Daiwa Capital Markets

Special Report

Regional
12 April 2013

The 10-second briefing

Broadening our horizons

- Our analysts stress-test their highest-conviction investment ideas on a three-year view
- We provide fair-value estimates over the same horizon for 23 stocks in six markets in Asia ex-Japan
- On near- and medium-term valuations, plus structural growth, AviChina, Liansu, Chailease, Jasmine Intl and Largan stand out

Top Three-Year Buys in Asia

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Daiwa and Thanachart Securities Research Teams

See important disclosures, including any required research certifications, beginning on page 104

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Note: closing share prices as at 10 April 2013

Broadening our horizons

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Why a top three-year buy report?

In this report, we have asked our analysts to profile their highest conviction multi-year stock investments. They were instructed to pick stocks on a three-year outlook, based upon their expectations of earnings prospects through to the end of calendar-year 2015, or end-1Q16 for companies with a March year-end, for all covered stocks.

This report stems in part from feedback from a number of clients around the world who base their investment decisions on a company's multi-year outlook. In addition, there was a desire internally to get our analysts to step back from the news flow and make a clear statement on the investment ideas they believe in most based on an industry's or company's structural opportunities, instead of the cyclical perspective that dominates much of sell-side research.

Which stocks are included?

Initially, more than 40 stocks were recommended for inclusion from around the region. Each analyst was then asked to defend his or her selection to our country research heads, an exercise that served to reduce the list by about 25%. The next step was for a two-page template to be completed for each remaining stock, covering the following five topics.

- What is the three-year story?
- What could the fair value be in 2015?
- Are there any near-term hurdles? In other words, what could negatively affect the short-term outlook?
- How to monitor progress. Or, what signals should be monitored to see that the story is on track, be it details in earnings results, data releases, or likely company announcements?
- What could go wrong? Or, what are the structural or long-term risks to the story?

The template served to clarify our analysts' opinions, with a few more stocks falling off the list. In the end, we chose 23 stocks from six equity markets in Asia for inclusion in this report, with the largest number of companies coming from Hong Kong, Korea, and Taiwan, while Thanachart Securities, with which Daiwa Securities has a research-distribution agreement, has contributed three stocks from Thailand. The full list is shown below.

■ **Daiwa's three-year buy list**

Country	Company	Bloomberg code	6-12 month rating	6-12 month target price (LC)	3-year fair-value estimate (LC)
HK/China	AviChina	2357 HK	Buy	5.0	7.2
HK/China	China Liansu	2128 HK	Buy	6.0	10.3
HK/China	ENN	2688 HK	Buy	48.5	67
HK/China	Geely	175 HK	Buy	5.15	6.55
HK/China	Tencent	700 HK	Buy	320	410
India	ING Vysya	VYSB IN	Outperform	632	893
India	Tata Motors	TTMT IN	Buy	360	470
Indonesia	Bank Negara	BBNI IJ	Outperform	5,300	8,280
Indonesia	XL Axiata	EXCL IJ	Outperform	6,069	7,758
Korea	Hana Financial Group	086790 KS	Buy	50,000	63,400
Korea	Hyundai E&C	000720 KS	Outperform	86,000	132,000
Korea	Hyundai Motor	005380 KS	Buy	270,000	400,000
Korea	Orion	001800 KS	Outperform	1,130,000	1,750,000
Korea	Samsung SDI	006400 KS	Buy	160,000	210,000
Taiwan	Chailease	5871 TT	Buy	96	142
Taiwan	Delta	2308 TT	Outperform	140	185
Taiwan	Fubon	2881 TT	Buy	49.2	65.1
Taiwan	Ginko	8406 TT	Buy	530	888
Taiwan	Largan	3008 TT	Buy	930	1,150
Taiwan	TSMC	2330 TT	Hold	98	140
Thailand	Bangkok Dusit Medical	BGH TB	Buy	177	242
Thailand	CP ALL	CPALL TB	Buy	60	73
Thailand	Jasmine International	JAS TB	Buy	8.0	11.2

Source: Daiwa

What are the common investment themes?

The three-year investment case for about half of the companies centres on a material structural change, be it the opening of a new market, benefits from deregulation, an evolving demographic opportunity, or technological innovation. The following table summarises the stories for these companies.

■ Beneficiaries of structural change

AviChina	China opening low-altitude airspace for private use, expanding potential market for company's products
Bangkok Dusit Medical	Increasing demand due to rising incomes, better insurance cover, and an ageing population, while supply is limited
Chailease	Leading leasing company in Taiwan. Well-positioned for rapid expansion in China's underdeveloped market
China Liansu	A beneficiary of the likely rise in government water-infrastructure investment, and increasing demand for better quality private-sector housing
ENN	A leading supplier in China's underdeveloped and rapidly growing city-gas market; new LNG vehicle demand
Fubon	Following several acquisitions in Hong Kong and China, the bank is well-positioned to benefit from greater cross-strait capital flows as regulatory hurdles are lowered
Ginko	The leader in China's rapidly-growing and under-penetrated contact-lens market. A beneficiary of a widespread shift to short-replacement cycle lenses
Jasmine International	Broadband penetration in Thailand is rising from a low 19% base; Jasmine's high capex period has passed
Largan	Leading smartphone camera-lens maker should benefit from demand for higher specifications, broader use of two cameras, and higher tablet-camera market share
Orion	Company is expanding its confectionary sales into new markets across east Asia, driving a 20% sales CAGR over 2013-15 based on our forecasts
TSMC	Several process migrations to small wafer sizes in next two years should increase the company's technological lead over competing foundries
XL Axiata	A beneficiary of the likely sharp rise in mobile-data usage in Indonesia due to a low penetration rate, cheaper 3G handsets and the popularity of social networks, while the company has best 3G infrastructure

Source: Daiwa

For another five companies, the investment case also focuses on a structural change, although only for part of the entire group. While the specific circumstances are different for each, in general these companies have legacy activities that are not likely to enjoy the rapid growth that certain businesses or market opportunities should produce.

■ Beneficiaries of partial structural change

Delta	Product-mix shift to higher margin data centre, industrial automation and passive component products, while sustaining existing power supply activities
Geely	Material exposure to the rapidly growing SUV market in China, supported by lower R&D costs as a percentage of revenue and increasing exports. Company is still, however, exposed to the cyclicality of the auto industry
Hyundai Motor	A global leader in fuel-efficient cars, a greater emerging market presence than its peers, and expanding financing operations. Rapid expansion challenged by greater Japan automaker cost-competitiveness
Samsung SDI	Battery division is the key growth driver, led by expanding smartphone usage and increased battery capacity per device, while auto battery sales turn profitable. Legacy display division a potential drag.
Tata Motors	While the domestic passenger-vehicle business is loss-making, the global JLR operations have bright prospects with a rejuvenated new model line-up and growing SUV opportunities for the Land Rover brand

Source: Daiwa

Of the rest, the investment cases are either multi-year cyclical recoveries, merger synergies, or continuations of existing growth stories.

■ Companies with a strong cyclical outlook

Bank Negara	Improved credit-risk management and increased balance-sheet leverage should drive earnings growth, along with better cost controls
CP ALL	Accelerated store expansion plan for the 7-Eleven franchise in Thailand, especially outside of Bangkok, likely to reaccelerate growth, along with an aggressive SSS target
Hana Financial Group	Gains expected from the merger with KEB, including better credit-cost controls, increased loan productivity, as well as operating cost and revenue synergies
Hyundai E&C	Expanding orders expected from the company's higher margin power-plant construction division due to its market-leading design capabilities
ING Vysya	Improving cost management is expected to produce a large ROE improvement, supported by sustainably lower credit costs
Tencent	Company is expected to replicate the tremendous success it achieved in China Internet services in the mobile market, notably through its WeChat service

Source: Daiwa

How have these stocks performed?

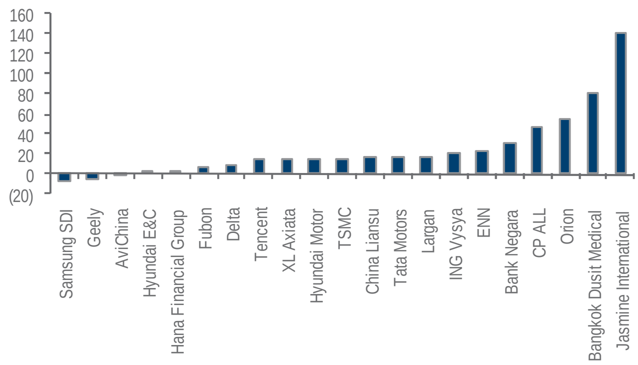
On page 4, we show the performance records of the 23 stocks in this report over three years, one year and year-to-date. Comparing the results from these performance snapshots, it is clear that our analysts have selected a mix of market darlings as well as stocks that have been broadly out of favour for some time.

There are eight stocks that clearly rank among the darlings, those that on a one- and three-year basis have produced high double-digit annualised returns. They include the three Thailand names on the list (CP ALL, Bangkok Dusit Medical and Jasmine International), one Hong Kong-listed growth story (ENN), the Korea confectionary company Orion, Taiwan optical-lens manufacturer Largan Precision, and two banks (Bank Negara in Indonesia and ING Vysya in India). Two small-cap Taiwan-listed China plays (Ginko and Chailease) have also performed extremely well, although neither has been listed long enough for us to calculate a three-year annualised return. Needless to say, our analysts expect the positive stories that have driven these stock prices for a number of years to continue, which may well prove true, although it should also be noted that the downside risk from an unexpected negative development could be greatest for these names.

At the other extreme, there are five stocks on the list that look like contrarian calls based on their negative or single-digit positive one- and three-year performance records. They include two Hong Kong-listed China plays (AviChina and Geely) and three Korea companies (Samsung SDI, Hyundai E&C and Hana Financial). The downside risk from a disappointing development may be less with these stocks, but there is likely also some more work needed to convince a broader range of investors that these stocks are worth adding to their portfolios.

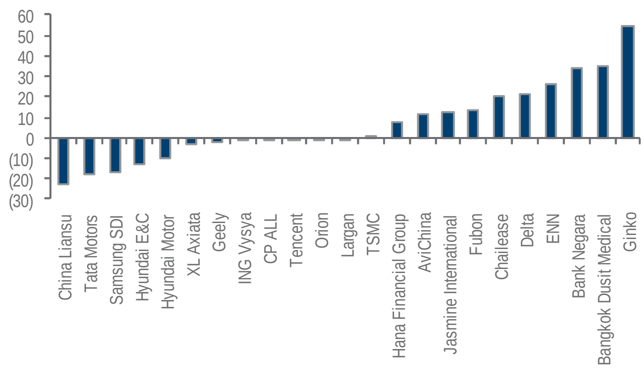
In between are eight mostly large-caps, a number of which have fallen out of favour relatively recently, with Hyundai Motor's -23% return over the past 12 months being the most extreme example. China Liansu and Tata Motors have also produced capital losses over the last year, with the latter's slide occurring entirely in 2013. The Indonesia telco XL Axiata has also produced negative returns year-to-date. Completing the list are Tencent, TSMC, Fubon and Delta, whose one- and three-year performance records have been healthy, although nowhere near as strong as the nine darlings discussed above. As a group, the four have returned 11-55% on a one-year basis and 6-16% annualised over three years.

■ Three-year share-price performance, annualised (%)



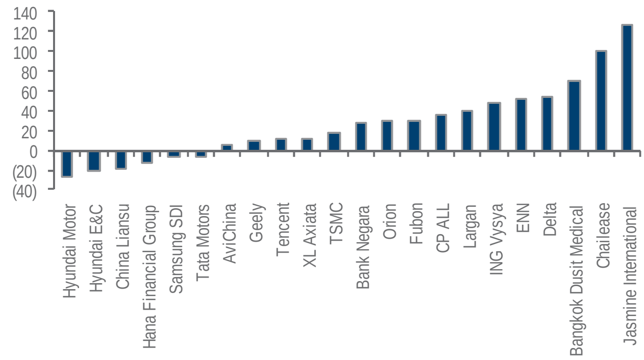
Source: Bloomberg, Daiwa

■ Year-to-date share-price performance (%)



Source: Bloomberg, Daiwa

■ One-year share-price performance (%)



Source: Bloomberg, Daiwa

How do the near- and medium-term outlooks compare?

In the two charts on page 5, we compare the upside potential to both Daiwa's six-month target prices (12-month target prices for Thanachart-rated stocks) and the fair-value estimates the analysts have calculated over a three-year horizon. The latter show across-the-board double-digit annualised increases, which is to be expected in a report that focuses on the top three-year buys. In a few instances, however, the share prices are very close to Daiwa's six-month target prices, a situation that is most apparent for TSMC, Ginko International (Ginko), and Orion.

Daiwa's Eric Chen has a Hold (3) rating for TSMC, as he is concerned about potential disappointment this year from Apple-related orders, and significantly higher depreciation expenses related to capex on next-generation foundry technology. Of course, the company's investment in the next-generation fabs is the reason why Eric is more positive on the company's prospects over a three-year period, as this should allow TSMC to extend its advantage in market-leading processes.

Ginko, in contrast, has excellent earnings-growth prospects this year, according to Mark Chang, although the stock's 64% YTD return has reflected most of the near-term opportunities, he believes.

Orion is a stock that has performed consistently well for four years now, and the recent share-price rise means the stock has reached Sang Hee Park's target price, although her optimism about the three-year outlook is demonstrated by the 61% potential upside to her three-year fair value, or 17% annualised.

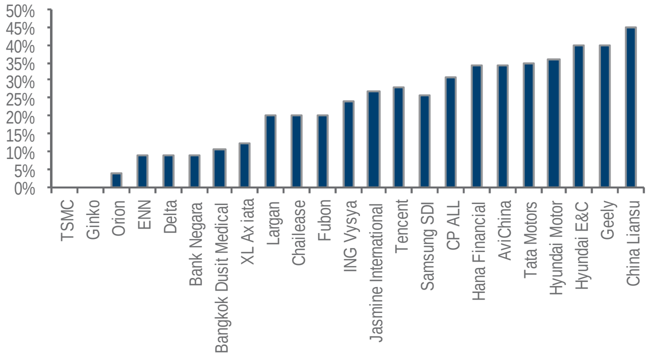
These three are exceptional cases, however, as 15 of the 23 stocks profiled in this report have six- to 12-month target prices that are at least 20% higher than the current levels, as at the pricing date of this report. This does complicate the decision-making process for investors looking for a narrower set of names for their portfolios, although there are other criteria that can help in filtering.

Geographically, these 15 stocks are spread across five markets, including four Hong Kong-listed China plays (AviChina Industry & Technology [AviChina], China Liansu, Geely Automobile [Geely], and Tencent), two India companies (ING Vysya Bank and Tata Motors), four from Korea (Hana Financial Group, Hyundai Motor, Hyundai Engineering & Construction, and Samsung SDI), two from Thailand (CP All and Jasmine International) and three from Taiwan (Chailease Holding [Chailease], Fubon Financial Holding [Fubon], and Largan Precision).

On a thematic basis, as discussed in more detail above, six of these 15 have been selected because of their strong structural-growth stories, namely AviChina, China Liansu, Chailease, Fubon, Jasmine International, and Largan Precision, while another four (Geely, Hyundai Motor, Samsung SDI, and Tata Motors) have significant structural-growth elements to their stories, in addition to other core activities that face either cyclical trends or slower earnings-growth prospects.

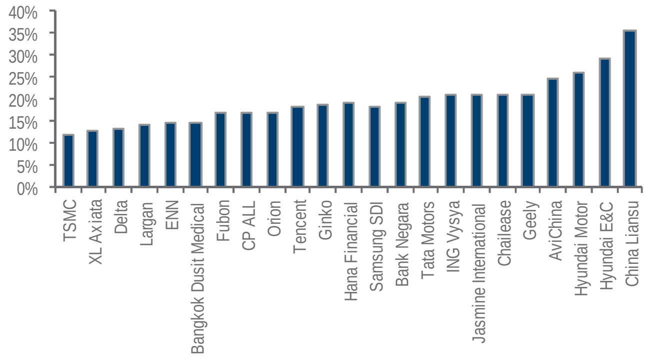
Another filter worth considering is the current year valuation versus the average earnings-growth outlook over the forecast period, or the PEG ratio. Five of the six structural-growth stories mentioned in the above paragraph have PEGs of well below 1x, mostly reflecting high double-digit growth expectations, the exception being Fubon. Among the companies that are only partial beneficiaries of structural changes, Geely and Tata Motors have PEGs of 0.3x, due to single-digit PERs and our analysts' expectations of rapid earnings growth.

■ Expected up/downside to six- or 12-month target price



Source: Bloomberg, Daiwa, Thanachart

■ Expected upside to three-year fair value, annualized



Source: Bloomberg, Daiwa, Thanachart

AviChina Industry & Technology (2357 HK)

Rating: **Buy [1]**
Share price: **HKD3.73**
6-mth target price: **HKD5.0** (34% potential upside)
3-year fair value: **HKD7.2** (93% potential upside)

The start of a new aviation market

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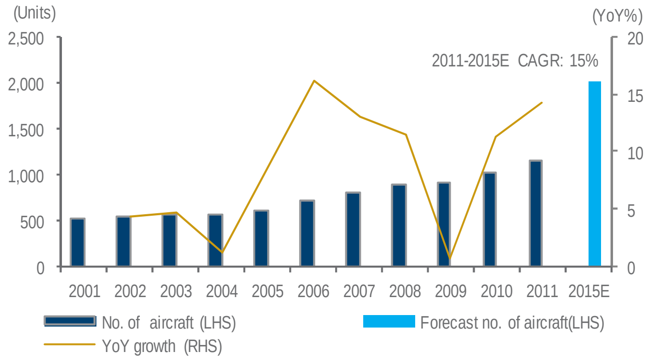
What is the three-year story?

The aviation authorities in China are in the process of opening up the country's low-altitude airspace for private civil-aviation use. This move is due to be completed by 2015, but it could be fully implemented by as early as the end of 2013. Securing approval to use private helicopters or aircraft in China is a protracted process (seven working days or more). However, following a full relaxation of the rules, we expect the approval time to be reduced to few hours.

This move is part of the government's efforts to develop the country's general aviation market and civil-aviation manufacturing over the next five years (part of the 12th Five-Year Plan from 2011-15). We believe the opening-up of the private civil-aviation market will boost AviChina Industry & Technology's (AviChina) production of helicopters and aircraft components.

Currently, 90% of the orders placed with AviChina come from government departments. The company's pricing mechanism is based on a guaranteed but low gross-profit margin of 5-10%. However, following the full opening up of the civil-aviation market, AviChina's margin should rise, as more private-sector orders are placed, which have margins of 10-15%, although in return the company must bear some cost-inflation risk.

■ China Aviation Sector: number of general aviation aircraft



Source: CAAC

What could the fair value be in 2015?

Our current six-month target price is based on a SOTP valuation which reflects the recent share-price rally of AviChina's A-share listed subsidiaries. We apply a 30% discount to our SOTP fair value of HKD7.20/share, and our discount is based on AviChina's discount since it started restructuring in 2009.

Our SOTP valuation to 2015 suggests a fair value of HKD7.20 representing 93% upside compared with the share price on 10 April.

■ AviChina: Daiwa SOTP analysis

Company	Per share value (HKD)
Jiangxi Hongdu Aviation	1.3
Hafei Aviation Industry	1.0
China Avic Avionics	3.1
China Aviation Optical	0.6
Tianjin Aviation	0.1
Subtotal	6.1
Changhe Aviation value	0.4
Net cash per share	0.7
SOTP	7.2

Source: Daiwa estimates

We expect 2015 to mark just the beginning of a period of strong order growth for aircraft. We forecast orders for general aviation aircraft to increase at a CAGR of 20% for 2015-20, compared with a CAGR of 15% for 2011-15 before the opening of the private market. We therefore expect positive sentiment towards the stock to continue over the coming three years.

Are there any near-term hurdles?

The major near-term hurdle is the uncertainty about when the opening-up of low-altitude airspace will take place.

Meanwhile, the government's plan to offer subsidies for the replacement of general aviation aircraft, equipment purchases, the setting up pilot-training schools, and new airport construction. No details have been announced.

Furthermore, there is a risk that raw-material prices will rise this year as the global economy recovers. Raw materials accounted for about 56% of AviChina's cost of sales in 2012.

How to monitor progress?

In addition to the semi-annual earnings announcements from the company itself, we believe the quarterly results of its A-share subsidiaries are a good indicator on how AviChina is doing. The A-share subsidiaries account for about 50% of the company's net profit, with the other 50% coming mostly from Changhe Aviation (not listed), mainly from helicopter manufacturing.

■ AviChina: net-profit contribution from subsidiaries (CNYm)

Subsidiary	Bloomberg code	Shareholding	2011	%	2012	%
Hafei Aviation	600038 CH	50%	55.0	12.4	58	9.6
Hongdu Aviation	600316 CH	44%	36.4	8.2	38	6.4
AVIC Avionics	600372 CH	44%	166.4	37.5	209	34.8
JONHON Optronic	002179 CH	43%	85.8	19.3	88	14.6
Others	n.a.	n.a.	100.6	22.6	207	34.5
Total			444.2	100.0	600.0	100.0

Source: Companies
Note: Others include unlisted subsidiaries

What could go wrong?

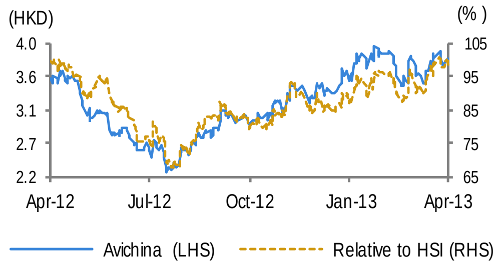
Slower-than-expected policy implementation. We expect policies favourable to AviChina (such as the opening of low-altitude airspace, government subsidies, and approval of the L15 trainer for domestic delivery) to be announced this year. However, there is a risk of delay as there are no deadlines for these policies to be announced.

Pilot shortage. A lack of civil aviation pilots is an issue in China, even though we expect the country to increase the capacity for pilot training in the coming three years to meet the demand from the private civil-aviation sector. However, there is risk that the supply of pilots does not improve by the time that low-altitude airspace is opened up. This would be a bottleneck to industry development. At present, only a small proportion of pilots work in the general aviation segment.

Raw-material price increases. The main cost item for AviChina that cannot be controlled is raw-material prices. As mentioned, we expect the global economy to recover from this year onwards, and believe this will drive up the prices of raw materials such as steel and aluminium, which would be negative for AviChina.

Insufficient infrastructure capability. At the end of 2011, China had only 70 general aviation airports operating compared with 178 scheduled air-service airports. Although China is aiming to increase the total number of general aviation airports by 2015, there is a risk that construction could be delayed, creating a bottleneck to the industry's development.

Share price performance



12-month range	2.27-3.96
Market cap (USDbn)	2.63
3m avg daily turnover (USDm)	6.07
Shares outstanding (m)	5,474
Major shareholder	AVIC (56.7%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	21,235	28,122	35,517
Operating profit (m)	1,683	2,439	3,459
Net profit (m)	830	1,176	1,596
Core EPS (fully-diluted)	0.152	0.215	0.292
EPS change (%)	38.3	41.6	35.8
Daiwa vs Cons. EPS (%)	14.0	29.4	38.8
PER (x)	19.6	13.9	10.2
Dividend yield (%)	0.8	1.1	1.5
DPS	0.023	0.032	0.044
PBR (x)	1.7	1.5	1.3
EV/EBITDA (x)	8.8	6.7	4.3
ROE (%)	8.8	11.3	13.8

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Revenue growth from helicopters (%)	3.4	(5.4)	8.3	22.0	3.2	31.7	29.9	27.6
Revenue growth from trainers (%)	(10.8)	(0.6)	8.5	6.3	22.3	31.2	38.2	39.4
Revenue growth from aviation parts and components (%)	0.0	0.0	117.2	17.7	27.0	21.4	32.7	21.4
Aluminium price change (%)	0.0	(35.0)	30.3	10.1	(4.6)	10.6	4.3	0.0

Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Aircraft revenue	4,979	3,028	5,268	6,555	8,273	10,885	14,384	18,834
Aviation components revenue	0	2,627	5,705	6,716	8,527	10,349	13,738	16,683
Other Revenue	0	0	0	0	0	(0)	0	0
Total Revenue	4,979	5,654	10,973	13,271	16,800	21,235	28,122	35,517
Other income	62	118	136	132	156	74	74	74
COGS	(3,963)	(4,285)	(8,097)	(10,179)	(13,102)	(16,515)	(22,030)	(27,675)
SG&A	(580)	(786)	(1,498)	(1,806)	(2,156)	(2,608)	(3,181)	(3,851)
Other op.expenses	(135)	(182)	(390)	(440)	(429)	(502)	(546)	(607)
Operating profit	364	519	1,125	979	1,270	1,683	2,439	3,459
Net-interest inc./(exp.)	(83)	(68)	(53)	(19)	13	(4)	(47)	(198)
Assoc/forex/extraord./others	39	33	32	92	56	68	81	97
Pre-tax profit	320	484	1,104	1,052	1,339	1,747	2,473	3,358
Tax	(40)	(61)	(145)	(143)	(182)	(237)	(336)	(456)
Min. int./pref. div./others	(1,342)	(185)	(74)	(410)	(557)	(679)	(962)	(1,306)
Net profit (reported)	(1,063)	237	885	499	600	830	1,176	1,596
Net profit (adjusted)	135	248	503	444	600	830	1,176	1,596
EPS (reported)(CNY)	(0.229)	0.051	0.181	0.101	0.110	0.152	0.215	0.292
EPS (adjusted)(CNY)	0.029	0.053	0.103	0.090	0.110	0.152	0.215	0.292
EPS (adjusted fully-diluted)(CNY)	0.029	0.053	0.103	0.090	0.110	0.152	0.215	0.292
DPS (CNY)	0.000	0.000	0.010	0.011	0.020	0.023	0.032	0.044
EBIT	364	519	1,125	979	1,270	1,683	2,439	3,459
EBITDA	499	701	1,515	1,419	1,698	2,185	2,985	4,065

Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	320	484	1,104	1,052	1,339	1,747	2,473	3,358
Depreciation and amortisation	135	182	390	440	429	502	546	607
Tax paid	(51)	(66)	(126)	(177)	(182)	(237)	(336)	(456)
Change in working capital	(605)	571	1,211	(920)	(2,225)	(769)	(1,089)	(1,364)
Other operational CF items	(72)	(98)	(103)	(143)	(107)	(92)	(106)	(122)
Cash flow from operations	(274)	1,072	2,475	252	(746)	1,151	1,489	2,023
Capex	(426)	(250)	(941)	(662)	(500)	(1,800)	(700)	(700)
Net (acquisitions)/disposals	149	90	217	259	(340)	189	189	189
Other investing CF items	(215)	(1,108)	(1,830)	(179)	(1,327)	(462)	(462)	(462)
Cash flow from investing	(493)	(1,268)	(2,555)	(582)	(2,167)	(2,073)	(973)	(973)
Change in debt	1,879	2,061	1,712	2,315	1,500	1,500	1,500	1,500
Net share issues/(repurchases)	0	0	894	0	1,740	0	0	0
Dividends paid	(32)	(102)	(96)	(172)	(55)	(109)	(125)	(176)
Other financing CF items	(1,476)	(1,909)	493	(2,325)	(1,357)	(2,727)	(1,733)	(1,733)
Cash flow from financing	371	50	3,004	(182)	1,829	(1,337)	(358)	(410)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(395)	(145)	2,924	(512)	(1,084)	(2,259)	158	641
Free cash flow	(700)	822	1,534	(410)	(1,246)	(649)	789	1,323

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	3,736	3,637	9,110	8,651	8,447	6,188	6,346	6,987
Inventory	5,265	3,414	5,679	8,197	11,226	14,190	18,791	23,733
Accounts receivable	3,910	2,445	3,569	4,388	5,957	7,530	9,972	12,594
Other current assets	2,077	8,931	9,273	2,831	2,464	2,656	2,955	3,276
Total current assets	14,987	18,427	27,632	24,067	28,094	30,563	38,064	46,590
Fixed assets	7,066	2,166	4,004	4,483	4,856	4,872	5,044	5,155
Goodwill & intangibles	241	225	247	53	51	51	0	0
Other non-current assets	995	1,253	2,153	2,370	2,895	4,617	7,962	5,556
Total assets	23,289	22,071	34,035	30,973	35,896	40,103	51,070	57,301
Short-term debt	5,681	1,458	2,073	1,887	2,652	1,658	1,658	1,658
Accounts payable	7,262	3,222	5,490	6,914	10,043	12,631	16,756	20,991
Other current liabilities	3,041	6,401	8,408	6,620	5,792	7,163	9,291	11,577
Total current liabilities	15,984	11,081	15,971	15,421	18,487	21,452	27,705	34,227
Long-term debt	949	1,152	957	1,171	696	538	3,238	222
Other non-current liabilities	225	231	339	263	220	220	220	220
Total liabilities	17,158	12,464	17,267	16,855	19,403	22,210	31,163	34,669
Share capital	4,644	4,644	4,949	4,949	5,474	5,474	5,474	5,474
Reserves/R.E./others	(1,984)	720	3,467	2,596	3,652	4,373	5,424	6,844
Shareholders' equity	2,660	5,363	8,416	7,545	9,126	9,847	10,898	12,318
Minority interests	3,471	4,244	8,353	6,573	7,367	8,046	9,008	10,314
Total equity & liabilities	23,289	22,071	34,035	30,973	35,896	40,103	51,070	57,301
EV	22,328	19,093	17,718	16,221	17,468	19,254	19,883	17,584
Net debt/(cash)	2,894	(1,028)	(6,080)	(5,593)	(5,099)	(3,992)	(1,450)	(5,107)
BVPS (CNY)	0.573	1.155	1.721	1.533	1.667	1.799	1.991	2.250

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	(69.9)	13.6	94.1	20.9	26.6	26.4	32.4	26.3
EBITDA (YoY)	(11.9)	40.5	116.2	(6.3)	19.7	28.7	36.6	36.2
Operating profit (YoY)	n.a.	42.6	117.0	(13.0)	29.7	32.5	45.0	41.8
Net profit (YoY)	n.a.	84.3	102.7	(11.8)	35.2	38.3	41.6	35.8
Core EPS (fully-diluted) (YoY)	n.a.	84.3	92.5	(12.3)	21.5	38.3	41.6	35.8
Gross-profit margin	20.4	24.2	26.2	23.3	22.0	22.2	21.7	22.1
EBITDA margin	10.0	12.4	13.8	10.7	10.1	10.3	10.6	11.4
Operating-profit margin	7.3	9.2	10.3	7.4	7.6	7.9	8.7	9.7
Net profit margin	2.7	4.4	4.6	3.3	3.6	3.9	4.2	4.5
ROAE	4.4	6.2	7.3	5.6	7.2	8.8	11.3	13.8
ROAA	0.6	1.1	1.8	1.4	1.8	2.2	2.6	2.9
ROCE	2.9	4.2	7.0	5.3	6.9	8.4	10.9	14.0
ROIC	3.4	5.1	10.1	8.8	11.0	11.5	13.0	16.6
Net debt to equity	108.8	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	12.5	12.6	13.1	13.6	13.6	13.6	13.6	13.6
Accounts receivable (days)	262.0	205.1	100.0	109.4	112.4	115.9	113.6	116.0
Current ratio (x)	0.9	1.7	1.7	1.6	1.5	1.4	1.4	1.4
Net interest cover (x)	4.4	7.6	21.3	52.4	n.a.	432.1	51.6	17.5
Net dividend payout	n.a.	0.0	5.6	11.0	18.2	15.0	15.0	15.0
Free cash flow yield	n.a.	5.0	9.4	n.a.	n.a.	n.a.	4.8	8.1

Source: FactSet, Daiwa forecasts

■ Company profile

AviChina Industry & Technology is mainly engaged in the development, manufacture, sale, and upgrading of aviation equipment and related products. The major shareholder of the company's H shares is Aviation Industry Corporation of China, with a 56.7% stake.

China Liansu Group (2128 HK)

Rating: **Buy [1]**
Share price: **HKD4.14**
6-mth target price: **HKD6.00** (45% potential upside)
3-year fair value: **HKD10.30** (149% potential upside)

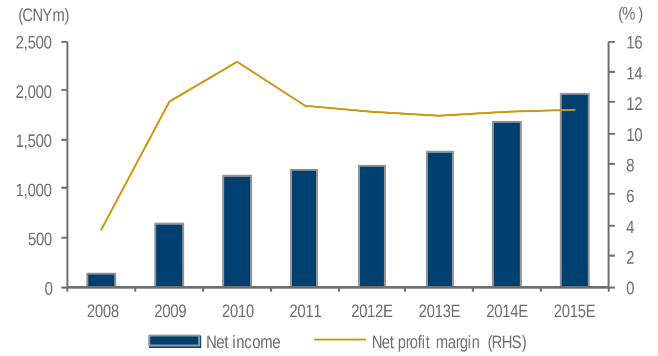
Well-placed to monetise China's priority to improve citizens' quality of life

Felix Lam
(852) 2532 4341 (felix.lam@hk.daiwacm.com)

What is the three-year story?

The PRC Government has targeted to spend CNY4tn on improving the country's water infrastructure over 2011-20. In addition, it has launched various measures which aim at increasing the supply of government-aided affordable housing as well as reasonably-priced private flats. As it is the country's largest producer of plastic pipes and is expanding rapidly into home-building products, China Liansu Group (Liansu) stands to benefit from the government's policies in the next 3-5 years.

■ Liansu: net profit and net-profit margin



Source: Company, Daiwa forecasts

According to the World Bank, China has per capita water resources of only 25% of the global average, and its water distribution is uneven, with 80% of its resources coming from 37% of the country (south of the Yangtze River). Given these conditions and the country's ongoing urbanisation, we see the need for the PRC Government to upgrade the water-supply and drainage networks over the next few years. We believe Liansu's pipes, used in water supply and drainage, should fit the government's water-network agenda.

Given the short history of China's residential property market (less than 15 years), demand for private housing has remained strong and we do not foresee a significant slowdown over the next 3-5 years. We expect demand to come not only from first-time buyers, but also from individuals and families wishing to upgrade their living quality. This should translate into robust demand for home-building products with good, reliable quality. To benefit from this demand, Liansu started to expand rapidly into plastic windows and doors, holistic kitchens, and plumbing sanitary ware in 2012. While the revenue from these products is small for now, top-line growth is strong, and we forecast revenue from these to reach CNY1.5-2bn over 2014-15, accounting for more than 10% of total revenue.

What could the fair value be in 2015?

Our six-month target price of HKD6.00 is based on a PER of 11x applied to our 2013E EPS. We see PER as an appropriate valuation methodology given the 17% EPS growth we forecast for 2012-15. As there are no other China plastic-pipe makers listed in Hong Kong, we benchmark Liansu against the cement companies as both produce materials used in building properties and infrastructure construction. Assuming that Liansu achieves EPS in line with our forecasts and applying our current target 11x PER, we estimate a fair value per share HKD10.30 for Liansu by end-2015.

Are there any near-term hurdles?

The investment community seems to perceive Liansu as one that has an interesting story but operates in an industry lacking transparency. Besides, management tends to keep a fairly low profile and does not give investors regular updates, which may have led many to believe that the company has limited share-price catalysts. In our view, these overhangs need resolving if Liansu is to achieve a better valuation.

On the first point, the transparency of an industry is generally aligned with its size and fragmentation. Plastic pipes and home-building products are both relatively small and fairly fragmented industries. We think it is understandable that there is insufficient data on the company's industry. Analysts and investors can gain an insight into the company's business by talking with industry participants.

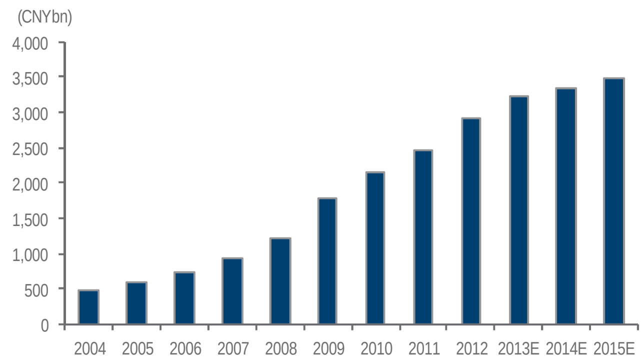
Second, we see managing the core business as a far more important priority than meeting with investors. This does not mean that management should ignore investors and analysts, and we do see room for Liansu to improve its investor relationships. Our observation is that the company's interaction with investors and analysts was insufficient after its IPO in 2010, but that this is much better now, at least with Asian investors.

Finally, investors seem to perceive Liansu as a 'boring' stock, as it lacks company-specific news. Management could raise investor awareness by providing quarterly updates.

How to monitor progress?

We believe the prospects for Liansu's primary products depend to a large extent on the PRC Government's investments in China's water infrastructure. In our view, the monthly data for fixed-asset investments related to water resources and infrastructure is a good indicator of growth in demand for water pipes, and thus of Liansu's sales momentum.

■ **China: investment in water conservation, environmental management and utility management**



Source: CEIC, Daiwa forecasts

For the company's home-building products (ie, plastic windows and doors, plumbing sanitary ware and holistic kitchens), we can monitor sales by keeping track of the contracted GFA of major property developers, as they are key customers of Liansu. The progress of property development in China's third and fourth-tier cities is of particular importance for Liansu given its expanding presence in these areas.

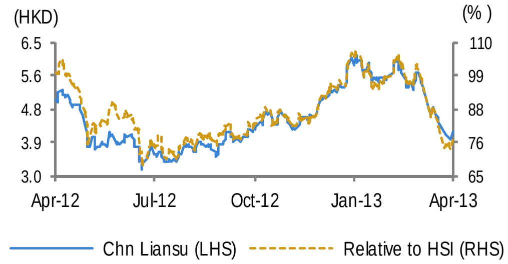
What could go wrong?

China's macro economy is a critical swing factor for Liansu's prospects, given that it is a building-products company. We also see the following as key challenges.

Emergence of an aggressive competitor: the key entry barriers for the plastic-pipes industry are a long-standing reputation for product reliability and critical mass. As the industry is becoming more developed, its profit margins are fairly good and stable, and capex is not that large. As such, one or more of Liansu's key competitors could decide to accelerate its business growth by expanding capacity rapidly and cutting prices aggressively.

Diversification into too many products: Liansu has been expanding its business in three home-building products for the past 18 months, and early this year it acquired the Chairman's valve business (for large-diameter pipes). While these businesses share similar distribution networks, we would be concerned if the company's ROE and profit margin were to be diluted and its balance sheet and cash flow were to deteriorate if the expansion took place too fast.

Share price performance



12-month range	3.18-6.15
Market cap (USDbn)	1.60
3m avg daily turnover (USDm)	4.47
Shares outstanding (m)	3,006
Major shareholder	n Hai (Founder and Chairman) (70.0%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	12,402	14,611	17,020
Operating profit (m)	1,925	2,285	2,680
Net profit (m)	1,382	1,672	1,963
Core EPS (fully-diluted)	0.443	0.536	0.629
EPS change (%)	10.3	20.9	17.4
Daiwa vs Cons. EPS (%)	(10.7)	(8.3)	3.9
PER (x)	7.5	6.2	5.3
Dividend yield (%)	3.6	3.6	3.6
DPS	0.120	0.120	0.120
PBR (x)	1.4	1.2	1.0
EV/EBITDA (x)	4.7	3.7	2.9
ROE (%)	21.2	21.7	21.4

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales volume: PVC pipe and pipe fittings (000 tonnes)	266	431	617	754	856	951	1,071	1,195
Sales volume: non-PVC pipe and pipe fittings (000 tonnes)	69	135	172	207	230	253	268	299
ASP: PVC pipe and pipe fittings (Rmb/t)	9,173	7,924	8,215	8,870	7,999	8,000	8,200	8,200
ASP: non-PVC pipe and pipe fittings (Rmb/t)	16,365	13,772	14,764	15,624	15,690	15,800	15,800	15,800
Gross profit margin: PVC pipe and pipe fittings (%)	0.0	21.3	24.6	24.9	25.7	25.5	25.5	25.5
Gross profit margin: non-PVC pipe and pipe fittings (%)	0.0	25.2	29.0	21.8	22.0	22.0	22.5	23.0

■ Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Pipe and pipe fittings - PVC	2,436	3,416	5,070	6,686	6,845	7,608	8,781	9,799
Pipe and pipe fittings - non-PVC	1,134	1,862	2,542	3,235	3,603	3,994	4,230	4,720
Other Revenue	49	45	100	222	443	800	1,600	2,500
Total Revenue	3,619	5,322	7,712	10,143	10,891	12,402	14,611	17,020
Other income	0	0	0	0	0	0	0	0
COGS	(3,114)	(4,109)	(5,678)	(7,691)	(8,242)	(9,423)	(11,084)	(12,910)
SG&A	(268)	(362)	(533)	(768)	(925)	(1,054)	(1,242)	(1,430)
Other op.expenses	0	0	0	0	0	0	0	0
Operating profit	236	851	1,500	1,684	1,725	1,925	2,285	2,680
Net-interest inc./(exp.)	(45)	(34)	(43)	(83)	(94)	(113)	(104)	(97)
Assoc/forex/extraord./others	(20)	(18)	(84)	(43)	(149)	(115)	(115)	(130)
Pre-tax profit	170	799	1,374	1,557	1,482	1,697	2,066	2,453
Tax	(34)	(155)	(241)	(296)	(251)	(297)	(372)	(491)
Min. int./pref. div./others	(0)	0	0	0	7	(5)	(10)	0
Net profit (reported)	135	644	1,132	1,261	1,238	1,395	1,684	1,963
Net profit (adjusted)	135	644	1,132	1,198	1,235	1,382	1,672	1,963
EPS (reported)(CNY)	0.060	0.286	0.428	0.420	0.412	0.464	0.560	0.653
EPS (adjusted)(CNY)	0.060	0.286	0.428	0.399	0.411	0.460	0.556	0.653
EPS (adjusted fully-diluted)(CNY)	0.060	0.286	0.423	0.389	0.402	0.443	0.536	0.629
DPS (CNY)	0.000	0.000	0.100	0.120	0.120	0.120	0.120	0.120
EBIT	234	833	1,417	1,563	1,572	1,795	2,177	2,573
EBITDA	291	904	1,540	1,737	1,834	2,133	2,538	2,962

■ Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	170	799	1,374	1,557	1,482	1,697	2,066	2,453
Depreciation and amortisation	57	71	123	174	262	339	383	412
Tax paid	(34)	(76)	(212)	(249)	(251)	(297)	(372)	(491)
Change in working capital	(228)	(233)	(731)	(216)	(311)	(144)	(278)	(358)
Other operational CF items	79	44	87	98	89	98	89	97
Cash flow from operations	44	606	641	1,364	1,272	1,692	1,887	2,113
Capex	(251)	(587)	(525)	(991)	(1,200)	(1,000)	(800)	(800)
Net (acquisitions)/disposals	36	18	9	(179)	(123)	0	0	0
Other investing CF items	(72)	(155)	52	(206)	(220)	0	0	0
Cash flow from investing	(287)	(724)	(464)	(1,376)	(1,543)	(1,000)	(800)	(800)
Change in debt	(40)	841	(516)	1,021	480	(396)	(21)	(21)
Net share issues/(repurchases)	0	0	1,630	0	0	0	0	0
Dividends paid	0	0	0	(303)	(303)	(294)	(361)	(361)
Other financing CF items	231	(497)	(132)	(61)	(99)	(126)	(74)	(73)
Cash flow from financing	191	344	982	656	78	(815)	(456)	(455)
Forex effect/others	1	0	(19)	(29)	0	0	0	0
Change in cash	(51)	226	1,139	615	(193)	(123)	631	858
Free cash flow	(207)	19	116	373	72	692	1,087	1,313

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	139	487	1,523	2,117	1,932	1,799	2,430	3,288
Inventory	584	744	1,139	1,294	1,766	1,815	2,107	2,465
Accounts receivable	203	467	681	748	1,010	1,117	1,295	1,517
Other current assets	255	259	270	348	405	466	540	633
Total current assets	1,181	1,956	3,615	4,507	5,113	5,196	6,372	7,902
Fixed assets	735	1,303	1,706	2,471	3,288	3,902	4,285	4,640
Goodwill & intangibles	1	1	2	3	10	10	10	10
Other non-current assets	213	239	306	811	1,372	1,363	1,397	1,430
Total assets	2,129	3,499	5,629	7,792	9,783	10,471	12,064	13,982
Short-term debt	417	428	630	70	596	221	221	200
Accounts payable	40	233	243	191	512	484	562	657
Other current liabilities	1,185	855	535	772	931	1,031	1,220	1,438
Total current liabilities	1,642	1,515	1,408	1,033	2,039	1,737	2,003	2,296
Long-term debt	52	882	154	1,675	1,629	1,607	1,586	1,586
Other non-current liabilities	11	60	63	96	87	59	74	98
Total liabilities	1,705	2,457	1,624	2,804	3,755	3,404	3,664	3,980
Share capital	0	0	131	132	132	132	132	132
Reserves/R.E./others	424	1,042	3,873	4,855	5,878	6,913	8,236	9,838
Shareholders' equity	424	1,042	4,004	4,987	6,010	7,044	8,367	9,969
Minority interests	0	0	0	0	18	23	33	33
Total equity & liabilities	2,129	3,499	5,629	7,792	9,783	10,471	12,064	13,982
EV	10,260	10,753	9,191	9,553	10,235	9,978	9,335	8,456
Net debt/(cash)	330	823	(739)	(372)	293	30	(623)	(1,502)
BVPS (CNY)	0.188	0.463	1.335	1.659	1.999	2.343	2.784	3.317

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	38.2	47.1	44.9	31.5	7.4	13.9	17.8	16.5
EBITDA (YoY)	76.3	211.2	70.3	12.8	5.6	16.3	19.0	16.7
Operating profit (YoY)	90.2	256.0	70.0	10.3	0.6	14.2	21.3	18.2
Net profit (YoY)	79.8	375.3	75.8	5.8	3.0	12.0	20.9	17.4
Core EPS (fully-diluted) (YoY)	79.8	375.3	47.9	(8.0)	3.1	10.3	20.9	17.4
Gross-profit margin	13.9	22.8	26.4	24.2	24.3	24.0	24.1	24.1
EBITDA margin	8.0	17.0	20.0	17.1	16.8	17.2	17.4	17.4
Operating-profit margin	6.5	15.7	18.4	15.4	14.4	14.5	14.9	15.1
Net profit margin	3.7	12.1	14.7	11.8	11.3	11.1	11.4	11.5
ROAE	40.6	87.8	44.9	26.7	22.5	21.2	21.7	21.4
ROAA	6.5	22.9	24.8	17.9	14.1	13.7	14.8	15.1
ROCE	26.9	51.4	39.7	27.1	21.0	20.9	22.8	23.4
ROIC	26.8	52.4	48.2	34.6	26.2	23.7	25.2	26.3
Net debt to equity	77.8	79.0	net cash	net cash	4.9	0.4	net cash	net cash
Effective tax rate	20.1	19.4	17.6	19.0	16.9	17.5	18.0	20.0
Accounts receivable (days)	22.2	23.0	27.2	25.7	29.5	31.3	30.1	30.1
Current ratio (x)	0.7	1.3	2.6	4.4	2.5	3.0	3.2	3.4
Net interest cover (x)	5.2	24.7	32.8	18.8	16.8	15.9	20.9	26.6
Net dividend payout	0.0	0.0	23.4	28.6	29.1	25.9	21.4	18.4
Free cash flow yield	n.a.	0.2	1.2	3.8	0.7	7.0	11.0	13.2

Source: FactSet, Daiwa forecasts

Company profile

China Liansu Group is a leading plastic-pipe and pipe-fittings producer in the PRC. The company began production in 1996 in Guangdong Province and started to expand to other parts of China in 2001. Products for water supply and drainage account for the majority of its sales. The company has entered into the market of homebuilding products including plastic-steel windows and doors, sanitary products and holistic kitchen which are likely to be next driver for earnings growth in the next 3-5 years.

