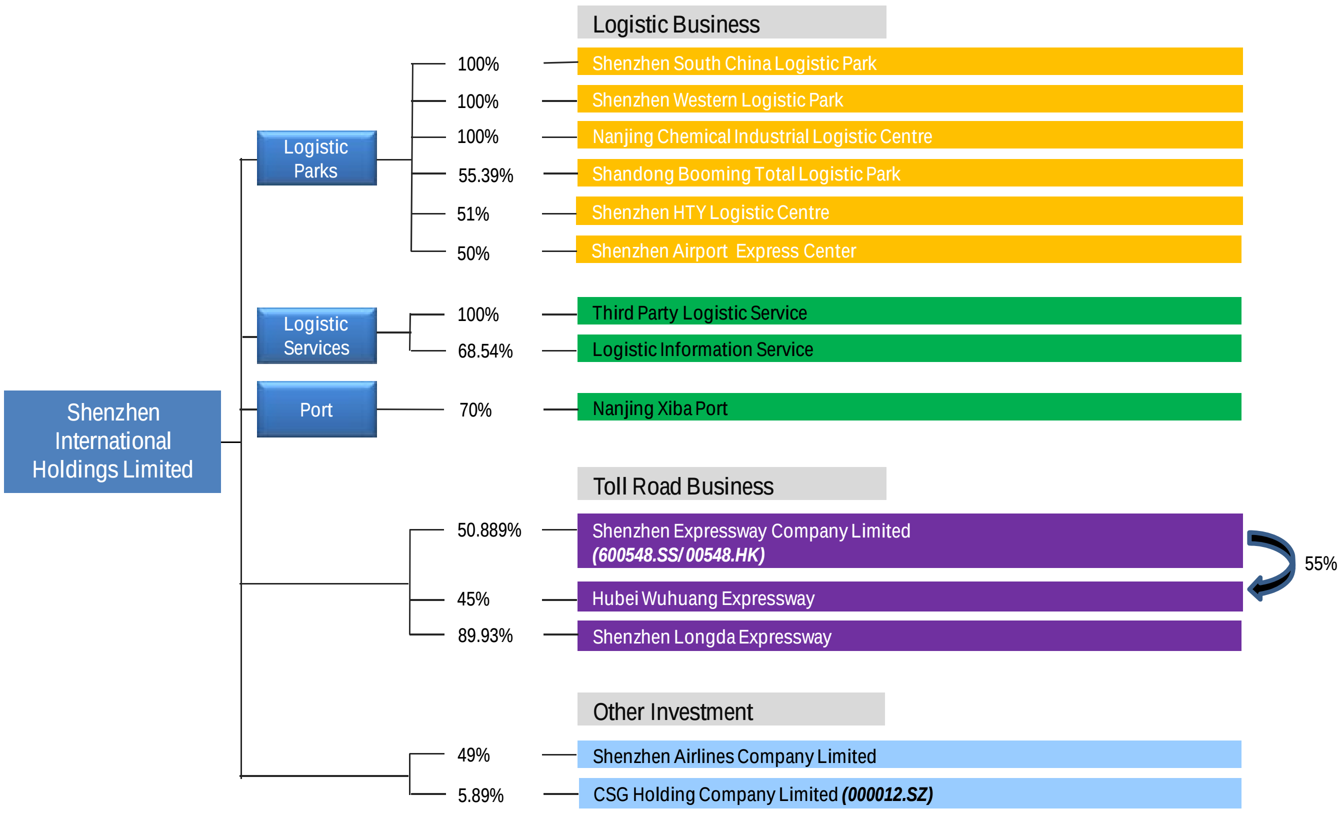
SZI is a conglomerate engaged in building and operating logistics infrastructure facilities in China and the provision of logistics services, the operation of toll roads through Shenzhen Expressway(51% owned), and an airlines business via Shenzhen Airlines. In addition, the company is one of the three main landowners in the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (Qianhai), alongside China Merchants Holding International (144 HK, HKD28.1, Buy [1]) and China International Marine Containers (2039 HK, HKD14.98, Buy [1]).

SZI currently generates the bulk of its earnings from its toll-road operation (about 68% of its adjusted EBIT for 1H13), followed by its logistics business (about 8%) and Shenzhen Airlines (about 7%), but its logistics business is management's main focus area for future years.

SZI is incorporated in Bermuda and has been listed on the Hong Kong Stock Exchange since 2000. The company's controlling shareholder is the Shenzhen Municipal Government, which has a 48% shareholding via Shenzhen Investment Holding Company.

We present SZI's current organisational structure and breakdown of its revenue and adjusted EBIT by business in the following charts.

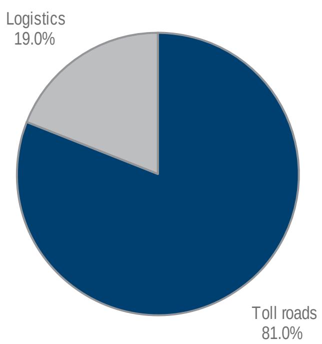
■ SZI organisation structure (2013)



(As of 30th June, 2013)

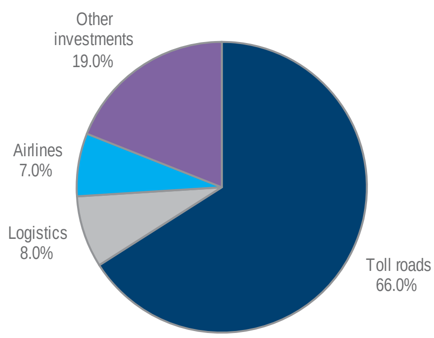
Source: Company

■ SZI: revenue breakdown (1H13)



Source: Company
Note: SZI's stake in Shenzhen Airlines is an associate, so its revenue is not consolidated

■ SZI: adjusted EBIT breakdown (1H13)



Source: Company

The 10-second briefing

Global Logistic Properties

GLP SP

Target (SGD): **3.320 → 3.320**
Upside: **14.9%**
12 Dec price (SGD): **2.890**

Pan-Asia's leading logistics property play

- Regardless of the fate of the individual operators or retailers, GLP offers exposure to the growing Pan-Asia logistics sector
- A leading developer, landlord and REIT manager of modern logistics facilities in China, Japan and Brazil
- Reiterate Outperform (2) rating and SOTP-derived six-month target price of SGD3.32

1 Buy
2 Outperform (unchanged)
3 Hold
4 Underperform
5 Sell

David Lum, CFA
(65) 6329 2102
david.lum@sg.daiwacm.com

■ What's new

We offer a new investment perspective on Global Logistic Properties (GLP), not as another landlord but as a distinctive play on the growing logistics sector, mostly in China and Japan. In our opinion, the company stands to benefit from the growth and transformation of the sector regardless of who the main 3PL/4PL winners and losers are.

■ What's the impact

GLP owns and develops modern logistics facilities and has leading positions in its three markets: China (59% of NAV as at 30 September 2013), Japan (29% of NAV) and Brazil (5% of NAV; the remaining 7% of the group's NAV consists of net cash in Singapore).

In each of its markets, GLP has the largest network (of properties owned, managed through joint ventures or REITs, and under development) by area. In China, it owns 6.3m sq m of logistics space, well ahead of the second-largest competitor, which has only 0.9m sq m. The China and Japan markets face an acute shortage of modern logistics facilities, while experiencing rapid growth of e-commerce and domestic consumption (for China), so these trends work in GLP's favour.

■ What we recommend

We reaffirm our Outperform (2) rating. Because GLP is trading at a 35% premium to tangible book value (of SGD2.14), it does not look cheap versus the typical property developers or landlords in Asia. But, we believe the stock is worth considering given its dominant market positions, strong logistics development-growth opportunities, and an inherently attractive business model with high returns. We peg our six-month target price to our SOTP valuation. We value the stable businesses (income-producing properties) at their tangible book value and the properties under development at a target PBR of 2.5x, derived from a two-stage Gordon Growth Model. The main risk to our rating would be a perceived slowdown in leasing activities in the next few quarters.