ENN Energy (2688 HK)

Rating: **Buy [1]**
Share price: **HKD44.60**
6-mth target price: **HKD48.50** (9% potential upside)
3-year fair value: **HKD67.00** (50% potential upside)

Winner in organic gas volume growth

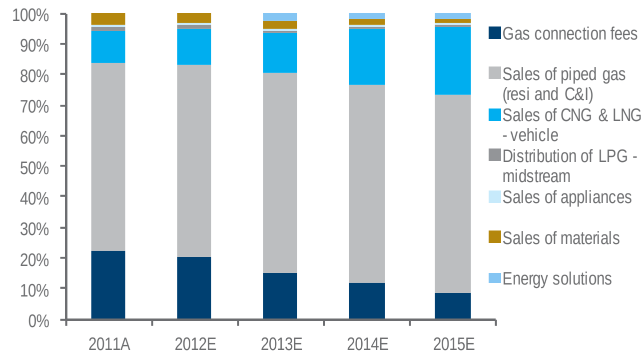
Dave Dai
(852) 2848 4068 (dave.dai@hk.daiwacm.com)

What is the three-year story?

China's city-gas segment is one of the few utilities and clean energy sub-sectors that is experiencing a supply shortage, and we believe it will remain a high-growth segment in terms of sales volume on a three-year view. According to the National Development and Reform Commission, China's gas consumption is forecast to reach 230bn m^3 by 2015, implying a CAGR of 16% over 2011-15. ENN Energy (ENN) recorded 24% YoY growth in its gas sales volume in 2012, one of the best growth rates among its peers in the same period. In the expansion of China's gas supplies in both 2011 and 2012, ENN led the way in organic growth due to its large exposure to the east coast relative to peers. We expect this trend in ENN's organic growth to continue in the coming three years, with new gas supplies or capacity expansion due to come on line for Shaanxi-Beijing III & IV, West-East II, Ningbo LNG, Zhuhai LNG, Tianjin LNG, Caofeidian, Qingdao LNG and Yangpu LNG, etc.

We believe that Liquefied Natural Gas (LNG) will be a major driver of the ramp-up in China's gas supply. Sinopec has announced an import capacity target for 2020 of 30m tonnes, and CNOOC has announced a target of 35.7m tonnes. Since Compressed Natural Gas (CNG) has been used mainly for passenger vehicles and taxies in selected cities, wider application of LNG for heavy-duty transportation is likely to trigger substantial investments in infrastructure, especially LNG refuelling stations, processing plants and storage facilities. The most aggressive company in such investments is Kunlun Energy (Not rated), a subsidiary of CNPC Group which is planning to build up to 1,500 LNG refuelling stations by 2015. ENN, for its part, expects to build up to 500 LNG stations, in addition to its planned 400 CNG refuelling stations.

■ ENN: total revenue forecasts



Source: Company, Daiwa forecasts

What could the fair value be in 2015?

Given the company's stable operating cash flows, we derive our six-month target price of HKD48.5 using a DCF valuation based on a WACC of 9.4% and a terminal growth rate of 2%. Our fair value estimate according to our DCF model would reach HKD55.0 by this time next year and HKD67.0 by this time in 2015.

The stock is trading at a 2013E PER of 19x (with its peers at around 21x), backed by a 2013E ROE of 21% and an EPS CAGR of 26% for 2012-15E.

Are there any near-term hurdles?

As we see it, the major hurdle for the company in the short term would be possible margin pressure arising from nationwide gas price reform, which we expect to be reinforced in mid-2013 through a 20% increase in price, ie, the procurement cost for city-gas companies.

In our earnings forecasts for the city-gas companies under Daiwa's coverage, we assume that only half of household sales see a pass-through (either with a partial pass-through or delays, which is consistent with what occurred in 2010). Moreover, we expect a complete pass-though for vehicle gas and power generation. Based on the experience in 2010, city-gas operators leveraged to other customer groups, especially commercial & industrial (C&I) users, are likely to receive a higher tariff hike to offset margin compression from household users. Based on our calculations, to pass on fully the 20% increase in cost, ENN would need to raise its tariffs for C&I customers by 15.6%, which would not be difficult, in our view, given still-wide gas shortages.

■ **ENN: increase in tariffs for C&I customers required to protect a dollar margin squeeze assuming a 20% cost increase**

(CNY/cm) – annualised basis	ENN	BJE	CRG	CHG
Unit cost of gas purchases	2.49	1.72	1.85	1.8
ASP				
Residential customers	2.55	2.28	1.78	2.22
C&I customers	3.47	2.33	2.62	2.57
CNG stations	3.93	n.a.	3.29	2.7
Unit cost after reform				
Unit cost after price reform (assuming 20% increase)	2.99	2.06	2.22	2.16
Unit cost increase	0.50	0.34	0.37	0.36
Unit gross profit before reform				
Residential customers	0.06	0.56	-0.07	0.42
C&I customers	0.98	0.61	0.77	0.77
CNG stations	1.44	n.a.	1.44	0.90
Unit gross profit/(loss) after price reform				
Residential (assuming 50% pass-through)	-0.19	0.39	-0.26	0.24
CNG stations (assuming 100% pass-through)	1.44	n.a.	1.44	0.90
Required price increase for C&I customers	15.6%	15.8%	17.3%	14.7%

Source: Companies, Daiwa estimates

Note: BJE stands for Beijing Enterprises (392 HK, HKD63.35, Outperform [2]), CRG for China Resources Gas (1193 HK, HKD21.85, Hold [3]),and CHG for China Gas (384 HK, HKD7.91, Hold [3])

How to monitor progress

First, we think investors should monitor the impact on costs of possible nation-wide gas price reform in 2013. In our base case, we assume a 20% gas cost increase, while recent reports suggest that gas city-gate prices might be raised by a more modest 8-12% in Zhejiang Province. A smaller-than-expected cost increase would be positive news for city-gas distributors.

Another data point to watch is monthly gas consumption in China. This can serve as a leading indicator of gas sales volume, since most gas companies report operating data only semi-annually.

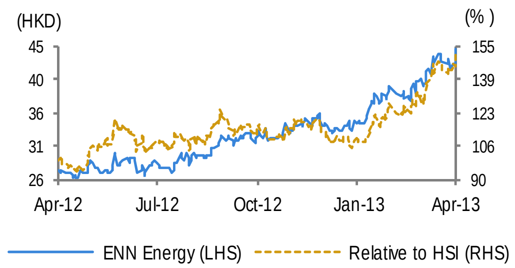
What could go wrong?

Higher-than-expected gas price increases would be the major downside risk to our earnings forecasts for ENN. If, instead of a 20% cost increase, we were to see a 40% increase, then we calculate that ENN would have to increase its C&I tariffs by close to 31% in order to avoid margin pressure, which could be much more difficult to do without having an adverse impact on demand.

Second, gas demand could be a swing factor if China's economic recovery is slower than expected. In the face of economic weakness in 2012, YoY growth in China's gas consumption slowed to a mid-teens percentage, compared with 20%-plus in 2011. Backed by the view of Daiwa's economics team that China's GDP should recover over the next two quarters, we believe that gas demand will be strong during the same period. However, investors should be alert to the risks if the monthly data disappoints.

Investors should also pay attention to ENN's expansion plans for LNG refuelling stations (we forecast 90 per year over 2012-20). According to our discussions with the company, the profitability of the LNG refuelling-station business is not as good as for CNG stations, due to a relatively low station utilisation rate of 30-50%, as there are a limited number of LNG trucks in China. As a result, ENN Group, the parent company, has signed a framework agreement with Westport Innovations, a global leader in natural gas engines, to develop the LNG vehicle market and possibly benefit from Westport's LNG-engine adaption technology, which is at the R&D stage. There could be a risk to ENN's LNG refuelling-station business if China's LNG vehicle market develops more slowly than expected.

Share price performance



12-month range	26.40-44.60
Market cap (USDbn)	6.13
3m avg daily turnover (USDm)	14.11
Shares outstanding (m)	1,066
Major shareholder	ENN Group (31.2%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	22,371	28,568	34,193
Operating profit (m)	3,540	4,326	4,995
Net profit (m)	2,008	2,452	2,908
Core EPS (fully-diluted)	1.884	2.299	2.728
EPS change (%)	36.5	22.1	18.6
Daiwa vs Cons. EPS (%)	8.4	11.2	16.4
PER (x)	18.9	15.5	13.0
Dividend yield (%)	1.3	1.6	2.3
DPS	0.471	0.575	0.818
PBR (x)	3.7	3.2	2.7
EV/EBITDA (x)	10.2	8.3	6.9
ROE (%)	21.4	22.1	22.3

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Gas sales volume (m cm)	2,889	2,940	4,149	5,373	6,460	8,269	10,481	12,909
Gas ASP - retail (Rmb/cm)	2.5	2.5	2.6	2.7	2.8	3.0	3.3	3.3
Gas ASP - CNG (Rmb/cm)	2.3	2.5	2.7	2.9	2.2	3.0	3.3	3.4
Gas purchase cost (Rmb/cm)	1.7	1.7	1.8	1.9	2.0	2.2	2.4	2.4
Revenue contribution – connection fee (%)	29.3	30.4	27.2	22.7	20.2	17.0	14.6	11.7
Gas penetration rate for residential households (%)	27.0	32.4	36.0	38.1	44.2	50.0	57.3	64.5

■ Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales of piped gas	3,095	4,078	6,633	9,152	11,547	14,827	18,410	21,487
Gas connection	2,422	2,554	3,049	3,415	3,633	3,807	4,178	4,015
Other Revenue	2,749	1,782	1,534	2,501	2,847	3,738	5,979	8,691
Total Revenue	8,266	8,413	11,215	15,068	18,027	22,371	28,568	34,193
Other income	184	84	162	96	20	66	66	66
COGS	(6,019)	(5,873)	(8,203)	(11,166)	(13,183)	(16,850)	(22,074)	(26,887)
SG&A	(847)	(625)	(929)	(1,242)	(1,443)	(1,440)	(1,558)	(1,666)
Other op.expenses	(313)	(391)	(453)	(421)	(528)	(608)	(676)	(711)
Operating profit	1,270	1,608	1,792	2,335	2,893	3,540	4,326	4,995
Net-interest inc./(exp.)	(351)	(308)	(284)	(389)	(470)	(291)	(270)	(173)
Assoc/forex/extraord./others	211	83	303	381	429	451	461	536
Pre-tax profit	1,131	1,383	1,811	2,327	2,852	3,700	4,516	5,358
Tax	(260)	(304)	(410)	(660)	(859)	(999)	(1,219)	(1,447)
Min. int./pref. div./others	(240)	(276)	(388)	(414)	(511)	(692)	(845)	(1,003)
Net profit (reported)	631	803	1,013	1,253	1,482	2,008	2,452	2,908
Net profit (adjusted)	631	803	1,013	1,253	1,482	2,008	2,452	2,908
EPS (reported)(CNY)	0.625	0.775	0.965	1.190	1.390	1.884	2.299	2.728
EPS (adjusted)(CNY)	0.625	0.775	0.965	1.190	1.390	1.884	2.299	2.728
EPS (adjusted fully-diluted)(CNY)	0.614	0.772	0.954	1.180	1.380	1.884	2.299	2.728
DPS (CNY)	0.154	0.192	0.286	0.303	0.345	0.471	0.575	0.818
EBIT	1,270	1,608	1,792	2,335	2,893	3,540	4,326	4,995
EBITDA	1,583	1,999	2,245	2,756	3,422	4,148	5,002	5,706

■ Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	1,131	1,383	1,811	2,327	2,852	3,700	4,516	5,358
Depreciation and amortisation	313	391	453	421	528	608	676	711
Tax paid	(260)	(304)	(410)	(660)	(859)	(999)	(1,219)	(1,447)
Change in working capital	55	910	902	416	930	734	188	805
Other operational CF items	23	198	93	(242)	(602)	31	94	15
Cash flow from operations	1,261	2,578	2,849	2,262	2,849	4,074	4,255	5,443
Capex	(1,418)	(1,552)	(2,497)	(1,889)	(2,521)	(3,100)	(2,000)	(1,000)
Net (acquisitions)/disposals	(180)	(289)	(509)	(578)	(642)	0	0	0
Other investing CF items	111	(144)	16	(200)	(356)	0	0	0
Cash flow from investing	(1,487)	(1,985)	(2,991)	(2,667)	(3,519)	(3,100)	(2,000)	(1,000)
Change in debt	349	481	378	(723)	576	(2,072)	(164)	(1,172)
Net share issues/(repurchases)	0	237	0	83	496	0	0	0
Dividends paid	(158)	(200)	(304)	(322)	(371)	(502)	(613)	(873)
Other financing CF items	47	258	206	5,215	490	3,200	0	0
Cash flow from financing	238	776	280	4,254	1,191	626	(777)	(2,044)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	12	1,369	139	3,848	521	1,600	1,478	2,399
Free cash flow	(157)	1,026	352	373	328	974	2,255	4,443

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	1,725	2,713	2,851	6,024	6,472	7,477	9,025	11,277
Inventory	254	286	249	272	311	398	521	634
Accounts receivable	1,431	1,208	1,356	1,837	2,062	2,559	3,268	3,911
Other current assets	943	547	623	811	842	885	1,805	2,030
Total current assets	4,354	4,754	5,079	8,944	9,687	11,319	14,618	17,852
Fixed assets	7,855	9,028	10,800	13,073	15,099	17,624	18,981	19,603
Goodwill & intangibles	634	622	894	1,247	1,434	1,181	1,147	1,114
Other non-current assets	1,731	2,231	2,867	3,624	4,673	4,673	4,673	4,673
Total assets	14,574	16,635	19,640	26,888	30,893	34,797	39,419	43,242
Short-term debt	1,869	1,484	2,379	3,213	3,945	1,208	1,208	1,208
Accounts payable	2,752	2,772	3,573	4,172	4,894	6,255	8,195	9,981
Other current liabilities	807	1,108	1,536	2,135	2,775	2,823	2,898	2,975
Total current liabilities	5,428	5,364	7,488	9,520	11,614	10,286	12,300	14,164
Long-term debt	3,534	4,400	3,884	7,459	7,297	11,162	10,998	9,826
Other non-current liabilities	171	444	728	1,069	1,312	480	569	661
Total liabilities	9,133	10,208	12,100	18,048	20,223	21,928	23,867	24,651
Share capital	106	110	110	110	113	113	113	113
Reserves/R.E./others	4,149	5,007	5,922	6,936	8,540	10,046	11,885	13,921
Shareholders' equity	4,256	5,117	6,031	7,046	8,653	10,159	11,998	14,034
Minority interests	1,186	1,310	1,508	1,794	2,017	2,709	3,555	4,558
Total equity & liabilities	14,574	16,635	19,640	26,888	30,893	34,797	39,419	43,242
EV	41,757	41,086	41,015	41,959	41,662	42,477	41,610	39,189
Net debt/(cash)	3,678	3,172	3,412	4,648	4,770	4,893	3,180	(243)
BVPS (CNY)	4.217	4.939	5.745	6.692	8.116	9.529	11.253	13.163

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	43.6	1.8	33.3	34.4	19.6	24.1	27.7	19.7
EBITDA (YoY)	28.4	26.2	12.3	22.7	24.2	21.2	20.6	14.1
Operating profit (YoY)	28.4	26.6	11.5	30.3	23.9	22.3	22.2	15.5
Net profit (YoY)	24.3	27.3	26.2	23.7	18.3	35.5	22.1	18.6
Core EPS (fully-diluted) (YoY)	22.1	25.7	23.6	23.7	16.9	36.5	22.1	18.6
Gross-profit margin	27.2	30.2	26.9	25.9	26.9	24.7	22.7	21.4
EBITDA margin	19.2	23.8	20.0	18.3	19.0	18.5	17.5	16.7
Operating-profit margin	15.4	19.1	16.0	15.5	16.1	15.8	15.1	14.6
Net profit margin	7.6	9.5	9.0	8.3	8.2	9.0	8.6	8.5
ROAE	15.8	17.1	18.2	19.2	18.9	21.4	22.1	22.3
ROAA	4.7	5.1	5.6	5.4	5.1	6.1	6.6	7.0
ROCE	12.4	13.9	13.7	14.0	14.0	15.0	16.3	17.4
ROIC	11.4	13.4	13.5	13.7	14.0	15.6	17.3	19.7
Net debt to equity	86.4	62.0	56.6	66.0	55.1	48.2	26.5	net cash
Effective tax rate	23.0	22.0	22.6	28.4	30.1	27.0	27.0	27.0
Accounts receivable (days)	55.2	57.3	41.7	38.7	39.5	37.7	37.2	38.3
Current ratio (x)	0.8	0.9	0.7	0.9	0.8	1.1	1.2	1.3
Net interest cover (x)	3.6	5.2	6.3	6.0	6.2	12.2	16.0	28.9
Net dividend payout	24.6	24.8	29.7	25.5	24.8	25.0	25.0	30.0
Free cash flow yield	n.a.	2.7	0.9	1.0	0.9	2.6	5.9	11.7

Source: FactSet, Daiwa forecasts

Company profile

Founded in 1989, ENN Energy is engaged principally in the investing in, and the operation and management of, gas-pipeline infrastructure and the sale and the distribution of piped and bottled gas in more than 80 cities in the PRC.

Geely Automobile (175 HK)

Rating: **Buy [1]**
Share price: **HKD3.69**
6-mth target price: **HKD5.15** (40% potential upside)
3-year fair value: **HKD6.55** (78% potential upside)

78% investment return possible over next three years

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What is the three-year story?

China demand for SUVs. We forecast SUV sales as a percentage of total passenger vehicles (PV) in China to rise from 12.9% for 2012 to 19.7% for 2015. This is because we see SUV segmental volume growth rising from 25.5% YoY for 2012 to 26% YoY for 2013, 26.5% YoY for 2014, and 27% YoY for 2015. We estimate that Geely's SUV sales accounted for 6.7% of its 2012 total sales volume and forecast this to increase to 18-22% for 2013.

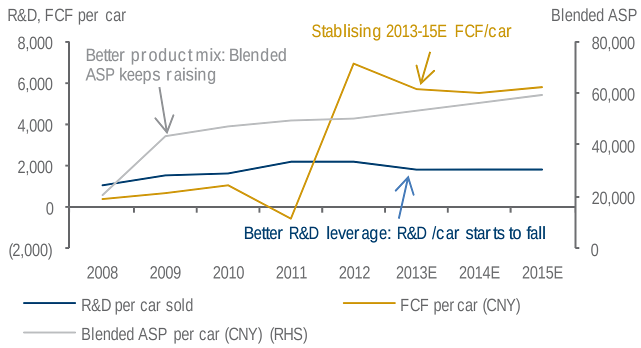
Good future product mix. With its quality model upgrades since 2009, strong export sales growth and well-located dealerships in China's lower-tier cities, we expect Geely Automobile (Geely) to be the main winner among the China domestic brands. For 2012-15, we forecast a PV sales-volume CAGR of 14.2% (to 720,306 units for 2015), a blended ASP CAGR of 5.5%, and a free-cash-flow/car CAGR of 0.5%. We believe this will be driven by the improved quality of the company's vehicles, with those with an ASP above CNY65,000/unit (including SUVs) accounting for 57% of total sales volume for 2015, up from 42% for 2012. As a result, we forecast Geely's blended gross margin to rise from 18.5% for 2012 to 19.9% for 2015, and the blended ASP to increase from CNY50,473 to CNY59,214 over the same period.

More cost-effective R&D from 2013. On the back of the increase we expect in sales volume, we forecast the CAGR in Geely's 2012-15 total R&D spending/car to drop by 6%, with total R&D spending (including capitalised R&D) as a percentage of revenue falling from 4.2% for 2012 to 3% for 2015. Compared with other domestic brands, we see Geely benefitting from the technological advantage it has in six-speed automatic gearboxes and the technological support it should receive from Volvo through its parent company. As such, we forecast Geely's operating-profit margin to rise from 11% for 2012 to 12.3% for 2015.

Improved sell-through efficiency should also come through. With most of Geely's domestic dealerships located in low-tier China cities where demand for vehicles is rising rapidly, we forecast the number of the outlets the company has to increase by 2.1% YoY for 2013, 4.2% YoY for 2014, and 4.1% YoY for 2015, with car sales per outlet rising by 6.6% YoY, 5.2% YoY, and 6.9% YoY for the respective years, from 389 units to 462 units over the period. As a result, we forecast Geely to maintain a stable selling and distribution cost per car between CNY2,860-2,896 over 2013-15, resulting in the EBIT margin increasing from 11.06% for 2012 to 12.25% for 2015 and the ROI (EBIT over two-year capex) improving from 82% for 2012 to 165% for 2015.

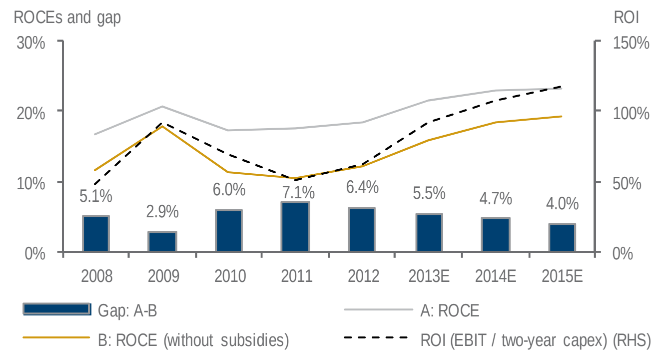
Export growth comes with falling accounts receivable. We forecast Geely's exports as a percentage of total sales volume to rise from 21% for 2012 to 30% for 2015. We believe the downside risk to EBIT-margin dilution from exports will be limited, as: 1) Geely's exports as a percentage of total sales volume is low (it increased from 9% for 2011 to 21% for 2012 with the gross-profit margin rising by 0.3pp YoY), 2) the company's trade-receivable days are also declining (they fell by 6% YoY between 2011 and 2012) and 3) all its export receivables are covered by insurance underwritten by the PRC Government.

■ **Geely: ASP, R&D and FCF spend/per car**



Source: Company, Daiwa forecasts

■ Geely: ROCE and ROI



Source: Company, Daiwa forecasts

Better earnings visibility. By 2015, we forecast Geely's core EPS (excluding subsidies) as a percentage of total EPS to improve from 51% in 2012 to 78% in 2015E, with the gap between ROCE (with the subsidies) and the core ROCE narrowing from 6.4pp in 2012 to 4pp in 2015E.

78% investment return possible over the next three years. Reflecting our view of the company's sustainable long-term earnings growth (we apply a PER of 13x [0.5SD above the company's past-seven-year average PER] based on our 2015 core EPS forecast), we estimate Geely's fair value at 6.55/share. We believe Geely deserves to trade at a premium to its peers given the significant improvement that we expect to see in its earnings in 2013. We assume the dividend-payout ratio is fixed at 14.5%, which implies an investment return of 78% over 2013-15E.

Are there any near-term hurdles?

The PRC Government's recent announcement that it aims to improve the automakers' overall fuel efficiency by 20% to 6.9L/100km by 2015 has led to a share-price correction. However, we believe Geely's more cost-effective R&D leverage and support from its parent company should help it mitigate any further effects from the government's announcement. We also believe that the strong SUV products of other local brands could challenge the profitability of Geely's new SUVs during the initial production ramp-up stage.

How to monitor progress

1) Monthly SUV sales volume (we forecast about 8,000 SUVs to be produced/month by the end of April 2013).

2) The pace of producing automatic gearboxes should ramp up (we forecast production of about 75,000 units/year in 2013).

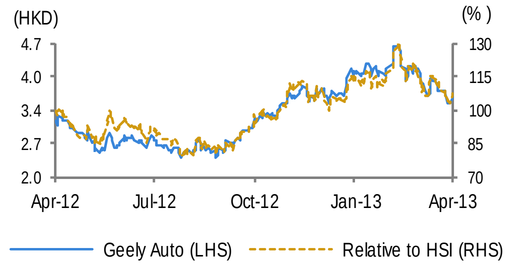
3) Export sales growth: we forecast 2013 export sales growth of 50% YoY.

4) We expect Geely to receive CNY880-900m in government subsidies each year for 2013-15.

What could go wrong?

1. Stronger-than-expected competition from the OEMs.
2. Further macro tightening.
3. Political risk (ie, trade barriers), which could result in a dramatic slowdown in export sales growth.
4. A slower-than-expected production ramp-up pace due to quality problems at the auto-part suppliers.
5. Higher-than-expected rises in raw-material costs.

Share price performance



12-month range	2.41-4.67
Market cap (USDbn)	3.56
3m avg daily turnover (USDm)	34.69
Shares outstanding (m)	7,487
Major shareholder	Geely Holding (51.3%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	31,261	37,895	44,384
Operating profit (m)	3,604	4,560	5,435
Net profit (m)	2,799	3,617	4,332
Core EPS (fully-diluted)	0.326	0.422	0.505
EPS change (%)	37.2	29.2	19.8
Daiwa vs Cons. EPS (%)	8.5	19.9	20.6
PER (x)	9.0	7.0	5.8
Dividend yield (%)	1.3	1.7	2.2
DPS	0.039	0.049	0.064
PBR (x)	1.6	1.3	1.1
EV/EBITDA (x)	3.9	2.8	2.0
ROE (%)	19.8	21.3	21.2

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Total sales volume (units)	204,205	325,413	415,286	421,611	483,483	568,451	645,032	720,306
Blended ASP (CNY)	21,003	43,234	46,916	49,812	50,473	53,043	56,600	59,214
Export sales volume (units)	n.a.	n.a.	20,555	39,600	101,908	152,862	189,549	217,981
Car sales per dealer YoY growth (%)	n.a.	n.a.	(21)	3	(1)	7	5	6
Total R&D as % of revenue (without capitalised R&D spending)	10	4	4	5	4	3	3	3

Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Car sales	4,289	14,069	19,483	20,965	24,403	30,152	36,509	42,652
Others	0	0	616	0	225	1,109	1,386	1,732
Other Revenue	0	0	0	0	0	0	0	0
Total Revenue	4,289	14,069	20,099	20,965	24,628	31,261	37,895	44,384
Other income	308	358	787	997	1,048	993	1,024	1,030
COGS	(3,638)	(11,528)	(16,379)	(17,145)	(20,069)	(25,288)	(30,479)	(35,535)
SG&A	(503)	(1,289)	(2,113)	(2,322)	(2,802)	(3,282)	(3,789)	(4,350)
Other op.expenses	0	0	(273)	(137)	(79)	(80)	(90)	(95)
Operating profit	456	1,610	2,120	2,358	2,725	3,604	4,560	5,435
Net-interest inc./(exp.)	(11)	(33)	(192)	(167)	(195)	(170)	(179)	(191)
Assoc/forex/extraord./others	473	(26)	(7)	(7)	(2)	(6)	(6)	(6)
Pre-tax profit	918	1,551	1,921	2,183	2,529	3,428	4,375	5,238
Tax	(52)	(231)	(351)	(467)	(479)	(617)	(744)	(890)
Min. int./pref. div./others	13	(136)	(181)	(172)	(10)	(12)	(14)	(15)
Net profit (reported)	879	1,184	1,389	1,543	2,040	2,799	3,617	4,332
Net profit (adjusted)	879	1,184	1,389	1,543	2,040	2,799	3,617	4,332
EPS (reported)(CNY)	0.150	0.171	0.189	0.207	0.259	0.339	0.438	0.525
EPS (adjusted)(CNY)	0.150	0.171	0.189	0.207	0.259	0.339	0.438	0.525
EPS (adjusted fully-diluted)(CNY)	0.143	0.165	0.163	0.180	0.238	0.326	0.422	0.505
DPS (CNY)	0.010	0.012	0.020	0.023	0.021	0.039	0.049	0.064
EBIT	456	1,610	2,120	2,358	2,725	3,604	4,560	5,435
EBITDA	597	1,975	2,625	3,000	3,585	4,593	5,648	6,686

Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	918	1,551	1,921	2,183	2,529	3,428	4,375	5,238
Depreciation and amortisation	141	365	504	642	860	989	1,088	1,251
Tax paid	10	(205)	(214)	(281)	(711)	(617)	(744)	(890)
Change in working capital	(59)	(849)	(701)	(1,647)	1,503	757	153	151
Other operational CF items	(686)	101	500	318	258	182	191	203
Cash flow from operations	324	963	2,010	1,215	4,439	4,738	5,063	5,953
Capex	(460)	(717)	(1,529)	(1,420)	(1,076)	(1,490)	(1,500)	(1,800)
Net (acquisitions)/disposals	1,187	(346)	(77)	(128)	(49)	0	0	0
Other investing CF items	(1,002)	(243)	261	(1,406)	(946)	(827)	(872)	(921)
Cash flow from investing	(275)	(1,306)	(1,346)	(2,954)	(2,071)	(2,317)	(2,372)	(2,721)
Change in debt	(54)	1,975	(639)	716	(1,460)	120	120	170
Net share issues/(repurchases)	0	839	106	14	24	0	0	0
Dividends paid	(60)	(91)	(148)	(170)	(170)	(322)	(406)	(524)
Other financing CF items	(35)	1,243	(52)	(166)	400	(210)	(224)	(237)
Cash flow from financing	(149)	3,966	(732)	393	(1,206)	(412)	(510)	(592)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(100)	3,623	(68)	(1,346)	1,162	2,010	2,181	2,641
Free cash flow	(136)	246	481	(205)	3,363	3,248	3,563	4,153

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	1,743	5,392	4,636	3,384	4,502	6,506	8,681	11,316
Inventory	487	641	987	1,358	1,822	2,356	2,839	3,310
Accounts receivable	2,336	6,145	9,913	12,215	13,476	16,701	20,245	23,712
Other current assets	508	0	2	0	4	4	4	4
Total current assets	5,073	12,178	15,538	16,956	19,804	25,567	31,769	38,342
Fixed assets	3,289	4,328	5,467	6,796	7,008	7,509	7,921	8,469
Goodwill & intangibles	657	1,076	1,455	2,232	2,821	3,687	4,604	5,571
Other non-current assets	1,131	1,220	1,514	1,613	1,747	1,741	1,735	1,729
Total assets	10,151	18,802	23,974	27,597	31,380	38,504	46,029	54,112
Short-term debt	686	1,510	1,097	2,532	1,379	1,399	1,419	1,469
Accounts payable	4,161	7,329	10,508	12,114	15,183	19,699	23,879	27,968
Other current liabilities	138	69	174	339	131	131	131	131
Total current liabilities	4,985	8,908	11,778	14,985	16,693	21,228	25,428	29,568
Long-term debt	87	1,318	1,562	843	525	625	725	845
Other non-current liabilities	296	1,480	1,556	1,619	958	958	958	958
Total liabilities	5,368	11,706	14,897	17,447	18,176	22,811	27,111	31,371
Share capital	123	137	139	139	139	139	139	139
Reserves/R.E./others	4,075	6,239	7,883	9,443	12,747	15,224	18,435	22,243
Shareholders' equity	4,198	6,376	8,022	9,582	12,887	15,363	18,574	22,382
Minority interests	585	721	1,056	568	317	330	344	359
Total equity & liabilities	10,150	18,803	23,974	27,597	31,380	38,504	46,029	54,112
EV	21,617	20,194	21,124	22,520	19,569	17,703	15,668	13,224
Net debt/(cash)	(971)	(2,565)	(1,977)	(9)	(2,598)	(4,482)	(6,537)	(9,002)
BVPS (CNY)	0.718	0.872	1.090	1.286	1.561	1.860	2.249	2.710

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	3,174.0	228.0	42.9	4.3	17.5	26.9	21.2	17.1
EBITDA (YoY)	n.a.	230.7	32.9	14.3	19.5	28.1	23.0	18.4
Operating profit (YoY)	n.a.	252.9	31.7	11.2	15.6	32.2	26.5	19.2
Net profit (YoY)	188.2	34.7	17.3	11.1	32.2	37.2	29.2	19.8
Core EPS (fully-diluted) (YoY)	135.2	15.4	(1.1)	10.3	32.2	37.2	29.2	19.8
Gross-profit margin	15.2	18.1	18.5	18.2	18.5	19.1	19.6	19.9
EBITDA margin	13.9	14.0	13.1	14.3	14.6	14.7	14.9	15.1
Operating-profit margin	10.6	11.4	10.5	11.2	11.1	11.5	12.0	12.2
Net profit margin	20.5	8.4	6.9	7.4	8.3	9.0	9.5	9.8
ROAE	26.9	22.4	19.3	17.5	18.2	19.8	21.3	21.2
ROAA	13.4	8.2	6.5	6.0	6.9	8.0	8.6	8.7
ROCE	11.2	20.8	19.6	18.7	19.0	22.0	23.5	23.6
ROIC	15.3	32.8	29.8	21.5	21.3	27.1	32.1	34.5
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	5.7	14.9	18.3	21.4	19.0	18.0	17.0	17.0
Accounts receivable (days)	102.2	110.0	145.8	192.6	190.4	176.2	177.9	180.7
Current ratio (x)	1.0	1.4	1.3	1.1	1.2	1.2	1.2	1.3
Net interest cover (x)	40.5	48.6	11.0	14.1	14.0	21.2	25.4	28.4
Net dividend payout	6.8	7.3	10.6	11.0	8.0	11.5	11.2	12.1
Free cash flow yield	n.a.	1.1	2.2	n.a.	15.3	14.7	16.2	18.8

Source: FactSet, Daiwa forecasts

■ Company profile

Geely Automobile Holding Limited (Geely) manufactures and sells automobiles and related components. Geely's headquarters are in Hangzhou, the capital of Zhejiang Province, and it operates six car-assembly and power-train manufacturing plants in China.

Tencent (700 HK)

Rating: **Buy [1]**
Share price: **HKD249.40**
6-mth target price: **HKD320** (28% potential upside)
3-year fair value: **HKD410** (64% potential upside)

Tencent's future lies with the growth prospects of the mobile Internet

John Choi
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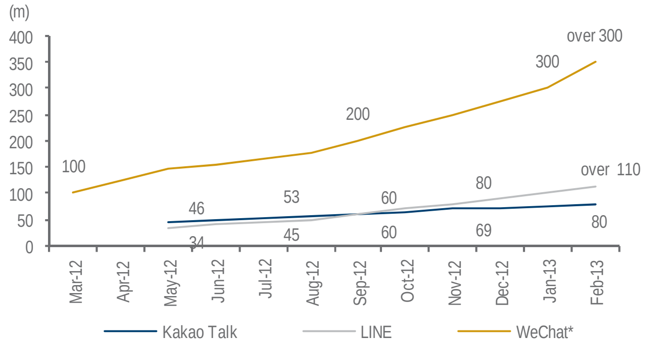
What is the three-year story?

We believe Tencent's structural story for the next three years will mainly come from the mobile space, especially with the company's leading position in mobile instant messaging through its WeChat (Weixin) application. As we expect the smartphone penetration rate to continue to rise in China for the foreseeable future, we believe the major Internet players will focus on the mobile Internet space going forward. Given WeChat's massive user base of 300m (as at January 2013), we believe Tencent has already achieved critical mass compared with other mobile instant-messaging platforms in China, creating a huge entry barrier to new entrants to this space. We think the WeChat service has provided a new way of communicating for many users, and is the most powerful mobile platform in China. We forecast WeChat subscribers to increase by 50% YoY to 450m by the end of 2013, and we look for a CAGR of 29% for 2012-15 and subscribers of 650m by the end of the period.

With many investors now focusing on the monetisation strategy for the WeChat platform, we expect Tencent to develop a business model that does not affect the user experience but leverages the large user base. Initially, we believe the success of Kakao Talk's mobile instant-messaging application will provide a template for Tencent to monetise WeChat as a mobile-game platform. Tencent is likely to launch social mobile games and encourage WeChat users to play them, with the aim of getting users to buy in-game items. Over the longer term, we expect mobile e-commerce to be added to the WeChat service, which could further drive the revenue from this mobile platform.

■ WeChat: user growth on mobile Internet platforms



Source: Company for WeChat, NAVER for LINE (a Japan-made mobile instant messaging application), and KAKAO for Kakao Talk

What could the fair value be in 2015?

We believe a PER multiple is the best way to value the stock, as it factors in earnings-growth momentum and the potential of the company's new business ventures.

Our six-month target price of HKD320 is based on a 2013E PER of 28x. As we believe the period of very high earnings growth is over for Tencent, and thus it will be difficult for the stock to trade at such a high multiple again, we apply a 25% discount to this average historical PER of 37x to derive our target PER. We believe a high multiple is justified as we forecast a strong earnings CAGR of 23% for 2012-15, driven by Tencent's key existing businesses, such as Internet value-added services (community and open platforms, online games), online-advertising business, and WeChat.

In three years' time, we forecast Tencent's fair value to rise to HKD410, based on a PER of 25x on our 2015 EPS forecast. While it is too early to forecast accurately the financial impact from the WeChat platform, especially in terms of the earnings contribution, we are confident that the company will be able to monetise its mobile Internet business given its large loyal user base and its experience with other services. Hence, we believe the stock warrants a premium multiple, as the mobile platform should open up new earnings-growth opportunities.

Are there any near-term hurdles?

One of the near-term hurdles that Tencent might face is a slowdown in the revenue growth in its core online-game business. Two games (Cross Fire and Dungeon & Fighter) have been the main drivers of the revenue growth in this segment over the past few years, and

Tencent could see a slower growth rate in 2013 due to a high base effect and the product life cycle. However, we believe this would be offset by a strong performance from League of Legends, and the launch of new games, such as Blade & Soul, likely in mid-2013.

How to monitor progress?

Earnings momentum and the profit-margin trend are keys indicators of the development of Tencent's overall business, especially new initiatives (ie, mobile Internet, online advertising, and e-commerce).

Among the various business areas, we believe progress with the mobile Internet is the key point to monitor. Investors should watch to see how successful the company is in launching a social mobile game service, especially from the WeChat platform. In particular, ARPU from the mobile Internet platform should be the key metric to monitor.

The gross-profit margin from e-commerce is currently at a mid-single digit level, but as Tencent expands its business and begins to benefit from economies of scale, we expect the margin to expand. However, we will be watching to see when the business breaks even, which we believe will be challenging over the next two years given the stiff competition in this space.

Another item we think investors should watch is the revenue growth in online advertising. The company has been focusing more on this since it launched Guang Dian Tong, a system through which advertisers can buy ad space, in 2012. An increase in the click-through rate would encourage demand for online advertising, in our view.

Over the next few years we expect earnings growth to continue as Tencent rolls out new services, while it strengthens the monetisation of existing products. Meanwhile, we believe the gross-profit margin will contract, as new services typically have lower margins than more established businesses and require large initial investments. It will be important for investors to monitor whether the margin is declining faster than the market expects and hence has a negative impact on overall earnings growth.

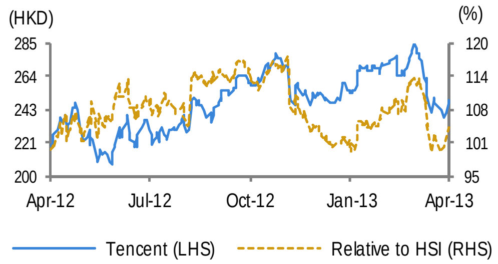
What could go wrong?

Tencent's primary business is still heavily reliant on the PC platform, and the migration to mobile Internet could have an impact on Tencent's earnings-growth momentum. As major services such as online games and other Internet value-added services, such as Q-Zone, Xiaoyou, and Tencent Micro-blog, are the key revenue drivers. Tencent could also be negatively affected if the migration were to take place faster than we expect, as there are not only few ways of monetising the mobile platform, but also the mobile platform typically has a lower profit margin than the desktop platform.

However, we believe that, if Tencent can find the right business model for its mobile Internet business, the monetisation of the mobile platform would offset any reduction in the profit margin and slow migration rate.

Fierce competition in the e-commerce area could be a concern for Tencent, as many of the company's rivals are competing aggressively to gain market share. If such competition were to last longer than the market expects, there could be a negative impact on the company's margins.

Share price performance



12-month range	208.40-284.40
Market cap (USDbn)	59.28
3m avg daily turnover (USDm)	166.67
Shares outstanding (m)	1,845
Major shareholder	Naspers Limited (34.1%)

Financial summary (CNY)

Year to 31 Dec	12E	13E	14E
Revenue (m)	43,878	56,821	69,608
Operating profit (m)	16,105	21,164	26,010
Net profit (m)	13,554	17,931	21,813
Core EPS (fully-diluted)	7.178	9.476	11.519
EPS change (%)	22.2	32.0	21.6
Daiwa vs Cons. EPS (%)	0.1	4.0	0.7
PER (x)	27.7	21.0	17.3
Dividend yield (%)	0.5	0.7	0.9
DPS	1.044	1.398	1.714
PBR (x)	9.0	6.6	5.0
EV/EBITDA (x)	17.7	13.1	10.3
ROE (%)	39.1	37.2	33.7

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Peak simultaneous online users accounts of QQ games (m)	3.8	8.7	12.6	15.5	20.5	29.8	32.7	35.6
Fee-based IVAS registered subscriptions (m)	17.6	31.4	51.6	65.7	77.2	74.3	80.3	84.3
ARPU of IVAS subs (Rmb)	13.9	16.7	19.1	22.0	26.9	33.2	40.6	41.3
Fee-based MVAS registered subscriptions(m)	10.9	14.7	20.3	24.6	31.4	35.5	43.2	49.6
Average revenue per mobile VAS subs (m)	6.5	9.1	9.1	10.1	9.7	9.3	9.8	10.3

Profit and loss (CNYm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Internet value-added services (IVAS)	2,514	4,915	9,531	15,482	23,043	32,593	42,595	50,186
Mobile and telecom value-add service	808	1,399	1,906	2,716	3,271	3,733	4,609	5,711
Other Revenue	500	841	1,004	1,448	2,183	7,552	9,617	13,711
Total Revenue	3,821	7,155	12,440	19,646	28,496	43,878	56,821	69,608
Other income	69	112	78	294	890	586	660	920
COGS	(1,118)	(2,170)	(3,889)	(6,320)	(9,928)	(18,218)	(23,606)	(29,382)
SG&A	(945)	(1,491)	(2,070)	(3,004)	(5,265)	(7,416)	(9,131)	(10,911)
Other op.expenses	(192)	(359)	(538)	(778)	(1,939)	(2,726)	(3,580)	(4,225)
Operating profit	1,635	3,246	6,021	9,838	12,254	16,105	21,164	26,010
Net-interest inc./(exp.)	(100)	(36)	134	255	504	502	618	801
Assoc/forex/extraord./others	(0)	(106)	(114)	(180)	(659)	(879)	(685)	(950)
Pre-tax profit	1,535	3,105	6,041	9,913	12,099	15,728	21,097	25,861
Tax	(34)	(289)	(819)	(1,798)	(1,874)	(2,853)	(3,825)	(4,689)
Min. int./pref. div./others	(2)	(31)	(66)	(62)	(22)	(58)	(78)	(96)
Net profit (reported)	1,499	2,785	5,156	8,054	10,203	12,817	17,194	21,076
Net profit (adjusted)	1,600	2,945	5,477	8,574	10,940	13,554	17,931	21,813
EPS (reported)(CNY)	0.843	1.553	2.852	4.407	5.552	6.957	9.320	11.424
EPS (adjusted)(CNY)	0.900	1.643	3.030	4.692	5.953	7.357	9.719	11.824
EPS (adjusted fully-diluted)(CNY)	0.910	1.584	2.928	4.573	5.874	7.178	9.476	11.519
DPS (CNY)	0.144	0.309	0.351	0.457	0.610	1.044	1.398	1.714
EBIT	1,736	3,406	6,342	10,359	12,991	16,842	21,901	26,747
EBITDA	1,929	3,766	6,880	11,137	14,930	19,568	25,481	30,972

Cash flow (CNYm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	1,535	3,105	6,041	9,913	12,099	15,728	21,097	25,861
Depreciation and amortisation	192	359	538	778	1,939	2,574	3,416	4,568
Tax paid	(106)	(322)	(456)	(1,542)	(1,836)	(2,500)	(3,740)	(4,585)
Change in working capital	0	202	2,106	3,501	1,177	2,541	1,005	785
Other operational CF items	(85)	236	170	(366)	(21)	(8,657)	(3,777)	(2,141)
Cash flow from operations	1,536	3,580	8,398	12,285	13,358	9,687	18,000	24,488
Capex	(764)	(1,404)	(821)	(2,024)	(4,835)	(4,299)	(5,682)	(6,961)
Net (acquisitions)/disposals	82	0	68	0	(6,602)	(4,546)	0	0
Other investing CF items	248	(1,110)	(4,272)	(9,991)	(3,918)	71	71	71
Cash flow from investing	(434)	(2,515)	(5,025)	(12,015)	(15,355)	(8,775)	(5,612)	(6,890)
Change in debt	292	0	202	0	2,917	2,381	0	0
Net share issues/(repurchases)	(3)	(301)	91	(144)	(887)	0	0	0
Dividends paid	(210)	(258)	(555)	(624)	(895)	(1,122)	(1,925)	(2,579)
Other financing CF items	0	(311)	(136)	4,880	3,238	0	0	0
Cash flow from financing	79	(870)	(397)	4,112	4,373	1,259	(1,925)	(2,579)
Forex effect/others	(76)	(76)	(1)	(52)	(172)	0	0	0
Change in cash	1,104	119	2,976	4,331	2,204	2,171	10,463	15,019
Free cash flow	772	2,175	7,578	10,261	8,523	5,388	12,318	17,528

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (CNYm)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & short-term investment	3,867	5,129	11,354	22,134	26,328	31,827	42,327	57,327
Inventory	2	5	0	0	0	243	310	379
Accounts receivable	536	983	1,229	1,715	2,021	2,883	3,678	4,506
Other current assets	430	378	574	1,524	7,155	5,717	6,663	7,346
Total current assets	4,835	6,496	13,157	25,374	35,503	40,669	52,977	69,558
Fixed assets	839	1,165	2,517	3,293	5,885	7,410	10,275	13,267
Goodwill & intangibles	671	370	269	573	3,780	3,909	3,240	2,570
Other non-current assets	640	1,824	1,563	6,591	11,636	22,192	25,196	27,337
Total assets	6,985	9,856	17,506	35,830	56,804	74,180	91,688	112,732
Short-term debt	292	0	202	5,299	8,020	5,717	5,717	5,717
Accounts payable	117	245	697	1,380	2,244	3,663	4,656	5,708
Other current liabilities	1,240	1,847	3,664	6,343	10,919	11,997	13,817	15,132
Total current liabilities	1,650	2,092	4,563	13,022	21,183	21,378	24,191	26,557
Long-term debt	0	0	0	0	3,733	8,373	8,295	8,295
Other non-current liabilities	60	645	644	967	2,799	2,863	2,948	3,052
Total liabilities	1,710	2,736	5,207	13,989	27,716	32,613	35,434	37,904
Share capital	0	0	0	0	0	0	0	0
Reserves/R.E./others	5,184	7,021	12,178	21,757	28,464	40,884	55,494	73,972
Shareholders' equity	5,184	7,021	12,179	21,757	28,464	40,885	55,494	73,972
Minority interests	92	98	120	84	625	683	761	856
Total equity & liabilities	6,985	9,856	17,506	35,830	56,804	74,180	91,688	112,732
EV	363,668	361,818	355,643	349,255	348,801	345,455	334,981	320,107
Net debt/(cash)	(3,575)	(5,129)	(11,151)	(16,835)	(14,574)	(17,737)	(28,314)	(43,314)
BVPS (CNY)	2.898	3.908	6.696	11.852	15.471	22.161	30.079	40.095

Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales (YoY)	36.4	87.2	73.9	57.9	45.0	54.0	29.5	22.5
EBITDA (YoY)	40.2	95.3	82.7	61.9	34.1	31.1	30.2	21.5
Operating profit (YoY)	39.9	96.2	86.2	63.3	25.4	29.6	30.0	22.1
Net profit (YoY)	40.2	84.0	86.0	56.6	27.6	23.9	32.3	21.7
Core EPS (fully-diluted) (YoY)	44.9	74.1	84.9	56.2	28.5	22.2	32.0	21.6
Gross-profit margin	70.8	69.7	68.7	67.8	65.2	58.5	58.5	57.8
EBITDA margin	50.5	52.6	55.3	56.7	52.4	44.6	44.8	44.5
Operating-profit margin	45.4	47.6	51.0	52.7	45.6	38.4	38.5	38.4
Net profit margin	41.9	41.2	44.0	43.6	38.4	30.9	31.6	31.3
ROAE	36.0	48.3	57.1	50.5	43.6	39.1	37.2	33.7
ROAA	27.5	35.0	40.0	32.2	23.6	20.7	21.6	21.3
ROCE	37.4	53.7	64.6	52.3	38.2	34.9	34.8	33.6
ROIC	145.5	159.5	331.7	261.8	106.1	68.8	66.9	71.6
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	2.2	9.3	13.6	18.1	15.5	18.1	18.1	18.1
Accounts receivable (days)	44.7	38.7	32.5	27.4	23.9	20.4	21.1	21.5
Current ratio (x)	2.9	3.1	2.9	1.9	1.7	1.9	2.2	2.6
Net interest cover (x)	17.3	95.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	17.1	19.9	12.3	10.4	11.0	15.0	15.0	15.0
Free cash flow yield	0.2	0.6	2.1	2.8	2.3	1.5	3.4	4.8

Source: FactSet, Daiwa forecasts

Company profile

Tencent is the largest and most used Internet service portal in China. Over the past decade, the company has been able to maintain steady earnings growth under its user-oriented strategy. On 16 June 2004, it was listed on the main board of the Hong Kong Stock Exchange.

ING Vysya Bank (VYSB IN)

Rating: **Outperform [2]**
Share price: **INR510.30**
6-mth target price: **INR632** (24% potential upside)
3-year fair value: **INR893** (75% potential upside)

Cost efficiencies could propel a substantial rerating over the long term

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What is the three-year story?

We believe the falling trend in ING Vysya Bank's cost-to income ratio, which is non-cyclical in nature and has room to drop further over time, will be the key driver of a rerating of the stock over the next two years.

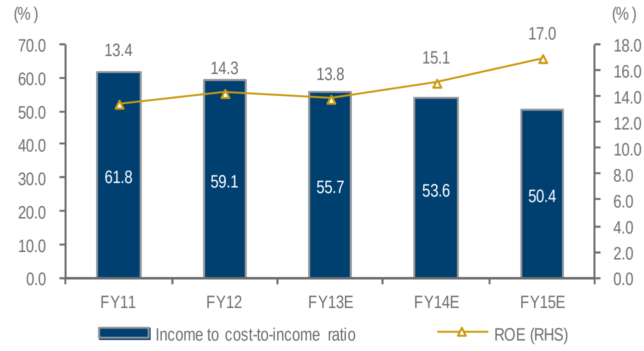
Over the past few years, the bank has improved its overall cost structure. This has resulted in its assets per branch increasing from INR698m for FY08 to INR954m for 3Q FY13 and the current account and savings account (CASA) amount per branch rising from INR158m for FY08 to INR226m for 3Q FY13.

ING Vysya Bank reduced its cost-to-income ratio from 61.8% for FY11 to 55.3% for 3Q FY13. Despite the considerable improvement, the ratio is still about 10pp higher than that of its peer group. If the current trend of cost efficiency continues, the bank will be able to take the ratio down to about 50% by FY15 and to about 47-48% in about the following 1.5 years (compared with about 14% for FY13E), based on our forecasts.

Moreover, although SMEs account for more than 33% of its loans, ING Vysya Bank has kept credit costs extremely low (35-40bps) in the current credit cycle, while maintaining the highest provisioning coverage ratio of 97% (as at end of 3Q FY13) among the India banks we cover.

We forecast the bank's cost-to-income ratio to fall by 6-7% over the next three years, which should help its ROE to rise by 2-2.5%. We expect this structural improvement in ROE to help drive a rerating of the stock over the period.

■ ING Vysya Bank: cost-to-income ratio and ROE (%)



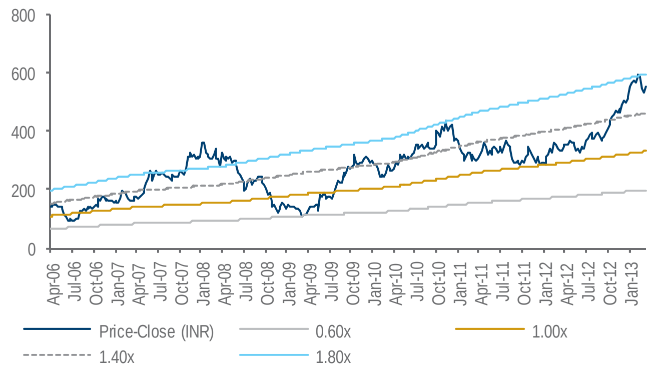
Source: Company, Daiwa forecasts

What could the fair value be in 2015?

A Gordon Growth Model remains our preferred methodology to value banks such ING Vysya Bank, as it includes all the important parameters, such as the normalised growth rate, ROE, and the COE to arrive at a fair valuation for the stock. Using this methodology, we derive a six-month target price of INR632, equivalent to an FY14E PBR of 1.9x.

Assuming ING Vysya Bank continues to improve its cost-to-income ratio while keeping credit costs in check, we forecast its ROE to rise to about 17% for FY15 and 18% for FY16. As we expect the bank to achieve a normalised ROE of 17.5-18% in the next 2.5-3 years, we believe it should achieve a valuation of close to 2x our one-year forward BVPS by FY15. We forecast a BVPS of INR447 by the end of FY16. Hence, by the end of FY15, the one-year forward fair value for the stock could be INR893, implying upside potential of about 75% from the current share price.

■ ING Vysya Bank: one-year rolling forward PBR bands



Source: Bloomberg, Daiwa estimates

Apart from the improvement we expect in its ROE, we believe ING Vysya Bank has a strong franchise and would be worth more if a larger bank were to buy it (at least 3-4x our one-year forward BVPS based on past buy-outs of similar-sized banks).

Are there any near-term hurdles?

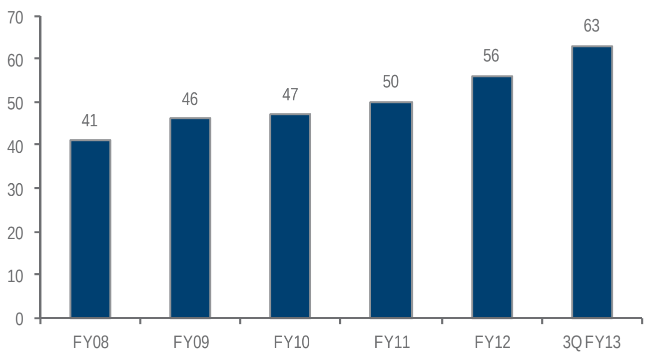
Although we believe the long-term story of cost reduction is intact, we see ING Vysya Bank's valuations as running slightly ahead of our forecast improvements in its return ratios, and this could be an overhang for the stock.

The share price has risen by 22% over the past six months, outperforming the benchmark SENSEX and CNX Bank NIFTY indices by 23% each. The rate by which the stock has been rerated has been much higher than the improvements in its cost base and ROE that we expect over the next 6-12 months, and hence earlier this year we downgraded our rating on the stock to Outperform (2) from Buy (1).

How to monitor progress

Monitoring progress on the cost-efficiency front by tracking variables, such as the cost-to-income ratio, cost-to-asset ratio, new branch additions, business per employee, should be important for investors, as this progress should drive future improvements in the bank's return ratios. Asset quality, which has remained healthy until now, is another key variable to monitor. Furthermore, we believe the bank will have to attain balance-sheet growth of about 20% every year over the next 2-3 years to keep its cost-reduction story intact.

■ ING Vysya Bank: business* per employee (INRm)



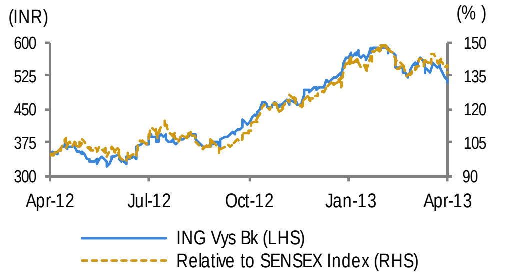
Source: Company
*Note: *Business= loans given+ deposits-interbank deposits*

What could go wrong?

A higher-than-expected rise in credit costs and a lower-than-expected fall in operating costs remain the key risks to our investment thesis. ING Vysya Bank has an SME-heavy loan portfolio, and although this has performed very well, deteriorating asset quality is a key risk to our thesis.

An improvement in the bank's return ratios should be driven primarily by an improvement in operating costs in the future, and any mis-steps on this front could also pose a threat to our view. The RBI has already initiated the process of granting new banking licences, and increased competition from newer banks – especially with respect to attracting employees, leading to a change in the overall dynamics of employee compensation – is another risk that could affect ING Vysya Bank's future share-price performance.

Share price performance



12-month range	322.75-590.85
Market cap (USDbn)	1.40
3m avg daily turnover (USDm)	1.42
Shares outstanding (m)	150
Major shareholder	ING Group (43.8%)

Financial summary (INR)

Year to 31 Mar	13E	14E	15E
Total operating income (m)	22,838	27,251	32,893
Pre-provision operating profit(m)	10,110	12,642	16,323
Net profit (m)	5,697	7,035	9,119
Core EPS (fully-diluted)	37.949	46.860	60.746
EPS change (%)	24.8	23.5	29.6
Daiwa vs Cons. EPS (%)	(5.1)	(3.2)	3.3
PER (x)	13.4	10.9	8.4
Dividend yield (%)	0.9	1.1	1.2
DPS	4.500	5.500	6.000
PBR (x)	1.8	1.5	1.3
ROE (%)	13.8	15.1	17.0

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Loan growth (YoY%)	22.3	14.4	10.4	27.5	21.8	23.0	25.0	26.0
Deposit growth (YoY%)	32.9	21.4	3.9	16.7	16.6	22.3	22.8	23.3
Average yield on advances (%)	9.7	11.1	9.7	9.7	11.0	10.9	10.8	10.7
Average cost of deposits (%)	5.8	6.2	4.6	4.8	6.6	6.2	5.7	5.7

Profit and loss (INRm)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Net-interest income	4,984	6,496	8,298	10,065	12,083	15,191	18,570	23,067
Net fees & commission	2,508	3,293	3,490	4,189	4,650	5,208	5,937	6,650
Trading and other income	1,678	2,184	2,712	2,361	2,048	2,439	2,744	3,177
Net insurance income	0	0	0	0	0	0	0	0
Total operating income	9,170	11,973	14,500	16,615	18,781	22,838	27,251	32,893
Personnel expenses	(3,024)	(3,922)	(4,289)	(6,057)	(6,510)	(7,585)	(8,695)	(9,887)
Other expenses	(3,071)	(3,802)	(3,793)	(4,204)	(4,592)	(5,143)	(5,914)	(6,683)
Total expenses	(6,095)	(7,725)	(8,081)	(10,260)	(11,102)	(12,728)	(14,610)	(16,570)
Pre-provision operating profit	3,075	4,248	6,419	6,355	7,679	10,110	12,642	16,323
Total provision	(560)	(1,301)	(2,704)	(1,516)	(1,137)	(1,478)	(1,983)	(2,506)
Operating profit after prov.	2,515	2,947	3,715	4,839	6,542	8,632	10,659	13,817
Non-operating income	0	0	0	0	0	0	0	0
Profit before tax	2,515	2,947	3,715	4,839	6,542	8,632	10,659	13,817
Tax	(945)	(1,059)	(1,293)	(1,652)	(1,979)	(2,935)	(3,624)	(4,698)
Min. int./pref. div./other items	0	0	0	0	0	0	0	0
Net profit	1,569	1,888	2,422	3,186	4,563	5,697	7,035	9,119
Adjusted net profit	1,569	1,888	2,422	3,186	4,563	5,697	7,035	9,119
EPS (INR)	15.315	18.401	20.190	26.335	30.397	37.949	46.860	60.746
EPS (adjusted) (INR)	15.315	18.401	20.190	26.335	30.397	37.949	46.860	60.746
EPS (adjusted fully-diluted) (INR)	15.315	18.401	20.190	26.335	30.397	37.949	46.860	60.746
DPS (INR)	1.500	2.000	2.000	3.000	4.000	4.500	5.500	6.000

Change (YoY %)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Net-interest income	11.9	30.3	27.7	21.3	20.0	25.7	22.2	24.2
Non-interest income	46.5	30.8	13.2	5.6	2.3	14.2	13.5	13.2
Total operating income	25.4	30.6	21.1	14.6	13.0	21.6	19.3	20.7
Total expenses	20.7	26.7	4.6	27.0	8.2	14.6	14.8	13.4
Pre-provision operating profit	35.9	38.2	51.1	(1.0)	20.8	31.7	25.0	29.1
Total provisions	(43.2)	132.3	107.8	(43.9)	(25.0)	30.0	34.2	26.4
Operating profit after provisions	97.0	17.2	26.1	30.2	35.2	31.9	23.5	29.6
Profit before tax	97.0	17.2	26.1	30.2	35.2	31.9	23.5	29.6
Net profit (adjusted)	76.5	20.3	28.3	31.6	43.2	24.8	23.5	29.6
EPS (adjusted, FD)	56.6	20.1	9.7	30.4	15.4	24.8	23.5	29.6
Gross loans	21.2	14.4	11.7	27.7	21.5	22.8	24.9	26.0
Deposits	32.9	21.4	3.9	16.7	16.6	22.3	22.8	23.3
Total assets	32.6	24.9	6.4	15.2	20.5	19.9	20.7	21.0
Total liabilities	32.0	25.7	4.6	15.3	18.2	20.6	21.3	21.4
Shareholders' equity	43.7	11.5	39.6	13.4	53.9	12.7	13.9	16.2
Avg interest-earning assets	25.2	26.9	14.6	12.7	18.8	19.8	20.3	21.8
Avg risk-weighted assets	24.9	22.2	3.9	8.1	30.0	28.0	25.4	27.6

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (INRm)

As at 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & equivalent	31,848	22,816	30,270	25,214	32,306	38,767	42,643	46,908
Investment securities	62,933	104,955	104,729	110,207	127,155	139,870	160,851	184,979
Net loans and advances	146,495	167,564	185,072	236,021	287,367	353,461	441,826	556,701
Fixed assets	2,897	3,284	3,879	3,986	3,974	4,053	4,134	4,217
Goodwill	0	0	0	0	0	0	0	0
Other assets	10,131	18,929	13,772	13,669	18,170	26,199	29,531	28,706
Total assets	254,304	317,549	337,722	389,097	468,971	562,350	678,985	821,510
Customers deposits	204,981	248,895	258,653	301,943	351,954	430,418	528,579	651,947
Borrowing	12,498	21,524	26,677	30,946	45,759	52,623	60,516	66,568
Debentures	4,969	10,329	10,037	10,522	11,206	12,206	13,206	14,206
Other liabilities	17,594	20,905	20,156	20,504	21,304	23,449	26,962	31,001
Total liabilities	240,043	301,653	315,523	363,915	430,223	518,696	629,263	763,722
Share capital	1,025	1,026	1,200	1,210	1,501	1,501	1,501	1,501
Reserves & others	13,237	14,871	20,999	23,972	37,246	42,153	48,222	56,287
Shareholders' equity	14,262	15,897	22,199	25,182	38,748	43,654	49,723	57,788
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	254,304	317,549	337,722	389,097	468,971	562,350	678,985	821,510
Avg interest-earning assets	209,978	266,493	305,349	344,049	408,718	489,800	589,400	717,888
Avg risk-weighted assets	167,391	204,484	212,446	229,700	298,564	382,080	479,173	611,651
BVPS (INR)	139.177	154.931	185.044	208.133	258.111	290.795	331.220	384.946

Key ratios (%)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Loan/deposit	72.0	67.8	72.8	79.7	83.1	83.4	84.8	86.7
Tier-1 CAR	6.8	6.9	10.1	9.4	11.2	10.3	9.2	8.4
Total CAR	10.2	11.7	14.9	12.9	14.0	13.2	12.0	11.2
NPLs/gross loans	1.4	1.9	3.0	2.3	1.9	1.9	1.8	1.8
Total loan-loss prov./NPLs	49.2	36.0	60.2	83.4	90.7	85.0	82.0	80.0
ROAA	0.7	0.7	0.7	0.9	1.1	1.1	1.1	1.2
ROAE	13.0	12.5	12.7	13.4	14.3	13.8	15.1	17.0
Net-interest margin	2.4	2.4	2.7	2.9	3.0	3.1	3.2	3.2
Gross yield	8.0	8.4	7.3	7.8	9.4	9.3	8.8	8.8
Cost of funds	6.0	6.3	4.9	5.3	7.0	6.7	6.1	6.0
Net-interest spread	2.0	2.1	2.4	2.5	2.4	2.6	2.7	2.8
Total cost/total income	66.5	64.5	55.7	61.8	59.1	55.7	53.6	50.4
Effective tax	37.6	35.9	34.8	34.1	30.2	34.0	34.0	34.0
Dividend-payout	9.8	10.9	9.9	11.4	13.2	11.9	11.7	9.9

Source: FactSet, Daiwa forecasts

Company profile

ING Vysya Bank is a private-sector bank with total assets of INR507bn as at the end of December 2012. Established in 1930, the bank is classified as an old private-sector bank by the Reserve Bank of India. The bank's network spans 532 branches and extension counters servicing more than 2m customers currently. The bank offers wholesale-, retail- and private-banking services in India.

Tata Motors (TTMT IN)

Rating: **Buy [1]**
Share price: **INR267.65**
6-mth target price: **INR360** (35% potential upside)
3-year fair value: **INR470** (76% potential upside)

JLR's new launches should drive gains in share of premium vehicle market

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What is the three-year story?

Jaguar Land Rover's (JLR) portfolio is heavily skewed towards SUVs, which account for more 80% of the company's total sales volumes. Through its Land Rover brand, the company offers six models covering most segments of the SUV market. We believe JLR's plans to upgrade its ageing SUV portfolio could act as a major driver of sales volume over the medium term.

Over the next 3-4 years, JLR is likely to upgrade almost all of its Land Rover portfolio, which currently contributes some 65% of its SUV sales volume. Since these upgrades will follow a gap of almost 7-12 years depending on the model, we think they could bring about a meaningful sales-volume boost for JLR.

In terms of the Jaguar range, JLR is looking to expand its addressable market by launching market-specific variants, such as an all-wheel drive option for the US, smaller engines for China, and a Sportsbrake variant for the European market. Besides these, the Jaguar range is to be broadened to fill in major product gaps with the planned launch of the F-Type sports car and a Jaguar compact in 2015. With these new offerings, we estimate that Jaguar's addressable market could expand by almost 1m to 1.3m units. Even a small market-share gain in this large segment of compact sedans could bring about substantial sales-volume gains for the Jaguar range. We forecast JLR's sales volume to rise at a 10.5% CAGR over FY13-15.

■ **JLR: product launch pipeline**

Product	Expected launch	Competitors
Jaguar		
Jaguar F-Type	2013	Porsche 911 Carrera
Compact Jaguar	2015	Merc C Class, BMW 3 Series, Audi A4 & A5
Land Rover		
New Range Rover	Launched	Merc G Class, Merc S Class, BMW 7 Series
Range Rover Sport	2013	BMW X5, Porsche Cayenne
Freelander	2014	BMW X3, Audi Q5
Defender	2015	Toyota Landcruiser, Nissan Patrol
Discovery	2016	Merc ML, Lexus GX 470, VW Touareg

Source: Company, compiled by Daiwa

What could the fair value be in 2015?

We value Tata Motors with the SOTP method, assigning different target multiples to three important sub-segments of the consolidated business – JLR, the standalone entity, and other subsidiaries.

We value the JLR business at a 4x EV/EBITDA multiple, based on the average of our FY14/15 EBITDA forecasts, to derive a value for JLR of INR273/share. Our target multiple for JLR marks a 10% premium to the multiple of BMW (based on the Bloomberg consensus forecast), which we believe is justified given JLR's higher earnings growth potential (14% CAGR in after-tax earnings over FY13-15E, on our forecasts). We value Tata Motors' standalone business at INR79/share, based on an EV/EBITDA multiple of 6.5x, its past-five-year average one-year forward multiple, applied to the average of our FY14/15 EBITDA forecasts. We value Tata Motors' other subsidiaries at INR28/share. From the total, we subtract the net debt pertaining to the group's automotive businesses of INR20/share, for a six-month target price of INR360.

We believe that, post-2015, JLR's earnings growth will depend largely on two important underlying changes. First, JLR's planned entry into the compact sedan segment in 2015 could be a significant driver of sales-volume growth but could also dilute margins. Second, once the joint venture with Chery commences operations, JLR's China earnings would be split between the joint-venture partners. Again, manufacturing in China would probably spur sales-volume growth but lead to a moderation in the profitability of models manufactured locally. All things considered, we assume that the upside potential and downside risks to earnings growth appear balanced.

Given the expected impact of these factors on JLR's earnings post FY15, we determine our fair value estimate for Tata Motors using its FY15 earnings as our basis. We assign a target multiple of 5x to our FY15E

EBITDA for JLR, in line with BMW's average valuation based on its current-year earnings, and value the standalone business at 7x EV/EBITDA on its FY15E EBITDA, similar to its long-term average valuation on a present-year basis. Using these parameters, we arrive at a fair value estimate of INR470/share for Tata Motors in 2015.

Are there any near-term hurdles?

Projecting JLR's monthly sales volumes and quarterly EBITDA margin in the coming months is likely to remain challenging, since JLR's planned product launches will necessitate run-down and build-up phases, affecting volumes and EBITDA margins during these periods. There is a significant risk of seasonal disappointments, in our view.

How to monitor progress

Our forecasts for JLR's sales-volume growth are largely predicated on the company's planned launches. The company's launch schedule should be monitored closely, since any deviation from its plans would have implications for volume growth. New products are typically showcased and reviewed prior to being launched at major auto shows, and such a trend can serve as an indicator that launches remain on schedule. In addition, the company's quarterly expenditure trend for product development can shed some light on the status of its investment pipeline.

Our positive thesis on JLR is premised on its new offerings gaining market share, either by way of refreshed products gaining ground in the market or through expansion of the addressable market by way of new model launches. The following table shows JLR's market share in various segments of the premium vehicle market as determined by product prices. We think the market-share impact of new launches in respective segments provides insight on the company's performance compared with those of its peers.

■ JLR: market share within segments of the premium car market

	2008	2009	2010	2011	2012
Sedans					
Compact sedans (USD20-35k)	0%	0%	0%	0%	0%
Lower-medium (USD35-45k)	1%	1%	0%	0%	0%
Upper-medium (USD50-65k)	5%	5%	4%	3%	3%
Luxury (> USD 65k)	7%	6%	9%	9%	9%
SUVs					
Compact SUVs (USD25-40k)	100%	69%	15%	13%	6%
Lower-medium (USD40-50k)	38%	23%	22%	20%	31%
Upper-medium (USD50-70k)	18%	16%	18%	18%	17%
Luxury (> USD70k)	100%	100%	100%	100%	100%

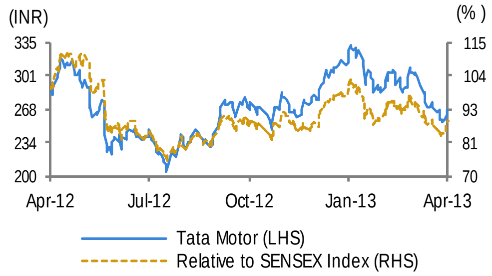
Source: Companies, Daiwa estimates
Note: Sales-volume data above includes BMW, Mercedes, Audi and JLR

What could go wrong?

In order to keep pace with some of the larger premium-vehicle manufacturers, JLR will need to continue making sizeable investments in product development. Further, it will need to invest in newer platforms and technologies in order to comply with the more stringent emission standards (ie, beyond Euro VI norms) that are likely to be implemented around 2019-21 in several developed markets. The requisite investment is hard to determine at this stage but could ultimately lead to higher-than-expected cash outflows.

In the standalone business, Tata Motors continues to invest in the loss-making passenger vehicle business. An inability to turn around this business could lead to further losses, thereby posing a downside risk to the value ascribed to the standalone business.

Share price performance



12-month range	205.10-333.40
Market cap (USDbn)	15.65
3m avg daily turnover (USDm)	56.91
Shares outstanding (m)	3,190
Major shareholder	Tata Group (35.0%)

Financial summary (INR)

Year to 31 Mar	13E	14E	15E
Revenue (m)	1,870,899	2,219,273	2,519,855
Operating profit (m)	169,896	216,215	241,988
Net profit (m)	103,959	140,074	159,740
Core EPS (fully-diluted)	32.591	43.912	50.078
EPS change (%)	(17.6)	34.7	14.0
Daiwa vs Cons. EPS (%)	(3.3)	6.9	10.2
PER (x)	8.2	6.1	5.3
Dividend yield (%)	1.5	1.5	2.2
DPS	4.000	4.000	6.000
PBR (x)	2.0	1.5	1.2
EV/EBITDA (x)	4.9	3.9	3.3
ROE (%)	27.4	28.5	25.7

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
MHCV volumes (units)	179,400	123,005	167,142	214,358	221,202	153,791	168,554	200,214
MHCV volumes (% YoY)	(3.0)	(31.4)	35.9	28.2	3.2	(30.5)	9.6	18.8
LCV volumes (units)	173,434	168,806	232,124	287,639	371,950	424,316	481,097	549,533
LCV volumes (% YoY)	16.2	(2.7)	37.5	23.9	29.3	14.1	13.4	14.2
JLR volumes (units)	n.a.	136,978	193,982	243,621	314,433	371,173	414,800	452,500
JLR volumes (% YoY)	n.a.	n.a.	41.6	25.6	29.1	18.0	11.8	9.1

Profit and loss (INRm)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
CV/PV business revenues	260,919	226,218	321,149	435,700	501,527	412,784	473,360	565,851
JLR revenues	0	385,071	494,769	698,846	1,067,424	1,363,226	1,640,165	1,832,824
Other Revenue	95,596	98,099	109,274	86,734	87,593	94,888	105,748	121,180
Total Revenue	356,515	709,389	925,193	1,221,279	1,656,545	1,870,899	2,219,273	2,519,855
Other income	0	0	0	0	0	0	0	0
COGS	(243,755)	(479,660)	(614,954)	(790,084)	(1,094,676)	(1,200,622)	(1,418,148)	(1,614,661)
SG&A	0	0	0	0	0	0	0	0
Other op.expenses	(78,507)	(235,730)	(267,950)	(309,576)	(395,011)	(500,381)	(584,910)	(663,205)
Operating profit	34,252	(6,001)	42,288	121,620	166,859	169,896	216,215	241,988
Net-interest inc./(exp.)	(7,431)	(19,309)	(22,397)	(20,454)	(24,946)	(28,102)	(29,051)	(30,950)
Assoc/forex/extraord./others	3,318	7,472	1,261	1,910	1,991	9,276	10,548	11,360
Pre-tax profit	30,140	(17,838)	21,152	103,075	143,903	151,069	197,713	222,399
Tax	(8,515)	(3,358)	(8,306)	(12,164)	(17,536)	(46,549)	(56,996)	(61,928)
Min. int./pref. div./others	54	(3,278)	12,865	1,825	8,798	4,579	(143)	(231)
Net profit (reported)	21,678	(24,474)	25,711	92,736	135,165	109,099	140,574	160,240
Net profit (adjusted)	20,302	(21,081)	12,543	90,426	125,544	103,959	140,074	159,740
EPS (reported)(INR)	11.246	(9.522)	9.012	29.083	42.588	34.202	44.069	50.234
EPS (adjusted)(INR)	10.532	(8.202)	4.396	28.359	39.557	32.591	43.912	50.078
EPS (adjusted fully-diluted)(INR)	10.532	(8.202)	4.396	28.359	39.557	32.591	43.912	50.078
DPS (INR)	3.001	1.212	3.011	4.000	4.035	4.000	4.000	6.000
EBIT	34,252	(6,001)	42,288	121,620	166,859	169,896	216,215	241,988
EBITDA	42,073	19,067	81,160	168,175	223,112	242,488	306,817	352,490

Cash flow (INRm)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	30,140	(17,838)	21,152	103,075	143,903	151,069	197,713	222,399
Depreciation and amortisation	7,821	25,068	38,871	46,555	56,254	72,592	90,602	110,501
Tax paid	(8,515)	(3,358)	(8,306)	(12,164)	400	(35,391)	(38,752)	(42,623)
Change in working capital	40,033	53,451	43,789	(5,952)	25,215	17,718	6,406	8,692
Other operational CF items	9,726	13,492	41,366	22,941	(8,841)	32,968	29,249	31,119
Cash flow from operations	79,204	70,815	136,872	154,456	216,932	238,956	285,218	330,087
Capex	(61,313)	(253,767)	(66,601)	(96,423)	(185,239)	(237,550)	(258,854)	(235,276)
Net (acquisitions)/disposals	0	0	0	0	0	0	0	0
Other investing CF items	(16,813)	(17,844)	(6,117)	(4,343)	(68,560)	0	0	0
Cash flow from investing	(78,126)	(271,610)	(72,719)	(100,766)	(253,799)	(237,550)	(258,854)	(235,276)
Change in debt	42,830	233,890	2,185	(23,818)	143,384	81,318	28,000	30,000
Net share issues/(repurchases)	(5,323)	362	6,867	31,596	(30)	2,006	0	0
Dividends paid	(6,597)	(3,457)	(9,919)	(14,683)	(14,637)	(14,826)	(14,826)	(22,240)
Other financing CF items	(7,381)	(26,465)	(15,172)	(20,454)	(14,549)	(28,389)	(29,392)	(31,350)
Cash flow from financing	23,529	204,329	(16,039)	(27,359)	114,168	40,109	(16,219)	(23,589)
Forex effect/others	2,183	(653)	(1,895)	331	605	561	643	731
Change in cash	26,790	2,881	46,220	26,663	77,907	42,076	10,788	71,953
Free cash flow	17,891	(182,951)	70,271	58,033	31,693	1,407	26,363	94,811

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (INRm)

As at 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	38,332	41,213	87,433	114,096	182,381	224,458	235,245	307,198
Inventory	32,946	101,547	113,120	140,705	182,160	214,829	251,191	281,937
Accounts receivable	20,605	48,001	71,912	65,257	82,368	102,628	117,013	132,576
Other current assets	100,790	126,514	152,831	187,539	262,978	271,793	275,201	278,814
Total current assets	192,674	317,275	425,296	507,597	709,888	813,707	878,650	1,000,526
Fixed assets	128,634	357,333	385,063	434,931	563,916	728,874	897,126	1,021,901
Goodwill & intangibles	5,662	37,187	34,229	35,848	40,937	40,937	40,937	40,937
Other non-current assets	16,984	12,998	8,743	10,805	117,434	106,276	88,033	68,728
Total assets	343,953	724,793	853,332	989,181	1,432,176	1,689,794	1,904,746	2,132,092
Short-term debt	0	0	0	0	0	0	0	0
Accounts payable	113,192	241,026	340,773	367,323	497,698	567,519	624,488	672,719
Other current liabilities	23,254	70,592	76,435	99,571	128,418	138,057	141,650	152,034
Total current liabilities	136,446	311,618	417,208	466,894	626,116	705,576	766,138	824,752
Long-term debt	115,849	349,739	351,924	328,106	471,490	552,808	580,808	610,808
Other non-current liabilities	0	0	0	0	0	0	0	0
Total liabilities	252,294	661,356	769,132	795,000	1,097,605	1,258,384	1,346,945	1,435,560
Share capital	3,855	5,141	5,706	6,377	6,348	6,380	6,380	6,380
Reserves/R.E./others	83,120	54,266	76,359	185,338	325,152	421,399	547,146	685,146
Shareholders' equity	86,975	59,406	82,065	191,715	331,499	427,778	553,526	691,526
Minority interests	4,683	4,030	2,135	2,466	3,071	3,632	4,275	5,006
Total equity & liabilities	343,953	724,793	853,332	989,181	1,432,176	1,689,794	1,904,746	2,132,092
EV	935,962	1,166,318	1,120,388	1,070,238	1,145,942	1,185,744	1,203,600	1,162,378
Net debt/(cash)	77,517	308,525	264,490	214,010	289,108	328,350	345,562	303,609
BVPS (INR)	45.119	23.113	28.764	60.124	104.450	134.106	173.527	216.790

■ Key ratios (%)

Year to 31 Mar	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	10.2	99.0	30.4	32.0	35.6	12.9	18.6	13.5
EBITDA (YoY)	6.1	(54.7)	325.7	107.2	32.7	8.7	26.5	14.9
Operating profit (YoY)	4.5	n.a.	n.a.	187.6	37.2	1.8	27.3	11.9
Net profit (YoY)	(3.6)	n.a.	n.a.	620.9	38.8	(17.2)	34.7	14.0
Core EPS (fully-diluted) (YoY)	(3.7)	n.a.	n.a.	545.1	39.5	(17.6)	34.7	14.0
Gross-profit margin	31.6	32.4	33.5	35.3	33.9	35.8	36.1	35.9
EBITDA margin	11.8	2.7	8.8	13.8	13.5	13.0	13.8	14.0
Operating-profit margin	9.6	n.a.	4.6	10.0	10.1	9.1	9.7	9.6
Net profit margin	5.7	(3.0)	1.4	7.4	7.6	5.6	6.3	6.3
ROAE	24.7	n.a.	17.7	66.1	48.0	27.4	28.5	25.7
ROAA	6.9	n.a.	1.6	9.8	10.4	6.7	7.8	7.9
ROCE	19.0	n.a.	10.0	25.4	25.1	19.0	20.4	19.8
ROIC	15.8	(2.2)	7.1	28.3	28.4	17.0	18.5	18.3
Net debt to equity	89.1	519.3	322.3	111.6	87.2	76.8	62.4	43.9
Effective tax rate	28.3	n.a.	39.3	11.8	12.2	30.8	28.8	27.8
Accounts receivable (days)	19.3	17.6	23.7	20.5	16.3	18.0	18.1	18.1
Current ratio (x)	1.4	1.0	1.0	1.1	1.1	1.2	1.1	1.2
Net interest cover (x)	4.6	n.a.	1.9	5.9	6.7	6.0	7.4	7.8
Net dividend payout	26.7	n.a.	33.4	13.8	9.5	11.7	9.1	11.9
Free cash flow yield	2.1	n.a.	8.2	6.8	3.7	0.2	3.1	11.1

Source: FactSet, Daiwa forecasts

■ Company profile

Tata Motors is India's largest automobile company with consolidated revenue of US$33bn for FY12. It is the leader in the commercial-vehicle segment and the third-largest player in the passenger-car segment. Through subsidiaries and associate companies, Tata Motors has operations in the UK, South Korea, Thailand, and Spain. Among them is Jaguar Land Rover, a business comprising the two iconic British brands, which was acquired in 2008.

Bank Negara Indonesia (BBNI IJ)

Rating: **Outperform [2]**
Share price: **IDR4,875**
6-mth target price: **IDR5,300** (9% potential upside)
3-year fair value: **IDR8,280** (70% potential upside)

Uptick in profitability

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What is the three-year story?

The three-year story of Bank Negara Indonesia (BBNI) is likely to be a normalisation of performance, from a balance sheet as well as a P&L perspective, which should lead to a material increase in the company's ROE. This should, in turn, lead to a narrowing of the PBR discount with its Indonesia peer banks, leading to superior share-price returns.

■ **DuPont analysis (2012): BBNI vs. Bank Mandiri (BMRI)**

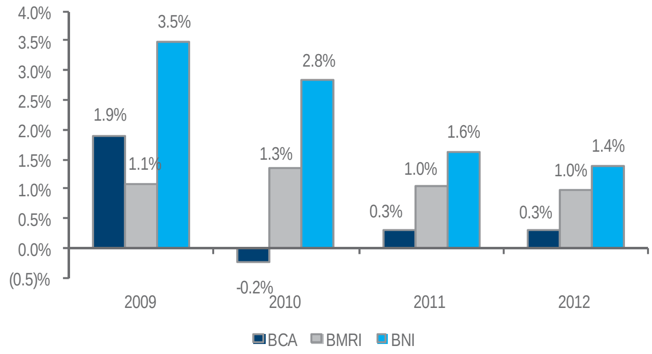
	BBNI	BMRI
Net-interest income	4.89%	4.64%
Non-net-interest income	2.38%	2.42%
Operating income	7.27%	7.06%
Operating expenses	-3.73%	-3.18%
Operating profit	3.53%	3.88%
Provisions	-0.80%	-0.57%
Profit before tax	2.81%	3.45%
Tax	-0.56%	-0.75%
Tax rate	20%	22%
Profit after tax	2.23%	2.61%
Assets/equity	7.8	8.5
ROE	17.32%	22.28%

Source: Daiwa

We believe that the relatively low profitability of BBNI compared with its peers is on account of higher operating and credit-cost ratios. On both these metrics, we see scope for the bank to see meaningful improvements over the next three years. In addition, we expect the company to improve the utilisation of its balance sheet. All of this should lead to an increase in its ROE and a narrowing of the profitability gap with its peers. It is this expectation that underpins our medium-term bullish view on the stock.

With respect to credit costs, the current level of relatively higher credit costs at BBNI than its peers is on account of legacy-portfolio issues rather than the company having an inherently higher-risk portfolio. The bank's credit-evaluation process for the medium-sized and small-size commercial segments was slack until 2008. Consequently, both these segments have seen a significant rise in bad loans since then, necessitating a corresponding pick-up in credit costs. Credit costs in the medium-sized commercial segment normalised in 2012, and we expect the same to happen in the small commercial segment over the next two years.

■ **Credit costs: BBNI vs. peers**



Source: Companies

On operating costs, we note that the company has the highest cost-to-income ratio among its peers. With loan growth now picking up, we expect operating-cost leverage to come through in the form of declining cost-to-income ratios.

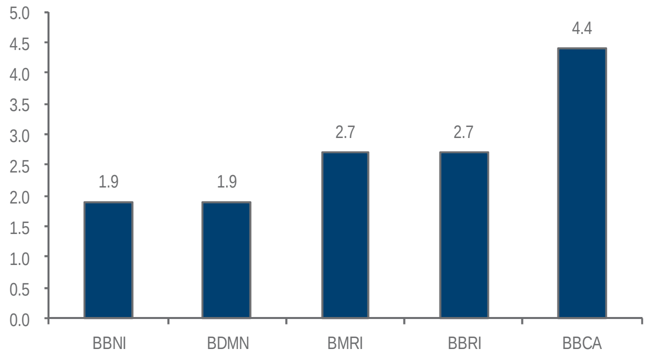
What could the fair value be in 2015?

We value the stock using a three-stage dividend discount model. This gives us our six-month target price of IDR5,300. While medium-term earnings and balance-sheet growth are the key inputs driving valuations, we do not see these parameters as being key differentiators when choosing among the various Indonesia banks. Rather, the key differentiator is the profitability of the bank as indicated by its ROE. Hence, relative changes in ROEs have a material impact on the valuations of the banks relative to each other.

Currently, BBNI is the cheapest large-cap Indonesia bank stock on both a PBR and PER basis. We believe the reason for this is the company's relatively poor ROE. As mentioned, we see scope for its ROE to increase as some of the operating metrics start to normalise. Hence, we believe there will be a corresponding increase in the valuation multiple.

Hence, by 2015, we expect the stock to trade almost on a par with BMRI (its closest peer) in terms of PBR. On our 2013 BVPS forecasts, BMRI is trading currently at a PBR of 2.7x compared with 1.9x for BBNI. Attributing this valuation multiple to BBNI gives a fair value of IDR8,280 based on 2015E BVPS, implying upside potential of 70% to the current share price.

■ Indonesia Banks Sector: PBR valuations (2013E) (x)



Source: Bloomberg, Daiwa

Are there any near-term hurdles?

The key near-term hurdle in terms of share-price performance would be the improvement in the asset quality of loans in the small commercial segment being only gradual. With the share price having seen a strong run-up over the past few months, investors may wait to see the extent of the improvement in the asset quality in this segment before giving the company credit for it.

In addition, we expect some near-term pressure on the cost of funding for BBNI, in line with the rest of the sector. This again would be negative for the near-term share-price performance.

How to monitor progress

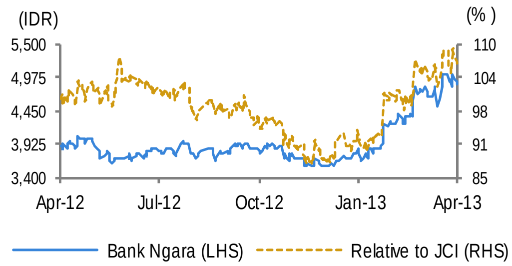
Steady progress in the normalisation of asset quality in the small commercial segment is the key for share-price performance, in our view. On the other hand, over a three-year period, we see an improving cost-to-income ratio as being key for an increase in the ROE. Investors should, therefore, track this metric.

What could go wrong?

The key risk is a re-emergence of asset-quality issues. The bull case on the bank is premised on the assumption that the current asset-quality issues are a reflection of the credit processes of the past (pre-2008). We believe, as does the market in our view, that BBNI has revamped significantly its credit processes over the past few years. Hence, asset quality trends on the loans granted over the past few years should be in line with the overall sector trends. However, if there is a relapse in asset-quality issues, then the market may infer that this assumption is wrong. Such a scenario could even lead to a derating of the stock.