■ How we differ

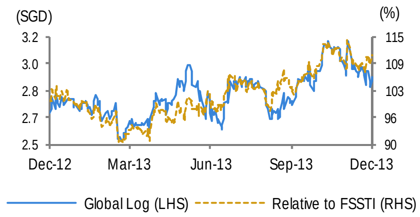
Our 2014-16E EPS (including revaluation gains) are significantly higher than those of the Bloomberg consensus. We believe the market is underestimating GLP's medium- to long-term revenue growth potential.

Forecast revisions (%)

Year to 31 Mar	14E	15E	16E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	2.520-3.130
Market cap (USDbn)	10.96
3m avg daily turnover (USDm)	21.07
Shares outstanding (m)	4,760
Major shareholder	GIC (36.4%)

Financial summary (USD)

Year to 31 Mar	14E	15E	16E
Revenue (m)	560	676	854
Operating profit (m)	345	421	550
Net profit (m)	578	621	775
Core EPS (fully-diluted)	0.121	0.130	0.163
EPS change (%)	(17.4)	7.4	24.7
Daiwa vs Cons. EPS (%)	10.3	27.8	27.0
PER (x)	19.0	17.7	14.2
Dividend yield (%)	1.4	1.5	1.5
DPS	0.033	0.033	0.034
PBR (x)	1.2	1.2	1.1
EV/EBITDA (x)	34.2	30.7	26.1
ROE (%)	6.7	6.8	8.1

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Mar	n.a.	2010	2011	2012	2013	2014E	2015E	2016E
China - construction starts (sqm m)	-	0.00	1.22	1.66	2.08	2.40	3.00	3.50
China - completions (sqm m)	-	0.00	0.56	1.04	1.20	1.50	2.40	3.00
China - land acquired (sqm m)	-	0.00	1.14	1.34	4.16	3.00	3.00	3.00
China - rents (CNY/sqm/day)	-	0.00	0.97	1.02	1.05	1.10	1.16	1.19
Japan - rents (JPY/sqm/mth)	-	0	1,079	1,075	1,097	1,144	1,155	1,167
PATMI ex-revaluations (USDm)	-	179	279	314	350	262	341	450
PATMI-ex reval per share (SGD)	-	0.102	0.093	0.068	0.075	0.055	0.072	0.094

■ Profit and loss (USDm)

Year to 31 Mar	n.a.	2010	2011	2012	2013	2014E	2015E	2016E
China	-	61	88	160	252	333	465	640
Japan	-	352	386	406	388	217	200	201
Other Revenue	-	0	0	0	2	10	12	13
Total Revenue	-	413	474	566	642	560	676	854
Other income	-	5	9	8	7	7	7	7
COGS	-	(97)	(87)	(92)	(105)	(107)	(135)	(175)
SG&A	-	(1)	(15)	(35)	(37)	(44)	(47)	(50)
Other op.expenses	-	(51)	(31)	(48)	(73)	(71)	(80)	(85)
Operating profit	-	269	350	398	434	345	421	550
Net-interest inc./(exp.)	-	(60)	(56)	(63)	(78)	(52)	(66)	(95)
Assoc/forex/extraord./others	-	(337)	513	304	485	472	464	558
Pre-tax profit	-	(128)	807	638	842	766	819	1,013
Tax	-	(22)	(85)	(83)	(126)	(164)	(169)	(203)
Min. int./pref. div./others	-	(27)	(16)	(14)	(31)	(24)	(29)	(35)
Net profit (reported)	-	(177)	706	541	684	578	621	775
Net profit (adjusted)	-	(177)	706	541	684	578	621	775
EPS (reported)(USD)	-	(0.101)	0.234	0.118	0.147	0.121	0.130	0.163
EPS (adjusted)(USD)	-	(0.101)	0.234	0.118	0.147	0.121	0.130	0.163
EPS (adjusted fully-diluted)(USD)	-	(0.101)	0.234	0.118	0.147	0.121	0.130	0.163
DPS (USD)	-	0.000	0.000	0.024	0.032	0.033	0.033	0.034
EBIT	-	269	350	398	434	345	421	550
EBITDA	-	274	359	399	439	353	428	558

■ Cash flow (USDm)

Year to 31 Mar	n.a.	2010	2011	2012	2013	2014E	2015E	2016E
Profit before tax	-	(128)	807	638	842	766	819	1,013
Depreciation and amortisation	-	5	8	5	7	7	7	7
Tax paid	-	(9)	(11)	(14)	(36)	(37)	(44)	(57)
Change in working capital	-	(48)	(48)	(48)	8	(66)	0	0
Other operational CF items	-	434	(395)	(164)	(398)	(420)	(398)	(462)
Cash flow from operations	-	254	361	418	422	249	384	501
Capex	-	(113)	(204)	(504)	(818)	(1,162)	(1,488)	(1,913)
Net (acquisitions)/disposals	-	(54)	(201)	(264)	2,263	278	200	200
Other investing CF items	-	8	2	(346)	(469)	(7)	13	13
Cash flow from investing	-	(159)	(402)	(1,115)	976	(891)	(1,275)	(1,700)
Change in debt	-	111	(364)	272	(1,118)	(34)	500	1,600
Net share issues/(repurchases)	-	(31)	1,726	0	331	0	0	0
Dividends paid	-	(17)	(135)	(2)	(108)	(153)	(156)	(159)
Other financing CF items	-	(60)	(76)	465	(110)	0	0	0
Cash flow from financing	-	3	1,151	734	(1,005)	(187)	344	1,441
Forex effect/others	-	10	38	19	(40)	0	0	0
Change in cash	-	108	1,148	56	352	(829)	(547)	241
Free cash flow	-	141	157	(87)	(396)	(913)	(1,104)	(1,412)

Source: FactSet, Daiwa forecasts

Financial summary continued …

■ Balance sheet (USDm)

As at 31 Mar	n.a.	2010	2011	2012	2013	2014E	2015E	2016E
Cash & short-term investment	-	412	1,560	1,616	1,957	1,129	582	823
Inventory	-	0	0	0	0	0	0	0
Accounts receivable	-	103	127	220	304	370	370	370
Other current assets	-	0	0	87	57	0	0	0
Total current assets	-	515	1,687	1,923	2,318	1,499	952	1,193
Fixed assets	-	0	5	8	14	28	30	32
Goodwill & intangibles	-	0	501	498	495	492	487	482
Other non-current assets	-	6,882	9,463	11,151	10,420	11,765	13,435	15,594
Total assets	-	7,397	11,656	13,580	13,248	13,784	14,904	17,302
Short-term debt	-	716	937	1,006	95	268	268	268
Accounts payable	-	1,380	503	463	529	529	529	529
Other current liabilities	-	18	18	16	52	26	27	29
Total current liabilities	-	2,114	1,458	1,485	677	824	825	826
Long-term debt	-	2,665	2,755	3,169	2,787	2,580	3,080	4,680
Other non-current liabilities	-	277	466	618	737	864	989	1,135
Total liabilities	-	5,055	4,679	5,272	4,201	4,267	4,894	6,641
Share capital	-	0	5,942	5,943	6,275	6,278	6,278	6,278
Reserves/R.E./others	-	1,566	677	1,845	2,123	2,567	3,032	3,647
Shareholders' equity	-	1,566	6,619	7,788	8,398	8,844	9,309	9,925
Minority interests	-	776	358	520	648	672	701	736
Total equity & liabilities	-	7,397	11,656	13,580	13,248	13,784	14,904	17,302
EV	-	14,385	13,073	13,244	11,328	12,082	13,157	14,551
Net debt/(cash)	-	2,969	2,132	2,559	925	1,720	2,767	4,125
BVPS (USD)	-	0.898	1.440	1.694	1.765	1.858	1.956	2.085