Another risk is that the company's NIM contracts at a greater pace than we expect. This may be due to trends in the sector rather a company-specific issue. For the sector as a whole, we believe that rising loan-to-deposit ratios will lead to increased competition for deposits. With lending rates continuing to fall, NIMs in the sector, including that of BBNI, may be lower than we and the market expect.

Share price performance



12-month range	3,575-5,050
Market cap (USDbn)	9.38
3m avg daily turnover (USDm)	13.00
Shares outstanding (m)	18,648
Major shareholder	Republic of Indonesia (60.0%)

Financial summary (IDR)

Year to 31 Dec	13E	14E	15E
Total operating income (bn)	25,645	29,531	33,962
Pre-provision operating profit(bn)	12,471	14,836	17,566
Net profit (bn)	7,866	9,464	11,059
Core EPS (fully-diluted)	422	507	593
EPS change (%)	11.7	20.3	16.9
Daiwa vs Cons. EPS (%)	3.8	7.6	n.a.
PER (x)	11.6	9.6	8.2
Dividend yield (%)	2.6	3.1	3.6
DPS	127	152	178
PBR (x)	1.9	1.6	1.4
ROE (%)	17.0	18.1	18.6

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Net loan growth (YoY %)	28	1	21	21	24	24	24	24
NIM (%)	5.51	5.63	5.32	5.16	5.25	5.18	5.13	5.04
Credit costs (bps)	434	348	282	161	139	120	110	110
Fee to income ratio (%)	15.3	15.9	14.5	14.5	14.7	15.7	16.3	16.9
Expense to income ratio (%)	50.7	48.3	47.6	51.4	51.4	51.4	49.8	48.3

Profit and loss (IDRbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Net-interest income	9,967	11,153	11,738	13,198	15,458	17,544	20,527	23,894
Net fees & commission	2,843	3,254	5,467	6,341	7,454	8,044	8,947	10,011
Trading and other income	58	19	234	351	57	57	57	57
Net insurance income	0	0	0	0	0	0	0	0
Total operating income	12,868	14,426	17,438	19,890	22,969	25,645	29,531	33,962
Personnel expenses	(3,299)	(3,460)	(4,127)	(5,042)	(5,578)	(6,192)	(6,873)	(7,629)
Other expenses	(3,223)	(3,509)	(4,174)	(5,181)	(6,228)	(6,983)	(7,822)	(8,767)
Total expenses	(6,522)	(6,969)	(8,300)	(10,223)	(11,806)	(13,174)	(14,695)	(16,396)
Pre-provision operating profit	6,346	7,457	9,138	9,667	11,163	12,471	14,836	17,566
Total provision	(4,359)	(4,051)	(3,629)	(2,421)	(2,525)	(2,698)	(3,067)	(3,803)
Operating profit after prov.	1,988	3,406	5,509	7,246	8,638	9,773	11,770	13,764
Non-operating income	58	58	(24)	219	259	60	60	60
Profit before tax	2,045	3,464	5,485	7,465	8,897	9,833	11,830	13,824
Tax	(706)	(957)	(1,382)	(1,653)	(1,851)	(1,967)	(2,366)	(2,765)
Min. int./pref. div./other items	(3)	(3)	(1)	(18)	(2)	0	0	0
Net profit	1,336	2,504	4,101	5,794	7,044	7,866	9,464	11,059
Adjusted net profit	1,336	2,504	4,101	5,794	7,044	7,866	9,464	11,059
EPS (IDR)	88	148	220	311	378	422	507	593
EPS (adjusted) (IDR)	88	148	220	311	378	422	507	593
EPS (adjusted fully-diluted) (IDR)	88	148	220	311	378	422	507	593
DPS (IDR)	8	57	47	99	76	127	152	178

Change (YoY %)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Net-interest income	32.8	11.9	5.2	12.4	17.1	13.5	17.0	16.4
Non-interest income	(15.6)	12.8	74.2	17.4	12.2	7.9	11.1	11.8
Total operating income	17.6	12.1	20.9	14.1	15.5	11.7	15.2	15.0
Total expenses	(5.9)	6.9	19.1	23.2	15.5	11.6	11.5	11.6
Pre-provision operating profit	58.2	17.5	22.5	5.8	15.5	11.7	19.0	18.4
Total provisions	61.2	(7.1)	(10.4)	(33.3)	4.3	6.9	13.7	24.0
Operating profit after provisions	52.0	71.4	61.7	31.5	19.2	13.1	20.4	16.9
Profit before tax	34.5	69.3	58.4	36.1	19.2	10.5	20.3	16.9
Net profit (adjusted)	42.4	87.5	63.8	41.3	21.6	11.7	20.3	16.9
EPS (adjusted, FD)	36.8	68.8	48.8	41.3	21.6	11.7	20.3	16.9
Gross loans	27.8	0.6	20.9	20.9	23.9	24.0	24.0	24.0
Deposits	11.6	15.5	3.1	19.0	11.4	18.9	20.0	19.1
Total assets	10.0	12.8	9.3	20.3	11.5	15.9	18.0	17.5
Total liabilities	12.2	11.8	3.4	21.3	10.9	16.3	18.6	18.0
Shareholders' equity	(10.4)	24.0	72.7	13.9	15.2	12.7	13.5	13.9
Avg interest-earning assets	9.6	9.5	11.3	16.0	15.1	15.0	18.3	18.4
Avg risk-weighted assets	16.8	13.4	14.1	15.1	26.6	25.7	18.4	17.7

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (IDRbn)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & equivalent	38,122	49,915	58,775	76,551	68,849	74,835	83,285	87,958
Investment securities	44,529	50,237	45,737	44,586	48,362	50,780	53,319	55,985
Net loans and advances	100,690	100,082	122,443	149,476	186,926	231,789	287,418	356,399
Fixed assets	3,733	3,708	3,708	3,708	3,708	3,708	3,708	3,708
Goodwill	0	0	0	0	0	0	0	0
Other assets	14,636	23,524	17,857	24,627	25,405	25,009	27,865	31,248
Total assets	201,710	227,466	248,520	298,948	333,250	386,122	455,596	535,298
Customers deposits	163,164	188,469	194,375	231,296	257,661	306,282	367,588	437,929
Borrowing	12,717	9,389	8,949	15,745	11,995	12,595	13,224	13,886
Debentures	0	0	0	0	0	0	0	0
Other liabilities	10,398	10,465	12,107	14,175	20,122	18,267	19,180	20,139
Total liabilities	186,279	208,322	215,430	261,216	289,778	337,143	399,993	471,954
Share capital	7,789	7,789	9,055	9,055	9,055	9,055	9,055	9,055
Reserves & others	7,672	11,385	24,065	28,677	34,417	39,923	46,548	54,289
Shareholders' equity	15,462	19,175	33,120	37,732	43,472	48,978	55,603	63,344
Minority interests	(31)	(31)	(30)	0	0	0	0	0
Total equity & liabilities	201,710	227,466	248,520	298,948	333,250	386,122	455,596	535,298
Avg interest-earning assets	180,961	198,074	220,533	255,777	294,344	338,507	400,307	474,078
Avg risk-weighted assets	115,386	130,859	149,312	171,906	217,690	273,645	324,061	381,494
BVPS (IDR)	1,012	1,258	1,776	2,023	2,331	2,626	2,982	3,397

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Loan/deposit	65.2	56.8	66.6	67.7	75.2	78.5	81.1	84.4
Tier-1 CAR	10.3	10.2	16.6	15.9	14.1	13.7	13.5	13.4
Total CAR	14.5	13.8	18.6	17.6	18.1	17.7	17.5	17.4
NPLs/gross loans	5.3	5.4	7.1	3.8	2.9	3.5	3.8	4.1
Total loan-loss prov./NPLs	65.3	81.3	60.6	84.2	72.9	81.6	86.6	89.9
ROAA	0.7	1.2	1.7	2.1	2.2	2.2	2.2	2.2
ROAE	8.2	14.5	15.7	16.4	17.3	17.0	18.1	18.6
Net-interest margin	5.5	5.6	5.3	5.2	5.3	5.2	5.1	5.0
Gross yield	9.2	9.8	8.5	8.1	7.7	7.8	7.7	7.7
Cost of funds	4.0	4.4	3.5	3.3	2.8	2.9	2.9	2.9
Net-interest spread	5.2	5.4	5.0	4.8	4.9	4.9	4.8	4.7
Total cost/total income	50.7	48.3	47.6	51.4	51.4	51.4	49.8	48.3
Effective tax	34.5	27.6	25.2	22.1	20.8	20.0	20.0	20.0
Dividend-payout	9.1	38.6	21.2	31.8	20.0	30.0	30.0	30.0

Source: FactSet, Daiwa forecasts

Company profile

Bank Negara Indonesia Persero (BBNI) was established in 1946 as the first bank formed and owned by the Indonesia Government. It is Indonesia's fourth-largest bank in terms of assets, and it had more than 1,550 outlets as at the end of 2012.

XL Axiata Tbk PT (EXCL IJ)

Rating: **Outperform [2]**
Share price: **IDR5,400**
6-mth target price: **IDR6,069** (12% potential upside)
3-year fair value: **IDR7,758** (44% potential upside)

Investment ahead of demand cycle for data services should reap rewards

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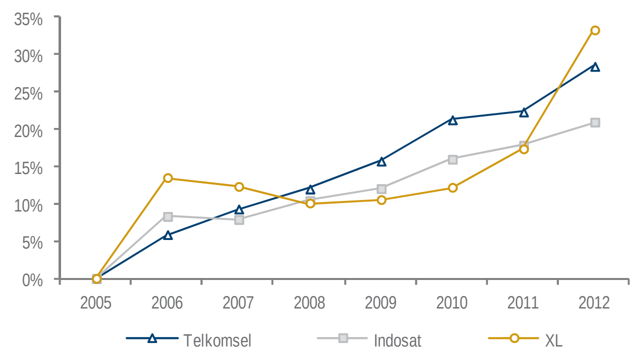
What is the three-year story?

XL Axiata (XL) is investing ahead of demand to benefit from the sharp rise in mobile data consumption in Indonesia. Demand for mobile-data services is likely to pick up, given the proliferation of increasingly cheaper 3G handsets, coupled with the popularity of social networking sites such as Facebook with Indonesians. Accordingly, XL has accelerated its 3G network build-out to ensure the company is best-positioned in terms of network-infrastructure readiness for its customers. As at the end of 2012, 3G base stations accounted for 33% of XL's total base-station count (compared with 28% for Telkomsel and 21% for Indosat).

■ **Indonesia Telecoms Sector: 3G base stations as a % of overall base stations**



Source: Companies

What could the fair value be in 2015?

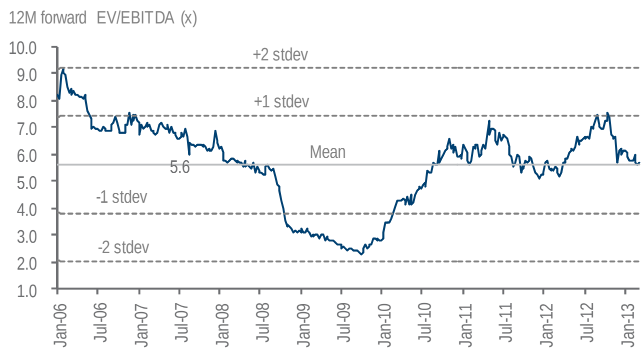
Our six-month target price of IDR6,069 is based on a DCF methodology with the following inputs: 1) a WACC of 10.6%, based on a 12.5% COE and a 30% long-term debt-to-capital ratio, and 2) a terminal free-cash-flow growth rate of 1.5%.

XL's fair value would be in the range of IDR7,758-9,775, based on our medium-term forecasts. We see IDR7,758 as the most likely, while IDR9,975 represents the best-case scenario.

A fair value of IDR7,758 effectively puts the business on multiples similar to those at which the stock is trading currently. It is trading at a 2013 EV/EBITDA of 5.9x, broadly in line with the past seven-year-average multiple of 5.5x. Our fair value of IDR7,758 implies 2016E PER and EV/EBITDA multiples of 14.8x and 5.8x, respectively.

A fair value of IDR9,775 translates into a 2016E EV/EBITDA of 7.1x, about 1SD above the past-seven-year mean. We believe the realisation of this potential is contingent on several factors, including a sharp fall in capex from 2017-20 to about 18% of sales (compared with 35% for 2013E).

■ **XL: 12-month forward EV/EBITDA**



Source: Bloomberg, Daiwa forecasts

Are there any near-term hurdles?

XL is facing two near-term hurdles, in our view: 1) price competition in the data segment from small player Hutch Indonesia, and 2) EBITDA-margin pressure on account of network expansion associated with its current business plan of investing ahead of demand.

These two issues affected XL's 4Q12 results and appear to be having an effect on the near-term share price performance as well: the share price (down 5.3% in local currency terms) has underperformed those of its peers as well as the domestic benchmark (by 16.2%) on a YTD basis.

Despite this hiccup, we remain optimistic on the company's prospects as: 1) we believe Hutch Indonesia's strategy is temporary as it has a weak market position; and only one block of 3G spectrum (XL has three carriers), which could be insufficient to cater to demand for data services over the medium term. Further, the underlying operational trends in the 4Q12 results suggest that the long-term story for the company is intact. The company continued to see data-traffic growth (4Q12: up 50% YoY) and, more importantly, monetise data-traffic volume. For 4Q12, its data services revenue rose by 29% YoY, which bodes well for the future.

How to monitor progress

Investors should continue to monitor data-revenue growth as well as this metric as a percentage of overall revenue, as we see this as a key indicator of XL's strategic positioning. Also, increases in the deployment of 3G base-station sites could suggest the data story is on track. As at the end of 2012, the company estimated its 3G population coverage to be 35-40%.

Quarterly results are also an important point of reference in understanding whether the high capex level and depressed EBITDA-margin profile over the near term is a result of the network-expansion strategy or something else.

The company has guided for capex to continue its trajectory in 2013 and range from IDR8-9 trillion. Against the backdrop of this acceleration in network roll-out, we forecast 2012-15 EPS and EBITDA CAGRs of 14% and 8%, respectively. While we forecast the EBITDA margin to decline in 2013 to 43.6%, we expect the increase in data revenue to drive margin expansion to 45.2% for 2015.

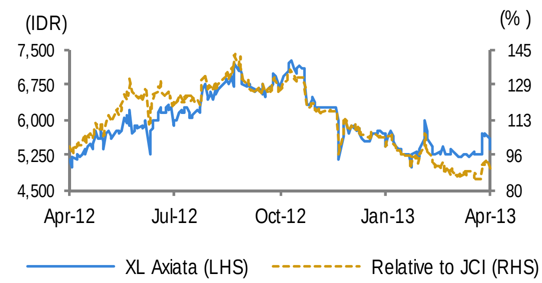
What could go wrong?

Inability to monetise its current investment in data services: shifts in communication patterns – from, for example, the rise in popularity of Whatsapp, which has clipped demand for SMS services in many countries – could result in the company being unable to monetise its data investments. This could lead to lower-than-expected revenue growth and a lower-than-forecast EBITDA-margin profile over the next five years.

Increased competition: the last significant competitive shift was in 4Q10, when bundled promotional programmes were introduced, resulting in a drop in revenue growth for the industry. Since then, the industry players have been content to allow the EBITDA margin to recover, and revenue growth to return to the industry as a whole. While the competitive pressure currently has come primarily from small players such as Hutch Indonesia, a full-scale price war would have a damaging effect even as we move toward the tail-end of operators' capex cycles.

Technology risk: the demand for data services has been a function of the meteoric rise of smartphone technology as well as 3G/4G transmission technology. Correspondingly, if a new form of technology were to emerge, it could lead to further difficulty in data monetisation efforts.

Share price performance



12-month range	5,000-7,300
Market cap (USDbn)	4.75
3m avg daily turnover (USDm)	3.57
Shares outstanding (m)	8,524
Major shareholder	Axiata Group (66.7%)

Financial summary (IDR)

Year to 31 Dec	13E	14E	15E
Revenue (bn)	23,380	25,470	27,561
Operating profit (bn)	4,574	5,277	6,384
Net profit (bn)	2,754	3,262	4,128
Core EPS (fully-diluted)	323	383	484
EPS change (%)	(0.4)	18.4	26.6
Daiwa vs Cons. EPS (%)	(21.7)	(17.1)	(14.9)
PER (x)	16.7	14.1	11.1
Dividend yield (%)	3.0	3.5	4.5
DPS	162	191	242
PBR (x)	2.7	2.5	2.3
EV/EBITDA (x)	5.9	5.2	4.5
ROE (%)	17.1	18.6	21.3

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Total mobile subs (m)	26.0	31.8	40.4	46.4	45.8	50.8	55.3	59.8
Subscriber net add (m)	10.5	5.8	8.6	6.0	(0.7)	5.0	4.5	4.5
Blended ARPU (Local curr.)	37.0	36.0	34.0	32.0	31.0	30.2	30.0	30.0

■ Profit and loss (IDRbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cellular	11,305	12,771	16,150	17,168	19,595	21,444	23,437	25,427
Infrastructure	851	1,109	1,487	1,754	1,683	1,935	2,032	2,134
Other Revenue	0	0	0	(0)	0	0	0	0
Total Revenue	12,156	13,880	17,637	18,921	21,278	23,380	25,470	27,561
Other income	0	0	0	0	0	0	0	1
COGS	(4,380)	(5,290)	(5,603)	(6,537)	(8,612)	(10,122)	(10,913)	(11,546)
SG&A	(2,645)	(2,384)	(2,746)	(3,035)	(2,920)	(3,068)	(3,316)	(3,568)
Other op.expenses	(3,379)	(3,741)	(4,122)	(4,683)	(5,066)	(5,615)	(5,963)	(6,065)
Operating profit	1,753	2,464	5,166	4,666	4,680	4,574	5,277	6,384
Net-interest inc./(exp.)	(1,095)	(1,218)	(780)	(580)	(601)	(777)	(790)	(720)
Assoc/forex/extraord./others	(734)	1,105	(516)	(220)	(326)	(50)	(50)	(49)
Pre-tax profit	(75)	2,350	3,870	3,866	3,753	3,747	4,437	5,615
Tax	60	(641)	(977)	(1,035)	(987)	(993)	(1,176)	(1,487)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	(15)	1,709	2,893	2,831	2,766	2,754	3,262	4,127
Net profit (adjusted)	(15)	1,709	2,893	2,831	2,766	2,754	3,262	4,128
EPS (reported)(IDR)	(2)	201	340	332	324	323	383	484
EPS (adjusted)(IDR)	(2)	201	340	332	324	323	383	484
EPS (adjusted fully-diluted)(IDR)	(2)	237	340	332	325	323	383	484
DPS (IDR)	20	0	107	130	130	162	191	242
EBIT	1,019	3,569	4,650	4,446	4,354	4,524	5,227	6,334
EBITDA	5,132	6,205	9,288	9,349	9,746	10,190	11,240	12,450

■ Cash flow (IDRbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	(75)	2,350	3,870	3,866	3,753	3,747	4,437	5,615
Depreciation and amortisation	3,379	3,741	4,122	4,683	5,066	5,615	5,963	6,066
Tax paid	(212)	(9)	(9)	(1,035)	(987)	(993)	(1,176)	(1,487)
Change in working capital	(453)	(96)	(549)	795	(953)	69	26	26
Other operational CF items	2,071	1,732	1,361	9	1,976	827	840	771
Cash flow from operations	4,710	7,718	8,795	8,317	8,855	9,265	10,091	10,991
Capex	(11,382)	(5,283)	(4,848)	(6,522)	(10,176)	(8,183)	(6,367)	(6,063)
Net (acquisitions)/disposals	0	0	0	0	0	0	0	0
Other investing CF items	(133)	159	118	(162)	175	0	0	0
Cash flow from investing	(11,514)	(5,123)	(4,729)	(6,683)	(10,001)	(8,183)	(6,367)	(6,063)
Change in debt	8,564	(4,499)	(3,228)	422	2,604	2,000	0	0
Net share issues/(repurchases)	0	2,786	0	0	0	0	0	0
Dividends paid	(142)	0	0	(911)	(1,107)	(1,377)	(1,631)	(2,063)
Other financing CF items	(1,133)	(1,240)	(827)	(513)	(560)	(777)	(790)	(720)
Cash flow from financing	7,290	(2,954)	(4,055)	(1,002)	937	(154)	(2,420)	(2,783)
Forex effect/others	(94)	(6)	(1)	(0)	2	0	0	0
Change in cash	390	(365)	9	632	(206)	928	1,303	2,144
Free cash flow	(6,672)	2,436	3,947	1,796	(1,321)	1,082	3,723	4,927

Source: FactSet, Daiwa forecasts

Financial summary continued ...

Balance sheet (IDRbn)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	1,170	747	366	998	792	1,722	3,025	5,165
Inventory	128	20	61	67	50	55	60	65
Accounts receivable	420	342	535	670	528	584	637	689
Other current assets	1,483	899	1,266	1,653	2,290	2,489	2,677	2,865
Total current assets	3,201	2,007	2,228	3,387	3,659	4,850	6,398	8,784
Fixed assets	23,180	23,616	23,197	25,615	29,643	32,211	32,615	32,614
Goodwill & intangibles	284	244	521	449	377	377	377	377
Other non-current assets	1,729	1,512	1,305	1,720	1,777	1,777	1,777	1,777
Total assets	28,393	27,380	27,251	31,171	35,456	39,214	41,167	43,551
Short-term debt	1,278	2,475	977	3,820	4,307	4,307	4,307	4,307
Accounts payable	3,707	2,649	2,603	3,701	2,710	3,039	3,311	3,583
Other current liabilities	692	884	983	1,207	1,723	1,776	1,826	1,876
Total current liabilities	5,678	6,009	4,563	8,728	8,740	9,122	9,443	9,765
Long-term debt	17,443	10,988	9,202	6,906	9,213	11,213	11,213	11,213
Other non-current liabilities	964	1,580	1,771	1,844	2,132	2,132	2,132	2,132
Total liabilities	24,085	18,577	15,536	17,478	20,086	22,467	22,789	23,111
Share capital	3,401	6,186	6,207	6,266	6,307	6,307	6,307	6,308
Reserves/R.E./others	907	2,617	5,508	7,427	9,063	10,440	12,071	14,134
Shareholders' equity	4,308	8,803	11,715	13,693	15,370	16,747	18,378	20,442
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	28,393	27,380	27,251	31,171	35,456	39,214	41,167	43,553
EV	63,580	58,746	55,842	55,758	58,758	59,827	58,525	56,385
Net debt/(cash)	17,551	12,717	9,813	9,728	12,728	13,798	12,495	10,355
BVPS (IDR)	608	1,035	1,378	1,606	1,803	1,965	2,156	2,398

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	45.3	14.2	27.1	7.3	12.5	9.9	8.9	8.2
EBITDA (YoY)	46.2	20.9	49.7	0.7	4.2	4.6	10.3	10.8
Operating profit (YoY)	(12.2)	250.0	30.3	(4.4)	(2.1)	3.9	15.5	21.2
Net profit (YoY)	n.a.	n.a.	69.2	(2.1)	(2.3)	(0.4)	18.4	26.6
Core EPS (fully-diluted) (YoY)	n.a.	n.a.	43.4	(2.2)	(2.4)	(0.4)	18.4	26.6
Gross-profit margin	64.0	61.9	68.2	65.5	59.5	56.7	57.2	58.1
EBITDA margin	42.2	44.7	52.7	49.4	45.8	43.6	44.1	45.2
Operating-profit margin	8.4	25.7	26.4	23.5	20.5	19.4	20.5	23.0
Net profit margin	(0.1)	12.3	16.4	15.0	13.0	11.8	12.8	15.0
ROAE	n.a.	26.1	28.2	22.3	19.0	17.1	18.6	21.3
ROAA	n.a.	6.1	10.6	9.7	8.3	7.4	8.1	9.7
ROCE	5.5	15.8	21.1	19.2	16.3	14.8	15.8	18.1
ROIC	10.0	8.3	17.9	15.2	13.4	11.5	12.6	15.2
Net debt to equity	407.4	144.5	83.8	71.0	82.8	82.4	68.0	50.7
Effective tax rate	n.a.	27.3	25.2	26.8	26.3	26.5	26.5	26.5
Accounts receivable (days)	11.0	10.0	9.1	11.6	10.3	8.7	8.8	8.8
Current ratio (x)	0.6	0.3	0.5	0.4	0.4	0.5	0.7	0.9
Net interest cover (x)	0.9	2.9	6.0	7.7	7.2	5.8	6.6	8.8
Net dividend payout	n.a.	0.0	31.5	39.2	40.0	50.0	50.0	50.0
Free cash flow yield	n.a.	5.3	8.6	3.9	n.a.	2.4	8.1	10.7

Source: FactSet, Daiwa forecasts

Company profile

PT XL Axiata is Indonesia's third-largest telecoms company in terms of cellular subscribers. It derives the bulk of its revenue from the provision of mobile-communication services, and also offers leased-line and tower services. Malaysian Axiata Group is the majority shareholder with a 67% stake.

Hana Financial Group (086790 KS)

Rating: **Buy [1]**
Share price: **KRW37,250**
6-mth target price: **KRW50,000** (34% potential upside)
3-year fair value: **KRW63,400** (70% potential upside)

Plenty of low-hanging fruit likely to benefit the bottom line

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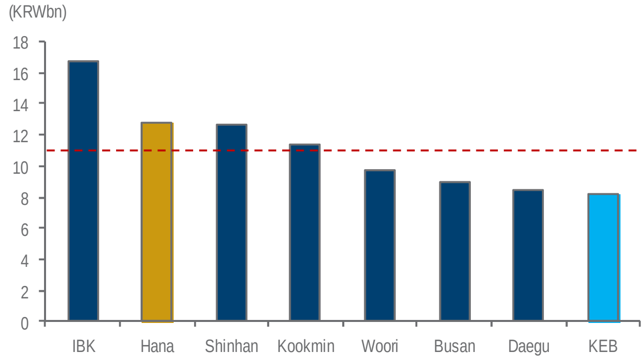
What is the three-year story?

In our view, the success of the share swap will accelerate the creation of synergies between Hana Financial Group (HFG) and Korea Exchange Bank (KEB) (004940 KS, KRW7,010, Outperform [2]). We see the following as areas for potential synergies.

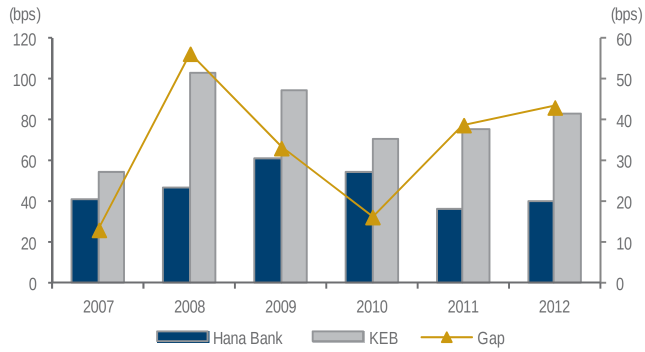
1. Improvement in productivity/profitability of KEB. We would expect the overall productivity/ profitability of KEB to improve under the direct control of HFG. In particular, HFG has demonstrated better risk-management capability over the past six years than KEB with respect to credit costs. In addition, there should be room to improve KEB's credit costs on the back of HFG's better risk-management system and a likely overall improvement in the corporate credit-quality cycle. Meanwhile, HFG's management expects KEB's overall productivity, such as loan balance per employee, to improve as a result of tightened budget management at the group level.

■ Loan balance per employee (ie, a yard-stick for productivity)



Source: FSS, Daiwa calculation
Note: Based on Won-denominated loans as at the end of September 2012

■ Hana Bank vs. KEB: credit costs (2007-12)



Source: Companies

2. Cost synergies. The potential integration of the credit-card businesses of HFG and KEB would help HFG to gain market share. According to the Credit Finance Association, Hana-SK Card (Not listed) had a 5.9% market share for 2011 in terms of credit-card purchases, while KEB had 2.8% market share. In addition, HFG's management expects to save on some IT-related expenses by integrating the IT infrastructures of HFG and KEB, although a specific timeline is not yet available.

3. Revenue synergies. We would expect an enhanced presence for the combined entity, especially in the corporate-lending segment, which would help Hana Bank (Not listed), the flagship bank unit of HFG, improve its future loan pricing. As at the end of September 2012, Hana Bank had a 7.3% share of the corporate-lending segment in Korea, compared with 4.2% for KEB. In addition, HFG believes the merged entity would be able to enhance its market leadership in nine of a total of 15 business lines, especially in private banking, bancassurance, and household lending.

What could the fair value be in 2015?

We use a Gordon Growth Model to derive the fair value of the stock, as this takes into account the most critical factors in the financial performance of a bank. We note that the Gordon Growth Model is the most widely used valuation methodology to value banks by sell-side analysts. Our six-month target price of KRW50,000 is also based on our Gordon Growth Model.

We forecast a BVPS CAGR over 2012-15 of 8.3%, meaning that the fair value of HFG would be KRW63,400/share, assuming the important inputs in our Gordon Growth Model are unchanged. In this calculation, we do not factor in the potential synergies that result from greater integration with KEB, as it is difficult to quantify the effect on the ROE at this time. However, this would present upside potential to our forecasts.

Are there any near-term hurdles?

Although HFG recognised a range of one-off costs in 2012, such as M&A bonus payments and additional loan-loss provisions, there could be more integration-related extra costs in 2013.

Meanwhile, strong opposition to the merger from KEB's labour union could delay the overall integration process, which would be negative for investment sentiment towards HFG's stock.

How to monitor progress?

While we expect the overall integration process to create synergies between HFG with KEB, we believe 2013 earnings will be the first litmus test of how smoothly the integration is going.

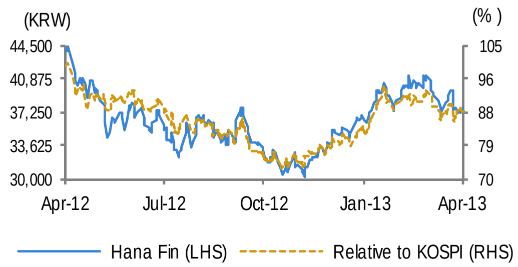
Over the medium term, investors should monitor the improvements in KEB's productivity/profitability, by looking at yardsticks such as its credit costs and loan balance per employee, as we see the improvements in productivity/profitability as low-hanging fruit that should be enhanced even without a merger between Hana Bank and KEB.

HFG's management remains confident that KEB's overall productivity would improve as a result of tighter budget control at the holding-company level, even before the merger between Hana Bank and KEB.

What could go wrong?

Over the near term, a worse-than-expected improvement in the macroeconomic environment could negatively affect corporate credit quality, leading to weaker-than-expected earnings momentum at KEB. Currently, we see a strong improvement in KEB's earnings as one of the most easily achievable synergies, as we would expect a substantial improvement in KEB's credit costs as a result of it adopting HFG's risk-management system under a benign credit-quality cycle.

Share price performance



12-month range	30,350-44,500
Market cap (USDbn)	8.00
3m avg daily turnover (USDm)	32.47
Shares outstanding (m)	243
Major shareholder	National Pension Service (9.4%)

Financial summary (KRW)

Year to 31 Dec	12E	13E	14E
Total operating income (bn)	7,474	7,833	8,416
Pre-provision operating profit(bn)	3,716	3,778	4,124
Net profit (bn)	1,832	1,564	1,646
Core EPS (fully-diluted)	7,539	6,434	6,774
EPS change (%)	44.4	(14.7)	5.3
Daiwa vs Cons. EPS (%)	(6.6)	11.3	8.0
PER (x)	5.0	5.8	5.5
Dividend yield (%)	1.3	2.6	3.7
DPS	468	977	1,372
PBR (x)	0.6	0.5	0.5
ROE (%)	12.4	9.5	9.2

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Net-interest margin (%)	2.31	2.06	1.72	2.22	2.22	2.18	2.15	2.18
Tier-1 CAR (%)	7.73	9.43	11.25	10.73	9.61	9.17	9.11	9.00
Total CAR (%)	11.75	13.51	14.98	14.06	13.44	12.80	12.46	12.09
Credit cost (bps)	41.21	114.48	68.52	67.25	49.33	69.70	55.33	56.84
NPL (%)	0.79	1.86	1.05	1.50	1.04	1.05	0.90	0.90
Loan growth (%)	5.63	16.85	0.63	7.12	15.61	59.14	7.00	6.50
Deposit growth (%)	0.00	16.87	0.58	10.53	11.99	72.16	7.00	7.00
Loan to deposit ratio (%)	111.99	111.92	113.64	116.98	124.69	115.40	115.50	115.03
Earning-asset growth (%)	2.91	15.50	5.99	1.16	9.00	4.34	3.03	3.01
Fee to income ratio(X)	0.2	0.2	0.2	0.1	0.2	0.2	0.2	0.2

■ Profit and loss (KRWbn)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Net-interest income	2,660	2,876	2,559	3,268	3,206	4,711	5,793	6,300
Net fees & commission	581	539	521	492	978	1,442	1,583	1,590
Trading and other income	403	52	(285)	74	307	1,321	457	526
Net insurance income	0	0	0	0	0	0	0	0
Total operating income	3,644	3,468	2,795	3,833	4,492	7,474	7,833	8,416
Personnel expenses	(878)	(917)	(911)	(939)	(1,194)	(2,128)	(2,296)	(2,431)
Other expenses	(718)	(774)	(760)	(853)	(914)	(1,630)	(1,758)	(1,862)
Total expenses	(1,597)	(1,691)	(1,671)	(1,792)	(2,109)	(3,758)	(4,054)	(4,293)
Pre-provision operating profit	2,047	1,777	1,123	2,042	2,383	3,716	3,778	4,124
Total provision	(377)	(1,209)	(738)	(761)	(643)	(1,446)	(1,228)	(1,344)
Operating profit after prov.	1,670	567	385	1,281	1,740	2,270	2,550	2,780
Non-operating income	83	81	(14)	90	(16)	5	69	63
Profit before tax	1,753	649	371	1,371	1,723	2,276	2,620	2,843
Tax	(436)	(165)	(75)	(369)	(414)	(312)	(629)	(682)
Min. int./pref. div./other items	(19)	(0)	10	9	(81)	(131)	(427)	(514)
Net profit	1,298	483	306	1,011	1,228	1,832	1,564	1,646
Adjusted net profit	1,298	483	306	1,011	1,228	1,832	1,564	1,646
EPS (KRW)	6,171	2,301	1,467	4,841	5,220	7,539	6,434	6,774
EPS (adjusted) (KRW)	6,171	2,301	1,467	4,841	5,220	7,539	6,434	6,774
EPS (adjusted fully-diluted) (KRW)	6,171	2,301	1,467	4,841	5,220	7,539	6,434	6,774
DPS (KRW)	1,300	200	400	301	768	468	977	1,372

■ Change (YoY %)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Net-interest income	10.3	8.1	(11.0)	27.7	(1.9)	46.9	23.0	8.8
Non-interest income	34.6	(39.9)	(60.1)	139.9	127.3	115.0	(26.2)	3.7
Total operating income	16.0	(4.8)	(19.4)	37.2	17.2	66.4	4.8	7.5
Total expenses	15.2	5.9	(1.2)	7.2	17.7	78.2	7.9	5.9
Pre-provision operating profit	16.5	(13.2)	(36.8)	81.7	16.7	56.0	1.7	9.1
Total provisions	51.2	220.6	(39.0)	3.1	(15.5)	124.8	(15.1)	9.4
Operating profit after provisions	10.8	(66.0)	(32.1)	232.5	35.8	30.5	12.3	9.0
Profit before tax	20.3	(63.0)	(42.8)	269.2	25.7	32.0	15.1	8.5
Net profit (adjusted)	26.4	(62.8)	(36.6)	230.0	21.5	49.2	(14.7)	5.3
EPS (adjusted, FD)	24.7	(62.7)	(36.3)	230.0	7.8	44.4	(14.7)	5.3
Gross loans	5.6	16.8	0.6	7.1	15.6	59.1	7.0	6.5
Deposits	0.0	16.9	0.6	10.5	12.0	72.2	7.0	7.0
Total assets	8.7	25.0	(4.8)	5.4	12.5	68.1	6.0	6.0
Total liabilities	7.9	27.3	(5.5)	4.8	11.1	70.4	5.9	5.9
Shareholders' equity	19.8	(4.2)	6.8	11.8	29.2	14.7	9.1	8.1
Avg interest-earning assets	2.9	15.5	6.0	1.2	9.0	4.3	3.0	3.0
Avg risk-weighted assets	4.6	6.4	(5.2)	(10.3)	4.5	14.1	10.2	8.2

Source: FactSet, Daiwa forecasts

Financial summary continued ...

Balance sheet (KRWbn)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & equivalent	8,212	9,520	8,193	8,687	11,053	17,690	15,606	15,918
Investment securities	20,830	24,494	26,145	27,700	28,968	45,981	47,964	48,904
Net loans and advances	88,356	102,504	103,569	110,848	129,189	205,914	220,328	234,649
Fixed assets	1,676	1,796	1,642	1,300	1,495	3,157	2,657	2,657
Goodwill	26	9	22	28	31	156	149	143
Other assets	7,149	19,516	10,748	9,935	7,500	26,629	30,794	34,277
Total assets	126,249	157,839	150,319	158,497	178,236	299,526	317,498	336,548
Customers deposits	79,945	93,471	92,633	96,397	104,552	179,783	192,201	205,530
Borrowing	14,573	16,864	13,114	15,818	15,442	24,755	25,374	26,008
Debentures	12,642	17,549	18,744	21,019	28,481	33,635	35,317	37,083
Other liabilities	9,520	20,656	15,936	13,892	14,934	40,353	41,946	43,603
Total liabilities	116,679	148,539	140,427	147,126	163,410	278,526	294,838	312,225
Share capital	1,059	1,059	1,059	1,059	1,215	1,215	1,215	1,215
Reserves & others	8,264	7,877	8,487	9,616	12,572	14,606	16,052	17,458
Shareholders' equity	9,324	8,936	9,547	10,675	13,788	15,821	17,267	18,673
Minority interests	246	364	345	696	1,039	5,179	5,393	5,650
Total equity & liabilities	126,249	157,839	150,319	158,497	178,236	299,526	317,498	336,548
Avg interest-earning assets	99,423	114,831	121,710	123,117	134,195	140,015	144,250	148,590
Avg risk-weighted assets	84,756	90,157	85,470	76,634	80,114	91,396	100,681	108,980
BVPS (KRW)	44,010	42,182	45,063	50,389	56,728	65,093	71,043	76,829

Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Loan/deposit	112.0	111.9	113.6	117.0	124.7	115.4	115.5	115.0
Tier-1 CAR	7.7	9.4	11.3	10.7	9.6	9.2	9.1	9.0
Total CAR	11.7	13.5	15.0	14.1	13.4	12.8	12.5	12.1
NPLs/gross loans	0.8	1.8	1.0	1.4	0.9	0.6	0.5	0.5
Total loan-loss prov./NPLs	170.8	111.4	154.3	118.0	95.9	120.0	141.3	142.0
ROAA	1.1	0.3	0.2	0.7	0.7	0.8	0.5	0.5
ROAE	15.2	5.3	3.3	10.0	10.0	12.4	9.5	9.2
Net-interest margin	2.3	2.1	1.7	2.2	2.2	2.2	2.2	2.2
Gross yield	7.0	7.5	6.2	6.1	5.9	8.4	9.5	9.8
Cost of funds	4.5	5.1	4.2	3.6	3.6	5.1	5.5	5.6
Net-interest spread	2.5	2.4	2.0	2.5	2.3	3.3	4.0	4.2
Total cost/total income	43.8	48.8	59.8	46.7	46.9	50.3	51.8	51.0
Effective tax	24.9	25.4	20.2	26.9	24.1	13.7	24.0	24.0
Dividend-payout	21.1	8.7	27.3	6.2	14.7	6.2	15.2	20.3

Source: FactSet, Daiwa forecasts

Company profile

Established in December 2005, Hana FG is one of Korea's leading bank-centric financial institutions. Having started with four affiliates in its early stage, the company now incorporates six subsidiaries, including Hana Bank and Hana Daetoo ITC. On 9 February, 2012, the group successfully acquired the majoirty stake (57.27%) in KEB.

Hyundai Engineering & Construction (000720 KS)

Rating: **Outperform [2]**
Share price: **KRW61,300**
6-mth target price: **KRW86,000** (40% potential upside)
3-year fair value: **KRW132,000** (115% potential upside)

Resilient new orders and quality order backlog should ensure sustainable EPS growth until 2015

Mike Oh
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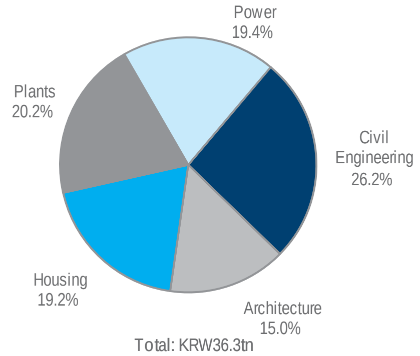
What is the three-year story?

We believe Hyundai Engineering & Construction's (Hyundai E&C) expertise and vertically integrated value chain in highly profitable power-plant projects should enable YoY operating-profit margin expansion over the next three years. The company owns Hyundai Engineering, a leading power-plant design company, which results in Hyundai E&C having a higher margin structure than its Korea peers in the power-plant engineering, procurement, and construction business. Its power and plant divisions accounted for 40% of the order book at the end of 2012.

■ **Hyundai E&C: backlog composition (2012 year-end, parent basis)**



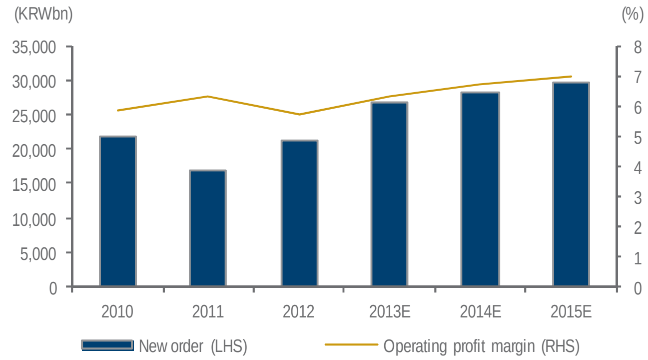
Source: Company

According to the *Middle East Economic Digest* (MEED), Gulf Cooperation Council countries' peak electricity demand will increase at a CAGR of 8.2% over 2010-20. As such, we expect continued investment in expanding power-generation capacity in the region, which should be positive for Hyundai E&C's new-order outlook.

In addition, upside to overseas orders could come from South America. Hyundai E&C won a USD2bn refinery order in Venezuela and a USD0.5bn power-plant order in Uruguay in 2012. It hopes to win another refinery order in Venezuela and more power-plant orders in other South America countries, which we believe will be a share-price catalyst.

The company slightly exceeded its new-order guidance of KRW20.7tn for 2012 and has guided for KRW22.2tn worth of new orders for 2013 (while we forecast KRW21.9tn).

■ **Hyundai E&C: new orders and operating-profit margin**



Source: Company

What could the fair value be in 2015?

We think a PBR, derived from a peer-regression analysis, best reflects the company's intrinsic value. Our six-month target price is KRW86,000, with an implied 2013E PBR of 1.8x.

We forecast an order-backlog CAGR of 16% for 2012-15, which we believe warrants a PBR premium of at least 10% over the stock's past five-year average of 2.0x. Given this, the share price could rise to KRW132,000 (based on a 2015 BVPS assumption of KRW60,000).

We think the management might consider asset sales (ie, idle landbank) or listing its subsidiary (ie, Hyundai Engineering) by 2015. Should this be the case, there would be additional positive catalysts for the share price, as we believe the market prices would exceed the current book values.

■ Korea Construction Sector: PBR valuations (x)

	2008 low	Past-five-year average	2013E	Target PBR
Daelim	0.2	0.8	0.7	0.7
Daewoo E&C	0.8	1.3	1.0	1.0
GS E&C	0.8	1.3	0.7	0.6
HDV	0.8	1.1	0.7	0.6
Hyundai E&C	1.4	2.0	1.4	1.6
Samsung C&T	0.7	1.1	1.0	1.1
Samsung Engineering	1.5	4.3	2.7	2.6
Average	0.9	1.7	1.2	1.2
Average (excl. Samsung Engineering)	0.8	1.3	0.9	0.9

Source: FnGuide, Daiwa forecasts

Are there any near-term hurdles?

This company managed to diversify its business beyond the Middle East in 2012. Notably, it won a refinery order worth more than USD2bn refinery in Venezuela last year. Although the company is interested in expanding its business in Venezuela in 2013, the current political instability there could increase uncertainty over the order flow from the country and other markets in the region over the near term.

Hyundai E&C has a strong presence in Saudi Arabia, Qatar, the UAE and Kuwait, and we expect the number of orders from Kuwait to rise YoY. Any major delays to orders from Kuwait would be a negative for Hyundai E&C.

How to monitor progress

The company's order flow and gross margin are the two most important factors affecting the share price. We think investors should check the order flow regularly (ie, quarterly), and that this should be the first step in monitoring the company's order achievements.

In recent years, investors have been keen to follow the trend in the gross-profit margin on existing orders. Hence, any changes in write-off/provisioning amounts would be another important factor to monitor.

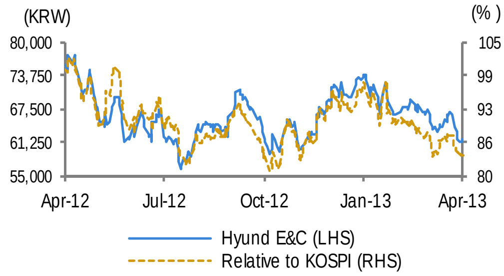
In terms of global macro variables, the price of natural resources (ie, oil) is crucial to the company's share price as the Middle Eastern countries are still a major market for the company.

What could go wrong?

The biggest risk would be a sharp decline in the price of oil and a subsequent decline in spending (ie, new orders) in the Middle East. This would reduce the order flow for large power-plant and infrastructure projects for the company in the region. If political tensions worsen in the Middle East and North Africa, this could lead to project delays.

In the longer term, Hyundai Auto Group may want only one big construction company in the group. If this were the case, the company's management may have to consider merging Hyundai E&C with Amco, another construction company in Hyundai Auto Group. Given that the founding family members of Hyundai Auto Group are also the major shareholders in Amco, Amco's enterprise value could be assessed to favour of the owning family.

Share price performance



12-month range	56,300-77,800
Market cap (USDbn)	6.06
3m avg daily turnover (USDm)	24.68
Shares outstanding (m)	111
Major shareholder	Hyundai Auto Group (34.9%)

Financial summary (KRW)

Year to 31 Dec	12E	13E	14E
Revenue (bn)	13,239	16,747	19,567
Operating profit (bn)	753	1,056	1,317
Net profit (bn)	555	782	979
Core EPS (fully-diluted)	4,976	7,013	8,782
EPS change (%)	(12.7)	40.9	25.2
Daiwa vs Cons. EPS (%)	(1.5)	14.2	19.6
PER (x)	12.4	8.8	7.0
Dividend yield (%)	1.1	1.3	1.5
DPS	700	800	900
PBR (x)	1.5	1.3	1.1
EV/EBITDA (x)	7.8	5.3	3.8
ROE (%)	12.5	15.6	16.9

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
New order growth (YoY%)	68.0	40.0	(4.7)	16.9	(35.8)	75.8	5.6	5.4
Order book growth (YoY%)	10.9	29.0	13.9	2.0	(35.0)	33.6	20.6	14.8
Overseas new order growth (YoY%)	50.4	92.4	(22.6)	130.1	(45.5)	67.6	13.1	5.4
Housing sales growth (%)	11.6	2.6	(9.8)	0.0	31.7	(17.5)	5.0	28.5
HOUSING GP MARGIN (%)	11.5	13.1	9.1	9.8	7.0	3.3	4.0	5.5
Civil engineering sales growth (%)	9.8	12.6	15.4	(3.1)	74.3	(17.7)	6.0	22.0
Civil engineering GP margin (%)	15.5	11.4	8.6	10.7	12.2	9.0	9.0	10.0

■ Profit and loss (KRWbn)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Domestic Revenues	4,566	4,816	4,954	5,097	5,195	3,472	3,303	3,728
Overseas Revenues	1,084	2,455	4,325	4,907	4,910	6,668	9,918	11,806
Other Revenue	0	0	(0)	0	1,816	3,099	3,526	4,033
Total Revenue	5,649	7,271	9,279	10,005	11,920	13,239	16,747	19,567
Other income	22	34	67	35	277	270	358	475
COGS	(5,068)	(6,524)	(8,554)	(8,958)	(10,752)	(11,891)	(14,988)	(17,468)
SG&A	(220)	(267)	(306)	(462)	(433)	(530)	(670)	(744)
Other op.expenses	(22)	(34)	(67)	(35)	(261)	(337)	(391)	(515)
Operating profit	362	480	419	584	752	753	1,056	1,317
Net-interest inc./(exp.)	0	(29)	(8)	6	20	0	0	0
Assoc/forex/extraord./others	26	96	176	117	78	30	(20)	(20)
Pre-tax profit	388	548	587	707	851	783	1,036	1,297
Tax	(111)	(175)	(131)	(178)	(166)	(180)	(238)	(298)
Min. int./pref. div./others	0	0	0	0	(50)	(48)	(16)	(20)
Net profit (reported)	277	373	457	529	635	555	782	979
Net profit (adjusted)	277	373	457	529	635	555	782	979
EPS (reported)(KRW)	2,500	3,362	4,097	4,744	5,701	4,976	7,013	8,782
EPS (adjusted)(KRW)	2,500	3,362	4,097	4,744	5,701	4,976	7,013	8,782
EPS (adjusted fully-diluted)(KRW)	2,500	3,362	4,097	4,744	5,701	4,976	7,013	8,782
DPS (KRW)	250	500	600	700	500	700	800	900
EBIT	362	480	419	584	752	753	1,056	1,317
EBITDA	384	514	486	620	829	825	1,162	1,499

■ Cash flow (KRWbn)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	388	548	587	707	851	783	1,036	1,297
Depreciation and amortisation	22	34	67	35	76	72	106	182
Tax paid	(111)	(175)	(131)	(178)	(166)	(180)	(238)	(298)
Change in working capital	(25)	725	223	60	(1,110)	(478)	(395)	(464)
Other operational CF items	(69)	(356)	109	(28)	193	(50)	(50)	(50)
Cash flow from operations	205	776	856	596	(156)	146	459	667
Capex	(39)	(175)	(156)	(34)	(68)	(125)	(151)	(115)
Net (acquisitions)/disposals	(369)	(674)	363	(730)	1,591	(162)	(50)	(50)
Other investing CF items	315	618	(353)	608	(1,591)	(100)	(200)	(200)
Cash flow from investing	(93)	(231)	(146)	(157)	(69)	(387)	(401)	(365)
Change in debt	(133)	(186)	(332)	(17)	470	556	250	200
Net share issues/(repurchases)	9	14	21	0	0	0	0	0
Dividends paid	(28)	(55)	(67)	(78)	(56)	(78)	(89)	(100)
Other financing CF items	21	(37)	18	22	(69)	74	67	113
Cash flow from financing	(130)	(264)	(360)	(73)	345	552	228	212
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(18)	280	349	366	121	312	286	515
Free cash flow	166	601	699	561	(224)	22	308	552

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (KRWbn)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & short-term investment	433	1,268	1,179	1,564	2,026	2,387	2,693	3,228
Inventory	371	722	734	673	1,283	1,451	1,606	1,876
Accounts receivable	2,378	2,029	2,020	2,280	4,001	4,353	4,818	5,093
Other current assets	850	1,263	1,077	1,083	1,402	1,500	1,500	1,500
Total current assets	4,031	5,282	5,010	5,599	8,711	9,691	10,617	11,697
Fixed assets	569	630	542	337	971	990	966	748
Goodwill & intangibles	0	0	0	0	44	45	45	45
Other non-current assets	2,071	2,233	2,539	3,056	2,145	2,048	2,226	2,380
Total assets	6,671	8,144	8,091	8,993	11,872	12,775	13,853	14,870
Short-term debt	653	920	727	365	347	400	450	450
Accounts payable	2,549	3,276	3,502	3,761	3,404	3,446	3,671	3,753
Other current liabilities	61	176	82	59	2,022	1,800	1,800	1,800
Total current liabilities	3,262	4,372	4,311	4,185	5,773	5,646	5,921	6,003
Long-term debt	838	385	246	590	1,079	1,400	1,400	1,400
Other non-current liabilities	284	494	509	661	657	927	1,011	1,036
Total liabilities	4,385	5,251	5,066	5,437	7,508	7,972	8,331	8,438
Share capital	555	555	557	557	557	557	557	557
Reserves/R.E./others	1,732	2,338	2,468	2,999	3,646	4,106	4,804	5,688
Shareholders' equity	2,287	2,893	3,026	3,556	4,203	4,663	5,362	6,245
Minority interests	0	0	0	0	160	139	160	187
Total equity & liabilities	6,671	8,144	8,091	8,993	11,872	12,775	13,853	14,870
EV	7,665	6,505	6,133	5,334	6,363	6,440	6,205	5,696
Net debt/(cash)	1,058	37	(207)	(608)	(600)	(587)	(843)	(1,378)
BVPS (KRW)	20,610	26,041	27,147	31,904	37,711	41,837	48,106	56,030

Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales (YoY)	11.1	28.7	27.6	7.8	19.1	11.1	26.5	16.8
EBITDA (YoY)	(7.2)	33.7	(5.5)	27.6	33.7	(0.5)	40.9	29.0
Operating profit (YoY)	(8.2)	32.6	(12.8)	39.5	28.7	0.1	40.2	24.7
Net profit (YoY)	(30.2)	34.6	22.3	15.8	20.2	(12.7)	40.9	25.2
Core EPS (fully-diluted) (YoY)	(30.4)	34.5	21.9	15.8	20.2	(12.7)	40.9	25.2
Gross-profit margin	10.3	10.3	7.8	10.5	9.8	10.2	10.5	10.7
EBITDA margin	6.8	7.1	5.2	6.2	7.0	6.2	6.9	7.7
Operating-profit margin	6.4	6.6	4.5	5.8	6.3	5.7	6.3	6.7
Net profit margin	4.9	5.1	4.9	5.3	5.3	4.2	4.7	5.0
ROAE	13.5	14.4	15.4	16.1	16.4	12.5	15.6	16.9
ROAA	4.5	5.0	5.6	6.2	6.1	4.5	5.9	6.8
ROCE	10.0	12.0	10.2	13.7	14.6	12.2	15.1	16.8
ROIC	8.2	10.4	11.3	15.2	18.1	14.5	18.3	20.8
Net debt to equity	46.3	1.3	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	28.5	31.8	22.3	25.2	19.5	23.0	23.0	23.0
Accounts receivable (days)	135.4	110.6	79.6	78.4	96.2	115.1	99.9	92.4
Current ratio (x)	1.2	1.2	1.2	1.3	1.5	1.7	1.8	1.9
Net interest cover (x)	n.a.	16.8	54.7	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	10.0	14.9	14.6	14.8	8.8	14.1	11.4	10.2
Free cash flow yield	2.4	8.7	10.2	8.1	n.a.	0.3	4.5	8.0

Source: FactSet, Daiwa forecasts

Company profile

Hyundai E&C is a general construction company that provides civil-engineering, architectural, industrial and electrical-engineering services. Domestic housing and construction accounted for 32% of sales for 2011, while domestic civil engineering accounted for 28%. Overseas sales made up 49% of total sales for 2011.

Hyundai Motor (005380 KS)

Rating: **Buy [1]**
Share price: **KRW198,500**
6-mth target price: **KRW270,000** (36% potential upside)
3-year fair value: **KRW400,000** (102% potential upside)

Wheels of long-term fortune

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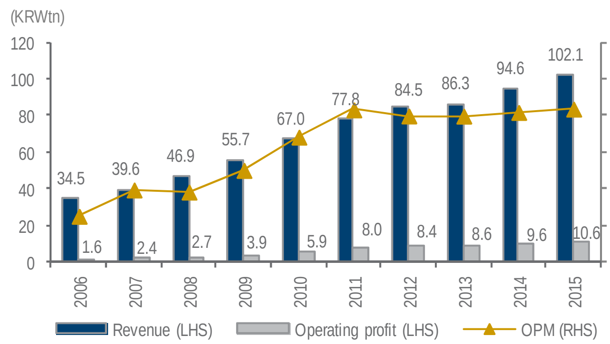
What is the three-year story?

We believe the recent fall in the share price of Hyundai Motor (HMC) on market concerns about the weakening Yen against the Won presents a buying opportunity on a three-year investment horizon. In our view, the company's internal competency is not only well aligned with the key trends in the auto industry globally, it also has a flexible cost structure amid a platform strategy that results in it having lower R&D expenses than its peers. We expect the following factors to lead to increased earnings visibility compared with its peers over the next three years.

■ HMC: revenue and operating profit



Source: Company, Daiwa forecasts

Strong competitive advantage in fuel-efficient cars: the company sells a higher proportion of small cars (60% of 2012 global shipments) globally than its peers. The appetite for small cars is growing not only from a "motorisation" perspective in emerging markets such as China, Brazil, India, Russia and Africa, but also due to regulatory measures in developed markets for cars to become more fuel-efficient and produce fewer emissions. As a result, there has been a clear trend of "downsizing" among automakers globally over the past few years, through gasoline or diesel-based engines to improve fuel efficiency and low-emission standards imposed by developed countries.

Higher presence than its peers in emerging markets: 50% of 2012 shipments of 4.41m units globally for the company came from these markets, where it has a strong competitive advantage in small cars and adopts a more affordable pricing strategy than its Japan peers. For instance, in China, the price difference between HMC's Yuedong Elantra and Honda's Civic is 30%, but these cars have virtually the same prices in the US market.

Focused on brand equity in developed markets: the company is able to increase manufacturer's suggested retail price by improving residual value as a result of product-quality improvements and the use of low incentive levels in the US (still offering the lowest incentives per car of USD1,107/car compared with an industry average of USD2,573/car in March 2013).

Room for a rise in profit from the high-margin captive-finance operations: the weighting of high-margin captive-finance operations in total new purchases in the US has yet to reach 50% at HMC (compared with nearly 70% at Honda), but improvements in the residual value of the company's vehicles should lead more consumers to lease HMC cars. We forecast the earnings contribution from the financing business to increase to 25% of total earnings by 2015 from 14% for 2012 (Japan tier-one automakers: about 30%).

Flexible cost structure: we forecast the proportion of cars sold under an integrated platform to increase to 100% by 2015, from 75% for 2012. Hyundai Motor Group aims to reduce the number of integrated platforms to four in 2015 from six currently. This should enable HMC to continue to reduce the fixed cost per vehicle and improve the efficiency of the company's R&D resources.

What could the fair value be in 2015?

The key-share price driver for HMC has been earnings growth, with a focus on how its earnings have fared compared with the Bloomberg-consensus forecasts. However, upward or downward earnings revisions and the trend may not be enough to reflect the long-term earnings-growth prospects, given numerous variables, such as changes in the macroeconomic environment, industry structure, competitive landscape and the new model cycle influencing automakers over the long-term. Thus, we base our valuation on PER and DCF methodology, both of which we believe reflect the cyclicality and sustainability of auto stocks.

Our DCF/PER-based six-month target price is KRW270,000.

For 2015, we expect the share price to reach KRW400,000, based on our DCF/PER-based valuation, derived from the weighted average of a terminal-growth rate of 3% and a WACC of 10% for the DCF, and the application of a target PER multiple of 10x, at the high end of the stock's past-three-year range given the resumption of its new model cycle from 2014, to our 2015E EPS forecast of KRW39,531.

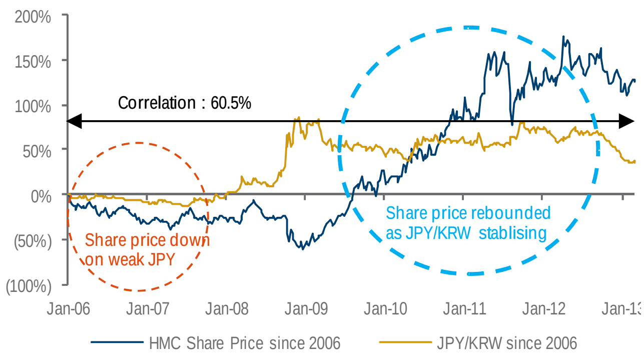
We envisage the resumption of HMC's new model cycle from 4Q13 – with the launch of its premium-sedan Genesis, the Sonata in 1Q14, and the Elantra in 2H15 – coupled with its fuel-efficient line-up, a strong presence in emerging markets, and platform strategy to drive up both earnings and multiples.

Are there any near-term hurdles?

After two years of marked outperformance against both the KOSPI and its peers globally, the stocks in the Korea Auto Sector have traded in a narrow range over the last one year. We believe this trend is likely to continue over the next three months from headwinds from a further depreciation of the Yen against the major currencies and especially against the Won.

As mentioned above, we expect the Yen to continue to depreciate against the Won on the back of more monetary easing, at least until the upper-house election in Korea this summer. Thus, 2H13 might provide a better entry point for the stock given our expectation that the Yen should stabilise against the Won then and also in view of HMC's new model cycle starting from 4Q13.

■ Won/Yen rate versus HMC's share-price



Source: Dataguide

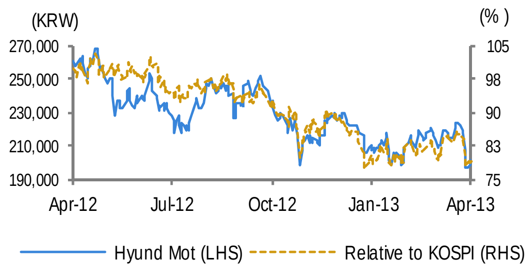
How to monitor progress

Key-share price drivers to monitor for HMC are global shipments and the direction of earnings compared with the Bloomberg-consensus forecast. We expect HMC's new model cycle from 4Q13, the company's strong competitive advantage in fuel-efficient cars and emerging markets, and its more flexible cost structure on cars sold under an increasingly integrated platform to drive up both global shipments and earnings at least until 2015.

What could go wrong?

The key risks to our view include major product-quality issues, which might be greater than for other automakers given the magnitude of HMC's platform integration, as well as a rapid appreciation of the Won against both the US Dollar and the Yen.

Share price performance



12-month range	198,000-268,500
Market cap (USDbn)	38.98
3m avg daily turnover (USDm)	119.61
Shares outstanding (m)	220
Major shareholder	Hyundai Mobis (20.8%)

Financial summary (KRW)

Year to 31 Dec	13E	14E	15E
Revenue (bn)	86,334	94,559	102,128
Operating profit (bn)	8,613	9,624	10,580
Net profit (bn)	9,280	10,285	11,285
Core EPS (fully-diluted)	32,507	36,026	39,531
EPS change (%)	2.5	10.8	9.7
Daiwa vs Cons. EPS (%)	4.5	6.5	8.8
PER (x)	6.2	5.6	5.1
Dividend yield (%)	0.9	0.9	0.9
DPS	1,900	1,900	1,900
PBR (x)	0.9	0.8	0.7
EV/EBITDA (x)	4.3	3.8	3.4
ROE (%)	18.9	19.2	18.5

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales volume ex. China ('000 Units)	n.a.	n.a.	n.a.	3,319	3,546	3,633	3,698	3,822
Average Selling Price ex. China (KRW '000)	n.a.	n.a.	n.a.	20,225	20,108	19,492	20,609	21,003

■ Profit and loss (KRWbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Auto Revenues	41,155	48,975	57,293	67,128	71,307	70,823	76,213	80,278
Finance Revenues	3,274	3,843	6,520	7,288	8,663	10,244	12,933	16,328
Other Revenue	2,433	2,862	3,172	3,382	4,500	5,267	5,413	5,522
Total Revenue	46,863	55,680	66,985	77,798	84,470	86,334	94,559	102,128
Other income	0	0	0	0	0	0	0	0
COGS	(36,481)	(43,490)	(51,266)	(58,902)	(64,972)	(65,870)	(71,728)	(77,469)
SG&A	(7,225)	(7,928)	(9,143)	(10,867)	(11,061)	(11,851)	(13,207)	(14,079)
Other op.expenses	(423)	(354)	(658)	0	0	0	0	0
Operating profit	2,733	3,908	5,918	8,029	8,437	8,613	9,624	10,580
Net-interest inc./(exp.)	47	(562)	(192)	(36)	164	160	156	151
Assoc/forex/extraord./others	(1,038)	1,060	1,765	2,454	3,005	2,989	3,239	3,464
Pre-tax profit	1,742	4,406	7,492	10,447	11,605	11,762	13,019	14,195
Tax	(384)	(955)	(1,490)	(2,342)	(2,549)	(2,482)	(2,734)	(2,910)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	1,358	3,451	6,001	8,105	9,056	9,280	10,285	11,285
Net profit (adjusted)	1,358	3,451	6,001	8,105	9,056	9,280	10,285	11,285
EPS (reported)(KRW)	4,765	12,096	21,021	28,390	31,723	32,507	36,026	39,531
EPS (adjusted)(KRW)	4,765	12,096	21,021	28,390	31,723	32,507	36,026	39,531
EPS (adjusted fully-diluted)(KRW)	4,765	12,096	21,021	28,390	31,723	32,507	36,026	39,531
DPS (KRW)	850	1,150	1,500	1,750	1,900	1,900	1,900	1,900
EBIT	2,733	3,908	5,918	8,029	8,437	8,613	9,624	10,580
EBITDA	4,339	5,648	8,102	9,615	10,159	10,373	11,552	12,662

■ Cash flow (KRWbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	1,742	4,406	7,492	10,447	11,605	11,762	13,019	14,195
Depreciation and amortisation	1,606	1,740	2,183	1,586	1,722	1,760	1,928	2,082
Tax paid	(384)	(955)	(1,490)	(2,342)	(2,549)	(2,482)	(2,734)	(2,910)
Change in working capital	1,776	1,937	17,878	3,688	6,249	1,003	2,665	2,524
Other operational CF items	(5,401)	6,468	(10,115)	(9,202)	(11,675)	(7,070)	(9,641)	(9,035)
Cash flow from operations	(660)	13,596	15,947	4,177	5,353	4,974	5,237	6,856
Capex	(4,967)	(3,763)	(2,045)	(2,899)	(3,000)	(2,850)	(2,565)	(2,309)
Net (acquisitions)/disposals	(1,256)	(2,504)	(5,102)	(4,224)	(4,048)	(319)	(933)	(962)
Other investing CF items	(3,373)	(536)	(9,642)	(362)	(182)	(2,772)	(2,698)	(2,698)
Cash flow from investing	(9,595)	(6,802)	(16,789)	(7,485)	(7,230)	(5,942)	(6,195)	(5,968)
Change in debt	11,830	(4,047)	2,591	3,928	2,684	(1,015)	291	323
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(404)	(277)	(588)	(458)	(523)	(419)	(419)	(419)
Other financing CF items	146	(918)	2,021	(514)	243	3,738	2,441	580
Cash flow from financing	11,572	(5,242)	4,023	2,956	2,404	2,305	2,314	484
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	1,317	1,552	3,182	(351)	527	1,338	1,355	1,372
Free cash flow	(5,627)	9,833	13,902	1,278	2,353	2,124	2,672	4,548

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (KRWbn)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	9,389	12,301	31,859	35,429	40,120	40,529	41,552	42,607
Inventory	15,057	10,213	5,491	6,238	6,773	6,953	7,571	8,177
Accounts receivable	5,412	4,892	4,469	6,013	5,925	6,475	7,092	7,660
Other current assets	1,686	1,572	1,701	1,247	2,030	2,070	2,236	2,415
Total current assets	31,544	28,978	43,520	48,926	54,848	56,027	58,451	60,859
Fixed assets	20,202	20,260	20,236	19,548	20,740	21,830	22,467	22,693
Goodwill & intangibles	2,391	2,548	2,642	2,660	2,883	3,027	3,179	3,338
Other non-current assets	28,292	28,320	28,316	38,345	43,067	45,168	47,881	51,172
Total assets	82,429	80,106	94,714	109,480	121,538	126,052	131,977	138,061
Short-term debt	24,119	17,907	15,859	15,048	11,050	11,603	12,183	12,792
Accounts payable	9,916	9,713	9,912	10,887	11,881	12,000	12,120	12,241
Other current liabilities	1,349	2,651	5,674	7,229	9,904	9,409	8,468	7,621
Total current liabilities	35,384	30,271	31,445	33,164	32,836	33,012	32,771	32,655
Long-term debt	17,956	19,453	22,737	27,138	30,513	28,946	28,657	28,370
Other non-current liabilities	2,031	2,530	7,644	8,850	10,271	14,042	13,544	12,075
Total liabilities	55,371	52,254	61,826	69,152	73,620	76,000	74,972	73,099
Share capital	1,489	1,489	1,489	1,489	1,489	1,489	1,489	1,489
Reserves/R.E./others	25,570	26,363	31,399	38,839	46,429	48,563	55,517	63,473
Shareholders' equity	27,059	27,852	32,888	40,328	47,918	50,052	57,006	64,962
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	82,429	80,106	94,714	109,480	121,538	126,052	131,977	138,061
EV	76,962	69,335	51,013	51,033	45,719	44,295	43,563	42,831
Net debt/(cash)	32,686	25,059	6,737	6,757	1,443	20	(713)	(1,445)
BVPS (KRW)	123,064	126,443	149,303	183,078	217,534	227,224	258,792	294,909

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	18.3	18.8	20.3	16.1	8.6	2.2	9.5	8.0
EBITDA (YoY)	18.6	30.2	43.4	18.7	5.7	2.1	11.4	9.6
Operating profit (YoY)	15.9	43.0	51.5	35.7	5.1	2.1	11.7	9.9
Net profit (YoY)	(6.8)	154.0	73.9	35.1	11.7	2.5	10.8	9.7
Core EPS (fully-diluted) (YoY)	(6.9)	153.9	73.8	35.1	11.7	2.5	10.8	9.7
Gross-profit margin	22.2	21.9	23.5	24.3	23.1	23.7	24.1	24.1
EBITDA margin	9.3	10.1	12.1	12.4	12.0	12.0	12.2	12.4
Operating-profit margin	5.8	7.0	8.8	10.3	10.0	10.0	10.2	10.4
Net profit margin	2.9	6.2	9.0	10.4	10.7	10.7	10.9	11.1
ROAE	5.4	12.6	19.8	22.1	20.5	18.9	19.2	18.5
ROAA	1.8	4.2	6.9	7.9	7.8	7.5	8.0	8.4
ROCE	4.4	5.8	8.7	10.4	9.8	9.6	10.2	10.4
ROIC	3.9	5.4	10.2	14.4	13.7	13.7	14.3	14.0
Net debt to equity	120.8	90.0	20.5	16.8	3.0	0.0	net cash	net cash
Effective tax rate	22.0	21.7	19.9	22.4	22.0	21.1	21.0	20.5
Accounts receivable (days)	37.4	33.8	25.5	24.6	25.8	26.2	26.2	26.4
Current ratio (x)	0.9	1.0	1.4	1.5	1.7	1.7	1.8	1.9
Net interest cover (x)	n.a.	7.0	30.8	223.1	n.a.	n.a.	n.a.	n.a.
Net dividend payout	17.8	9.5	7.1	6.2	6.0	5.8	5.3	4.8
Free cash flow yield	n.a.	22.2	31.4	2.9	5.3	4.8	6.0	10.3

Source: FactSet, Daiwa forecasts

■ Company profile

Established in 1967, HMC is the largest vehicle manufacturer in Korea. With the 33.58%-owned Kia Motors, it has 6.4m units of production capacity globally. The company produces a range of vehicles, including passenger cars, SUVs, minivans and commercial vehicles.

Orion (001800 KS)

Rating: **Outperform [2]**
Share price: **KRW1,090,000**
6-mth target price: **KRW1,130,000** (4% potential upside)
3-year fair value: **KRW1,750,000** (61% potential upside)

Too good to miss

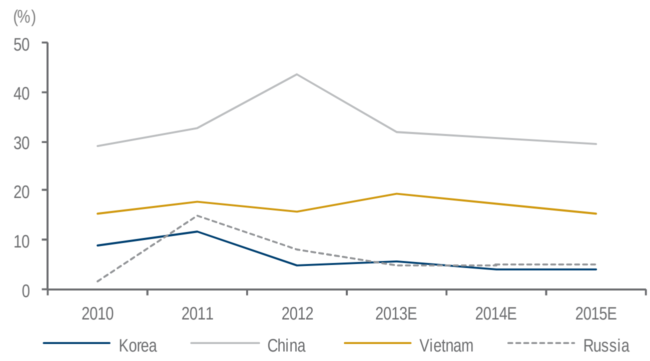
Sang Hee Park
(82) 2 787 9165 (sanghee.park@kr.daiwacm.com)

What is the three-year story?

We forecast Orion's core earnings to rise by an average of 24% YoY each year over 2013-15 on the back of strong confectionery sales at the company's overseas operations. We believe Orion will be able to achieve a sales CAGR of more than 20% in emerging markets over the period on the back of geographical expansion, distribution coverage expansion, the introduction of new products, and ASP rises. Sales growth and EBITDA-margin expansion over 2013-15 should be the fastest in China among the emerging markets. We forecast the operating profit margin in China to expand to 16% by 2015E from 12% for 2012E. The second-biggest emerging market for Orion is Vietnam, where we forecast confectionery sales to rise by 15% CAGR over 2013-15 due to similar factors to those in China: geographical expansion, market-share gains, and growing exports to the other countries in Southeast Asia.

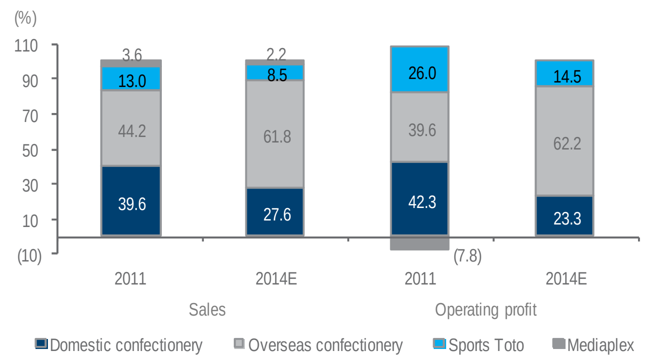
The Korea confectionery market has reached maturity. Therefore, we expect industry sales growth to rise in line with overall GDP growth from hereon. Given this, we forecast Orion's Korea confectionery sales to rise by mid-single digit percentages over 2013-15 as a result of market-share gains and new product launches. Also, the favourable working-capital structure (as the company adopts a cash-and-carry system for payments) in the overseas operation facilitates the company's expansion and enhances sales growth.

■ Orion: confectionery sales growth in key markets



Source: Company, Daiwa forecasts

■ Orion: sales and earnings breakdown by division



Source: Company, Daiwa forecasts

What could the fair value be in 2015?

Our six-month target price of KRW1,130,000 is based on an SOTP analysis, given the various business divisions. However, given the 24% earnings CAGR we forecast for 2013-15, we see the share price rising to close to KRW1,750,000 by 2015, 61% higher than the current share price.

We believe the stock will continue to trade at a PER of 26x over the coming three years as the company has the strongest earnings growth among the Korea consumer stocks we cover. In addition, the market is likely to assign a premium for Orion's strong brand, and its scarcity value (as there are only a few Korea consumer companies with half of their sales driven by overseas markets, and where profit margins are equivalent to those of the domestic operation).

■ **Orion: SOTP analysis**

	% stake	Valuation methodology		Value to Orion (KRWbn) 2013E	2015E
1. Confectionery				5,798	9,227
Domestic		2013E EV/EBITDA (x)	12	1,555	1,780
Overseas		2013E PER (x)	30	4,243	7,447
2. Affiliates				382	116
Sports Toto	67%	2013E PER (x)	10	269	
Mediaplex	58%	Current market cap		56	56
Megamark	100%	Book value		60	60
3. Treasury shares				800	1,227
4. Property				140	140
5. Net Debt				390	390
Total				6,730	10,320
Value per share (KRW)				1,128,282	1,730,069

Source: Daiwa

Are there any near-term hurdles?

One of the Korea Government's key aims is to curb inflation, which suggests that raising product prices will be difficult this year. Therefore, we believe that Orion's domestic sales growth will be dependent on volume growth this year.

The company's main retail channels for the domestic confectionery operation are modern retail channels. Currently, the government is implementing various measures to boost SMEs and corner stores, and a large number of regulations are being imposed on modern retail channels, such as store operating days and hours. As a result, hypermarkets and super-supermarkets are seeing same store sales growth decline. This is likely to affect domestic confectionery sales growth over the near term.

In the overseas markets, Orion is competing both against the local brands as well as the global brands. Therefore, the competition always remains intense. Currently, Orion's operating profit margin is lucrative and is comparable to the domestic operation. However, the main factor which determines the overseas market's operating profit margin is marketing expenses which we believe could fluctuate if the level of market competition intensifies.

How to monitor progress

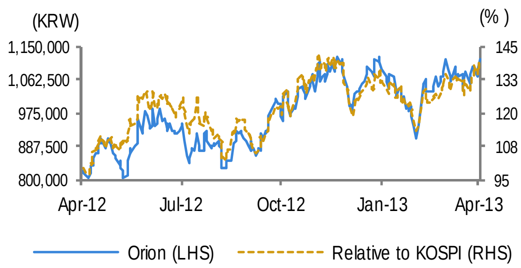
As the key share-price driver for Orion is sales growth in overseas markets, particularly China, we monitor closely the sales performance in China. Overall private consumption growth in the country will be one of the key drivers of confectionery industry growth. The company's expansion plans and the production-line addition schedule suggest that it expects considerable demand in the future. Furthermore, we track the company's expansion in China and Vietnam in order to gauge its scope for further expansion.

What could go wrong?

Since mid-2000, Orion's share price has been negatively affected by the news flow on the 67%-owned Sports Toto (a sports betting business). We believe the current share price no longer factors in Orion retaining the Sports Toto licence. Therefore, if the company were to lose the licence in mid-2014 when it is up for renewal, the share price should be little affected.

Marketing expenses are one of the major swing factors in the company's profitability. Should market competition in China intensify and Orion allocate greater-than-expected marketing expenses to expand its market share, then the operating-profit margin may be lower than we expect.

Share price performance



12-month range	803,000-1,123,000
Market cap (USDbn)	5.88
3m avg daily turnover (USDm)	14.99
Shares outstanding (m)	6
Major shareholder	Hwa Kyeong Lee and related (31.3%)

Financial summary (KRW)

Year to 31 Dec	12E	13E	14E
Revenue (bn)	2,338	2,686	3,169
Operating profit (bn)	301	347	424
Net profit (bn)	186	224	284
Core EPS (fully-diluted)	35,436	42,715	54,174
EPS change (%)	68.4	20.5	26.8
Daiwa vs Cons. EPS (%)	30.5	21.2	22.7
PER (x)	31.6	26.2	20.7
Dividend yield (%)	0.3	0.4	0.4
DPS	3,500	4,000	4,500
PBR (x)	6.4	5.4	4.4
EV/EBITDA (x)	19.6	17.1	14.0
ROE (%)	19.4	19.6	20.5

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Domestic confectionery market YoY growth (%)	3.7	4.4	7.4	8.4	8.0	7.0	6.0	6.0
Market share of Orion Domestic (%)	27.1	27.2	27.4	27.6	27.9	28.1	28.3	28.3
A&P as of sales (%)	6.9	4.9	9.9	10.9	9.9	9.8	9.7	9.6
Domestic operating profit margin (%)	10.7	7.1	9.3	10.4	11.1	12.9	12.9	13.4
Overseas operating profit margin (%)	n.a.	3.7	7.0	8.8	10.0	11.5	12.8	13.5
China sales YoY growth (%)	n.a.	0.0	0.0	29.0	32.8	43.6	32.0	30.7
Vietnam sales YoY growth (%)	n.a.	0.0	0.0	15.3	17.9	15.9	19.2	17.2

Profit and loss (KRWbn)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Confectionery Revenues	1,423	1,361	1,542	1,621	1,914	2,338	2,686	3,169
others Revenues	0	0	0	0	0	0	0	0
Other Revenue	0	0	0	0	0	0	0	0
Total Revenue	1,423	1,361	1,542	1,621	1,914	2,338	2,686	3,169
Other income	0	0	0	0	0	0	0	0
COGS	(712)	(703)	(757)	(911)	(1,077)	(1,338)	(1,672)	(1,991)
SG&A	(559)	(562)	(642)	(542)	(624)	(699)	(667)	(754)
Other op.expenses	0	0	0	0	0	0	0	0
Operating profit	152	97	143	168	213	301	347	424
Net-interest inc./(exp.)	(24)	(30)	(41)	(37)	(28)	(27)	(19)	(9)
Assoc/forex/extraord./others	99	(46)	(23)	158	(9)	(8)	(8)	(8)
Pre-tax profit	228	21	78	289	176	266	320	406
Tax	(78)	(39)	(50)	(88)	(65)	(80)	(96)	(122)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	150	(18)	29	201	110	186	224	284
Net profit (adjusted)	150	(18)	29	201	110	186	224	284
EPS (reported)(KRW)	28,709	(3,477)	5,449	38,303	21,044	35,436	42,715	54,174
EPS (adjusted)(KRW)	28,709	(3,477)	5,449	38,303	21,044	35,436	42,715	54,174
EPS (adjusted fully-diluted)(KRW)	28,709	(3,477)	5,449	38,303	21,044	35,436	42,715	54,174
DPS (KRW)	2,250	1,750	2,000	2,250	3,000	3,500	4,000	4,500
EBIT	152	97	143	168	213	301	347	424
EBITDA	321	258	323	220	273	362	410	487

Cash flow (KRWbn)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	228	21	78	289	176	266	320	406
Depreciation and amortisation	209	211	258	126	110	142	147	153
Tax paid	(78)	(39)	(50)	(88)	(65)	(80)	(96)	(122)
Change in working capital	39	27	(14)	45	54	70	47	75
Other operational CF items	(265)	(143)	62	(194)	(105)	(7)	(16)	(13)
Cash flow from operations	133	77	334	179	170	391	402	499
Capex	(135)	(158)	(236)	(204)	(190)	(198)	(198)	(198)
Net (acquisitions)/disposals	(10)	(28)	4	(16)	(3)	(10)	(10)	(10)
Other investing CF items	(76)	9	(24)	260	93	(153)	(88)	(125)
Cash flow from investing	(221)	(178)	(255)	40	(99)	(360)	(296)	(332)
Change in debt	145	141	(115)	(227)	42	46	(75)	(165)
Net share issues/(repurchases)	4	13	0	0	0	0	0	0
Dividends paid	(13)	(12)	(10)	(16)	(17)	(18)	(21)	(24)
Other financing CF items	(28)	(60)	1	8	(11)	1	1	1
Cash flow from financing	109	81	(123)	(235)	14	29	(95)	(188)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	21	(20)	(45)	(15)	85	60	11	(21)
Free cash flow	(2)	(82)	99	(25)	(20)	193	205	301

Source: FactSet, Daiwa forecasts

Financial summary continued …

■ Balance sheet (KRWbn)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & short-term investment	414	321	212	261	361	421	432	410
Inventory	75	74	89	221	269	324	367	426
Accounts receivable	222	193	164	142	156	190	219	258
Other current assets	181	171	194	181	114	121	128	135
Total current assets	892	760	659	804	899	1,055	1,145	1,229
Fixed assets	607	621	818	972	1,234	1,340	1,441	1,537
Goodwill & intangibles	248	299	104	104	93	94	95	96
Other non-current assets	172	362	335	107	93	107	120	134
Total assets	1,919	2,042	1,915	1,988	2,320	2,596	2,801	2,996
Short-term debt	348	472	530	474	389	480	370	220
Accounts payable	67	64	91	68	80	99	124	148
Other current liabilities	259	214	258	339	358	402	456	507
Total current liabilities	673	750	880	882	826	981	950	875
Long-term debt	274	361	380	271	376	331	366	350
Other non-current liabilities	123	98	95	70	108	110	110	111
Total liabilities	1,071	1,208	1,354	1,223	1,310	1,422	1,425	1,336
Share capital	30	30	30	30	30	30	30	30
Reserves/R.E./others	430	413	424	619	847	1,012	1,213	1,497
Shareholders' equity	459	442	454	649	877	1,042	1,242	1,527
Minority interests	389	392	107	116	133	133	133	133
Total equity & liabilities	1,919	2,042	1,915	1,988	2,320	2,596	2,801	2,996
EV	6,889	7,192	7,378	7,166	7,084	7,071	6,985	6,841
Net debt/(cash)	208	511	697	485	403	390	304	160
BVPS (KRW)	77,314	74,308	76,205	108,892	146,972	174,640	208,275	255,961

■ Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales (YoY)	2.9	(4.3)	13.3	5.1	18.1	22.1	14.9	18.0
EBITDA (YoY)	4.2	(19.4)	25.0	(31.9)	24.0	32.6	13.3	19.0
Operating profit (YoY)	(9.2)	(36.6)	47.9	17.8	26.5	41.2	15.6	22.0
Net profit (YoY)	(8.3)	n.a.	n.a.	603.6	(45.1)	68.4	20.5	26.8
Core EPS (fully-diluted) (YoY)	(8.7)	n.a.	n.a.	602.9	(45.1)	68.4	20.5	26.8
Gross-profit margin	50.0	48.4	50.9	43.8	43.7	42.7	37.8	37.2
EBITDA margin	22.5	19.0	21.0	13.6	14.2	15.5	15.2	15.4
Operating-profit margin	10.7	7.1	9.3	10.4	11.1	12.9	12.9	13.4
Net profit margin	10.5	(1.3)	1.9	12.4	5.8	8.0	8.3	9.0
ROAE	34.4	n.a.	6.4	36.5	14.5	19.4	19.6	20.5
ROAA	8.3	n.a.	1.4	10.3	5.1	7.6	8.3	9.8
ROCE	11.2	6.2	9.1	11.3	13.0	16.0	17.0	19.5
ROIC	9.8	(7.1)	4.0	9.3	10.1	14.1	15.0	17.0
Net debt to equity	45.3	115.5	153.7	74.7	46.0	37.4	24.5	10.5
Effective tax rate	34.1	188.4	63.6	30.5	37.1	30.0	30.0	30.0
Accounts receivable (days)	54.4	55.6	42.2	34.4	28.4	27.0	27.8	27.4
Current ratio (x)	1.3	1.0	0.7	0.9	1.1	1.1	1.2	1.4
Net interest cover (x)	6.4	3.3	3.5	4.6	7.5	11.3	18.4	45.1
Net dividend payout	7.8	n.a.	36.7	5.9	14.3	9.9	9.4	8.3
Free cash flow yield	n.a.	n.a.	1.5	n.a.	n.a.	2.9	3.1	4.5

Source: FactSet, Daiwa forecasts

■ Company profile

Orion is Korea's second-largest confectionery manufacturer, with a 27% share of the domestic market as at the end of 2010. Through its aggressive overseas expansion, which started in 1995, Orion now generates more than 50% of its revenue from its overseas businesses, including those in China, Vietnam, and Russia. Its key affiliates, other than those in China, Vietnam, and Russia, include Mediaplex and Sports Toto.

Samsung SDI (006400 KS)

Rating: **Buy [1]**
Share price: **KRW126,500**
6-mth target price: **KRW160,000** (26% potential upside)
3-year fair value: **KRW210,000** (66% potential upside)

Automobile battery outlook appears bright over the longer term

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What is the three-year story?

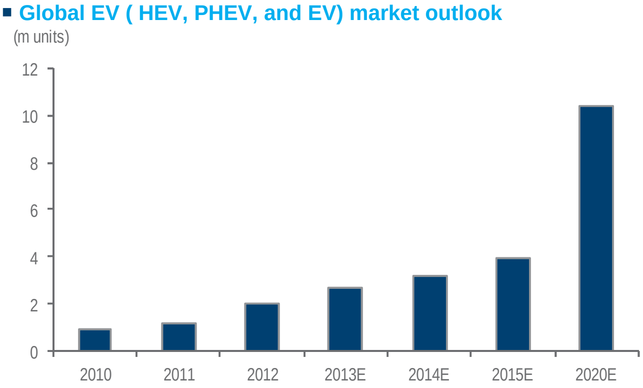
The battery business remains the key driver of Samsung SDI's (SDI) earnings. Although the plasma display panel (PDP) and cathode ray tube (CRT) segments accounted for 40% of its 2012 revenue, the profit contribution is extremely small and revenue from display products will gradually disappear going forward. Having exposure to the top two smartphone makers globally, SDI is upbeat about its IT battery business for 2013. The company expects both the top-line and earnings to expand YoY for 2013 on the back of robust growth in smart device shipments as well as rising battery capacity per device.

However, SDI's automobile battery business is a major drag on earnings as the company guides for an operating loss of KRW40bn/quarter for 2013. As the current production volume of automobile batteries is not large enough to cover the fixed costs, it expects the losses to continue over the near term.

Meanwhile, SDI plans to start supplying the automobile batteries for BMW's new electric vehicle (EV) from late 2Q13, and as volume increases with the addition of new customers (including Chrysler and Volkswagen), the company expects the losses to reduce substantially from 2014.

As countries worldwide are aiming to reduce their carbon emissions and reduce the dependence on fossil fuels, we expect strong demand growth for hybrid electric vehicles (HEVs), plug-in hybrid electric vehicles (PHEVs) and EVs over the next 3-8 years. We forecast the size of the green-car market to expand to 10.4m vehicles for 2020 from 1.2m units for 2011.

■ Global EV (HEV, PHEV, and EV) market outlook



Source: Companies, Daiwa forecasts

SDI currently has an automobile battery production line in Ulsan with a monthly cell (based on 60Ah) capacity of 50,000 units. However, the company plans to ramp up production on this line to 400,000 cells/month by the middle of 2013 to meet the rising demand from various automakers. Although for 2013 we forecast automobile battery revenue of KRW91bn and an operating loss of KRW159bn, reducing earnings from the IT battery business by 40%, we expect this business to be profitable from 2015.

What could the fair value be in 2015?

The stock is trading currently at a PBR of 0.7x on our 2013E BVPS. Although IT battery earnings have expanded continuously over the past few years, this has been somewhat diluted by the losses in other businesses. However, as the company increases the shipment of automobile batteries over the next three years, we expect the losses to decline substantially. Our six-month target price of KRW160,000 is based on an SOTP valuation. Given that the stock's PBR has ranged from 0.5-1.6x over the past five years with an average of 1.0x, in 2015, we expect it to trade at least at 1.0x on our 2015 BVPS forecast, at KRW210,000.

Are there any near-term hurdles?

Although we forecast green cars to account for a 4.2% share of the global market in 2015, so far, most demand has been policy/incentive driven. To move from niche to volume production, PHEVs and EVs will need to see a breakthrough in battery performance and cost to offer a decent range of total cost of ownership. As SDI will begin mass production of automobile batteries from 2Q13, it would need to cut costs as well as improve battery performance.