■ Key ratios (%)

Year to 31 Mar	n.a.	2010	2011	2012	2013	2014E	2015E	2016E
Sales (YoY)	-	n.a.	14.6	19.4	13.5	(12.7)	20.6	26.2
EBITDA (YoY)	-	n.a.	30.7	11.4	10.0	(19.7)	21.4	30.2
Operating profit (YoY)	-	n.a.	30.0	13.6	9.1	(20.4)	21.9	30.8
Net profit (YoY)	-	n.a.	n.a.	(23.4)	26.5	(15.5)	7.4	24.7
Core EPS (fully-diluted) (YoY)	-	n.a.	n.a.	(49.8)	24.9	(17.4)	7.4	24.7
Gross-profit margin	-	76.6	81.7	83.7	83.7	80.9	80.1	79.5
EBITDA margin	-	66.4	75.7	70.6	68.4	62.9	63.3	65.3
Operating-profit margin	-	65.2	73.9	70.3	67.6	61.6	62.2	64.5
Net profit margin	-	(42.7)	149.0	95.6	106.6	103.1	91.9	90.8
ROAE	-	n.a.	17.3	7.5	8.5	6.7	6.8	8.1
ROAA	-	n.a.	7.4	4.3	5.1	4.3	4.3	4.8
ROCE	-	n.a.	4.3	3.4	3.6	2.8	3.3	3.8
ROIC	-	n.a.	4.3	3.5	3.5	2.6	2.8	3.2
Net debt to equity	-	189.5	32.2	32.9	11.0	19.4	29.7	41.6
Effective tax rate	-	n.a.	10.5	13.0	15.0	21.4	20.6	20.1
Accounts receivable (days)	-	n.a.	88.6	111.8	148.9	219.6	199.9	158.3
Current ratio (x)	-	0.2	1.2	1.3	3.4	1.8	1.2	1.4
Net interest cover (x)	-	4.5	6.3	6.3	5.6	6.7	6.4	5.8
Net dividend payout	-	n.a.	0.0	20.3	21.9	27.0	25.6	21.0
Free cash flow yield	-	1.3	1.4	n.a.	n.a.	n.a.	n.a.	n.a.

Source: FactSet, Daiwa forecasts

■ Company profile

Global Logistic Properties is one of the world's largest providers of modern logistics facilities. The company owns, manages, and leases out 22.4m sq m of logistics-property space (as at 30 September 2013) to a network of over 700 customers in 62 major cities in China, Japan, and Brazil, where it maintains market-leading positions. GLP is a logistics-facilities owner and developer. The company was listed in Singapore on 18 October 2010.

Pan-Asia's leading logistics property play

GLP offers distinctive Pan-Asia exposure and market dominance in the modern logistics-property sector

A new perspective

Investment thesis

GLP owns and develops modern logistics facilities and has leading positions in its three markets: China (59% of NAV as at 30 September 2013), Japan (29% of NAV) and Brazil (5% of NAV; the remaining 7% of the group's NAV consists of net cash in Singapore).

Rather than viewing GLP as just another logistics-property landlord (albeit a dominant one), we view it as a distinctive play on the growing logistics industry, mostly in China and Japan, regardless of who the winners/losers are among the 3PL/4PL players.

The leading logistics companies in China and Japan are currently among GLP's major tenants. If some of these players lose their competitiveness or if the retailing or 3PL industries undergo consolidation, GLP's tenants might change, but the rental value of the underlying properties would remain intact as the need for well-located modern logistics facilities would still exist, in our opinion, to support the burgeoning domestic consumption and e-commerce markets.

Market leader, dominant in China

In each of its markets, GLP has the largest network (of properties owned, managed through joint ventures or REITs, and under development) by area. In China, it owns 6.3m sq m of logistics space, well ahead of the second-largest competitor, which owns only 0.9m sq m. In Japan, its network consists of 3.7m sq m versus 2.4m sq m for the second-largest player, while in Brazil, its network consists of 2.0m sq m versus 1.2m sq m for the second-largest player. (All comparisons are as at 30 September 2013.)

Positive macro factors

At the macro level, China's logistics-property sector is supported by favourable demographics and industry trends. Urbanisation reached 51% of the population in 2011. The National Statistics Bureau of China estimates that more than 10m people migrate to the urban areas annually. The urbanisation has been accompanied by rising wealth (income per capita), which has spurred an increase in consumption. The PRC Government recognises the importance of domestic consumption as an engine of economic growth and has featured it prominently in the 12^{th} Five-Year Plan (2011-15).

According to GLP, about 80% of its leased space in China is used by tenants for domestic-consumption-related activities, while 20% is used for import-export-related activities.

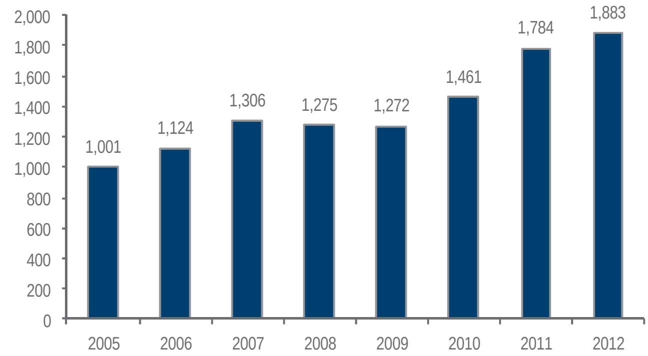
Acute shortage of modern logistics facilities

In addition to these favourable macro trends, we believe there are still considerable growth opportunities for modern logistics space in China, on the back of the replacement of obsolete stock. On a per capita basis, the total warehouse stock (both modern and non-modern) is only 0.38 sq m for China versus 5.16 sq m for the US (according to GLP, from data obtained from the China Association of Warehouses and Storage, CBRE estimates, and the CIA's *The World Factbook*). In China, GLP estimates that 75% of warehouses do not meet modern logistics requirements (such as wide column spacing, large floor plates (at least 10,000 sq m), high ceilings (at least 5.5m), and modern loading docks and enhanced safety systems and other value-added features), while some warehouses could face demolition amid the rapid pace of urbanisation.

A shortage exists even in Japan

Even in Japan, modern logistics facilities are relatively scarce, and make up only 2.5% of existing logistics facilities nationwide, according to CBRE. The 3PL market (according to Logi-Biz) grew by 78% in six years (2005-11) as companies have increasingly outsourced their logistics to reduce costs and focus on their core businesses.

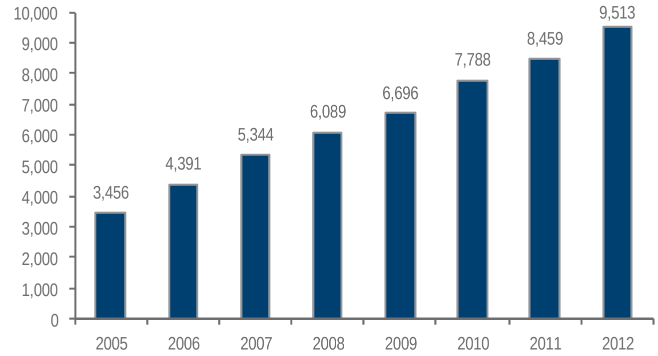
■ Japan: 3PL market (JPYbn)



Source: Logi-Biz (Logistics Business, September 2012 issue)

E-commerce sales have also increased rapidly, exceeding JPY8tn for 2011, surpassing the combined sales of department stores in 2011. For 2012, they reached JPY9.5tn.

■ Japan: market size of B to C e-commerce (JPYbn)



Source: Ministry of Economy, Trade and Industry 'e-commerce market survey'

GLP's properties attract the leading logistics industry players

Many of GLP's tenants in China are the top-tier 3PLs and e-commerce retailers.