How to monitor progress

As BMW is due to launch its first EV, the i-3, in September 2013, we believe the potential sell-through of the i-3 will be a good indicator of SDI's automobile battery shipments. In addition, as SDI has won battery-supply contracts with other automakers – including Chrysler, Delphi (commercial) and Volkswagen – potential order wins from new automakers would be a key catalyst for its battery revenue growth. Although the company expects an operating loss of KRW40bn/quarter for its automobile battery business in 2013, we will monitor potential loss reductions from rising battery shipments.

What could go wrong?

In 2009, US President Obama announced a USD2.4bn grant programme to support the domestic EV battery industry. However, many of the factories funded by these grants are operating substantially below their originally planned capacity, as consumers are not purchasing many PHEVs and EVs due to the relatively high cost of ownership compared with conventional automobiles.

As mentioned, energy density and costs are the two most important variables for automobile batteries. Although EVs are necessary for the automobile industry to achieve close to zero carbon emissions, automakers have taken steps to reduce engine sizes, develop advanced fuel injection systems, advanced transmissions and other technologies to meet the regulatory requirements globally on fuel efficiency and carbon emissions by 2020.

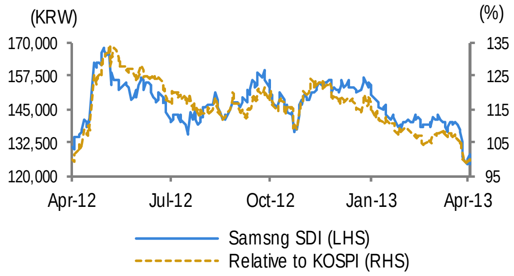
Therefore, if automobile battery makers cannot effectively reduce the production costs of batteries while improving the performance, we believe that potential opportunities for green cars could disappoint. In fact, due to lower-than-expected sales of green cars such as the Chevrolet Volt in 2012, SDI cut its automobile battery revenue target for 2015 to KRW1.0tn from KRW2.4tn.

SDI formed a joint venture in the automobile battery business with Germany automobile component maker Bosch in 2008. However, due to differences between the two companies, the joint venture was broken up and SDI assumed a 100% stake from 4Q12. The joint venture had been set up to combine SDI's battery-cell technology and Bosch's packaging-system knowhow.

Due to the unwinding of the joint venture, SDI is currently developing its own packaging system technology. If the company is not able to develop a competitive package system, its efforts to differentiate itself from other battery makers and provide value-added services to customers would be difficult.

SDI currently holds a 15.2% stake in Samsung Display (Not listed). Samsung Display was formed in 2012 through a merger of the LCD division spun off from Samsung Electronics and an organic light-emitting diode (OLED) affiliate. Since SDI's holding in the OLED affiliate has been diluted several times due to large capital-investment requirements for the OLED business, additional dilution could negatively affect SDI's bottom line. For 2012, the equity-method contribution from Samsung Display amounted to KRW537bn, compared with its operating profit of KRW187bn.

Share price performance



12-month range	125,000-168,000
Market cap (USDbn)	5.07
3m avg daily turnover (USDm)	19.52
Shares outstanding (m)	46
Major shareholder	Samsung Electronics (20.4%)

Financial summary (KRW)

Year to 31 Dec	13E	14E	15E
Revenue (bn)	6,017	6,506	6,789
Operating profit (bn)	178	302	416
Net profit (bn)	554	699	815
Core EPS (fully-diluted)	12,152	15,336	17,884
EPS change (%)	(62.8)	26.2	16.6
Daiwa vs Cons. EPS (%)	5.3	5.9	9.6
PER (x)	10.4	8.2	7.1
Dividend yield (%)	1.2	1.3	1.4
DPS	1,500	1,600	1,800
PBR (x)	0.7	0.7	0.6
EV/EBITDA (x)	9.6	7.5	6.0
ROE (%)	7.2	8.4	8.9

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Battery shipment (m)	476.0	565.0	771.0	979.0	1,125.0	1,290.0	1,465.0	1,635.0
PDP shipment (m)	4.3	4.8	6.4	6.8	7.0	6.4	6.0	5.8
CRT shipment (m)	29.9	16.6	14.2	10.9	9.0	3.7	3.1	2.4

■ Profit and loss (KRWbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Battery	1,813	2,017	2,281	2,744	3,349	3,981	4,605	5,016
PDP	2,018	2,114	2,268	2,213	2,029	1,612	1,346	1,134
Other Revenue	1,472	821	575	487	393	423	555	638
Total Revenue	5,303	4,952	5,124	5,444	5,771	6,017	6,506	6,789
Other income	0	0	0	0	0	0	0	0
COGS	(4,572)	(4,210)	(4,334)	(4,761)	(4,863)	(5,088)	(5,396)	(5,533)
SG&A	(598)	(551)	(556)	(573)	(721)	(751)	(808)	(840)
Other op.expenses	94	78	53	0	0	0	0	0
Operating profit	227	268	287	110	187	178	302	416
Net-interest inc./(exp.)	14	3	14	2	(4)	(10)	(7)	0
Assoc/forex/extraord./others	(43)	(5)	122	366	1,846	591	661	701
Pre-tax profit	199	266	423	478	2,029	758	957	1,116
Tax	(39)	(25)	(37)	(127)	(543)	(205)	(258)	(301)
Min. int./pref. div./others	(103)	0	0	0	0	0	0	0
Net profit (reported)	57	241	385	351	1,487	554	699	815
Net profit (adjusted)	57	241	385	351	1,487	554	699	815
EPS (reported)(KRW)	1,258	5,298	8,453	7,706	32,635	12,152	15,336	17,884
EPS (adjusted)(KRW)	1,258	5,298	8,453	7,706	32,635	12,152	15,336	17,884
EPS (adjusted fully-diluted)(KRW)	1,258	5,298	8,453	7,706	32,635	12,152	15,336	17,884
DPS (KRW)	250	1,000	1,600	1,500	1,500	1,500	1,600	1,800
EBIT	227	268	287	110	187	178	302	416
EBITDA	826	746	662	549	641	654	811	958

■ Cash flow (KRWbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	199	266	423	478	2,029	758	957	1,116
Depreciation and amortisation	598	478	375	439	455	476	509	542
Tax paid	(39)	(25)	(37)	(127)	(543)	(205)	(258)	(301)
Change in working capital	(32)	193	(135)	(275)	(8)	(182)	21	(25)
Other operational CF items	52	(58)	(137)	(215)	(1,356)	(570)	(651)	(700)
Cash flow from operations	778	855	489	300	578	278	577	632
Capex	(559)	(135)	(63)	(6)	(418)	(600)	(600)	(600)
Net (acquisitions)/disposals	(442)	(86)	2	39	(25)	(94)	(104)	(27)
Other investing CF items	11	(112)	(191)	(912)	(69)	410	296	277
Cash flow from investing	(989)	(332)	(252)	(879)	(511)	(284)	(408)	(350)
Change in debt	273	(45)	(586)	355	187	(154)	(43)	(72)
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	0	(38)	(60)	(77)	(76)	(71)	(71)	(76)
Other financing CF items	82	29	26	(9)	2	130	126	121
Cash flow from financing	354	(53)	(621)	269	113	(95)	12	(26)
Forex effect/others	26	(14)	17	0	0	0	0	0
Change in cash	169	456	(367)	(311)	179	(100)	181	257
Free cash flow	220	720	426	294	160	(322)	(23)	32

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (KRWbn)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	978	1,434	1,066	758	947	846	1,027	1,284
Inventory	420	368	484	584	558	573	603	625
Accounts receivable	753	658	764	921	776	796	830	857
Other current assets	259	324	137	102	133	153	177	201
Total current assets	2,409	2,783	2,451	2,364	2,415	2,369	2,637	2,967
Fixed assets	2,051	1,722	1,727	1,827	1,971	2,095	2,186	2,244
Goodwill & intangibles	45	70	79	140	171	182	200	213
Other non-current assets	2,147	2,572	3,676	4,196	6,338	6,632	7,132	7,625
Total assets	6,653	7,148	7,934	8,527	10,895	11,277	12,155	13,049
Short-term debt	309	586	130	761	659	514	955	444
Accounts payable	654	784	807	962	1,318	1,188	1,264	1,309
Other current liabilities	149	114	161	27	28	30	33	36
Total current liabilities	1,112	1,484	1,098	1,750	2,004	1,731	2,252	1,788
Long-term debt	747	369	228	0	474	474	0	449
Other non-current liabilities	100	162	376	463	852	894	972	1,020
Total liabilities	1,959	2,016	1,703	2,213	3,331	3,099	3,224	3,257
Share capital	241	241	241	241	241	241	241	241
Reserves/R.E./others	4,274	4,732	5,810	5,877	7,133	7,740	8,488	9,343
Shareholders' equity	4,515	4,973	6,051	6,118	7,373	7,981	8,729	9,584
Minority interests	179	159	180	196	191	197	202	208
Total equity & liabilities	6,653	7,148	7,934	8,527	10,895	11,277	12,155	13,049
EV	6,200	5,603	5,415	6,160	6,332	6,298	6,094	5,787
Net debt/(cash)	78	(479)	(708)	4	187	142	(73)	(391)
BVPS (KRW)	99,099	109,151	132,822	134,292	161,841	175,182	191,604	210,365

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	3.0	(6.6)	3.5	6.2	6.0	4.3	8.1	4.3
EBITDA (YoY)	n.a.	(9.6)	(11.2)	(17.2)	16.9	2.0	23.9	18.1
Operating profit (YoY)	n.a.	18.1	6.9	(61.7)	69.9	(4.7)	69.7	37.4
Net profit (YoY)	n.a.	321.1	59.6	(8.8)	323.5	(62.8)	26.2	16.6
Core EPS (fully-diluted) (YoY)	n.a.	321.1	59.6	(8.8)	323.5	(62.8)	26.2	16.6
Gross-profit margin	13.8	15.0	15.4	12.6	15.7	15.4	17.1	18.5
EBITDA margin	15.6	15.1	12.9	10.1	11.1	10.9	12.5	14.1
Operating-profit margin	4.3	5.4	5.6	2.0	3.2	3.0	4.6	6.1
Net profit margin	1.1	4.9	7.5	6.4	25.8	9.2	10.7	12.0
ROAE	1.3	5.1	7.0	5.8	22.0	7.2	8.4	8.9
ROAA	0.8	3.5	5.1	4.3	15.3	5.0	6.0	6.5
ROCE	3.9	4.5	4.5	1.6	2.4	2.0	3.2	4.0
ROIC	3.8	5.2	5.1	1.4	1.9	1.6	2.6	3.3
Net debt to equity	1.7	net cash	net cash	0.1	2.5	1.8	net cash	net cash
Effective tax rate	19.5	9.3	8.9	26.6	26.7	27.0	27.0	27.0
Accounts receivable (days)	51.8	52.0	50.6	56.5	53.7	47.7	45.6	45.4
Current ratio (x)	2.2	1.9	2.2	1.4	1.2	1.4	1.2	1.7
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	48.6	17.3	45.4	n.a.
Net dividend payout	19.9	18.9	18.9	19.5	4.6	12.3	10.4	10.1
Free cash flow yield	3.8	12.5	7.4	5.1	2.8	n.a.	n.a.	0.6

Source: FactSet, Daiwa forecasts

Company profile

Samsung SDI has four business divisions: rechargeable batteries, plasma-display-panel (PDP) modules, CRTs and energy systems. The company is the largest lithium-ion battery maker, globally with 24% share for 2012 and the second-largest PDP maker (54% share for 2012).

Chailease Holding (5871 TT)

Rating: **Buy [1]**
Share price: **TWD80.30**
6-mth target price: **TWD96** (20% potential upside)
3-year fair value: **TWD142** (77% potential upside)

A long-term China play

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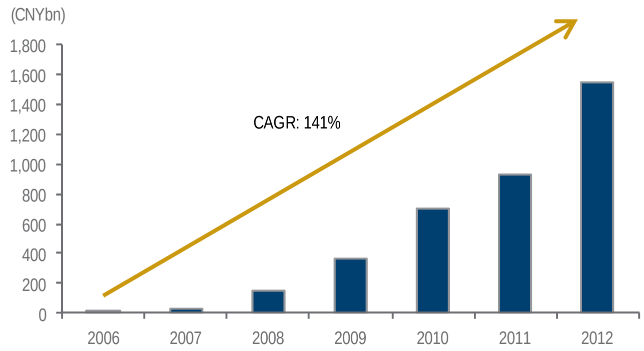
What is the three-year story?

China's leasing market in terms of value expanded at a CAGR of 141% from 2006-12. Meanwhile, leasing as a percentage of China's fixed-asset investment is only 3.8%, lower than the rates of other countries in Asia (5%) and developed markets (19%).

■ China: leasing contract value balance



Source: China Leasing Association

Well-positioned to take off in China: with over 35 years of experience in asset-financing and leasing in Taiwan, Chailease Holding (Chailease) dominates the Taiwan market with a 42% share in 2012. Meanwhile, with seven years of operating in the China market, we believe the company is well-positioned to benefit from a pick-up in alternative financing there.

We see Chailease benefiting from the following.

1) Solid loan growth in China with a decent interest spread.
2) Good asset quality backed by the company's tight credit control system.
3) A wide range of funding sources.
4) New business potential through its vendor-financing programme, and the scope to diversify its business.

We forecast Chailease's loan book in China to increase by a CAGR of 34% over 2011-2015 while maintaining good asset quality.

What could the fair value be in 2015?

Our six-month target price of TWD96 is based on a target PBR of 2.8x applied to our 2013-14 BVPS forecasts, as we expect increased business visibility in China and ASEAN and a rise in the ROE.

We believe Chailease is a long-term China play with a solid earnings-growth story. We use a Gordon Growth Model to derive our target PBR, with a terminal growth rate of 5%, as we expect the company to see greater loan growth than its China bank peers, for which Daiwa assumes a terminal growth rate of about 4%.

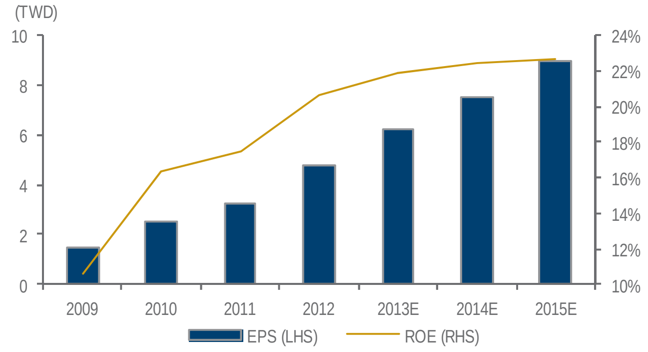
We believe Chailease's 2015 fair value is TWD142, based on a PBR of 2.8x and our 2016 BVPS forecast of TWD51. We believe a PBR of 2.8x is justified by our 22-23% ROE forecast over 2014-16.

■ Chailease: Gordon Growth Model

ROE	23.0%
g	5.0%
COE	11.48%
Rf	2%
Rm-Rf	8%
Beta	1.2
Implied or target P/BV	2.8x

Source: Daiwa

■ Chailease: ROE & EPS



Source: Company. Daiwa forecasts

Are there any near-term hurdles?

We see the following as the near-term issues faced by the company.

1) **Staff recruitment, training and retention**: to expand its business, Chailease has to keep recruiting staff and retain them once trained.

2) **Regulations/licence**: although the company has a nationwide licence in China, it still needs to obtain local approval to open a branch in a new city. Sometimes the approval process can take longer than it expects.

3) **Funding**: China has an asset-to-equity limit of 10x for leasing companies. To continue to expand its assets, Chailease needs to be able to find alternative funding sources.

How to monitor progress

We forecast lending in China to account for around 50% of Chailease's total portfolio for 2015. Asset growth, the interest spread and asset quality will be the keys to monitoring the company's development over the next few years.

1) We forecast Chailease's China loan assets to increase by 30-40% YoY over 2013-15, supported by the addition of 3-5 branches each year. The progress on this will be apparent in the quarterly results.

2) Chailease earns an interest spread of 10-11% in China, and 8-9% in Taiwan. With more competition, will the company be able to maintain its high spread in China?

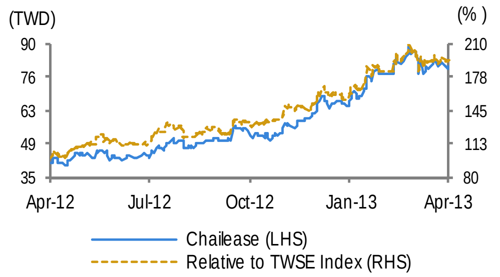
3) The delinquency ratio is critical in monitoring Chailease's asset quality. The delinquency ratio in China peaked at 4.3% in 2Q12 and improved to 3.8% for 4Q12. The worst rate for the company was 8% in Taiwan during the global financial crisis. We would be alarmed if the quarterly delinquency ratio in China reached 5%.

What could go wrong?

A sharp downturn in China's economy would affect the operations and cash flow of the country's SMEs, which could affect Chailease's asset quality or slow the rate of increase in new loans.

Meanwhile, the company might not be able to maintain the interest rate it charges SMEs if these companies were not willing to invest large amounts when the economic environment is uncertain. Overbanking and competition could reduce Chailease's margin spread or the company might have to start lending to clients that would previously have been considerable not ideal.

Share price performance



12-month range	40.00-88.60
Market cap (USDbn)	2.42
3m avg daily turnover (USDm)	19.35
Shares outstanding (m)	905
Major shareholder	Koo Family (30.0%)

Financial summary (TWD)

Year to 31 Dec	13E	14E	15E
Revenue (m)	27,743	33,303	39,964
Operating profit (m)	8,128	9,866	11,832
Net profit (m)	5,758	6,927	8,213
Core EPS (fully-diluted)	6.360	7.651	9.072
EPS change (%)	29.8	20.3	18.6
Daiwa vs Cons. EPS (%)	6.0	1.9	n.a.
PER (x)	12.6	10.5	8.9
Dividend yield (%)	2.8	3.3	4.0
DPS	2.2	2.7	3.2
PBR (x)	2.5	2.2	1.9
EV/EBITDA (x)	16.1	14.1	12.5
ROE (%)	21.9	22.4	22.6

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Taiwan loan asset growth YoY (%)	n.a.	n.a.	8.4	31.2	21.0	14.7	9.7	9.6
China loan asset growth YoY (%)	n.a.	n.a.	152.1	164.1	29.6	37.4	35.5	33.4
Total loan asset growth YoY (%)	n.a.	n.a.	10.2	51.2	21.1	23.4	21.2	22.1
Credit cost (%)	n.a.	n.a.	0.7	0.8	1.5	1.5	1.6	1.7
Delinquency ratio (%)	n.a.	n.a.	3.2	3.1	3.1	3.1	3.1	3.1
Provision coverage as % of expected bad debt	n.a.	n.a.	241.7	232.8	253.8	253.2	258.3	270.9

Profit and loss (TWDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Taiwan	n.a.	5,314	5,625	7,371	9,132	9,661	10,545	11,304
China	n.a.	4,486	5,818	7,362	10,469	14,631	18,758	23,931
Other Revenue	n.a.	1,377	1,480	2,036	2,484	3,451	4,001	4,729
Total Revenue	n.a.	11,177	12,924	16,770	22,085	27,743	33,303	39,964
Other income	n.a.	0	0	0	0	0	0	0
COGS	n.a.	(5,685)	(6,571)	(8,114)	(9,680)	(10,690)	(12,710)	(14,899)
SG&A	n.a.	(5,108)	(3,356)	(4,785)	(7,004)	(8,703)	(10,514)	(13,016)
Other op.expenses	n.a.	(187)	(126)	(138)	(86)	(222)	(213)	(217)
Operating profit	n.a.	198	2,869	3,733	5,315	8,128	9,866	11,832
Net-interest inc./(exp.)	n.a.	(114)	(91)	(75)	(37)	(64)	(86)	(76)
Assoc/forex/extraord./others	n.a.	(618)	620	180	946	659	713	686
Pre-tax profit	n.a.	(534)	3,399	3,839	6,223	8,723	10,493	12,442
Tax	n.a.	(106)	(1,081)	(1,202)	(1,834)	(2,617)	(3,148)	(3,733)
Min. int./pref. div./others	n.a.	2,138	(191)	(189)	(248)	(348)	(419)	(496)
Net profit (reported)	n.a.	1,498	2,127	2,448	4,141	5,758	6,927	8,213
Net profit (adjusted)	n.a.	1,498	2,127	2,448	4,141	5,758	6,927	8,213
EPS (reported)(TWD)	n.a.	1.636	2.650	3.345	4.899	6.360	7.651	9.072
EPS (adjusted)(TWD)	n.a.	1.636	2.650	3.345	4.899	6.360	7.651	9.072
EPS (adjusted fully-diluted)(TWD)	n.a.	1.636	2.650	3.345	4.899	6.360	7.651	9.072
DPS (TWD)	n.a.	0.000	1.190	2.300	2.000	2.226	2.678	3.175
EBIT	n.a.	198	2,869	3,733	5,315	8,128	9,866	11,832
EBITDA	n.a.	571	3,122	4,008	5,487	8,571	10,292	12,267

Cash flow (TWDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	n.a.	(534)	3,399	3,839	6,223	8,723	10,493	12,442
Depreciation and amortisation	n.a.	2,133	2,241	2,198	1,864	4,063	4,210	4,137
Tax paid	n.a.	(106)	(1,081)	(1,202)	(1,834)	(2,617)	(3,148)	(3,733)
Change in working capital	n.a.	3,904	4,436	7,421	5,795	7,187	7,084	8,456
Other operational CF items	n.a.	114	91	75	37	64	86	76
Cash flow from operations	n.a.	5,511	9,086	12,330	12,086	17,420	18,725	21,379
Capex	n.a.	(3,156)	(5,811)	(1,909)	(2,127)	(2,000)	(3,000)	(2,000)
Net (acquisitions)/disposals	n.a.	1,466	(17,470)	(42,284)	(33,829)	(29,453)	(32,986)	(44,628)
Other investing CF items	n.a.	0	(142)	(279)	(502)	0	0	0
Cash flow from investing	n.a.	(1,689)	(23,423)	(44,472)	(36,458)	(31,453)	(35,986)	(46,628)
Change in debt	n.a.	(7,000)	19,776	32,909	24,230	16,559	18,829	27,773
Net share issues/(repurchases)	n.a.	0	(3,846)	1,851	5,964	0	0	0
Dividends paid	n.a.	(74)	(81)	(943)	(1,922)	(1,811)	(2,015)	(2,424)
Other financing CF items	n.a.	2,013	0	0	0	0	0	0
Cash flow from financing	n.a.	(5,060)	15,849	33,816	28,272	14,749	16,814	25,349
Forex effect/others	n.a.	22	(210)	536	(327)	0	0	0
Change in cash	n.a.	(1,216)	1,302	2,211	3,573	716	(447)	100
Free cash flow	n.a.	2,356	3,275	10,421	9,959	15,420	15,725	19,379

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (TWDm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	n.a.	3,166	4,564	7,079	12,365	10,847	10,400	10,500
Inventory	n.a.	0	0	0	0	0	0	0
Accounts receivable	n.a.	43,773	52,212	82,078	106,073	131,649	160,874	197,307
Other current assets	n.a.	3,684	3,646	7,707	9,147	8,427	8,787	8,607
Total current assets	n.a.	50,624	60,423	96,864	127,584	150,924	180,061	216,414
Fixed assets	n.a.	11,524	11,410	8,610	6,333	15,024	15,054	15,039
Goodwill & intangibles	n.a.	25	27	25	23	0	0	0
Other non-current assets	n.a.	20,754	21,198	30,219	32,852	40,120	47,160	56,745
Total assets	n.a.	82,927	93,057	135,718	166,793	206,067	242,275	288,197
Short-term debt	n.a.	31,101	27,444	27,362	32,056	40,257	50,146	60,430
Accounts payable	n.a.	5,384	8,633	14,782	20,761	25,576	30,930	37,690
Other current liabilities	n.a.	18,422	25,120	43,937	62,547	72,861	92,819	117,896
Total current liabilities	n.a.	54,906	61,197	86,081	115,363	138,695	173,895	216,016
Long-term debt	n.a.	10,648	16,179	28,419	23,312	33,869	30,172	27,772
Other non-current liabilities	n.a.	1,385	2,429	3,862	2,265	3,063	2,664	2,864
Total liabilities	n.a.	66,940	79,804	118,362	140,940	175,627	206,731	246,652
Share capital	n.a.	9,159	6,911	7,853	9,053	9,053	9,053	9,053
Reserves/R.E./others	n.a.	4,918	5,116	8,226	15,048	19,460	24,372	30,160
Shareholders' equity	n.a.	14,077	12,027	16,079	24,101	28,513	33,425	39,213
Minority interests	n.a.	1,910	1,226	1,278	1,752	1,927	2,120	2,332
Total equity & liabilities	n.a.	82,927	93,057	135,718	166,793	206,067	242,275	288,197
EV	n.a.	113,187	112,980	122,675	117,450	137,902	144,733	152,730
Net debt/(cash)	n.a.	38,582	39,058	48,702	43,003	63,279	69,918	77,703
BVPS (TWD)	n.a.	15.370	17.403	20.475	26.622	31.496	36.921	43.315

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	n.a.	n.a.	15.6	29.8	31.7	25.6	20.0	20.0
EBITDA (YoY)	n.a.	n.a.	446.4	28.4	36.9	56.2	20.1	19.2
Operating profit (YoY)	n.a.	n.a.	1,349.4	30.1	42.4	52.9	21.4	19.9
Net profit (YoY)	n.a.	n.a.	41.9	15.1	69.2	39.0	20.3	18.6
Core EPS (fully-diluted) (YoY)	n.a.	n.a.	62.0	26.2	46.5	29.8	20.3	18.6
Gross-profit margin	n.a.	49.1	49.2	51.6	56.2	61.5	61.8	62.7
EBITDA margin	n.a.	5.1	24.2	23.9	24.8	30.9	30.9	30.7
Operating-profit margin	n.a.	1.8	22.2	22.3	24.1	29.3	29.6	29.6
Net profit margin	n.a.	13.4	16.5	14.6	18.8	20.8	20.8	20.6
ROAE	n.a.	10.6	16.3	17.4	20.6	21.9	22.4	22.6
ROAA	n.a.	1.8	2.4	2.1	2.7	3.1	3.1	3.1
ROCE	n.a.	0.3	5.0	5.7	6.9	8.7	9.0	9.6
ROIC	n.a.	0.4	3.7	4.3	5.6	7.0	6.9	7.4
Net debt to equity	net cash	274.1	324.8	302.9	178.4	221.9	209.2	198.2
Effective tax rate	n.a.	n.a.	31.8	31.3	29.5	30.0	30.0	30.0
Accounts receivable (days)	n.a.	714.7	1,355.4	1,461.5	1,554.8	1,563.8	1,603.0	1,635.7
Current ratio (x)	n.a.	0.9	1.0	1.1	1.1	1.1	1.0	1.0
Net interest cover (x)	n.a.	1.7	31.7	50.1	141.9	127.0	115.3	155.6
Net dividend payout	n.a.	0.0	44.9	68.8	40.8	35.0	35.0	35.0
Free cash flow yield	n.a.	3.2	4.5	14.3	13.7	21.2	21.6	26.7

Source: FactSet, Daiwa forecasts
Note: accounts receivable days are not applicable

Company profile

With over 35 years of experience in asset-financing and leasing, Chailease Holding (Chailease) dominates the Taiwan leasing market with a 42% share in June 2012. The company has operations in five countries globally: Taiwan (100%-held), China (100%-held), the US (100%-held), Vietnam (100%-held) and Thailand (48.18%-held).

Delta Electronics (2308 TT)

Rating: **Outperform [2]**
Share price: **TWD129.00**
6-mth target price: **TWD140** (9% potential upside)
3-year fair value: **TWD185** (43% potential upside)

Strong EBIT growth likely over the next three years

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What is the three-year story?

We are confident about an expansion in Delta Electronics's (Delta) gross margin over the next three years due to a long-term structural improvement in the company's business. For 2012-15, we forecast a 17% earnings CAGR and 22% EBIT CAGR.

Delta is working on improving its product mix by increasing the proportion of high-margin items, such as industrial-automation products, data-centre-related products, and passive components. We forecast these products together to account for 65% and 71%, respectively of its total sales and gross profit by 2015, up from 47% and 57% for 2012.

We see the following as the key revenue-growth drivers for the company over the next three years.

1) Data centres

   We see Delta as being best-positioned among the downstream technology hardware companies to benefit from data-centre systems over the long term. The company provides added-value total systems to customers, including server power supply, uninterrupted power supply products, and cooling-system products. We believe its whole system design, together with heat dissipation and power usage, will be key points of product differentiation in the future.

   We forecast data-centre demand to increase at a CAGR of 27% over 2012-15, with the growing popularity of smartphones and mobile Internet devices the catalyst for increased data-computing services, with more online content being stored in data centres.

2) Industrial automation

   We are positive on Delta's diversification into more differentiated products in the industrial-automation sector. The company's industrial-automation products cover three areas: drives, motion, and controls. Its key products include AC motor drives, AC servo motors, human-machine interfaces, programmable logic controllers and computer numerical control systems. For 2012-15, we forecast a revenue CAGR of 27% in Delta's overall industrial-automation sales.

3) Passive components

   Miniature passive components should be one of the earnings drivers for the company, as they are priced 3x higher than bigger components for other electronic devices (other than tablets and smartphones), and have a higher gross margin.

   Delta says it will expand from being a component provider to a module provider in the next couple of years, which we expect to boost revenue growth over the long term. For 2012-15, we forecast a sales CAGR of about 33% for the passive-component business.

What could the fair value be in 2015?

Our six-month target price of TWD140 is based on a 2014E PER of 17x, which is above the stock's past-five-year average. We use this higher PER because: 1) we forecast Delta's improving profitability to lead to a 17% earnings CAGR over 2012-15 (higher than the 7% CAGR over the past five years), 2) we forecast the ROE to improve from 15% for 2011 to 25% for 2015, and 3) we expect cash DPS to rise on the back of the company's earnings growth, and forecast a stable dividend-payout ratio of more than 70% over the next few years.

The stock is trading currently at a PER premium to its Taiwan automation peers. We believe this premium is due largely to its more diversified earnings-growth engines compared with the pure automation players. In addition, Delta is in a net-cash position, and we forecast its net cash-to-equity ratio to stay at about 30% over 2012-15. According to the Bloomberg-consensus forecasts, only Rockwell and Fanuc among its competitors will generate net cash during the same period.

By applying a 17x PER to our 2015E EPS of TWD10.6, we forecast the stock's fair value to be TWD185 in 2015.

Are there any near-term hurdles?

Currently, Delta's PC-related business (power-supply component and cooling fans for desktop and notebook PCs) accounts for 30% of total sales. We believe this business will face weakness this year, with fewer product shipments and pricing erosion.

The size of the PC market is shrinking. We forecast global PC shipments (excluding tablets) to decline by 4% YoY for 2013 and fall by 2% YoY for 2014, following on from a 4% YoY decline for 2012.

Pricing erosion is another issue, because the company's competitors are keen to increase their share of a decreasing market. Delta's strategy of focusing on high-margin products will be a risk to the company's mature PC-related business, as the company could reduce its sales exposure in this area faster than we expect if the gross-profit margin erosion is greater than we forecast.

How to monitor progress

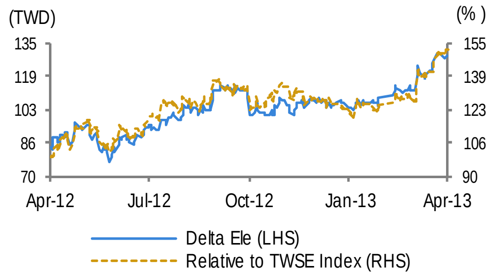
- Margin improvements: to check that the shift in the company's product mix is on track. We forecast its data-centre-related, passive-component, and industrial-automation businesses together to account for an increasing proportion of total sales, rising from 53% this year to 65% for 2015.
- New project wins: Delta expects data-centre revenue to increase by 20-30% YoY this year. Continued project wins would ensure long-term revenue growth.
- China PMI data: 50% of the company's industrial-automation business is related to China, and its industrial-automation revenue has a positive correlation with China's PMI.
- Global shipment data and capacity expansion plans for tablets/smartphones: its miniature passive components are used mainly in tablets and smartphones. The company plans to double production capacity this year, following on from a 50% YoY rise last year. Future capacity expansion plans would indicate revenue growth in this segment.

What could go wrong?

The downside risks to our view on Delta include the following.

- Worse-than-expected global PC shipments and greater than-expected price erosion on related products.
- The migration to low-watt power-supply products for notebook PCs takes place faster than we expect, resulting in ASP and gross-margin erosion.
- Increased competition in the areas of the company's fast-growing high-margin products, such as passive components, data-centre infrastructure solutions, and industrial automation. We see that the passive-component product line is more sensitive to pricing and also has lower entry barriers than the other two businesses.

Share price performance



12-month range	76.80-130.50
Market cap (USDbn)	10.42
3m avg daily turnover (USDm)	19.38
Shares outstanding (m)	2,421
Major shareholder	AsusTek Computer Inc. (15.0%)

Financial summary (TWD)

Year to 31 Dec	12E	13E	14E
Revenue (m)	175,824	186,841	203,208
Operating profit (m)	15,950	20,088	22,870
Net profit (m)	16,110	17,425	20,320
Core EPS (fully-diluted)	6.654	7.197	8.393
EPS change (%)	36.0	8.2	16.6
Daiwa vs Cons. EPS (%)	3.2	(0.6)	4.1
PER (x)	19.4	17.9	15.4
Dividend yield (%)	2.7	3.7	4.0
DPS	3.5	4.8	5.2
PBR (x)	3.7	3.5	3.2
EV/EBITDA (x)	12.4	10.4	9.0
ROE (%)	20.0	20.2	21.9

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Worldwide PC shipment (m units)	264	292	314	358	365	351	336	329
Worldwide power supply market (USDb) YoY %	7.7	5.5	(5.5)	7.9	7.0	6.5	6.0	5.5
China AC motor drive (RMBb) YoY%	32	25	12	32	7	7	10	15

■ Profit and loss (TWDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Power electronics	67,948	77,134	65,138	75,752	107,086	106,525	109,800	116,012
Energy management	12,439	14,611	16,157	25,955	35,430	35,732	41,550	48,111
Other Revenue	50,227	50,900	44,216	69,595	29,540	33,567	35,491	39,086
Total Revenue	130,614	142,645	125,511	171,302	172,056	175,824	186,841	203,208
Other income	0	0	0	0	0	0	0	0
COGS	(103,210)	(116,927)	(99,143)	(134,699)	(139,274)	(134,470)	(140,614)	(152,628)
SG&A	(6,577)	(8,138)	(7,862)	(10,434)	(12,478)	(14,170)	(15,071)	(16,130)
Other op.expenses	(5,109)	(6,447)	(6,743)	(8,901)	(9,986)	(11,233)	(11,068)	(11,579)
Operating profit	15,717	11,133	11,762	17,269	10,318	15,950	20,088	22,870
Net-interest inc./(exp.)	1,016	926	411	349	508	494	490	487
Assoc/forex/extraord./others	2,815	2,728	1,364	2,528	3,758	4,660	2,821	1,800
Pre-tax profit	19,548	14,787	13,538	20,146	14,585	21,104	23,400	25,157
Tax	(2,400)	(2,524)	(470)	(2,271)	(2,826)	(3,226)	(3,506)	(3,764)
Min. int./pref. div./others	(2,086)	(2,012)	(1,411)	2,128	0	(1,768)	(2,469)	(1,074)
Net profit (reported)	15,061	10,251	11,657	20,003	11,759	16,110	17,425	20,320
Net profit (adjusted)	15,061	10,251	11,657	20,003	11,759	16,110	17,425	20,320
EPS (reported)(TWD)	7.150	4.691	5.164	8.353	4.893	6.654	7.197	8.393
EPS (adjusted)(TWD)	7.150	4.691	5.164	8.353	4.893	6.654	7.197	8.393
EPS (adjusted fully-diluted)(TWD)	7.150	4.691	5.164	8.353	4.893	6.654	7.197	8.393
DPS (TWD)	4.508	6.022	3.622	4.436	6.175	3.502	4.763	5.152
EBIT	15,717	11,133	11,762	17,269	10,318	15,950	20,088	22,870
EBITDA	19,400	15,568	16,562	22,660	16,829	23,979	28,645	32,614

■ Cash flow (TWDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	19,548	14,787	13,538	20,146	14,585	21,104	23,400	25,157
Depreciation and amortisation	3,683	4,435	4,800	5,391	6,511	8,029	8,557	9,744
Tax paid	(2,400)	(2,524)	(470)	(2,271)	(2,826)	(3,226)	(3,506)	(3,764)
Change in working capital	(1,661)	(642)	1,300	(6,273)	(6,683)	(353)	(2,169)	(1,574)
Other operational CF items	1,848	23	2,221	5,087	6,280	(1,922)	(3,697)	(2,400)
Cash flow from operations	21,018	16,078	21,389	22,080	17,867	23,632	22,585	27,163
Capex	(7,790)	(7,478)	(3,970)	(8,860)	(14,130)	(10,996)	(8,968)	(8,535)
Net (acquisitions)/disposals	1,027	4,987	(5,143)	731	(9,131)	(275)	0	0
Other investing CF items	246	(832)	(394)	(874)	1,371	(604)	(427)	(1,161)
Cash flow from investing	(6,517)	(3,323)	(9,507)	(9,003)	(21,890)	(11,875)	(9,395)	(9,696)
Change in debt	618	3,116	7,589	4,781	23,791	(21,718)	6,281	(3,141)
Net share issues/(repurchases)	7,284	168	1,490	0	0	0	0	0
Dividends paid	(8,878)	(12,686)	(7,915)	(10,013)	(14,789)	(8,417)	(11,532)	(12,473)
Other financing CF items	(184)	(8)	263	662	(1,926)	6,224	(1,207)	(1,087)
Cash flow from financing	(1,160)	(9,411)	1,427	(4,569)	7,077	(23,911)	(6,457)	(16,700)
Forex effect/others	336	1,164	1,022	(5,312)	2,447	(2,600)	0	0
Change in cash	13,677	4,508	14,331	3,197	5,500	(14,755)	6,732	767
Free cash flow	13,228	8,600	17,419	13,221	3,737	12,635	13,616	18,629

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (TWDm)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & short-term investment	40,231	44,609	58,453	61,408	68,424	52,470	57,786	57,641
Inventory	9,963	9,245	9,748	14,789	19,126	15,461	18,084	19,629
Accounts receivable	30,625	26,635	29,581	34,970	38,938	38,192	40,982	44,571
Other current assets	742	1,949	1,421	2,076	3,520	15,767	15,673	15,953
Total current assets	81,560	82,438	99,203	113,243	130,008	121,890	132,524	137,794
Fixed assets	18,846	22,341	20,268	26,901	36,918	34,908	37,017	36,174
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	17,508	12,778	14,442	21,595	26,269	25,090	24,097	29,471
Total assets	117,915	117,557	133,913	161,738	193,194	181,889	193,638	203,439
Short-term debt	4,043	7,093	11,773	9,878	17,599	5,037	11,318	8,178
Accounts payable	30,095	26,504	32,845	39,355	41,281	38,436	41,680	45,241
Other current liabilities	5,435	3,886	3,681	9,003	9,873	15,222	12,082	13,615
Total current liabilities	39,573	37,483	48,299	58,235	68,753	58,695	65,080	67,034
Long-term debt	0	66	2,974	9,540	24,862	16,492	16,492	16,492
Other non-current liabilities	5,976	7,421	6,795	6,571	7,093	7,298	7,298	7,298
Total liabilities	45,550	44,969	58,068	74,346	100,708	82,485	88,869	90,823
Share capital	21,064	21,850	22,573	23,948	24,034	24,212	24,212	24,212
Reserves/R.E./others	38,717	36,493	40,728	51,883	53,787	59,454	64,820	72,667
Shareholders' equity	59,781	58,343	63,301	75,831	77,821	83,666	89,031	96,878
Minority interests	12,584	14,245	12,544	11,561	14,665	15,738	15,738	15,738
Total equity & liabilities	117,915	117,557	133,913	161,738	193,194	181,889	193,638	203,439
EV	288,729	289,127	281,170	281,902	301,035	297,129	298,094	295,098
Net debt/(cash)	(36,187)	(37,450)	(43,706)	(41,990)	(25,962)	(30,941)	(29,976)	(32,971)
BVPS (TWD)	28.380	26.701	28.043	31.665	32.379	34.556	36.772	40.013

Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales (YoY)	24.1	9.2	(12.0)	36.5	0.4	2.2	6.3	8.8
EBITDA (YoY)	27.3	(19.8)	6.4	36.8	(25.7)	42.5	19.5	13.9
Operating profit (YoY)	26.4	(29.2)	5.7	46.8	(40.3)	54.6	25.9	13.8
Net profit (YoY)	32.9	(31.9)	13.7	71.6	(41.2)	37.0	8.2	16.6
Core EPS (fully-diluted) (YoY)	24.3	(34.4)	10.1	61.7	(41.4)	36.0	8.2	16.6
Gross-profit margin	21.0	18.0	21.0	21.4	19.1	23.5	24.7	24.9
EBITDA margin	14.9	10.9	13.2	13.2	9.8	13.6	15.3	16.0
Operating-profit margin	12.0	7.8	9.4	10.1	6.0	9.1	10.8	11.3
Net profit margin	11.5	7.2	9.3	11.7	6.8	9.2	9.3	10.0
ROAE	27.5	17.4	19.2	28.8	15.3	20.0	20.2	21.9
ROAA	14.6	8.7	9.3	13.5	6.6	8.6	9.3	10.2
ROCE	23.3	14.3	13.8	17.5	8.5	12.5	15.8	16.9
ROIC	39.7	25.9	33.8	39.5	14.9	20.0	23.8	25.2
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	12.3	17.1	3.5	11.3	19.4	15.3	15.0	15.0
Accounts receivable (days)	76.3	73.3	81.7	68.8	78.4	80.1	77.3	76.8
Current ratio (x)	2.1	2.2	2.1	1.9	1.9	2.1	2.0	2.1
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	63.0	128.4	70.1	53.1	126.2	52.6	66.2	61.4
Free cash flow yield	4.2	2.8	5.6	4.2	1.2	4.0	4.4	6.0

Source: FactSet, Daiwa forecasts

Company profile

Delta Electronics is the global leader in switching power supply products. Its products include switching power supply products, brushless fans, transformers, projector systems and industrial automation systems. Delta is expanding into green-energy related products including solar products, LEDs, electric vehicle motors and E-paper.

Fubon Financial
(2881 TT)

Rating: **Buy [1]**
Share price: **TWD40.90**
6-mth target price: **TWD49.2** (20% potential upside)
3-year fair value: **TWD65.1** (59% potential upside)

New business-growth phase about to start

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What is the three-year story?

Fubon Financial (Fubon) is well positioned to benefit from growing business opportunities in Greater China for another decade, in our view. It is the fifth financial name (after Citi, DBS, HSBC and Standard Chartered) globally to have received a full licence to operate in Greater China, Taiwan and Hong Kong. Fubon should continue to benefit from cross-strait deregulation, particularly in terms of capital flows, its potential A-share brokerage business and RMB business developments.

In our view, Fubon's medium-term earnings-growth potential in Greater China is significant. We forecast its earnings contribution for this area to reach 30% in 2015 (from 10% currently), representing a CAGR of 60% for 2013-15. Additionally, the gradual easing of restrictions on its overseas investments by the Taiwan regulator should benefit the long-term recurring investment yield for its life subsidiary.

Over the past decade, Fubon's strong acquisition discipline and post-acquisition consolidation experiences have enabled it to exploit new revenue-growth opportunities. Specifically, these acquisitions included: Fubon Bank Hong Kong (in 2004), Xiamen Bank (2008), ING Life Taiwan (2009), and First Sino Bank (2012).

For the next three years, Fubon's business-growth potential should come from its recently announced acquisition of an 80% stake in First Sino Bank, a China bank that has its headquarters in Shanghai and a nationwide branch network. We expect First Sino Bank to achieve both fee income and loan growth of above 20% YoY for the next few years by first taking advantage of its strong corporate client base and then developing its retail-banking business by adding 5-10 branches every year from 2014 (management expects the number of branches to reach 40-50 in five years from 14 currently).

Although the earnings contribution from Greater China (excluding Taiwan) was insignificant in 2012 (about 10%), the capital invested in the Greater China operation is equivalent to 20% of the company's current book value. That said, we expect higher asset and earnings growth for the Greater China operation over the next three years, and more synergy effects from further cross-strait deregulation, ie, the establishment of an RMB offshore centre and free economic demonstration zone in 2013 in Taiwan should benefit banks with good access to both the Taiwan and Greater China markets.

What could the fair value be in 2015?

Given the different characteristics of Fubon's main businesses, we believe an SOTP methodology is justified to calculate the company's valuation. In our view, as Fubon is in the early stages of a business-growth story in Greater China, we have not yet factored in any earnings impact from this operation. Our SOTP-derived six-month target price of TWD49.2 implies a 1.5x 2013E PBR.