■ GLP: top-10 tenants in China (September 2013)

		Industry	Of leased area
1	Amazon*	Retailer	5.3%
2	Deppon	3PL	4.5%
3	Nice Talent	3PL	2.2%
4	Vipshop*	Retailer	2.1%
5	DHL	3PL	1.8%
6	Toll Warehouse	3PL	1.8%
7	Schenker	3PL	1.7%
8	VANCL*	Retailer	1.5%
9	JD.com (360buy)*	Retailer	1.2%
10	PGL	3PL	1.2%
	Total		23.3%

*Source: GLP; *E-commerce customers*

A highly profitable business

We believe GLP's development business is an inherently high ROE and IRR one, helped by the relatively short development cycle (typically two years or less) for its logistics facilities. According to GLP, its properties have a cash-conversion cycle of 1.5 years, from investment to achieving a stabilised cash flow. We estimate that the unlevered IRR for its development business in China (assuming a two-year cash-conversion cycle and a 5-year investment period before divestment) is 21.5% during the current growth phase and 18% during the mature phase.

Valuation

We peg our six-month target price for GLP to our SOTP valuation. In this approach, we value the stable properties (the stabilised, income-producing properties) at their tangible book value (GLP revalues its portfolio on a quarterly basis) and the properties under development at a target PBR of 2.5x, derived from a two-stage Gordon Growth Model. We tie the assumptions used in our Gordon Growth Model with the operational returns of GLP's development business in China (see our 20 March 2013 GLP company report: *The song remains the same*).

■ GLP: Daiwa's SOTP valuation

USDm	Total	Stable	Development
Prorated investment properties			
China			
completed and stabilised	3,619	3,619	
completed and pre-stabilised	466		466
other facilities	109		109
properties under dev	825		825
land held for future dev	764		764
Japan			
completed and stabilised	3,962	3,962	
completed and pre-stabilised	138		138
properties under dev	184		184
Brazil			
completed and stabilised	470	470	
completed and pre-stabilised	5		5
properties under dev	65		65
land held for future dev	104		104
Total prorated property value	10,711	8,051	2,660
Share of other assets	541	541	0
Cash	1,463	1,463	
Total prorated assets	12,715	10,055	2,660
Less:			
effective share of borrowings	(3,271)	(3,271)	0
effective share of other liabilities	(1,391)	(1,391)	0
Total liabilities	(4,662)	(4,662)	0
NTA	8,053	5,393	2,660
Value of stable business	5,393		
Value of development business*	6,777		
Value of fund management	382		
Sum of the parts value	12,552		
Shares outstanding (m)	4,759.5		
Value per share (USD)	2.64		
Value per share (SGD)	3.32		

*Source: Daiwa estimates; *at a PBR of 2.5x derived from a Gordon Growth Model formulation*

Still worth accumulating

The stock is trading at a 35% premium to its tangible book value (of SGD2.14), so it does not look cheap compared with the typical property developers or landlords. However, we believe this stock is worth considering given its dominant market positions, development-growth opportunities, and inherently attractive business model. Our SOTP valuation attempts to quantify these positive factors.

Risks to our call

The main risk would be a perceived slowdown in leasing activity over the next several quarters. Due to the nature of GLP's business, the magnitude of development starts, completions, and leasing activities can vary greatly from quarter to quarter. The market still appears to be fixated on quarterly performance, even though GLP's management has highlighted that it does not manage the company on a three-month (or even one-year) horizon.

Another risk would be possible volatility in the US dollar versus the Yen and Renminbi in the future.

Daiwa Capital Markets

Company

Industrials / China
16 December 2013

The 10-second briefing

China International Marine Containers
2039 HK

Target (HKD): **20.00**
Upside: **33.5%**
12 Dec price (HKD): **14.98**

Initiation: beneficiary of secular growth and cyclical recovery

- Increasing demand for logistics services and LNG should support earnings growth for CIMC's equipment businesses
- We expect its container and offshore marine businesses to turn around in 2014
- Initiating with a Buy (1) rating and SOTP-based six-month target price of HKD20

1 Buy (initiation)
2 Outperform
3 Hold
4 Underperform
5 Sell

How do we justify our view?

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■ Investment case

We believe the increasing demand for logistics in China will lead to more demand for transportation vehicles, which should benefit CIMC from 2014 onward. Also, we expect the profitability of its other core businesses to improve in 2014, in step with a recovery in the shipping industry. We initiate with a Buy (1).

■ Catalysts

We expect CIMC's transportation-equipment manufacturing business to benefit from increasing demand for logistics services in China over the next few years. Also, we expect earnings for its core container-manufacturing business to start improving in 2014, as replacement demand comes into play – this demand has been on hold for three years due to the weak profitability of the China container-shipping industry.

As we expect shipping-industry earnings to improve in 2014 on the back of improved capacity discipline, we expect orders for containers to pick up by 4% YoY in 2014, vs. the 3% decline we expect for 2013. As a result, we forecast CIMC's global container-shipping capacity to increase by 7% for 2014. Also, we expect its offshore engineering business to be close to breaking even in 2014, which should further boost sentiment on the stock. Meanwhile, its energy business (through its 70% stake in CIMC Enric (3899 HK, HKD12.56, Buy [1]) should be robust, given the long-term demand that we see for LNG in China.

In addition, any appreciation in the value of the land CIMC has in Qianhai would likely be a share-price catalyst. We estimate the land is worth HKD6.6/share after stripping out the CNY10,000/sq m CIMC has to pay as a land-conversion fee, and assuming a plot ratio of 6x and a 20% land premium to be paid to the government.

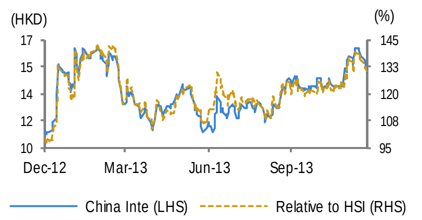
■ Valuation

We have an SOTP-based six-month target price of HKD20. We believe an SOTP valuation is the most appropriate methodology as the company has many businesses, including container manufacturing, transportation vehicles, energy-equipment manufacturing, airport facilities, and the land in Qianhai.

■ Risks

The major risk to our call would be weaker-than-expected demand for CIMC's container, transportation vehicle and energy businesses.

Share price performance



12-month range	10.90-16.56
Market cap (USDbn)	5.14
3m avg daily turnover (USDm)	2.15
Shares outstanding (m)	2,662
Major shareholder	Merchants Holding International (25.5%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	57,572	64,386	72,215
Operating profit (m)	3,793	4,960	6,068
Net profit (m)	1,795	2,444	3,024
Core EPS (fully-diluted)	0.674	0.918	1.136
EPS change (%)	(14.6)	36.1	23.8
Daiwa vs Cons. EPS (%)	26.5	15.6	7.9
PER (x)	17.4	12.8	10.3
Dividend yield (%)	2.0	2.0	2.0
DPS	0.230	0.230	0.230
PBR (x)	1.5	1.3	1.1
EV/EBITDA (x)	10.0	8.2	6.9
ROE (%)	8.7	10.6	11.5

Source: FactSet, Daiwa forecasts

1 Buy (initiation)
2 Outperform
3 Hold
4 Underperform
5 Sell

How do we justify our view?