Fubon: SOTP valuation

Entity/Item	Methodology	Implied 15E PBR (x)	Total Value (TWDm)	Value/share (TWD)	% of total (%)
Fubon Taipei Bank	1.3x book	1.3	193,998	19.0	29%
Fubon Securities	1.1x book	1.1	55,023	5.4	8%
Fubon Life	1.0x 2013E EV	1.6	257,075	25.2	39%
	Liability (mark-to-market)		116,794	11.4	18%
Fubon P&C	1.1x book	1.1	39,321	3.9	6%
Fubon Asset Management	1x book	1.0	2,523	0.2	0%
Fubon FHC	3-yr fair value	1.7	664,734	65.1	100%
Implied upside				59%	

Source: Daiwa forecasts

Extrapolating into 2015, we estimate that Fubon's fair value could rise to TWD65.1, which implies 1.7x 2015E PBR. We justify this by: 1) the higher earnings growth that we see for 2015: driven by the First Sino Bank acquisition and by taking advantage of the Taiwanese corporate business first and then expanding the retail business within China from 2014, 2) higher fee income: the liberalising of capital flows (between Hong Kong, China, Taiwan) would stimulate hedging needs for corporates that have cross-strait operations, as well as demand for RMB-related wealth-management products, and 3) a better reinvestment environment: as the global bond yield has started to rebound, Fubon's life subsidiary should be a natural beneficiary of the resulting higher investment yield. Also, the easing-up of investment regulations for qualified Taiwan life insurers, allowing them to invest in overseas commercial buildings and China Government bonds, would boost the recurring investment yield. To value the life-insurance business, we apply an embedded value of 1.0x 2015E and mark to market Fubon's reserve portfolio by applying a long-term recurring investment yield of 3.9% versus a cost of liability of 4% (vs. 3.4% and 4.07% in 2012, respectively).

Are there any near-term hurdles?

Two key hurdles that might have a negative effect on the share price are:

1) **Eurozone tensions**: as one-third of Fubon's business is insurance-related, escalating debt problems in Europe would have an effect on Fubon's investment performance, which plays an important role in valuing the company.

2) **Regulatory approval**: failure to receive cross-strait approval for the First Sino Bank acquisition would materially impact the Greater China competitive landscape and our valuation thesis for Fubon. Management currently expects to receive approval in 3Q13.

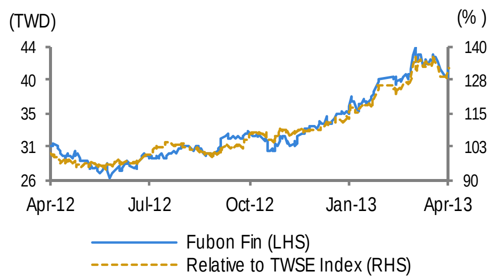
How to monitor progress?

- In 2013, the key milestones for Fubon include: 1) receiving regulatory approval in 2Q-3Q13 and a controlling stake in First Sino Bank, 2) successfully raising TWD20-25bn in capital through the issuance of a global depository receipt, and 3) a capital injection of CNY1bn into First Sino Bank when the deal is approved, which should benefit Fubon exponentially.
- For 2014, we forecast: 1) 20%+ YoY loan growth: corporate loans should remain Fubon's focus initially, aimed at serving the Taiwan corporate. It plans to open 5-10 First Sino Bank branches/year in China from 2014, 2) 20%+ YoY fee income growth: increased capital flows (Hong Kong, China, Taiwan) will mean greater hedging needs.
- In 2015, we expect: 1) Fubon's core business (loans and fee income) to continue to grow by more than 20% YoY, 2) Fubon to build up a meaningful presence in Greater China, specifically, through the expansion of First Sino Bank branches and its brokerage joint venture, which will give it an A-share brokerage licence, 3) Greater China earnings contribution to reach 20-30% (vs. 10% currently), and 4) an enhancement of the recurring investment yield.

What could go wrong?

Political cross-strait uncertainties remain one of the key obstacles when it comes to the company's China expansion. Although Fubon has expanded successfully in Taiwan over the past decade, its China growth story may face the following challenges: 1) First Sino Bank has yet to develop its retail business and competition for retail deposits could be fierce if China's financial sector were to face a cyclical slowdown, and 2) Fubon plans to inject CNY1bn into First Sino Bank and to open 5-10 new branches a year, targeting to reach 40-50 branches within five years. The key risks to our call would be higher-than-expected expansion costs or lower-than-expected earnings, which could mean further capital injections to fund business growth.

Share price performance



12-month range	26.43-44.00
Market cap (USDbn)	13.00
3m avg daily turnover (USDm)	33.53
Shares outstanding (m)	9,527
Major shareholder	Tsai Family (23.9%)

Financial summary (TWD)

Year to 31 Dec	13E	14E	15E
Total operating income (m)	77,246	85,716	96,358
Pre-provision operating profit(m)	39,816	42,648	51,360
Net profit (m)	31,721	34,053	41,555
Core EPS (fully-diluted)	3.330	3.574	4.362
EPS change (%)	6.5	7.4	22.0
Daiwa vs Cons. EPS (%)	7.4	9.0	27.5
PER (x)	12.3	11.4	9.4
Dividend yield (%)	2.4	2.4	2.4
DPS	1.0	1.0	1.0
PBR (x)	1.2	1.1	1.0
ROE (%)	10.1	10.2	11.5

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
FYP growth (%) – Life Insurance	127.5	62.0	60.5	(27.5)	12.0	5.0	5.0	5.0
Value of New Business – Life Insurance (local. Curr. bn)	9.2	17.9	24.8	28.0	31.6	31.6	31.6	31.6
Embedded Value – Life Insurance (local. Curr. Bn)	77.7	128.8	155.5	176.0	200.3	210.4	221.2	236.6
Investment Yield (%) – Life	4.0	3.1	3.1	3.0	3.5	3.7	3.7	3.7
Net-interest margin (%) – Bank	1.6	1.0	0.9	1.0	1.0	1.1	1.1	1.2
Loan Growth (%) – Bank	14.5	10.2	3.1	11.6	5.0	5.0	5.0	5.0
Tier-1 BIS (%) – Bank	9.5	9.8	9.2	9.3	10.2	11.0	11.9	12.7

Profit and loss (TWDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Net-interest income	38,503	43,651	50,657	59,065	68,725	80,243	90,975	102,135
Net fees & commission	8,748	10,306	11,830	12,370	12,803	13,081	14,015	15,042
Trading and other income	7,630	23,422	20,227	31,642	20,393	21,515	23,377	24,402
Net insurance income	(5,229)	(17,319)	(24,416)	(23,826)	(34,285)	(37,593)	(42,651)	(45,221)
Total operating income	49,652	60,060	58,298	79,250	67,636	77,246	85,716	96,358
Personnel expenses	(13,352)	(12,337)	(11,831)	(13,876)	(12,645)	(15,308)	(17,562)	(18,331)
Other expenses	(17,352)	(19,372)	(22,384)	(25,015)	(18,787)	(22,121)	(25,506)	(26,667)
Total expenses	(30,704)	(31,708)	(34,215)	(38,892)	(31,433)	(37,429)	(43,068)	(44,998)
Pre-provision operating profit	18,948	28,351	24,083	40,359	36,203	39,816	42,648	51,360
Total provision	(5,512)	(3,937)	(1,020)	(1,061)	(1,939)	(2,677)	(2,884)	(3,225)
Operating profit after prov.	13,436	24,415	23,063	39,298	34,264	37,139	39,764	48,135
Non-operating income	(547)	(1,646)	(683)	(790)	(790)	(790)	(790)	(790)
Profit before tax	12,889	22,769	22,380	38,508	33,474	36,350	38,974	47,345
Tax	(3,831)	(3,090)	(1,290)	(3,626)	(3,826)	(3,963)	(4,256)	(5,124)
Min. int./pref. div./other items	1,817	259	(1,185)	(4,340)	(665)	(665)	(665)	(665)
Net profit	10,875	19,938	19,905	30,542	28,983	31,721	34,053	41,555
Adjusted net profit	10,875	19,938	19,905	30,542	28,983	31,721	34,053	41,555
EPS (TWD)	1.409	2.517	2.386	3.476	3.126	3.330	3.574	4.362
EPS (adjusted) (TWD)	1.409	2.517	2.386	3.476	3.126	3.330	3.574	4.362
EPS (adjusted fully-diluted) (TWD)	1.409	2.517	2.386	3.476	3.126	3.330	3.574	4.362
DPS (TWD)	0.000	2.000	1.000	1.000	1.000	1.000	1.000	1.000

Change (YoY %)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Net-interest income	40.6	13.4	16.1	16.6	16.4	16.8	13.4	12.3
Non-interest income	(50.9)	47.2	(53.4)	164.2	n.a.	n.a.	n.a.	n.a.
Total operating income	(0.9)	21.0	(2.9)	35.9	(14.7)	14.2	11.0	12.4
Total expenses	31.0	3.3	7.9	13.7	(19.2)	19.1	15.1	4.5
Pre-provision operating profit	(29.0)	49.6	(15.1)	67.6	(10.3)	10.0	7.1	20.4
Total provisions	(46.5)	(28.6)	(74.1)	4.0	82.7	38.1	7.7	11.8
Operating profit after provisions	(17.9)	81.7	(5.5)	70.4	(12.8)	8.4	7.1	21.0
Profit before tax	(13.5)	76.6	(1.7)	72.1	(13.1)	8.6	7.2	21.5
Net profit (adjusted)	(24.6)	83.3	(0.2)	53.4	(5.1)	9.4	7.4	22.0
EPS (adjusted, FD)	(24.6)	78.6	(5.2)	45.7	(10.1)	6.5	7.4	22.0
Gross loans	18.4	(2.5)	2.9	18.9	6.6	5.5	5.7	5.8
Deposits	0.6	13.4	7.7	1.1	14.6	2.7	2.7	2.7
Total assets	11.2	52.5	12.8	4.8	11.0	8.6	8.4	8.3
Total liabilities	13.8	53.2	13.5	4.8	9.8	8.7	8.6	8.2
Shareholders' equity	(13.3)	45.1	4.3	7.5	28.9	7.5	6.2	9.3
Avg interest-earning assets	18.0	28.6	21.5	14.5	10.6	8.5	9.6	9.3
Avg risk-weighted assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (TWDm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & equivalent	329,491	442,900	268,447	297,263	287,674	307,625	320,515	326,375
Investment securities	366,685	877,870	1,376,389	1,552,677	1,691,867	1,907,808	2,139,433	2,392,238
Net loans and advances	957,196	933,004	959,916	1,139,086	1,216,169	1,282,980	1,356,105	1,435,041
Fixed assets	18,254	17,938	18,637	21,070	21,152	21,589	22,035	22,490
Goodwill	497	9,130	9,503	9,503	9,503	9,503	9,503	9,503
Other assets	334,597	779,410	819,884	598,536	790,900	833,407	883,667	939,341
Total assets	2,006,720	3,060,253	3,452,775	3,618,135	4,017,264	4,362,912	4,731,257	5,124,990
Customers deposits	968,424	1,097,959	1,182,965	1,196,431	1,371,459	1,408,026	1,445,689	1,484,483
Borrowing	158,253	83,791	94,193	149,194	160,946	165,756	170,807	176,110
Debentures	38,866	56,437	58,655	58,655	58,655	58,655	58,655	58,655
Other liabilities	692,903	1,609,085	1,894,688	1,980,173	2,125,013	2,406,586	2,712,199	3,029,815
Total liabilities	1,858,446	2,847,272	3,230,502	3,384,453	3,716,072	4,039,023	4,387,351	4,749,063
Share capital	77,191	81,262	85,584	90,137	95,269	95,269	95,269	95,269
Reserves & others	66,524	127,206	131,806	143,545	205,923	228,620	248,638	280,658
Shareholders' equity	143,715	208,468	217,390	233,683	301,192	323,889	343,907	375,927
Minority interests	4,559	4,513	4,884	0	0	0	0	0
Total equity & liabilities	2,006,720	3,060,253	3,452,775	3,618,135	4,017,264	4,362,912	4,731,257	5,124,990
Avg interest-earning assets	1,722,939	2,215,079	2,691,278	3,082,040	3,409,095	3,700,001	4,054,825	4,431,209
Avg risk-weighted assets	0	0	0	0	0	0	0	0
BVPS (TWD)	18.618	25.654	25.401	25.925	31.615	33.997	36.098	39.459

Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Loan/deposit	99.3	85.4	81.6	95.9	89.2	91.6	94.3	97.2
Tier-1 CAR	9.5	9.8	9.2	9.3	10.2	11.0	11.9	12.7
Total CAR	11.3	12.1	13.0	13.5	14.2	14.8	15.5	16.2
NPLs/gross loans	0.6	0.5	0.3	0.2	0.2	0.2	0.2	0.2
Total loan-loss prov./NPLs	73.5	111.6	198.4	335.5	230.0	220.0	210.0	210.0
ROAA	0.6	0.8	0.6	0.9	0.8	0.8	0.7	0.8
ROAE	7.0	11.3	9.3	13.5	10.8	10.1	10.2	11.5
Net-interest margin	2.2	2.0	1.9	1.9	2.0	2.2	2.2	2.3
Gross yield	3.4	2.4	2.1	2.2	2.3	2.5	2.5	2.6
Cost of funds	1.7	0.7	0.5	0.7	0.6	0.6	0.6	0.6
Net-interest spread	1.7	1.6	1.6	1.6	1.7	1.9	1.9	1.9
Total cost/total income	61.8	52.8	58.7	49.1	46.5	48.5	50.2	46.7
Effective tax	29.7	13.6	5.8	9.4	11.4	10.9	10.9	10.8
Dividend-payout	0.0	79.5	41.9	28.8	32.0	30.0	28.0	22.9

Source: FactSet, Daiwa forecasts

Company profile

Fubon Financial Holding (Fubon) is one of the largest financial holding companies in Taiwan with total assets of over USD120bn. Its major subsidiaries include banking, life insurance, P&C insurance, and securities companies. Fubon integrated Fubon Bank and Taipei Bank in 2005 and consolidated seven brokers into Fubon Securities in 2000. In addition, the company acquired ING Taiwan in 2009, Fubon Bank Hong Kong in 2004, and a 20% stake in China's Xiamen Bank in 2008.

Ginko International (8406 TT)

Rating: **Buy [1]**
Share price: **TWD530.00**
6-mth target price: **TWD530** (0% potential upside)
3-year fair value: **TWD888** (68% potential upside)

Product migration should drive a rerating

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What is the three-year story?

We think the China contact-lens market is at the very beginning of a long-term growth story and expect Ginko to benefit on the back of:

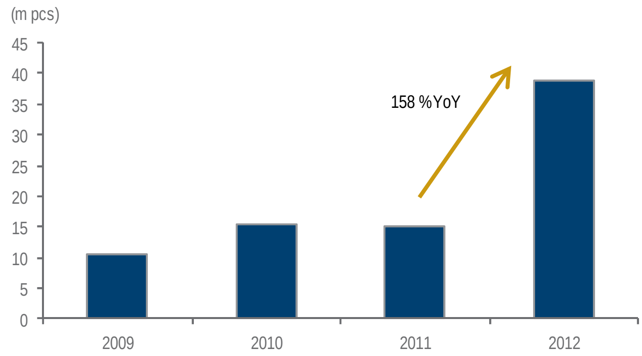
1) Rising penetration: contact-lens penetration in China is about 5% currently, which is still lower than the average Pan-Asia penetration rate of 15-20%.
2) The shift from long replacement-cycle (LRC) conventional lenses (such as semi-annual products) to short replacement-cycle (SRC) products (such as monthly, bi-weekly or daily) should continue as the affordability of contact lenses increases.
3) Cosmetic lenses for young girls: this trend started in the higher-tier China cities a few years ago, and follows the trends we have seen in Japan, Korea and Taiwan.

Ginko is China's leading maker of own-brand contact lenses and contact-lens-care products, with a 36% market share in terms of sales in 2012 (up from 32% in 2010), according to management.

We believe it will continue to capture rising contact-lens spend given its extensive network of 62,000 points of sale, covering the high-to-lower tier cities across China. We forecast a sales CAGR of 26% for Ginko over the 2011-15 period.

The rise in SRC demand that we saw starting in 2H12 points to the early stages of what we believe will be a decade-long migration trend LRC conventional lenses to SRC products. If consumers replace their annual lenses with daily lenses under a full-migration scenario, we estimate that the value of the contact-lens market would rise by 1,900% a year. We believe Ginko is benefiting from the shift to SRC lenses, and expect the company's sales momentum to continue for the next few years.

■ Ginko: sharp rise in demand for SRC lenses from 2H12



Source: Company

What could the fair value be in 2015?

We set our six-month target price at TWD530, based on a target PER of 30x applied to the average of our 2013-14 EPS forecasts, as we believe earnings will improve on the back of the product shift trend. Our target PER of 30x is equivalent to the past-10-year average trading PERs of the Taiwan consumer-brand companies that we believe offer strong China stories, like Ginko.

Given our revenue-CAGR forecast of 26% for 2011-15, we believe the benefits of scale and operating leverage should lead to further operating-profit margin expansion, to 33% in 2015 from 28% in 2008.

We forecast Ginko to deliver a 31% earnings CAGR over 2011-15 and estimate a 2015 fair value of TWD888, based on our target PER of 30x and 2016E EPS of TWD29.6.

Are there any near-term hurdles?

1) **Capacity constraints**: Ginko is currently facing a production bottleneck following strong sales growth of SRC lenses in 2H12. A high yield rate when the new capacity ramps up and a more

aggressive expansion plan from 2014 are critical to Ginko's revenue growth.

2) **Default risk on its accounts receivable**: Ginko provides up to 150 days credit as an incentive to its distributors. Though the company has not seen significant defaults in the past, a major systematic credit crunch could have a negative impact on Ginko's earnings.

3) **Sales of its Taiwan-made contact lenses in China**: Ginko will introduce its Taiwan-made contact lenses in China in 2H13, targeting the mid-to-high-end segment. We forecast the Taiwan-made contact lenses to account for 3% of Ginko's 2013 turnover. Based on our worst-case scenario (that the new product will not generate any revenue in 2013), total 2013 earnings would be about 5% lower than we forecast currently.

How to monitor progress

The keys to Ginko's long-term revenue-growth story are: its market share, China's contact-lens penetration rate, and the migration shift to (SRC) products in the country. To monitor this, the key data points to look for are as follows.

1) **Market share**: Ginko expanded its market share by 1pp, to 36%, in 2012. We believe further expansion would be limited by competition. However, we would like to see Ginko maintain its market share at the 34-36% level going forward.

2) **Revenue contribution from SRC sales**: this is critical to see whether Ginko is capturing the shift to SRC products. In 2012, the proportion of SRC products as a percentage of Ginko's total portfolio increased to 12.4% from 9% for 2011. In a mature market, SRC lenses account for 80% of turnover.

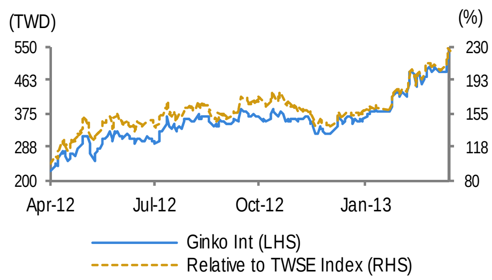
3) **Launch of a new mid-to-high-end brand in China in 2H13**: Will it be on schedule? And how successful will the sell-through of the Taiwan-made mid-to-high end brand be in China?

What could go wrong?

A risk to our call would be growing demand for Lasik surgery to correct poor eyesight, which would decrease the demand for contact lenses. However, we think this risk is manageable as Lasik is an invasive surgery and not suitable for everyone. Meanwhile, we expect demand for cosmetic and colour lenses to continue, mitigating any risks from an increase in demand for laser eye surgery.

Hygiene is very important when it comes to manufacturing contact lenses, with some international brands recalling their lenses because of this, thus damaging their image. If this were to happen to Ginko, a loss of brand image could easily occur.

Share price performance



12-month range	223.50-530.00
Market cap (USDbn)	1.60
3m avg daily turnover (USDm)	5.23
Shares outstanding (m)	91
Major shareholder	Tsai family (42.0%)

Financial summary (TWD)

Year to 31 Dec	12E	13E	14E
Revenue (m)	3,806	4,892	6,382
Operating profit (m)	1,246	1,634	2,120
Net profit (m)	1,052	1,387	1,810
Core EPS (fully-diluted)	12.020	15.323	19.986
EPS change (%)	26.4	27.5	30.4
Daiwa vs Cons. EPS (%)	(1.5)	(2.5)	1.3
PER (x)	44.1	34.6	26.5
Dividend yield (%)	1.0	0.9	1.1
DPS	5.2	4.6	6.0
PBR (x)	7.6	6.6	5.5
EV/EBITDA (x)	32.5	24.9	19.3
ROE (%)	22.0	20.3	22.7

Source: FactSet, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Contact lens ASP (TWD)	0.0	54.9	44.1	37.4	43.5	31.9	21.6	19.7
Contact lens volume ('000 pcs)	0.0	16,859.3	26,186.0	33,217.0	39,821.0	70,433.2	136,813.9	204,929.6
Contact lens solution ASP (TWD)	0.0	36.9	36.9	35.0	37.4	32.1	33.3	32.3
Contact lens solution volume ('000 pcs)	0.0	19,241.2	25,497.0	34,006.0	40,279.0	46,435.0	58,261.6	72,827.0
Consolidated gross margin (%)	0.0	62.3	60.6	64.4	63.6	64.0	61.8	60.1

Profit and loss (TWDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Contact lens	0	926	1,154	1,244	1,731	2,244	2,954	4,032
Lens care product	0	709	941	1,191	1,507	1,492	1,938	2,350
Other Revenue	0	0	0	0	(123)	70	0	0
Total Revenue	0	1,635	2,095	2,435	3,116	3,806	4,892	6,382
Other income	0	0	0	0	0	0	0	0
COGS	0	(616)	(825)	(867)	(1,133)	(1,372)	(1,868)	(2,545)
SG&A	0	(560)	(688)	(842)	(1,023)	(1,188)	(1,389)	(1,717)
Other op.expenses	0	0	0	0	0	0	0	0
Operating profit	0	459	582	726	960	1,246	1,634	2,120
Net-interest inc./(exp.)	0	(34)	(62)	(65)	(58)	0	(2)	9
Assoc/forex/extraord./others	0	21	10	7	26	3	0	0
Pre-tax profit	0	445	529	668	928	1,250	1,632	2,129
Tax	0	(122)	(113)	(111)	(168)	(198)	(245)	(319)
Min. int./pref. div./others	0	0	0	4	0	0	0	0
Net profit (reported)	0	324	416	560	761	1,052	1,387	1,810
Net profit (adjusted)	0	324	416	560	761	1,052	1,387	1,810
EPS (reported)(TWD)	n.a.	4.248	5.457	7.354	9.509	12.090	15.323	19.986
EPS (adjusted)(TWD)	n.a.	4.248	5.457	7.354	9.509	12.090	15.323	19.986
EPS (adjusted fully-diluted)(TWD)	n.a.	4.248	5.457	7.354	9.509	12.020	15.323	19.986
DPS (TWD)	0.000	1.682	0.000	0.000	0.000	5.190	4.597	5.996
EBIT	0	459	582	726	960	1,246	1,634	2,120
EBITDA	0	510	675	832	1,096	1,434	1,872	2,397

Cash flow (TWDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	0	445	529	668	928	1,250	1,632	2,129
Depreciation and amortisation	0	51	94	107	136	187	238	277
Tax paid	0	(83)	(167)	(119)	(126)	(198)	(245)	(319)
Change in working capital	0	(70)	(610)	(119)	(602)	(463)	(666)	(901)
Other operational CF items	0	29	68	65	67	0	2	(9)
Cash flow from operations	0	372	(86)	601	402	776	962	1,177
Capex	0	(273)	(240)	(283)	(637)	(795)	(550)	(500)
Net (acquisitions)/disposals	0	0	(32)	0	0	0	0	0
Other investing CF items	0	23	5	(5)	(45)	0	14	16
Cash flow from investing	0	(250)	(267)	(288)	(682)	(795)	(536)	(484)
Change in debt	0	293	178	106	527	(728)	(400)	(100)
Net share issues/(repurchases)	0	248	0	0	0	1,980	0	0
Dividends paid	0	(70)	(129)	(121)	0	0	(452)	(416)
Other financing CF items	0	(347)	163	5	(85)	0	(16)	(7)
Cash flow from financing	0	123	211	(11)	442	1,252	(868)	(523)
Forex effect/others	0	11	(10)	(13)	43	0	0	0
Change in cash	0	256	(152)	290	205	1,233	(442)	170
Free cash flow	0	99	(326)	318	(234)	(19)	412	677

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (TWDm)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & short-term investment	0	386	234	524	815	2,010	1,568	1,738
Inventory	0	237	278	390	476	590	822	1,145
Accounts receivable	0	909	1,239	1,526	1,950	2,319	2,845	3,556
Other current assets	0	441	237	98	135	729	694	820
Total current assets	0	1,974	1,987	2,538	3,376	5,647	5,929	7,260
Fixed assets	0	991	1,105	1,168	1,719	2,327	2,640	2,862
Goodwill & intangibles	0	24	52	45	42	42	42	42
Other non-current assets	0	8	9	15	16	16	16	16
Total assets	0	2,996	3,153	3,767	5,153	8,032	8,626	10,180
Short-term debt	0	857	670	943	1,095	500	200	100
Accounts payable	0	501	659	727	529	1,000	1,058	1,318
Other current liabilities	0	167	70	26	14	14	14	14
Total current liabilities	0	1,525	1,399	1,696	1,638	1,513	1,271	1,431
Long-term debt	0	195	213	15	233	100	0	0
Other non-current liabilities	0	0	11	41	66	66	66	66
Total liabilities	0	1,720	1,622	1,753	1,936	1,679	1,337	1,497
Share capital	0	2	800	800	800	905	905	905
Reserves/R.E./others	0	1,274	730	1,214	2,416	5,448	6,384	7,777
Shareholders' equity	0	1,276	1,530	2,014	3,216	6,353	7,289	8,683
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	0	2,996	3,153	3,767	5,153	8,032	8,626	10,180
EV	47,805	48,471	48,454	48,240	48,318	46,395	46,437	46,167
Net debt/(cash)	0	666	649	434	513	(1,410)	(1,368)	(1,638)
BVPS (TWD)	n.a.	15.949	19.131	25.173	40.203	70.171	80.507	95.896

Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales (YoY)	n.a.	n.a.	28.1	16.2	28.0	22.2	28.5	30.5
EBITDA (YoY)	n.a.	n.a.	32.5	23.2	31.6	30.8	30.6	28.0
Operating profit (YoY)	n.a.	n.a.	26.8	24.8	32.3	29.8	31.1	29.7
Net profit (YoY)	n.a.	n.a.	28.4	34.8	35.8	38.3	31.9	30.4
Core EPS (fully-diluted) (YoY)	n.a.	n.a.	28.4	34.8	29.3	26.4	27.5	30.4
Gross-profit margin	n.a.	62.3	60.6	64.4	63.6	64.0	61.8	60.1
EBITDA margin	n.a.	31.2	32.2	34.2	35.2	37.7	38.3	37.6
Operating-profit margin	n.a.	28.1	27.8	29.8	30.8	32.7	33.4	33.2
Net profit margin	n.a.	19.8	19.8	23.0	24.4	27.6	28.4	28.4
ROAE	n.a.	25.4	29.6	31.6	29.1	22.0	20.3	22.7
ROAA	n.a.	10.8	13.5	16.2	17.1	16.0	16.7	19.2
ROCE	n.a.	19.7	24.5	26.9	25.5	21.7	22.6	26.1
ROIC	n.a.	17.2	22.2	26.1	25.5	24.2	25.6	27.8
Net debt to equity	net cash	52.2	42.4	21.6	16.0	net cash	net cash	net cash
Effective tax rate	n.a.	27.3	21.4	16.7	18.1	15.8	15.0	15.0
Accounts receivable (days)	n.a.	101.5	187.2	207.2	203.6	204.7	192.6	183.0
Current ratio (x)	n.a.	1.3	1.4	1.5	2.1	3.7	4.7	5.1
Net interest cover (x)	n.a.	13.4	9.3	11.1	16.7	n.a.	817.1	n.a.
Net dividend payout	n.a.	39.6	0.0	0.0	0.0	42.9	30.0	30.0
Free cash flow yield	0.0	0.2	n.a.	0.7	n.a.	n.a.	0.9	1.4

Source: FactSet, Daiwa forecasts

Company profile

Founded in 2007, Ginko International (Ginko) is the leading own-brand contact-lens producer in China, with a 35% market share in 2011, and launched its main Hydron brand in Taiwan in 3Q12. Ginko was listed on Taiwan's OTC market through an IPO in April 2012.

Largan Precision Industry (3008 TT)

Rating: **Buy [1]**
Share price: **TWD778.00**
6-mth target price: **TWD930** (20% potential upside)
3-year fair value: **TWD1,150** (48% potential upside)

Company stands to benefit from optical-feature upgrades for smartphone cameras.

Birdy Lu
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What is the three-year story?

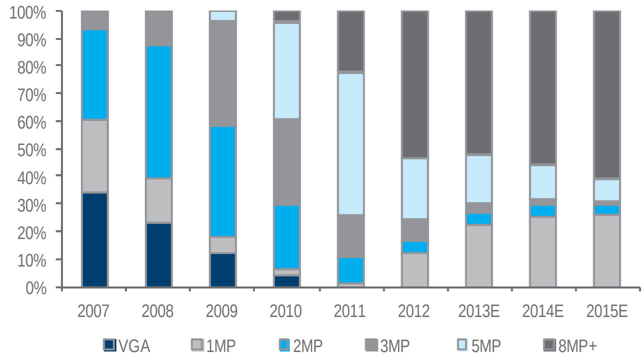
Largan Precision Industry (Largan) is the world's largest smartphone camera lens maker, with solid long-term relationships with major phone makers that include Apple, Nokia, HTC, and Research In Motion (RIM).

Largan supplies more than 60% of the lens modules for the iPhone 5, which is equipped with the slimmest 8MP camera in the world at present. We estimate that the ASP of lens modules with slim form factors is at least 20% higher than that of its bulkier peers.

We believe the design and fabrication of lenses is a business with a bright long-term outlook, because many people are still frustrated by the current limitations of taking photos with their smartphones, especially when trying to photograph moving objects or those set in a low-light environment. As such, there is substantial room to upgrade a smartphone camera's optical features, such as the lens aperture, auto-focus speed, shutter time, depth of field, wide-angle view, etc.

We expect the upgrades of the pixel count for smartphone cameras to resume in 2013. According to our market research, the tier-one smartphone vendors are working on 10-14MP cameras for the next generation of their flagship devices. We believe this will trigger another round of pixel competition, which should support Largan's revenue growth. We forecast an EPS CAGR of 21% for Largan over 2012-15.

■ Largan: lens sales breakdown – surging demand for front cameras should lift its VGA and 1MP lens revenue



Source: Company, Daiwa forecasts
Note: the breakdown only includes revenue from lenses and excludes revenue from VCM assembly business

Owing to the success of the iPhone's FaceTime app, a dual-camera design is becoming a standard for high-end smartphones and is also becoming more popular for mid-range phones. The dual-camera design entails having a main camera (5MP/8MP in resolution) on the back of the handset to take pictures of still images plus a secondary camera (VGA/1MP) on the front to conduct video calls.

Largan has been gaining share in the market for camera-lens modules for tablet PCs globally since 2012 Recent new project wins include supplying the modules for the iPad mini and Kindle Fire.

What could the fair value be in 2015?

Our six-month target price for Largan is TWD930, based on a 16x PER (around the average level of its past-three-year trading range) to our 2013E EPS of TWD58.1.

We believe the PER methodology is the most appropriate way to evaluate downstream tech companies like Largan. It is a straightforward, intuitive and arguably accurate way to gauge a tech company's earnings power.

We apply a 16x PER to our 2015E EPS of TWD71.6 to obtain a fair value of TWD1,150/share by 2015E for Largan.

Largan has consistently traded at a premium (a 12-24x one-year forward PER) to its peers in the region over the past decade. Its local peers tend to trade currently in a range of 8-18x, with an average of 13x. We believe Largan's valuation premium is justifiable. As well as the solid fundamental outlook we see for the company, its concentrated shareholder structure should also help to support its valuation.

Are there any near-term hurdles?

Lately, some investors have been concerned about slowing iPhone shipments. We believe total iPhone production for 1Q13 is now tracking below our previous expectation and should decline to only 30-32m units (down by about 35% QoQ). Similarly, we forecast 2Q13 iPhone shipments to fall further by 10% QoQ to 28m units. We expect the iPad to see a similar QoQ decline over 1Q-2Q13, with the iPad mini being the only bright spot. As Largan supplies both the iPhone and iPad/iPad mini, its revenue is likely to decline sequentially in 1H13 as a result.

However, we expect shipments in the Apple supply chain to pick up again from early 3Q13, driven by the planned launches of a new iPhone and iPad/iPad mini. We believe Largan's long-term growth story is still intact.

How to monitor progress

The key driver for Largan's multi-year growth is its ASP. We expect its lens-module ASP to trend up in the next three years, driven by upgrades in smartphone cameras with better resolution, ultra-slim form factors, anti-vibration, and enhanced optical features (aperture, wide angle, etc.). Investors can monitor whether future smartphones from Apple, Samsung Electronics and other global OEMs come with superior lens modules.

In addition, revenue from Apple accounts for about 50% of Largan's total revenue currently, so any fluctuations in sales of Apple's product would have an impact on Largan's revenue performance. We expect Apple to introduce an iPhone 5S and a new iPad/iPad mini in 3Q12. Watching the acceptance and shipment of these products will give investors further insight into Largan's revenue-growth momentum.

What could go wrong?

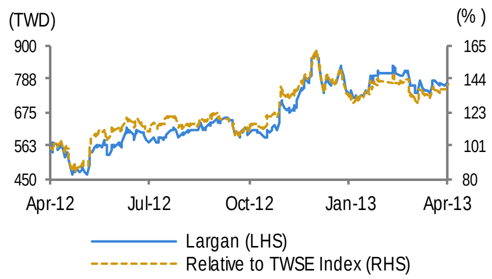
In our view, the key multi-year downside risks are the following.

1) Slow upgrades to smartphone cameras due to cost concerns: Largan's gross margin would be lower than we expect if it does not obtain higher-margin camera orders.

2) Increased price competition from low-cost competitors: currently, low-cost competitors include Genius, Sunny Optical, and some China players. Although Largan differentiates itself by providing high-end products, its shares may still be threatened by low-cost products if its clients start to value low-cost structures more.

3) TWD appreciation against the USD in the long term: Largan's accounts receivables are mostly USD-dominated, so it may face large forex losses if the TWD were to appreciate substantially.

Share price performance



12-month range	464.00-879.00
Market cap (USDbn)	3.48
3m avg daily turnover (USDm)	48.91
Shares outstanding (m)	134
Major shareholder	Cathay Life Insurance Co., Ltd. (5.2%)

Financial summary (TWD)

Year to 31 Dec	12E	13E	14E
Revenue (m)	20,073	26,302	30,744
Operating profit (m)	6,537	8,952	10,416
Net profit (m)	5,373	7,796	9,069
Core EPS (fully-diluted)	40.057	58.122	67.608
EPS change (%)	3.4	45.1	16.3
Daiwa vs Cons. EPS (%)	11.3	7.6	11.7
PER (x)	19.4	13.4	11.5
Dividend yield (%)	2.6	3.7	4.3
DPS	20.0	29.1	33.8
PBR (x)	4.6	3.7	3.1
EV/EBITDA (x)	11.8	8.3	6.8
ROE (%)	25.2	30.6	29.6

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Mobile phone lens shipment (K units)	152,836	200,491	173,300	215,100	286,554	344,730	479,042	568,887
Blended ASP of handset lens (USD)	0.98	1.01	1.12	1.21	1.33	1.44	1.45	1.41
Gross margin of VCM assembly (%)	0.0	0.0	5.0	7.3	6.8	4.9	5.0	5.0

■ Profit and loss (TWDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Mobile Phone Lens Revenues	4,825	6,412	7,421	11,433	15,243	19,062	25,416	29,854
DSC Lens Revenues	487	507	377	555	391	415	385	381
Other Revenue	571	559	357	363	351	596	501	510
Total Revenue	5,882	7,478	8,154	12,351	15,984	20,073	26,302	30,744
Other income	0	0	0	0	0	0	0	0
COGS	(2,604)	(3,491)	(4,580)	(6,546)	(9,043)	(12,030)	(15,404)	(18,176)
SG&A	(159)	(412)	(345)	(374)	(506)	(979)	(1,265)	(1,399)
Other op.expenses	(203)	(456)	(507)	(770)	(963)	(527)	(681)	(753)
Operating profit	2,917	3,119	2,722	4,661	5,472	6,537	8,952	10,416
Net-interest inc./(exp.)	54	56	30	28	50	99	120	164
Assoc/forex/extraord./others	31	163	(109)	(356)	314	(83)	100	89
Pre-tax profit	3,002	3,338	2,643	4,334	5,837	6,553	9,172	10,669
Tax	(432)	(96)	(157)	(289)	(638)	(1,179)	(1,376)	(1,600)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	2,570	3,242	2,486	4,044	5,199	5,373	7,796	9,069
Net profit (adjusted)	2,570	3,242	2,486	4,044	5,199	5,373	7,796	9,069
EPS (reported)(TWD)	19.846	24.653	18.651	30.150	38.755	40.057	58.122	67.608
EPS (adjusted)(TWD)	19.846	24.653	18.651	30.150	38.755	40.057	58.122	67.608
EPS (adjusted fully-diluted)(TWD)	19.846	24.653	18.651	30.150	38.755	40.057	58.122	67.608
DPS (TWD)	9.515	9.895	10.064	13.500	17.000	20.028	29.061	33.804
EBIT	2,917	3,119	2,722	4,661	5,472	6,537	8,952	10,416
EBITDA	3,468	3,684	3,344	5,398	6,372	7,814	10,486	12,179

■ Cash flow (TWDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	3,002	3,338	2,643	4,334	5,837	6,553	9,172	10,669
Depreciation and amortisation	551	565	622	737	900	1,276	1,534	1,762
Tax paid	(432)	(96)	(157)	(289)	(638)	(1,179)	(1,376)	(1,600)
Change in working capital	510	711	(466)	(539)	1,202	(544)	(342)	(258)
Other operational CF items	(10)	(17)	14	21	18	(15)	(5)	(5)
Cash flow from operations	3,621	4,502	2,656	4,263	7,318	6,091	8,983	10,568
Capex	(733)	(1,420)	(1,057)	(1,066)	(3,149)	(2,150)	(1,900)	(2,115)
Net (acquisitions)/disposals	12	(39)	(20)	(1)	(2)	(10)	(10)	(10)
Other investing CF items	4	(16)	(26)	(21)	(23)	72	0	0
Cash flow from investing	(716)	(1,475)	(1,103)	(1,088)	(3,173)	(2,088)	(1,910)	(2,125)
Change in debt	(230)	94	(120)	142	319	(335)	23	(41)
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(1,383)	(1,232)	(1,301)	(1,341)	(1,811)	(2,280)	(2,687)	(3,898)
Other financing CF items	(220)	(200)	591	(23)	37	0	0	0
Cash flow from financing	(1,834)	(1,338)	(831)	(1,223)	(1,456)	(2,615)	(2,664)	(3,939)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	1,071	1,688	723	1,952	2,690	1,388	4,410	4,504
Free cash flow	2,889	3,081	1,599	3,197	4,169	3,941	7,083	8,453

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (TWDm)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & short-term investment	4,216	5,904	6,627	8,579	11,268	12,656	17,066	21,570
Inventory	620	625	622	902	1,461	1,943	2,488	2,935
Accounts receivable	1,782	1,494	2,377	3,182	3,510	4,408	5,776	6,752
Other current assets	97	234	199	153	234	294	385	450
Total current assets	6,715	8,257	9,825	12,815	16,473	19,301	25,715	31,707
Fixed assets	4,163	5,018	5,453	5,795	8,057	8,931	9,296	9,649
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	294	365	397	386	379	332	347	363
Total assets	11,172	13,640	15,675	18,996	24,909	28,564	35,359	41,719
Short-term debt	24	111	16	112	444	122	134	145
Accounts payable	248	273	410	560	1,358	1,483	1,899	2,241
Other current liabilities	740	1,278	1,521	1,871	3,243	4,015	5,260	6,149
Total current liabilities	1,012	1,662	1,948	2,543	5,045	5,620	7,293	8,535
Long-term debt	0	0	0	0	0	0	0	0
Other non-current liabilities	40	47	21	67	54	41	52	0
Total liabilities	1,051	1,709	1,969	2,610	5,099	5,661	7,345	8,535
Share capital	1,257	1,301	1,341	1,341	1,341	1,341	1,341	1,341
Reserves/R.E./others	8,863	10,629	12,365	15,045	18,469	21,562	26,672	31,843
Shareholders' equity	10,121	11,931	13,706	16,386	19,810	22,903	28,013	33,184
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	11,172	13,640	15,675	18,996	24,909	28,564	35,359	41,719
EV	100,169	98,568	97,751	95,894	93,537	91,827	87,429	82,936
Net debt/(cash)	(4,192)	(5,793)	(6,610)	(8,467)	(10,824)	(12,534)	(16,932)	(21,425)
BVPS (TWD)	77.415	89.902	102.178	122.156	147.685	170.741	208.835	247.382

■ Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales (YoY)	(19.9)	27.1	9.0	51.5	29.4	25.6	31.0	16.9
EBITDA (YoY)	(25.0)	6.2	(9.2)	61.4	18.0	22.6	34.2	16.1
Operating profit (YoY)	(29.1)	6.9	(12.7)	71.3	17.4	19.5	36.9	16.4
Net profit (YoY)	(33.9)	26.2	(23.3)	62.7	28.5	3.4	45.1	16.3
Core EPS (fully-diluted) (YoY)	(34.7)	24.2	(24.3)	61.7	28.5	3.4	45.1	16.3
Gross-profit margin	55.7	53.3	43.8	47.0	43.4	40.1	41.4	40.9
EBITDA margin	59.0	49.3	41.0	43.7	39.9	38.9	39.9	39.6
Operating-profit margin	49.6	41.7	33.4	37.7	34.2	32.6	34.0	33.9
Net profit margin	43.7	43.4	30.5	32.7	32.5	26.8	29.6	29.5
ROAE	26.7	29.4	19.4	26.9	28.7	25.2	30.6	29.6
ROAA	23.9	26.1	17.0	23.3	23.7	20.1	24.4	23.5
ROCE	29.8	28.1	21.1	30.8	29.8	30.2	35.0	33.9
ROIC	40.9	50.2	38.7	57.9	57.7	55.4	70.9	77.5
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	14.4	2.9	6.0	6.7	10.9	18.0	15.0	15.0
Accounts receivable (days)	119.7	79.9	86.6	82.1	76.4	72.0	70.7	74.4
Current ratio (x)	6.6	5.0	5.0	5.0	3.3	3.4	3.5	3.7
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	47.9	40.1	54.0	44.8	43.9	50.0	50.0	50.0
Free cash flow yield	2.8	3.0	1.5	3.1	4.0	3.8	6.8	8.1

Source: FactSet, Daiwa forecasts

■ Company profile

In Asia ex-Japan, Largan Precision (Largan) is the leading lens manufacturer for mobile handsets. Nokia, Motorola, Sony Ericsson, Apple, HTC and RIM are the company's major customers. It currently has around a 28% share of the global handset lens market.

TSMC (2330 TT)

Rating: **Hold [3]**
Share price: **TWD98.30**
6-mth target price: **TWD98** (0.3% potential downside)
3-year fair value: **TWD140** (42% potential upside)

Solid long-term growth story

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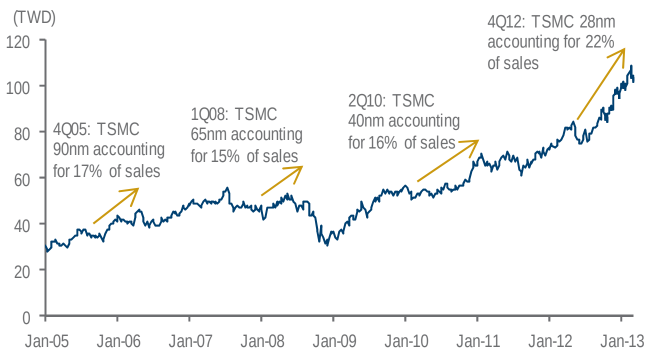
What is the three-year story?

TSMC is the leading player in the global foundry industry as a result of its leading-edge technology. It ramped up production at the 28nm node in 2012 (28nm accounted for 22% of the company's 4Q12 revenue, up from 2% for 4Q11), way ahead of its foundry peers. Its profit margins are currently higher than those of its peers globally.

As the company aims to migrate to the 20nm process in 3Q13 and 16nm in 4Q14, we expect it to continue to outperform the global semiconductor and foundry industries (in terms of its technology) over the next three years. This is likely to be driven by large market-share gains, fuelled by strong demand for advanced-node technology and the company's high exposure to integrated device manufacturers (IDMs).

■ **TSMC: technology migration**



Source: Company, Bloomberg, Daiwa

Due to their fierce rivalry in the communication-device business, Apple has been looking to reduce its reliance on Samsung Electronics (SEC) for its key components (especially since SEC started developing the latest generation of application processors [AP], the A6, in 2011). We forecast TSMC to win 40% of Apple's next generation AP (A7) orders (while we forecast SEC, with its competitive pricing and good understanding of Apple's products, should account for 50% of A7 orders), which could account for about 6% of TSMC 2014E revenue. We expect TSMC's entry into Apple's supply chain (likely by the end of 2013) to be viewed as confirmation of TSMC's leading-edge technology (ie, its migration to the 20nm process).

What could the fair value be in 2015?

The stock's past-10-year PBR range was 1.9-3.9x (10-year average PBR of about 2.9x). We have a six-month target price of TWD98, based on a 2013E PBR of 3.1x, due to the company's strong 1H13 earnings outlook.

Looking at the next 3-4 years, we expect TSMC's revenue growth to be solid and for its market share to expand, on the back of its technological expertise and the success it is having in providing components to the leading mobile-device suppliers. The share price could trade at +1-2SD above its past-10-year PBR average, which is what has happened in the past when the company has successfully ramped up production to the next-generation process, and consolidated its higher market share.