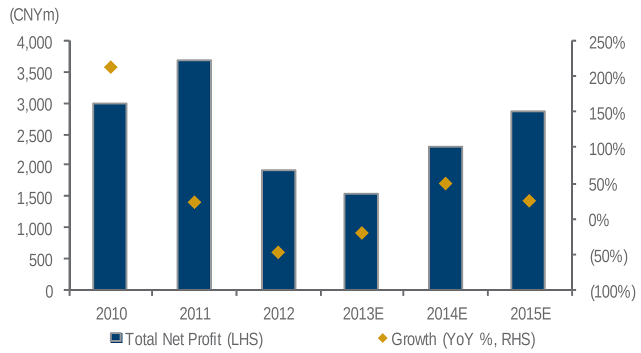
- Growth outlook ✔✔✔✔✔
- Valuation ✔✔✔✔✔
- Earnings revisions ✔✔✔✔✔

Growth outlook ✔✔✔✔✔

We expect CIMC's net profit to bottom out in 2013 and start recovering in 2014, as we think the shipping companies will start ordering more shipping containers (the replacement cycle has been on hold since 2011). Also, we expect the company's energy-equipment business to remain robust for the next three years, given our expectation of continued growth in LNG demand in China.

We forecast an EPS CAGR of 33% for 2014-15.

CIMC: net profit and net profit growth

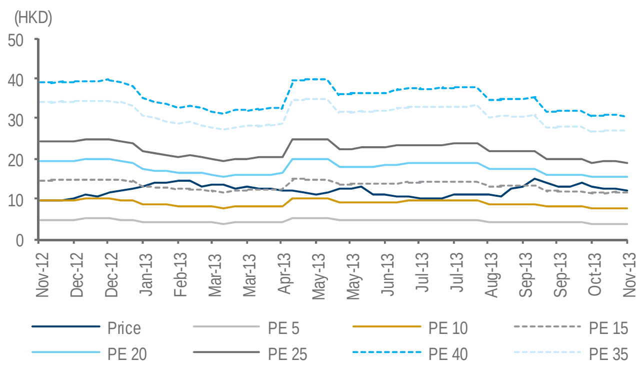


Source: Company, Daiwa forecasts

Valuation ✔✔✔✔✔

For the most part, the stock has been trading at a one-year forward PER of around 10-15x for the past 12 months, in line with its peers, as the company's core business showed no sign of improving. However, as we now expect the container-manufacturing business to begin turning around in 2014, and its transportation and energy equipment businesses to continue to record stable and robust earnings growth, we expect investor sentiment on CIMC to improve in 2014. Also, the value of the company's land in Qianhai should offer protection against any potential share-price downside, in our view.

CIMC: 12-month forward PER Bands

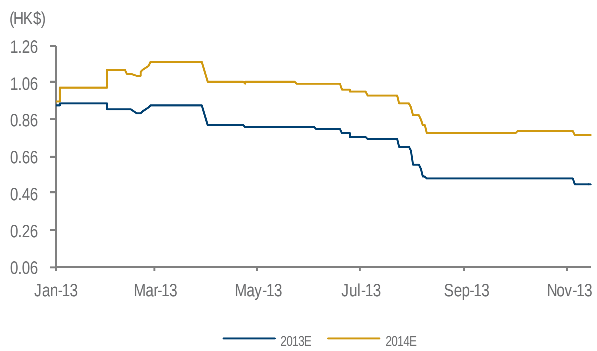


Source: Thomson Reuters, Daiwa forecasts

Earnings revisions ✔✔✔✔✔

Our 2013-15 EPS forecasts are 8-27% higher than those of the Bloomberg consensus, as we believe the market is too pessimistic on the outlook for CIMC's container-manufacturing business and has not factored in earnings-growth potential for its energy and transportation-equipment businesses.

Consensus earnings revisions (2013-14E)



Source: Bloomberg, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Container sales volume growth	(26.2)	(56.2)	113.1	15.5	(23.4)	(2.5)	4.4	4.4
Container ASP growth	14.6	30.8	(31.5)	52.0	(8.2)	(10.1)	(1.0)	(1.0)
Transportation equipment volume	(3.6)	7.6	4.4	49.9	(35.2)	(1.0)	5.0	5.0
Transportation equipment ASP	7.2	21.6	44.6	(31.0)	26.7	0.0	2.0	2.0

■ Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Container manufacturing revenue	29,099	5,574	25,440	35,072	24,840	23,378	24,626	25,954
Transportation equipment revenue	10,050	11,013	16,632	17,199	14,130	13,989	14,982	16,046
Other Revenue	8,178	3,889	9,697	11,855	15,363	20,204	24,777	30,215
Total Revenue	47,327	20,476	51,768	64,125	54,334	57,572	64,386	72,215
Other income	355	1,464	(64)	65	(21)	(60)	0	0
COGS	(41,874)	(17,402)	(43,598)	(52,225)	(44,601)	(47,179)	(52,124)	(57,983)
SG&A	(2,741)	(2,704)	(3,985)	(5,635)	(5,486)	(5,813)	(6,501)	(7,292)
Other op.expenses	(1,865)	(1,332)	(1,501)	(1,951)	(2,095)	(1,891)	(1,930)	(2,002)
Operating profit	1,900	1,348	4,005	5,475	3,241	3,793	4,960	6,068
Net-interest inc./(exp.)	(551)	(111)	(444)	(575)	(525)	(604)	(552)	(527)
Assoc/forex/extraord./others	578	229	113	123	192	(168)	100	100
Pre-tax profit	1,927	1,465	3,675	5,023	2,907	3,020	4,508	5,641
Tax	(242)	(385)	(824)	(1,364)	(977)	(1,015)	(1,515)	(1,895)
Min. int./pref. div./others	(278)	(122)	151	32	9	(457)	(682)	(854)
Net profit (reported)	1,407	959	3,002	3,691	1,939	1,548	2,311	2,891
Net profit (adjusted)	1,671	84	3,011	3,888	2,101	1,795	2,444	3,024
EPS (reported)(CNY)	0.528	0.360	1.127	1.386	0.728	0.581	0.868	1.086
EPS (adjusted)(CNY)	0.628	0.032	1.131	1.460	0.789	0.674	0.918	1.136
EPS (adjusted fully-diluted)(CNY)	0.628	0.032	1.131	1.460	0.789	0.674	0.918	1.136
DPS (CNY)	0.150	0.120	0.350	0.460	0.230	0.230	0.230	0.230
EBIT	1,900	1,348	4,005	5,475	3,241	3,793	4,960	6,068
EBITDA	2,597	2,194	5,390	6,571	4,351	4,958	6,091	7,197

■ Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	1,927	1,465	3,675	5,023	2,907	3,020	4,508	5,641
Depreciation and amortisation	697	846	1,385	1,096	1,110	1,165	1,131	1,130
Tax paid	(242)	(385)	(824)	(1,364)	(977)	(1,015)	(1,515)	(1,895)
Change in working capital	282	(1,353)	(3,027)	(2,910)	(1,335)	(1,147)	(2,500)	(2,841)
Other operational CF items	702	396	275	410	537	200	200	200
Cash flow from operations	3,367	970	1,483	2,254	2,243	2,224	1,824	2,234
Capex	(2,383)	(1,370)	(2,117)	(2,998)	(2,087)	(2,000)	(2,500)	(2,500)
Net (acquisitions)/disposals	(280)	1,283	(678)	(798)	249	0	0	0
Other investing CF items	135	90	64	221	279	0	0	0
Cash flow from investing	(2,527)	3	(2,730)	(3,576)	(1,559)	(2,000)	(2,500)	(2,500)
Change in debt	1,072	1,183	1,099	6,368	(156)	3,300	3,738	3,738
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	0	0	0	0	0	0	0	0
Other financing CF items	(2,031)	(662)	(622)	(1,860)	(2,734)	(612)	(612)	(612)
Cash flow from financing	(959)	521	477	4,508	(2,890)	2,687	3,126	3,126
Forex effect/others	(74)	81	171	(420)	40	0	0	0
Change in cash	(193)	1,574	(599)	2,766	(2,166)	2,911	2,449	2,860
Free cash flow	984	(401)	(634)	(744)	156	224	(676)	(266)

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (CNYm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	3,101	5,269	4,656	7,788	5,222	8,590	11,721	15,435
Inventory	7,833	6,754	13,424	15,468	18,035	19,109	21,371	23,970
Accounts receivable	4,194	3,863	8,130	8,111	8,238	8,729	9,762	10,949
Other current assets	3,690	4,650	7,582	9,360	6,852	6,898	6,996	7,108
Total current assets	18,818	20,535	33,792	40,727	38,346	43,326	49,850	57,462
Fixed assets	7,154	7,695	10,006	10,885	11,609	12,514	13,932	15,330
Goodwill & intangibles	3,796	3,984	4,387	4,380	4,541	4,270	4,022	3,794
Other non-current assets	4,790	5,144	5,946	8,370	8,497	8,497	8,497	8,497
Total assets	34,558	37,358	54,131	64,362	62,992	68,607	76,301	85,083
Short-term debt	3,490	5,839	13,692	13,886	7,690	7,309	7,419	7,549
Accounts payable	4,391	4,462	9,118	7,329	7,059	7,467	8,250	9,177
Other current liabilities	4,517	4,741	7,161	10,021	10,791	10,791	10,791	10,791
Total current liabilities	12,399	15,043	29,971	31,236	25,540	25,567	26,459	27,517
Long-term debt	6,557	5,622	3,912	10,561	14,104	16,580	19,056	21,532
Other non-current liabilities	667	867	1,040	951	1,231	1,881	2,530	3,180
Total liabilities	19,623	21,532	34,924	42,748	40,875	44,028	48,046	52,229
Share capital	2,662	2,662	2,662	2,662	2,662	2,662	2,662	2,662
Reserves/R.E./others	10,767	11,536	13,561	15,971	16,851	18,856	21,849	25,594
Shareholders' equity	13,429	14,198	16,223	18,633	19,513	21,519	24,512	28,257
Minority interests	1,506	1,628	2,984	2,981	2,604	3,061	3,743	4,597
Total equity & liabilities	34,558	37,358	54,131	64,362	62,992	68,607	76,301	85,083
EV	38,401	37,534	46,041	49,333	48,919	49,588	49,724	49,470
Net debt/(cash)	6,946	6,192	12,949	16,659	16,573	15,299	14,753	13,646
BVPS (CNY)	5.044	5.333	6.093	6.999	7.329	8.082	9.207	10.613

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	(2.9)	(56.7)	152.8	23.9	(15.3)	6.0	11.8	12.2
EBITDA (YoY)	(40.8)	(15.5)	145.7	21.9	(33.8)	13.9	22.9	18.2
Operating profit (YoY)	(50.2)	(29.1)	197.2	36.7	(40.8)	17.0	30.8	22.3
Net profit (YoY)	(41.8)	(95.0)	3,469.4	29.1	(46.0)	(14.6)	36.1	23.8
Core EPS (fully-diluted) (YoY)	(41.8)	(95.0)	3,469.4	29.1	(46.0)	(14.6)	36.1	23.8
Gross-profit margin	11.5	15.0	15.8	18.6	17.9	18.1	19.0	19.7
EBITDA margin	5.5	10.7	10.4	10.2	8.0	8.6	9.5	10.0
Operating-profit margin	4.0	6.6	7.7	8.5	6.0	6.6	7.7	8.4
Net profit margin	3.5	0.4	5.8	6.1	3.9	3.1	3.8	4.2
ROAE	11.4	0.6	19.8	22.3	11.0	8.7	10.6	11.5
ROAA	4.5	0.2	6.6	6.6	3.3	2.7	3.4	3.7
ROCE	7.1	5.2	12.5	13.2	7.2	8.2	9.6	10.4
ROIC	7.0	4.5	11.5	11.3	5.6	6.4	7.9	9.0
Net debt to equity	51.7	43.6	79.8	89.4	84.9	71.1	60.2	48.3
Effective tax rate	12.5	26.3	22.4	27.2	33.6	33.6	33.6	33.6
Accounts receivable (days)	50.5	71.8	42.3	46.2	54.9	53.8	52.4	52.3
Current ratio (x)	1.5	1.4	1.1	1.3	1.5	1.7	1.9	2.1
Net interest cover (x)	3.4	12.1	9.0	9.5	6.2	6.3	9.0	11.5
Net dividend payout	28.4	33.3	31.0	33.2	31.6	39.6	26.5	21.2
Free cash flow yield	3.2	n.a.	n.a.	n.a.	0.5	0.7	n.a.	n.a.

Source: FactSet, Daiwa forecasts

Company profile

China International Marine Containers is mainly focused on manufacturing container, road transportation vehicles, energy, Chemical and food equipment, offshore engineering equipment and airport facilities equipment.

Initiation: beneficiary of secular growth and cyclical recovery

We expect CIMC's transportation-equipment and energy-equipment businesses to provide long-term earnings support, while a cyclical recovery in its container-manufacturing business should also boost earnings in 2014.

Secular earnings-growth story remains intact

Demand for transportation equipment likely to surge over the next decade

The ongoing increase in demand for logistics services in China should lead to a rise in demand for trucks and transportation equipment, such as trailers, over the next decade. Currently, the average utilisation for trucks used by the logistics industry is less than 50%, according to our industry research. This is mainly because the logistics companies do not have enough equipment to unload/load trucks immediately. Thus, as the industry matures over time, we expect investment in equipment to increasing, boosting the utilisation rate.

In this light, as CIMC specialises in producing different types of transportation equipment, such as trailers, semi-trailers and van-trailers, we believe it will benefit more than its peers from the eventual increase in the truck utilisation rate. Meanwhile, for 2014, we forecast CIMC's equipment sales volume to increase by 5% YoY.

■ CIMC: example of its skeletal semi-trailers

Source: Company

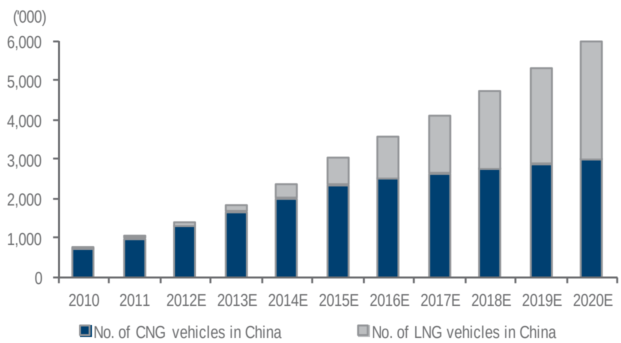
■ CIMC: example of its bulk cargo semi-trailers

Source: Company

Energy business remains a positive earnings driver

CIMC owns 70% of listed company CIMC Enric (3899 HK, HKD12.56, Buy [1]), a leading manufacturer of liquefied natural gas (LNG) and compressed natural gas (CNG) equipment in China. Our utilities analyst Dennis Ip expects China's LNG-vehicle market sales to grow by more than 100% YoY for 2012-15, and a CNG-vehicle sales growth of around 5-6% p.a. for 2013-15. As such, Dennis expects EPS growth for CIMC Enric of 16-18% YoY for 2014-15, which would have a positive impact on CIMC's bottom line.

■ LNG and CNG vehicles in China



Source: CIMC Enric, Daiwa forecasts

Ready for a cyclical recovery in the shipping industry

Demand for containers should recover in 2014

We forecast the price of a standard 20-foot container box for CIMC to be about USD2,200/TEU for 2013, down 10% YoY, and the lowest price for the past 5 years. We believe this is due to the global container-shipping industry's weak profitability over the past three years, resulting in many shipping companies delaying their replacement demand.

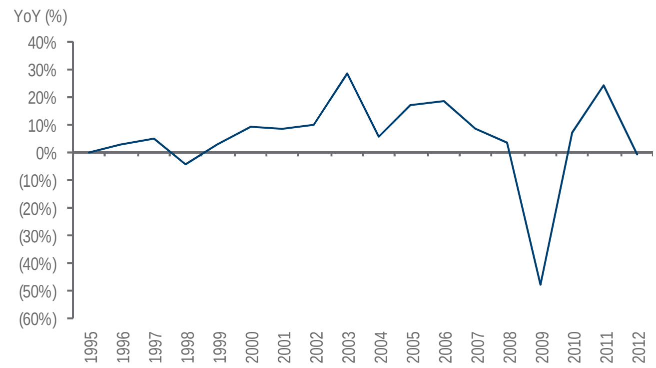
■ **Global 20ft container-box price**

Source: Company, Container International

We expect the price of containers to remain low for 4Q13, although we do see a gradual recovery as we assume that global net capacity will grow by 7% YoY for 2014. Also, we think replacement demand for container boxes will finally resume in 2014 due to improved profitability for shipping companies in 2014.

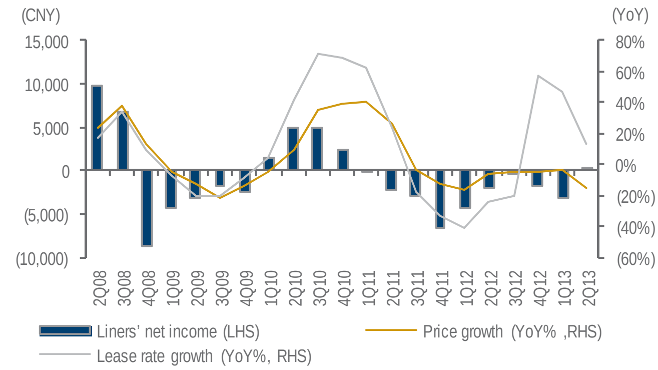
Currently, the average age of a container box globally is 6.5 years, the highest it has been for the past decade. Thus, we do think the shipping companies will start replacing them soon, as container boxes around the globe tend to be replaced every five years, on average. Also, we believe that an ongoing pick-up in demand is likely to drive up the lease rate for containers, which, in turn, should encourage more liners to buy new boxes rather than leasing them.

■ **Container box capacity growth**



Source: Container International

■ **20ft container box price, lease price vs. liners' profitability**



Source: Container International, companies

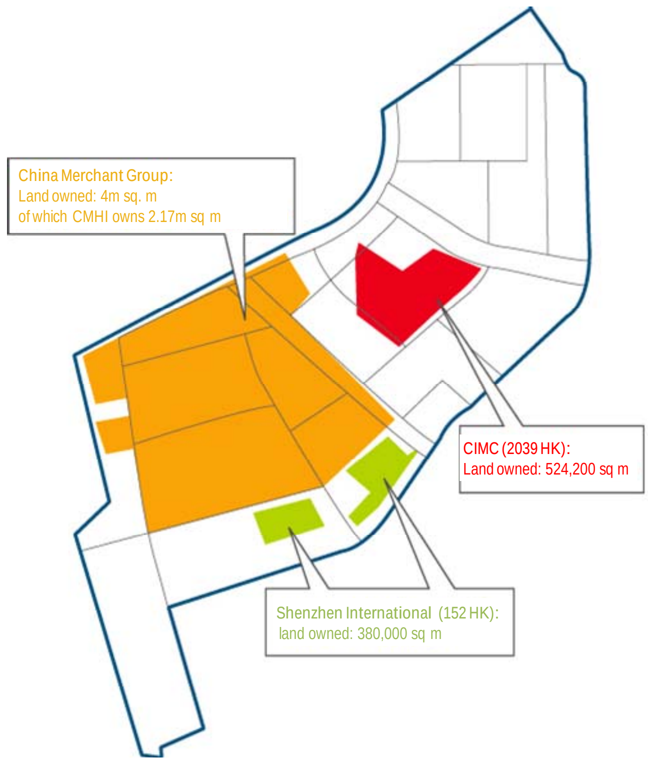
Qianhai land should present an additional catalyst

In 2010, the PRC Government approved a plan to develop the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone (Qianhai). The main aim is to transform Shenzhen into a high-end manufacturing and service centre, from a low-end manufacturing one.

The project should be completed by 2015 and the land auction process started in June 2013. So far, the average land price at auction has been mostly about CNY16,000/sq m, higher than for nearby plots at CNY10,000-12,000/sq m. As such, and given that CIMC's land (524,000 sq km) is in the high-end manufacturing area, we expect the value of its land to be CNY15,000-20,000/sq m.

Thus, we assume a land price of CNY16,000/sq m, a plot ratio of 6x, and 20% land premium to be paid to the government. We believe CIMC will need to pay a CNY10,000/sq m land conversion fee, and including this, we estimate a land value of HKD6.6/share. Any appreciation in the value of the land would be a share-price catalyst for CIMC.

■ **Qianhai: landbank distribution**



Source: HKET, Daiwa

Qianhai: land sales since June 2013 [

Land plot no.	T201-0077	T201-0075	T201-0078	T102-0244	T102-0245
GFA (sq m)	320,400	450,200	503,000	150,000	64,000
Base price (CNYbn)	3.5	4.7	6.72	2.42	0.998
Transaction price (CNYbn)	5.19	7.18	10.9	2.43	1.63
Difference vs. base price	48%	53%	62%	0.4%	63%
Transaction price per GFA (CNY/sq m)	16,199	15,948	21,670	16,220	25,469
Land usage (years)	40	40	40	40	40
Criteria for bidders:					
Total assets (2012) (CNYbn)	> 10	> 10	n.a	n.a	n.a
Total mkt cap (as of 24-Jun-13) (HKD bn)	n.a	n.a	40	n.a	n.a
Total revenue (2012) (CNYbn)	> 10	> 10	> 20	>5	>5
Types of companies	Both domestic and international		Hong Kong listed, with assets of no less than CNY5bn	Hong Kong enterprise; must be registered in Qianhai Free Trade Zone with principal business activities in supply-chain management, product exhibition and trade, industrial product design and related trade activities.	
	property company		>3 international top 500 financial institutions to invest in the project	Bidder must not bid for both T102-0245 and T102-0244 land together.	
				Parent company or holding company must be registered in Hong Kong.	

Source: Hong Kong Economic Times

Ship-leasing business should provide new opportunities

CIMC started its ship-leasing business in July 2013 to diversify its business model. We believe this move offers good earnings potential given that many shipping companies currently need to upgrade their vessels, replacing them with larger and more fuel-efficient models, and given that many of these shipping companies are struggling to obtain financing due to their weak profitability over the past three years. All these mean leasing could be the way to go.

Also, as CIMC has close relationships with the shipping companies, it should be able to sell leasing packages that include its container boxes. As a result, its container-box volume should increase by 4.4% YoY for 2014. The lease agreements offer yields of around 10-15%, which should provide a stable earnings stream for CIMC over the long term.

■ Ship-leasing contracts announced so far this year

Name	Operator	Shipyard	No. of vessels	Size	Delivery	Price/ Ship (USDm)	Announced Date
	NYK(plan)	In talks with Imabari/Japan Marine United	4	13,200	2016	100	15-Nov-13
	UASC	Hyundai	2	14,000	1Q16	125	14-Nov-13
CIMC	MSC		2	8,800		85	12-Sep-13
	MSC	New Times	5	8,800	2015		29-Jul-13
	MSC	Dalian	8	8,800	2015	75	3-Jul-13
	CMA CGA	Samsung	3	16,000	1H15		14-Jun-13
	CSCL	Hyundai	5	18,400	2H14	137	13-May-13
	K Line	Imabari	5	14,000	1H15		25-Mar-13
Seaspan		Jiangsu New, Yangzi/Jiangsu Yangzi, Xinfu	5	10,000	7-Jul-05	90	7-Oct-13
	Ham-burg Sud	DSME	3	10,500	2H15	90	7-Oct-13
	YML	Hyundai/ CSBC	5	14,000	2016	110	23-Aug-13
	CSAV	Samsung	9	9,000	2014		20-Aug-13
	YML	Hyundai	5	14,000	7-Jul-05	120	23-Jan-13
Bank of Communi-cations	MSC	Daewoo	3	18,400	2015	140.5	3-Sep-13
	UASC	Hyundai	5	18,000	2H14	150	2-Sep-13
	UASC	Hyundai	5	14,000	2H14	150	2-Sep-13
	Zim	Samsung	Cancelled order	12,600			29-Aug-13
CSSC	CMA CGA	Jiangnan, Changxing/Shang-hai, Waigao qiao	3	16,000	2H15		12-Aug-13
	MSC	Jiangnan/ Jiangnan Changxin	6	9,400	2015	82	5-Jul-13
HKAM	MSC	Daewoo	3	18,000	3Q15		12-Jul-13

Source: Companies, HKEx

Valuation and recommendation

We initiate coverage with a Buy (1) rating and SOTP-based six-month target price of HKD20.We believe an SOTP valuation is the most appropriate methodology to value this stock as the company is a conglomerate with many businesses, including container manufacturing, transportation vehicles, energy-equipment manufacturing, airport facilities (baggage-handling equipment) and valuable land in Qianhai, which we estimate is already worth HKD6.6/share.

The stock has been trading at a one-year forward PER of around 10-15x for the past 12 months as the company's core business showed little sign of improving. But this was higher than its major peer Singamas Container Holdings Limited (not rated), which traded at around 10x (Bloomberg consensus forecasts) for the same period. We consider the premium between the two to be justified as CIMC has the largest share of the container-manufacturing business (around 50% vs. 20-30% for Singamas), while its Qianhai development also provides extra comfort.

■ CIMC: one-year forward PER

Source: Reuters Datastream

■ SOTP table

SOTP valuation	Value per share(HKD)
CIMC Enric	10.1
Container business	2.0
Road transport vehicle business	0.9
Others	0.0
Land value in Qianhai	6.6
Total	19.6

Source: Daiwa forecast

Risks

The major risk to our call would be weaker-than-expected demand for new containers, which could be due to a weaker-than-expected recovery in the profitability of the shipping industry (which could lead to further delays in container replacement).

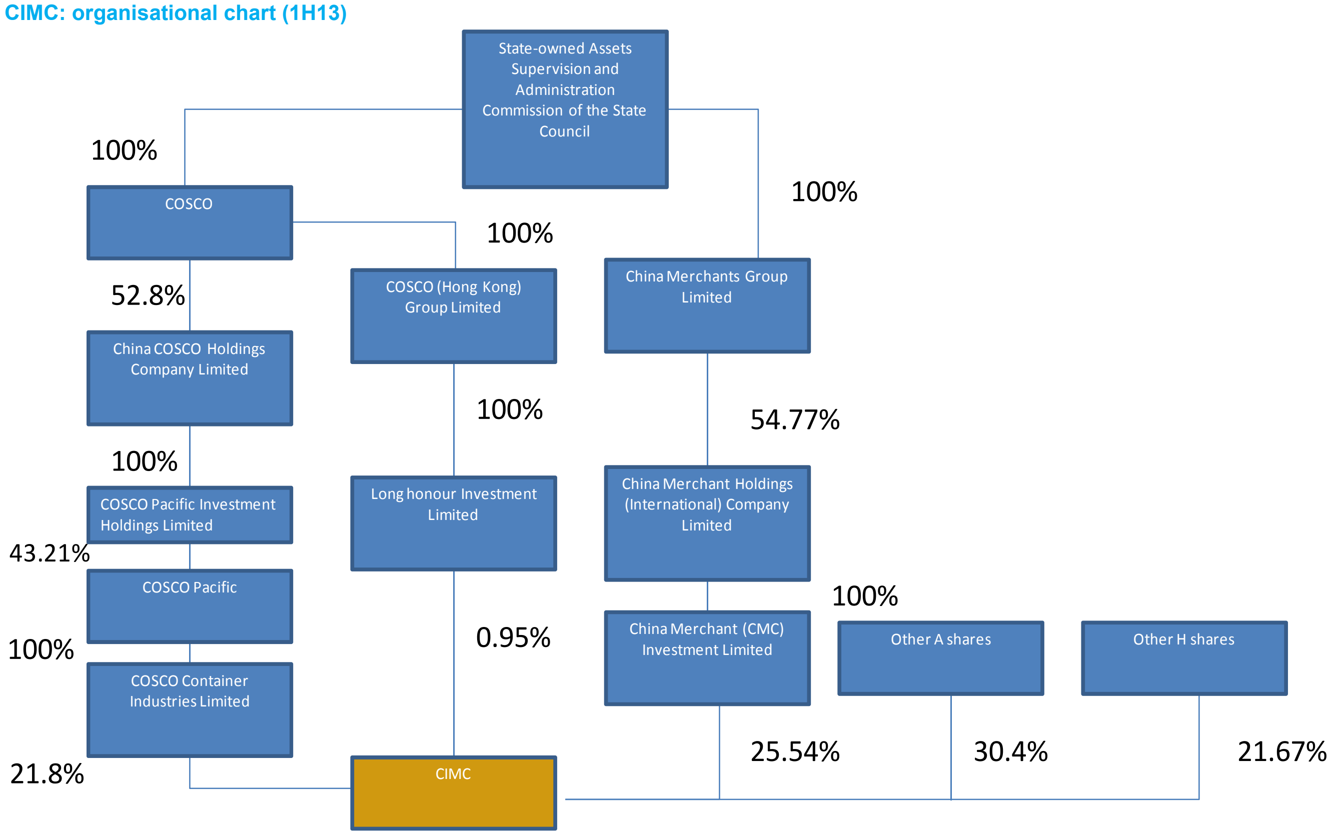
Other risks would include weaker-than-expected demand for logistics and LNG, which would lead to lower demand for CIMC's vehicles and equipment.

Company background

CIMC was founded in 1980 and is the world's leading company in terms of container manufacturing – it produces about 50% of the world's total container boxes. The world's second-largest container manufacturer is Singamas (not rated), which makes 20-30% of the world's container boxes. Apart from container manufacturing, CIMC also has businesses involved in the manufacturing of transportation equipment, LNG and CNG vehicles (through its 70% stake in CIMC Enric), equipment to transport and store chemical and food, as well as offshore-engineering and airport equipment, such as luggage-handling equipment.

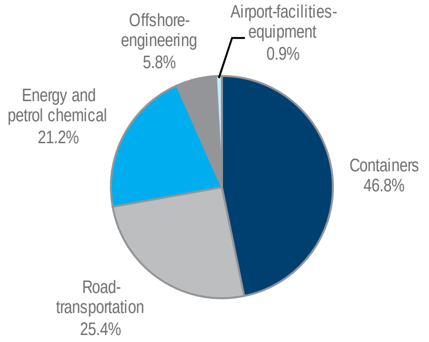
The stock was listed on both the A- and B-share markets in Shenzhen in 1994. And in 2012, its B shares were converted into H-shares, at the same time as CIMC's listing in 2012.

■ CIMC: organisational chart (1H13)



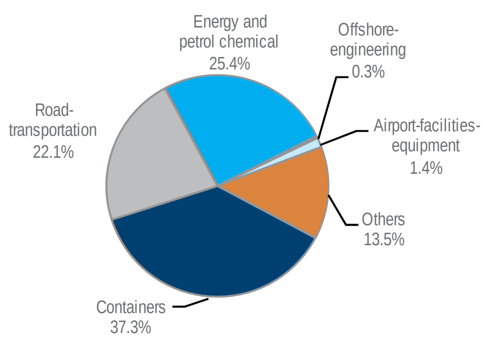
Source: company

■ CIMC: revenue breakdown (1H13)



Source: Company

■ CIMC: gross-profit breakdown (1H13)



Source: Company

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