■ **TSMC: 12-month forward PBR bands**

Source: Bloomberg, Daiwa forecasts

Assuming TSMC successfully migrates to the next-generation technology process, maintains its outperforming revenue growth (compared with its peers) and consolidates its market share (while its peers, namely United Microelectronics, Semiconductor Manufacturing International Corp, and Global Foundries, fall behind in terms of technology, capex and production scale), we believe the share price could rise to TWD140 by 2015. This target price is based on a 2015E PBR of 3.6x, which is 2SD above the stock's past-10-year trading average.

Are there any near-term hurdles?

We believe the market is too optimistic in terms of the revenue contribution it sees for TSMC from Apple's business over the near term. The market appears to be looking at TSMC winning up to 100% of the A7 orders while we forecast 40% (with 50% for SEC and 10% for Intel). We believe SEC has a competitive edge over TSMC as SEC's 20nm production schedule does not lag TSMC's, and it has the potential to offer competitive pricing, such as through bundling (as it is also a major global memory supplier).

In addition, we believe TSMC's high capex plans (USD10bn for 2013E and USD10.5bn for 2014E) will lead to high depreciation costs. We forecast the company's 2013-14 earnings growth to fall short of its revenue growth (due to respective 2013-14 rises in depreciation expenses of 24% YoY and 21% YoY and revenue growth of 13% YoY and 11% YoY). Also, the foundry companies might start competing more aggressively in pricing as they catch up with the 28nm process, which could decelerate TSMC's revenue-growth momentum slightly over 2Q-3Q13.

The market has been concerned about Intel's plans to move into the foundry business (at the end of February 2013, the company said it would provide 14nm-process foundry services to Altera). However, we do not believe Intel's foundry services will have a significant impact on TSMC or the competitive landscape initially, as Intel tends to focus on highly advanced geometry technology, and is unlikely to offer competitive pricing in order to maintain its high gross margin.

How to monitor progress

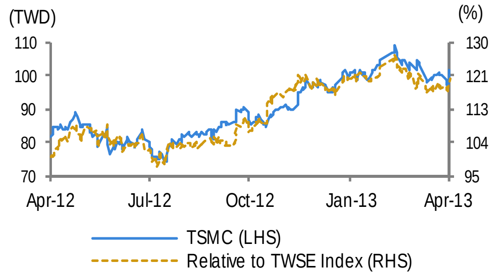
The key indicator of whether TSMC is maintaining its leading position and market-share growth will be the timeliness of its migration to more advanced technology nodes. The company aims to ramp up production at the 20nm process by 3Q13 and 16nm process by the end of 2014. We believe the technology gap between TSMC and Intel will narrow over the next 12 months, given TSMC's high capex plans, and that the company has a strong track record in developing new technology.

As we expect TSMC to ramp up production to more advanced processes over 2013-14, we believe the main semiconductor providers, such as Advanced Micro Devices (AMD), Nvidia, Broadcom and Qualcomm will maintain their orders with TSMC (as opposed to shifting to Intel). Hence, we expect the impact of Intel's foundry business on TSMC to be limited at this stage and that TSMC will remain the world's leading foundry player in terms of technology.

What could go wrong?

The major risks to TSMC's long-term revenue-growth story would be the company failing to ramp up production to the 16nm process and/or more advanced processes on time. If this were to happen, the company's competitive advantage could be affected (as its competitors might start to catch up) as well as the market share it gains. The impact of Intel's entry into the foundry business would increase if TSMC were to fail to do what it has set out to.

Share price performance



12-month range	74.30-109.00
Market cap (USDbn)	85.00
3m avg daily turnover (USDm)	121.64
Shares outstanding (m)	25,925
Major shareholder	National Development Fund (6.4%)

Financial summary (TWD)

Year to 31 Dec	12E	13E	14E
Revenue (m)	506,249	574,086	634,365
Operating profit (m)	181,057	190,271	198,486
Net profit (m)	165,964	166,909	174,076
Core EPS (fully-diluted)	6.402	6.400	6.636
EPS change (%)	23.3	(0.0)	3.7
Daiwa vs Cons. EPS (%)	(0.1)	(9.0)	(15.9)
PER (x)	15.4	15.4	14.8
Dividend yield (%)	2.5	2.5	2.5
DPS	2.5	2.5	2.5
PBR (x)	3.5	3.1	2.8
EV/EBITDA (x)	8.0	7.3	6.6
ROE (%)	24.4	21.5	19.8

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Utilisation rate(%)	94	87	75	102	92	90	95	95
Average selling price (USD)	1,152	1,157	1,057	1,034	1,053	1,129	1,186	1,233
Wafer shipment ('000)	8,005	8,468	7,738	11,860	12,549	14,045	14,747	15,632

■ Profit and loss (TWDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Computer Revenues	102,512	107,763	82,126	114,435	116,492	138,086	156,590	173,032
Communication Revenues	137,003	137,469	124,356	180,143	183,381	217,375	246,503	272,386
Other Revenue	83,115	87,925	89,261	124,961	127,207	150,788	170,993	188,948
Total Revenue	322,631	333,158	295,742	419,538	427,081	506,249	574,086	634,365
Other income	0	0	0	0	0	0	0	0
COGS	(180,280)	(191,408)	(166,414)	(212,484)	(232,937)	(262,654)	(312,560)	(358,739)
SG&A	(12,682)	(15,833)	(15,773)	(18,172)	(18,682)	(22,137)	(24,793)	(26,033)
Other op.expenses	(17,946)	(21,481)	(21,593)	(29,707)	(33,830)	(40,401)	(46,462)	(51,108)
Operating profit	111,722	104,435	91,962	159,175	141,631	181,057	190,271	198,486
Net-interest inc./(exp.)	4,809	5,374	2,209	1,240	853	(121)	(171)	(230)
Assoc/forex/extraord./others	5,111	2,277	1,291	9,855	2,737	618	3,980	4,158
Pre-tax profit	121,642	112,086	95,463	170,270	145,222	181,554	194,080	202,414
Tax	(11,710)	(10,949)	(5,996)	(7,988)	(10,694)	(15,590)	(27,171)	(28,338)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	109,932	101,137	89,466	162,282	134,527	165,964	166,909	174,076
Net profit (adjusted)	109,932	101,137	89,466	162,282	134,527	165,964	166,909	174,076
EPS (reported)(TWD)	4.151	3.877	3.464	6.264	5.191	6.402	6.400	6.636
EPS (adjusted)(TWD)	4.151	3.877	3.464	6.264	5.191	6.402	6.400	6.636
EPS (adjusted fully-diluted)(TWD)	4.151	3.877	3.464	6.264	5.191	6.402	6.400	6.636
DPS (TWD)	2.337	2.354	2.381	2.400	2.490	2.489	2.490	2.490
EBIT	111,722	104,435	91,962	159,175	141,631	181,057	190,271	198,486
EBITDA	191,727	185,948	172,777	246,985	249,313	312,406	353,144	395,563

■ Cash flow (TWDm)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Profit before tax	121,642	112,086	95,463	170,270	145,222	181,554	194,080	202,414
Depreciation and amortisation	80,005	81,512	80,815	87,810	107,682	131,349	162,873	197,076
Tax paid	(11,710)	(10,949)	(5,996)	(7,988)	(10,694)	(15,590)	(27,171)	(28,338)
Change in working capital	(563)	33,979	6,761	(3,793)	(1,905)	(2,257)	622	684
Other operational CF items	(5,608)	5,480	(17,076)	(16,823)	7,283	(5,991)	0	0
Cash flow from operations	183,767	222,109	159,966	229,476	247,587	289,064	330,404	371,837
Capex	(83,103)	(59,223)	(87,761)	(186,829)	(213,264)	(245,980)	(300,000)	(315,000)
Net (acquisitions)/disposals	12,413	51,181	(8,707)	(15,258)	30,741	(27,216)	(8,522)	(9,374)
Other investing CF items	0	0	0	0	0	0	0	0
Cash flow from investing	(70,690)	(8,042)	(96,468)	(202,086)	(182,523)	(273,196)	(308,522)	(324,374)
Change in debt	(2,257)	(2,698)	(9,197)	28,570	9,435	66,288	30,685	65,753
Net share issues/(repurchases)	(45,413)	(33,481)	0	0	(72)	0	0	0
Dividends paid	(77,387)	(76,779)	(76,876)	(77,708)	(77,730)	(77,749)	(78,232)	(78,702)
Other financing CF items	(10,353)	(2,434)	602	501	509	(2,350)	0	0
Cash flow from financing	(135,410)	(115,393)	(85,471)	(48,638)	(67,858)	(13,811)	(47,548)	(12,949)
Forex effect/others	(518)	1,568	(1,364)	(2,141)	(1,620)	(2,118)	0	0
Change in cash	(22,851)	100,242	(23,337)	(23,389)	(4,415)	(61)	(25,666)	34,514
Free cash flow	100,664	162,886	72,205	42,647	34,323	43,084	30,404	56,837

Source: FactSet, Daiwa forecasts

Financial summary continued …

Balance sheet (TWDm)

As at 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Cash & short-term investment	174,834	211,450	195,797	181,574	150,622	150,918	125,703	160,694
Inventory	23,862	14,877	20,914	28,406	24,841	37,831	41,614	45,776
Accounts receivable	42,424	18,497	35,382	42,982	40,948	52,093	57,302	63,033
Other current assets	8,702	7,795	7,711	8,557	8,850	11,447	12,592	13,851
Total current assets	249,822	252,619	259,804	261,519	225,260	252,289	237,211	283,353
Fixed assets	260,252	243,645	273,675	388,444	490,375	617,529	769,657	887,580
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	60,791	62,653	61,217	68,966	58,630	85,217	93,739	103,113
Total assets	570,865	558,917	594,696	718,929	774,265	955,035	1,100,607	1,274,046
Short-term debt	281	8,222	949	32,862	33,889	34,843	44,843	64,843
Accounts payable	13,078	6,043	11,689	12,971	11,859	15,239	16,763	18,439
Other current liabilities	35,347	42,542	66,495	77,358	71,259	92,354	101,589	111,748
Total current liabilities	48,706	56,807	79,133	123,191	117,007	142,436	163,195	195,031
Long-term debt	12,500	4,500	4,500	12,051	20,458	80,000	100,000	145,000
Other non-current liabilities	18,973	17,237	12,015	4,983	4,756	6,845	7,530	8,282
Total liabilities	80,179	78,544	95,648	140,224	142,221	229,281	270,725	348,313
Share capital	317,613	306,129	314,513	259,101	259,162	259,245	274,697	275,174
Reserves/R.E./others	173,073	174,244	184,535	319,604	372,881	466,509	555,185	650,559
Shareholders' equity	490,686	480,373	499,048	578,704	632,044	725,754	829,882	925,733
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	570,865	558,917	594,696	718,929	774,265	955,035	1,100,607	1,274,046
EV	2,386,325	2,349,650	2,358,030	2,411,717	2,452,104	2,512,303	2,567,518	2,597,527
Net debt/(cash)	(162,053)	(198,728)	(190,348)	(136,661)	(96,275)	(36,075)	19,140	49,149
BVPS (TWD)	18.398	18.554	19.266	22.335	24.388	27.995	31.824	35.288

Key ratios (%)

Year to 31 Dec	2007	2008	2009	2010	2011	2012E	2013E	2014E
Sales (YoY)	1.6	3.3	(11.2)	41.9	1.8	18.5	13.4	10.5
EBITDA (YoY)	(4.6)	(3.0)	(7.1)	43.0	0.9	25.3	13.0	12.0
Operating profit (YoY)	(12.2)	(6.5)	(11.9)	73.1	(11.0)	27.8	5.1	4.3
Net profit (YoY)	(13.6)	(8.0)	(11.5)	81.4	(17.1)	23.4	0.6	4.3
Core EPS (fully-diluted) (YoY)	(15.0)	(6.6)	(10.6)	80.8	(17.1)	23.3	(0.0)	3.7
Gross-profit margin	44.1	42.5	43.7	49.4	45.5	48.1	45.6	43.4
EBITDA margin	59.4	55.8	58.4	58.9	58.4	61.7	61.5	62.4
Operating-profit margin	34.6	31.3	31.1	37.9	33.2	35.8	33.1	31.3
Net profit margin	34.1	30.4	30.3	38.7	31.5	32.8	29.1	27.4
ROAE	22.0	20.8	18.3	30.1	22.2	24.4	21.5	19.8
ROAA	19.0	17.9	15.5	24.7	18.0	19.2	16.2	14.7
ROCE	21.4	21.0	18.4	28.2	21.6	23.7	21.0	18.8
ROIC	30.0	30.9	29.2	40.4	26.8	27.0	21.3	18.7
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	2.3	5.3
Effective tax rate	9.6	9.8	6.3	4.7	7.4	8.6	14.0	14.0
Accounts receivable (days)	41.9	33.4	33.2	34.1	35.9	33.5	34.8	34.6
Current ratio (x)	5.1	4.4	3.3	2.1	1.9	1.8	1.5	1.5
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	1,501.9	1,109.7	862.4
Net dividend payout	56.3	60.7	68.7	38.3	48.0	38.9	38.9	37.5
Free cash flow yield	4.0	6.4	2.8	1.7	1.3	1.7	1.2	2.2

Source: FactSet, Daiwa forecasts

Company profile

Incorporated in Taiwan in 1987, Taiwan Semiconductor Manufacturing (TSMC) is the world's largest semiconductor foundry. The company offers wafer-fabrication, mask-making, probing and testing services. Its manufacturing fabs are located in Taiwan, China, the US and Singapore. At the end of 2009, the company had a processing capacity of 9.95 million eight-inch-equivalent wafers, of which 42% were advanced 12-inch wafers, 47% were eight-inch wafers, and 11% were legacy six-inch wafers.

Bangkok Dusit Medical Services PCL (BGH TB)

Rating: **Buy [1]**
Share price: **THB160.0**
6-mth target price: **THB177.0** (11% potential upside)
3-year fair value: **THB242** (51% potential upside)

Potential upsides seem far from over

Siriporn Arunothai
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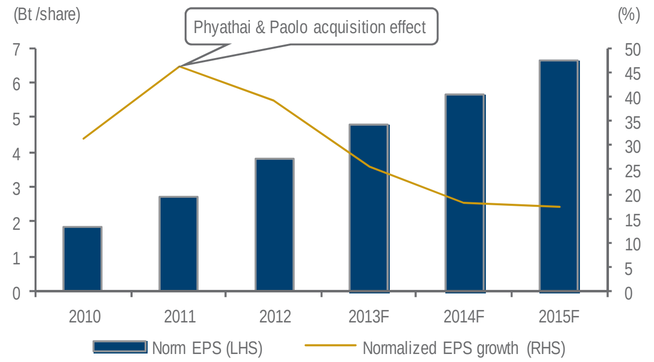
What is the three-year story?

We see the top-down fundamentals of Thailand's healthcare sector as solid both on the demand and supply sides. Healthcare demand is robust, supported by rising incomes, growing healthcare insurance coverage, more severe and chronic diseases being treated along with an ageing population, while healthcare infrastructure and the supply of medical services are limited, particularly public healthcare services. Foreign patient flows from the Middle East and ASEAN-based countries are very strong.

■ **BGH: normalised earnings and growth**



Sources: Company data; Thanachart estimates

Together with Bangkok Dusit Medical Services's (BGH) strong franchises and M&A synergies realised through its extensive nationwide network, we forecast its growth to continue outperforming that of its peers. We forecast BGH's three-year EPS CAGR at 20.4% in 2012-15, outstripping both Bumrungrad Hospital's (BH TB, THB81.5, BUY) 8.3% and Bangkok Chain Hospital's (BCH TB, THB12.2, BUY) 9.7%.

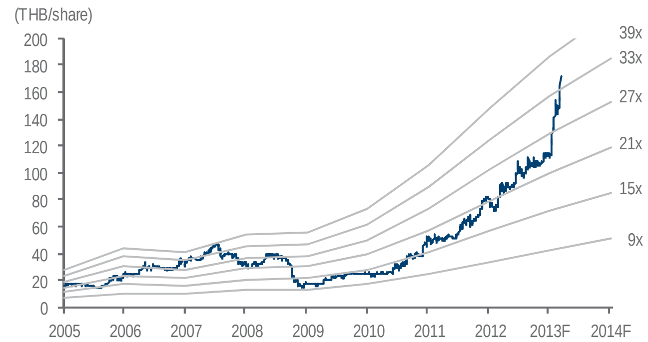
What could the fair value be in 2015?

We forecast BGH to enjoy strong and sustained cash inflow streams and we use a DCF methodology to determine our fair value estimate. We have a 12-month target price of THB177.0/share, excluding future acquisitions. With an 8.1% WACC, we arrive at an implied fair value estimate for 2015 of THB242/share.

In our view, strong flows of domestic and international patients, and the operating-leverage effect, remain key factors leading to what we expect to be a valuation boost for BGH in the next few years. Given BGH's continued expansion via M&As, we see future acquisitions creating more value for the company.

In our view, BGH deserves a high valuation, with prospective upside to our target price still decent. The stock is trading at 33.6x 2013E PER, compared with a near-40x PER multiple of its Malaysian peer IHH Healthcare Bhd (IHH MK, MYR3.73, Not rated), based on the Bloomberg consensus EPS forecast. Moreover, BGH is trading at discounts to its own historical peak PER of 39x, recorded in 2007, and its average multiples of 32x PER and 1.5x PEG in 2005-07, when foreign patients were increasing sharply. While we believe that BGH's earnings growth outlook is similar to back then, we now project higher earnings quality and ROE. We estimate BGH's ROE will rise to 20.3% in 2015 from 17.7% in 2012, versus 13% in 2005-07.

■ **BGH: PER bands**



Sources: Company, Thanachart forecasts

Are there any near-term hurdles?

BGH's earnings are sensitive to changes in the number of patients. However, we believe that domestic and international patient flow will remain strong in the next few years. In our view, demand for medical treatment is resilient to adverse economic conditions. In addition, we believe that people are becoming more health-conscious. We thus do not expect patient flows to be hit by the slowdown in the economy in the short term. On the supply side, we believe that the healthcare market is still in a consolidation phase. We thus do not expect an oversupply situation. Thanks to strong patient flows, BGH is seeing decent operating leverage while group synergies are functioning well.

Near-term hurdles to the above growth drivers appear limited. Longer term, however, we think Thailand's healthcare industry is vulnerable to shortages of doctors and nurses. Together with the opening-up of the ASEAN Economic Community (AEC) in 2015, which could further increase doctor and nurse costs, there is a risk of rising operating costs.

How to monitor progress

For BGH's existing business, we believe that investors should look for rising patient flows and higher average billing per head to boost earnings. Our forecasts call for continued strength in the number of domestic and international patients in the next few years due to rising demand for medical treatment and limited healthcare supply, particularly in ASEAN. Investors should monitor these figures in the company's quarterly results releases.

Further out, the company is targeting to have 50 hospitals in its portfolio by the end of 2015, compared with the 32 we have assumed in our model. In other words, it would need to acquire or invest in six greenfield hospital projects per year which we have yet to factor into our forecasts.

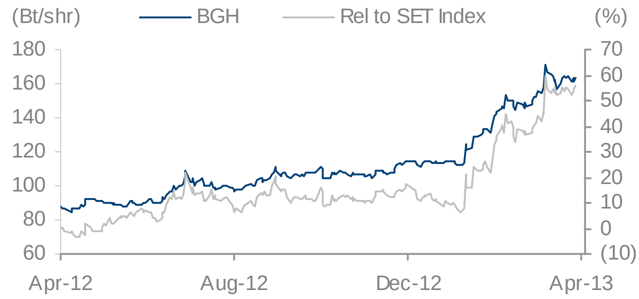
New acquisitions or investments could have a positive or negative impact on our earnings forecasts in the short term, depending whether the earnings contributions come through as gains or losses. But, over the longer term, we believe that newly added projects would boost earnings and add value to BGH.

What could go wrong?

If there are softer-than-expected patient flows due to weaker-than-expected domestic and foreign economies, political unrest, or more intense competition from international competitors following the launch of the AEC, our earnings forecasts would be subject to downside risk.

Unexpected extra costs resulting from future M&As could present downside risks to our earnings forecasts. If acquisition prices for future projects exceed our expectations, returns on investment would be lower than we expect.

However, given its extensive healthcare service network across 13 provinces in Thailand, well-diversified market segmentation, strong franchises backed by recognised brands (Bangkok Hospital, Samithivej Hospital, Bangkok Nursing Home Hospital, Phyathai Hospital and Paolo Hospital), and well-regarded doctor and nurse teams, we believe that BGH stands out as a highly competitive hospital group. The company's strength in terms of both franchise and network should enhance its ability to acquire more new hospitals and ultimately realise further synergies, in our view.



12-month range	172.5/85.0
Market cap (US$ bn)	8,517.9
3m avg daily turnver (US$ m)	16.3
Share outstanding (m)	1,545.5
Major shareholder	Prasarttong-Osoth Family 22.3%

Y/E Dec (Bt m)	2012A	2013F	2014F	2015F
Sales	44,307	50,962	58,211	66,138
Operating profit	6,100	7,230	8,473	9,932
Net profit	7,937	7,363	8,694	10,216
Consensus NP	—	7,174	8,587	10,651
Diff frm cons (%)	—	2.6	1.2	(4.1)
Norm profit	5,859	7,363	8,694	10,216
Norm EPS (Bt)	3.8	4.8	5.6	6.6
Norm EPS grw (%)	39.2	25.7	18.1	17.5
Norm PE (x)	42.2	33.6	28.4	24.2
Div yield (%)	0.9	1.2	1.6	2.1
DPS (Bt/sh)	1.4	1.9	2.5	3.3
P/BV (x)	6.6	5.9	5.2	4.7
EV/EBITDA (x)	29.1	25.0	21.6	18.6
ROE (%)	16.9	18.5	19.4	20.3

Sources: Company data; Thanachart estimates

INCOME STATEMENT

FY ending Dec (Bt m)	2011A	2012A	2013F	2014F	2015F
Sales	35,224	44,307	50,962	58,211	66,138
Cost of sales	23,675	29,239	33,547	38,190	43,199
Gross profit	**11,549**	**15,069**	**17,414**	**20,021**	**22,939**
% gross margin	32.8%	34.0%	34.2%	34.4%	34.7%
Selling & administration expenses	7,224	8,969	10,184	11,548	13,007
Operating profit	**4,325**	**6,100**	**7,230**	**8,473**	**9,932**
% operating margin	12.3%	13.8%	14.2%	14.6%	15.0%
Depreciation & amortization	2,707	2,951	3,267	3,586	3,893
EBITDA	**7,032**	**9,050**	**10,497**	**12,059**	**13,825**
% EBITDA margin	20.0%	20.4%	20.6%	20.7%	20.9%
Non-operating income	1,668	1,760	2,051	2,262	2,536
Non-operating expenses	0	0	0	0	0
Interest expense	(770)	(849)	(998)	(873)	(801)
Pre-tax profit	**5,222**	**7,010**	**8,283**	**9,862**	**11,666**
Income tax	1,456	1,521	1,532	1,874	2,275
After-tax profit	**3,766**	**5,490**	**6,751**	**7,989**	**9,391**
% net margin	10.7%	12.4%	13.2%	13.7%	14.2%
Shares in affiliates' Earnings	382	685	975	1,119	1,296
Minority interests	(241)	(315)	(363)	(414)	(471)
Extraordinary items	479	2,078	0	0	0
NET PROFIT	**4,386**	**7,937**	**7,363**	**8,694**	**10,216**
Normalized profit	**3,907**	**5,859**	**7,363**	**8,694**	**10,216**
EPS (Bt)	3.1	5.1	4.8	5.6	6.6
Normalized EPS (Bt)	2.7	3.8	4.8	5.6	6.6

BALANCE SHEET

FY ending Dec (Bt m)	2011A	2012A	2013F	2014F	2015F
ASSETS:					
Current assets:	8,877	9,086	7,992	8,576	9,168
Cash & cash equivalent	3,876	3,590	1,500	1,500	1,500
Account receivables	3,377	4,287	4,887	5,422	5,980
Inventories	1,038	780	919	942	947
Others	586	429	686	712	741
Investments & loans	7,865	13,360	13,360	13,360	13,360
Net fixed assets	29,430	33,152	36,133	38,347	40,254
Other assets	12,620	12,863	14,795	16,900	19,201
Total assets	**58,792**	**68,461**	**72,280**	**77,183**	**81,982**
LIABILITIES:					
Current liabilities:	7,578	11,373	10,001	10,878	11,875
Account payables	3,391	3,614	4,136	4,708	5,326
Bank overdraft & ST loans	231	1,225	850	735	579
Current LT debt	963	2,982	808	699	550
Others current liabilities	2,993	3,551	4,208	4,736	5,421
Total LT debt	**15,598**	**15,708**	**15,344**	**13,273**	**10,443**
Others LT liabilities	2,198	2,553	2,936	3,354	3,811
Total liabilities	**25,375**	**29,634**	**28,282**	**27,506**	**26,128**
Minority interest	1,422	1,532	1,894	2,308	2,779
Preferreds shares	0	0	0	0	0
Paid-up capital	1,545	1,545	1,545	1,545	1,545
Share premium	20,022	20,022	20,022	20,022	20,022
Warrants	0	0	0	0	0
Surplus	1,268	476	476	476	476
Retained earnings	**9,159**	**15,252**	**20,060**	**25,325**	**31,032**
Shareholders' equity	31,995	37,296	42,104	47,369	53,075
Liabilities & equity	**58,792**	**68,461**	**72,280**	**77,183**	**81,982**

Source: Company; Thanachart forecasts

CASH FLOW STATEMENT

FY ending Dec (Bt m)	2011A	2012A	2013F	2014F	2015F
Earnings before tax	5,222	7,010	8,283	9,862	11,666
Tax paid	(1,084)	(1,640)	(1,265)	(1,850)	(2,096)
Depreciation & amortization	2,707	2,951	3,267	3,586	3,893
Chg In working capital	(621)	(429)	(217)	14	55
Chg In other CA & CL / minorities	797	1,116	1,287	1,552	1,772
Cash flow from operations	**7,021**	**9,008**	**11,355**	**13,164**	**15,291**
Capex	(13,279)	(6,672)	(6,248)	(5,800)	(5,800)
ST loans & investments	1,275	197	(232)	0	0
LT loans & investments	(3,954)	(5,495)	0	0	0
Adj for asset revaluation	(838)	(793)	0	0	0
Chg In other assets & liabilities	(7,693)	2,189	(1,496)	(1,641)	(1,845)
Cash flow from investments	**(24,489)**	**(10,574)**	**(7,976)**	**(7,441)**	**(7,645)**
Debt financing	6,041	3,124	(2,914)	(2,294)	(3,137)
Capital increase	13,333	0	(0)	0	0
Dividends paid	(990)	(1,700)	(2,554)	(3,429)	(4,510)
Warrants & other surplus	470	(144)	0	0	0
Cash flow from financing	**18,854**	**1,280**	**(5,468)**	**(5,723)**	**(7,647)**
Free cash flow	**(6,258)**	**2,336**	**5,107**	**7,364**	**9,491**

FY ending Dec	2011A	2012A	2013F	2014F	2015F
Normalized PE (x)	58.8	42.2	33.6	28.4	24.2
Normalized PE - at target price (x)	65.0	46.7	37.2	31.5	26.8
PE (x)	52.3	31.2	33.6	28.4	24.2
PE - at target price (x)	57.9	34.5	37.2	31.5	26.8
EV/EBITDA (x)	34.5	29.1	25.0	21.6	18.6
EV/EBITDA - at target price (x)	37.9	32.0	27.5	23.8	20.5
P/BV (x)	7.7	6.6	5.9	5.2	4.7
P/BV - at target price (x)	8.5	7.3	6.5	5.8	5.2
P/CFO (x)	32.7	27.4	21.8	18.8	16.2
Price/sales (x)	7.0	5.6	4.9	4.2	3.7
Dividend yield (%)	0.7	0.9	1.2	1.6	2.1
FCF Yield (%)	(2.7)	0.9	2.1	3.0	3.8
(Bt)					
Normalized EPS	2.7	3.8	4.8	5.6	6.6
EPS	3.1	5.1	4.8	5.6	6.6
DPS	1.2	1.4	1.9	2.5	3.3
BV/share	20.7	24.1	27.2	30.7	34.3
CFO/share	4.9	5.8	7.3	8.5	9.9
FCF/share	(4.4)	1.5	3.3	4.8	6.1

FINANCIAL RATIOS

FY ending Dec	2011A	2012A	2013F	2014F	2015F
Growth Rate					
Sales (%)	49.8	25.8	15.0	14.2	13.6
Net profit (%)	91.1	81.0	(7.2)	18.1	17.5
EPS (%)	63.9	68.0	(7.2)	18.1	17.5
Normalized profit (%)	70.2	50.0	25.7	18.1	17.5
Normalized EPS (%)	46.0	39.2	25.7	18.1	17.5
Dividend payout ratio (%)	41.8	27.3	40.0	45.0	50.0
Operating performance					
Gross margin (%)	32.8	34.0	34.2	34.4	34.7
Operating margin (%)	12.3	13.8	14.2	14.6	15.0
EBITDA margin (%)	20.0	20.4	20.6	20.7	20.9
Net margin (%)	10.7	12.4	13.2	13.7	14.2
D/E (incl. minor) (x)	0.5	0.5	0.4	0.3	0.2
Net D/E (incl. minor) (x)	0.4	0.4	0.4	0.3	0.2
Interest coverage - EBIT (x)	5.6	7.2	7.2	9.7	12.4
Interest coverage - EBITDA (x)	9.1	10.7	10.5	13.8	17.2
ROA - using norm profit (%)	8.6	9.2	10.5	11.6	12.8
ROE - using norm profit (%)	16.4	16.9	18.5	19.4	20.3
WACC (%)	8.1	8.1	8.1	8.1	8.1
ROIC (%)	13.1	10.6	11.0	11.9	13.2
NOPAT (Bt m)	3,119	4,777	5,893	6,863	7,995

Source: company, Thanachart forecasts

CP All (CPALL TB)

Rating: **Buy [1]**
Share price: **THB45.75**
6-mth target price: **THB60.0** (31% potential upside)
3-year fair value: **THB73.0** (60% potential upside)

In a more aggressive mode

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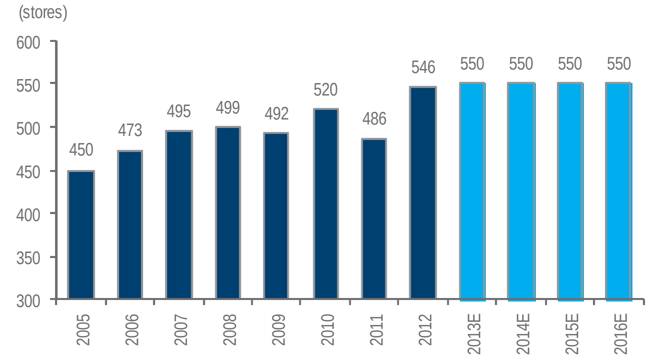
What is the three-year story?

CPALL has turned more aggressive with its latest store expansion target, which implies to us that the 7-Eleven business in Thailand will not be maturing anytime soon. Amid fiercer competition in the small-format segment, it has raised both new store and same-store sales (SSS) growth targets for this year. Its natural monopoly in the convenience store (CVS) segment enhances its profitability, and we forecast a decent forecast ROE of 48% in 2013, rising to 60% in 2017.

From an expansion target of 400-450 new stores a year for the past few years, it is now looking to open 500-550/year from this year. CPALL expects the 7,000-store nationwide target to be achieved this year, and it has announced a new target of 10,000 stores by 2018. It has also raised its SSS growth guidance to the highest point (5%) of the previous target of 3-5%. As it sees plenty of room to expand outside of Bangkok, it plans for its new stores to be geared more to these areas (at a ratio of 65% outside of Bangkok and 35% in Bangkok, from 53% outside of Bangkok currently).

We do not think new competition will be a threat any time soon, as the company's strong platform and franchise make it difficult for newcomers to compete. It has a well-established logistics system with five distribution centres currently, and there are plans to expand. Product offerings at 7-Eleven stores are distinct given its food CVS concept (many ready-to-eat and drink products in the mix) and that it has its own-engineered private brands and co-develops products with suppliers.

■ CPALL: store openings



Sources: Company, Thanachart forecasts

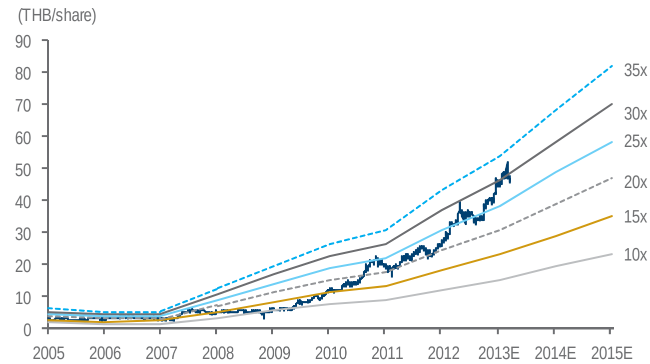
We project a strong 2012-15E EPS CAGR of 24% driven by: 1) SSS growth of 7% YoY, 6% YoY, 5% YoY for 2013-15E, respectively, 2) new store additions of 550 a year over 2013-15E, and 3) an expansion of the total product gross-profit margin by 40-50bp p.a. on stronger bargaining power.

What could the fair value be in 2015?

Given CPALL's growing recurring cash-flow stream from its solid 7-Eleven business in Thailand, we apply a DCF methodology to derive CPALL's valuation, with a 12-month DCF-based target price of THB60.0/share. At a WACC of 10.3%, this would imply that the stock's fair value would be THB73.0/share in 2015.

The PER gap to its sector peers has now closed and we believe this is unjustified given CPALL's big-cap size (USD13.6bn market cap, No.8 on the Stock Exchange of Thailand), very strong franchise name with what we view as low business risk and very high forecast ROE. While we see its earnings-growth prospects as matching those of the other Thailand retailers, we believe CPALL deserves to trade at a premium to its peers.

■ CPALL: PER bands



Sources: Company, Thanachart forecasts

Are there any near-term hurdles?

We see new competition in the CVS segment from FamilyMart, under Central Retail Corporation (CRC, not listed), Mini Big Cs and the upcoming Lawson CVS chain (a joint venture with Saha Group), implying a strong demand outlook and lots of room to accommodate new players. However, competition has forced CPALL, a CVS leader with a 53% market share as at 2012, to speed up store openings to secure even more market share. Though it has hefty bargaining power with suppliers, its frequent marketing campaigns are likely to dilute its ability to improve its gross margin.

While we see the Thai 7-Eleven business as low risk, a near-term hurdle would be if the firm were awarded a licence to operate 7-Eleven CVS in some cities in China, given the intense competition in that market, which could reduce the company's profitability.

How to monitor progress?

We believe the key positive earnings catalysts for CPALL would be rising SSS growth, branch expansion, further margin improvement and growing economies of scale along with its expansion. Hence, we can monitor its performance by following the company's quarterly announcement following its quarterly results on SSS growth, number of new stores and the gross margin for food and non-food items.

We expect CPALL's SSS to be slightly better than the Thai GDP level every year on the back of increasing customer traffic (1,290 customers/store/day in 2012) and higher spending per ticket (THB58/bill in 2012).

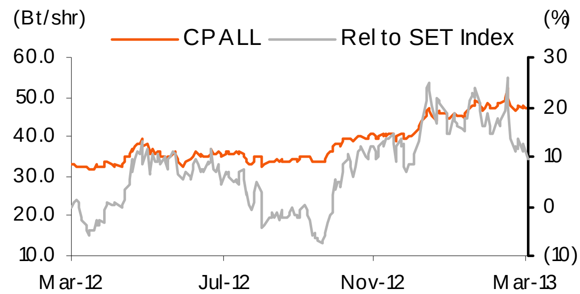
The company's expansion milestone is to reach around 10,000 stores by 2018 at an expansion rate of 500-550 a year. Logistics is the key in our view and CPALL is building another distribution centre in Thailand's Central region in Samut Sakhon Province, which would add capacity to serve 2,500 stores (due to open in 2014) from its existing capacity to cater to 8,000 branches from five distribution centres (two in Bangkok and three in Khon Kaen, Lamphun and Surat Thani).

CPALL plans to boost its gross margin via store additions and by introducing higher-margin products to stores, including increasing the coverage area for chilled-food items, and opening more Kudsan coffee corners offering freshly baked items and freshly brewed coffee, and eXta health & beauty product shops and pharmacies.

What could go wrong?

We believe a weaker-than-expected Thailand economy in the future would have a direct impact on the performance of 7-Eleven as it is highly leveraged to domestic consumption. In this event, we would expect the company to offer promotional campaigns, which could affect its degree of margin expansion. A staff shortage could impede store expansion but we do not think this is a key threat to CPALL as it owns Panyapiwat Technological College, which trains new staff, while new store openings are more for franchise stores at 70% versus 30% for corporate-owned.

The key downside risks to our sales-growth and gross-margin forecasts would be if other competitors, for example, Tesco Express (not listed), and other newcomers were to expand faster than we expected.



12-month range	52.0/31.8
Market cap (US$ bn)	13,552.1
3m avg daily turnver (US$ m)	34.3
Share outstanding (m)	8,983.1
Major shareholder	CP Group 48.0%

Y/E Dec (Bt m)	2012A	2013F	2014F	2015F
Sales	197,045	228,382	260,062	292,050
Operating profit	6,100	7,230	8,473	9,932
Net profit	11,023	13,781	17,434	20,986
Consensus NP	—	13,366	16,126	19,029
Diff frm cons (%)	—	3.1	8.1	10.3
Norm profit	10,985	13,781	17,434	20,986
Norm EPS (Bt)	1.2	1.5	1.9	2.3
Norm EPS grw (%)	40.4	25.2	26.5	20.4
Norm PE (x)	38.6	30.8	24.4	20.2
Div yield (%)	1.9	2.4	3.3	4.2
DPS (Bt/sh)	1.4	1.9	2.5	3.3
P/BV (x)	15.9	13.6	11.7	10.3
EV/EBITDA (x)	24.4	19.9	15.7	13.1
ROE (%)	45.5	47.6	51.7	54.1

Source: Company, Thanachart forecasts

INCOME STATEMENT

FY ending Dec (Bt m)	2011A	2012A	2013F	2014F	2015F
Sales	161,223	197,045	228,382	260,062	292,050
Cost of sales	116,863	140,091	161,222	182,539	203,816
Gross profit	**44,360**	**56,953**	**67,159**	**77,523**	**88,235**
% gross margin	27.5%	28.9%	29.4%	29.8%	30.2%
Selling & administration expenses	34,032	43,736	51,080	57,090	63,686
Operating profit	**10,328**	**13,217**	**16,079**	**20,433**	**24,549**
% operating margin	6.4%	6.7%	7.0%	7.9%	8.4%
Depreciation & amortization	3,123	3,173	3,510	3,910	4,279
EBITDA	**13,451**	**16,390**	**19,589**	**24,343**	**28,828**
% EBITDA margin	8.3%	8.3%	8.6%	9.4%	9.9%
Non-operating income	451	732	824	863	1,132
Non-operating expenses	0	0	0	0	0
Interest expense	(0)	(0)	114	231	232
Pre-tax profit	**10,778**	**13,950**	**17,017**	**21,527**	**25,913**
Income tax	2,981	2,931	3,233	4,090	4,924
After-tax profit	**7,797**	**11,019**	**13,784**	**17,437**	**20,990**
% net margin	4.8%	5.6%	6.0%	6.7%	7.2%
Shares in affiliates' Earnings	0	0	0	0	0
Minority interests	(6)	(34)	(3)	(3)	(4)
Extraordinary items	216	39	0	0	0
NET PROFIT	**8,008**	**11,023**	**13,781**	**17,434**	**20,986**
Normalized profit	**7,791**	**10,985**	**13,781**	**17,434**	**20,986**
EPS (Bt)	0.9	1.2	1.5	1.9	2.3
Normalized EPS (Bt)	0.9	1.2	1.5	1.9	2.3

BALANCE SHEET

FY ending Dec (Bt m)	2011A	2012A	2013F	2014F	2015F
ASSETS:					
Current assets:	36,404	48,854	46,341	55,645	64,219
Cash & cash equivalent	14,202	23,085	17,938	25,035	31,396
Account receivables	477	541	627	714	802
Inventories	8,642	9,148	11,043	12,503	13,960
Others	13,083	16,080	16,733	17,394	18,061
Investments & loans	1,759	2,215	2,215	2,215	2,215
Net fixed assets	14,994	18,094	20,884	22,574	23,495
Other assets	2,184	2,635	3,054	3,478	3,905
Total assets	**55,341**	**71,798**	**72,495**	**83,912**	**93,834**
LIABILITIES:					
Current liabilities:	30,479	41,025	37,780	43,692	48,057
Account payables	24,393	32,580	33,128	37,508	40,763
Bank overdraft & ST loans	2	0	(4,551)	(4,628)	(4,662)
Current LT debt	0	0	0	0	0
Others current liabilities	6,084	8,445	9,203	10,813	11,956
Total LT debt	**0**	**0**	**0**	**0**	**0**
Others LT liabilities	2,405	2,833	3,283	3,739	4,199
Total liabilities	**33,642**	**44,812**	**41,063**	**47,431**	**52,256**
Minority interest	208	242	245	249	252
Preferreds shares	0	0	0	0	0
Paid-up capital	4,493	8,983	8,986	8,986	8,986
Share premium	1,684	1,684	1,684	1,684	1,684
Warrants	0	0	0	0	0
Surplus	(361)	(512)	(400)	(400)	(400)
Retained earnings	**15,675**	**16,588**	**20,915**	**25,962**	**31,056**
Shareholders' equity	21,491	26,744	31,186	36,233	41,326
Liabilities & equity	**55,341**	**71,798**	**72,495**	**83,912**	**93,834**

Source: Company, Thanachart forecasts

CASH FLOW STATEMENT

FY ending Dec (Bt m)	2011A	2012A	2013F	2014F	2015F
Earnings before tax	10,778	13,950	17,017	21,527	25,913
Tax paid	(2,934)	(2,864)	(2,934)	(3,943)	(4,686)
Depreciation & amortization	3,123	3,173	3,510	3,910	4,279
Chg In working capital	653	7,616	(1,432)	2,833	1,710
Chg In other CA & CL / minorities	660	1,375	(195)	802	238
Cash flow from operations	**12,280**	**23,250**	**15,966**	**25,129**	**27,455**
Capex	(3,592)	(6,273)	(6,300)	(5,600)	(5,200)
ST loans & investments	(5,458)	(2,077)	0	0	0
LT loans & investments	(1,068)	(456)	0	0	0
Adj for asset revaluation	0	0	0	0	0
Chg In other assets & liabilities	378	174	(923)	32	32
Cash flow from investments	**(9,739)**	**(8,633)**	**(7,223)**	**(5,568)**	**(5,168)**
Debt financing	218	36	(4,551)	(78)	(33)
Capital increase	0	4,490	3	0	0
Dividends paid	(4,490)	(5,612)	(9,212)	(12,141)	(15,893)
Warrants & other surplus	1,491	(4,648)	(130)	(245)	0
Cash flow from financing	**(2,780)**	**(5,734)**	**(13,889)**	**(12,464)**	**(15,926)**
Free cash flow	**8,688**	**16,977**	**9,666**	**19,529**	**22,255**

FY ending Dec	2011A	2012A	2013F	2014F	2015F
Normalized PE (x)	54.1	38.6	30.8	24.4	20.2
Normalized PE - at target price (x)	68.8	49.0	39.1	30.9	25.7
PE (x)	52.7	38.4	30.8	24.4	20.2
PE - at target price (x)	66.9	48.8	39.1	30.9	25.7
EV/EBITDA (x)	30.3	24.4	19.9	15.7	13.1
EV/EBITDA - at target price (x)	38.8	31.4	25.8	20.4	17.0
P/BV (x)	19.6	15.9	13.6	11.7	10.3
P/BV - at target price (x)	24.9	20.2	17.3	14.9	13.0
P/CFO (x)	34.4	18.2	26.6	16.9	15.5
Price/sales (x)	2.6	2.2	1.9	1.6	1.5
Dividend yield (%)	1.3	1.9	2.4	3.3	4.2
FCF Yield (%)	2.1	4.0	2.3	4.6	5.2
(Bt)					
Normalized EPS	0.9	1.2	1.5	1.9	2.3
EPS	0.9	1.2	1.5	1.9	2.3
DPS	0.6	0.9	1.2	1.6	2.0
BV/share	2.4	3.0	3.5	4.0	4.6
CFO/share	1.4	2.6	1.8	2.8	3.1
FCF/share	1.0	1.9	1.1	2.2	2.5

FINANCIAL RATIOS

FY ending Dec	2011A	2012A	2013F	2014F	2015F
Growth Rate					
Sales (%)	14.8	22.2	15.9	13.9	12.3
Net profit (%)	20.2	37.7	25.0	26.5	20.4
EPS (%)	20.2	37.1	24.7	26.5	20.4
Normalized profit (%)	15.1	41.0	25.5	26.5	20.4
Normalized EPS (%)	15.1	40.4	25.2	26.5	20.4
Dividend payout ratio (%)	70.1	73.4	75.0	80.0	85.0
Operating performance					
Gross margin (%)	27.5	28.9	29.4	29.8	30.2
Operating margin (%)	6.4	6.7	7.0	7.9	8.4
EBITDA margin (%)	8.3	8.3	8.6	9.4	9.9
Net margin (%)	4.8	5.6	6.0	6.7	7.2
D/E (incl. minor) (x)	0.0	0.0	(0.1)	(0.1)	(0.1)
Net D/E (incl. minor) (x)	(0.7)	(0.9)	(1.1)	(1.1)	(1.2)
Interest coverage - EBIT (x)	na	na	na	na	na
Interest coverage - EBITDA (x)	na	na	na	na	na
ROA - using norm profit (%)	15.1	17.3	19.1	22.3	23.6
ROE - using norm profit (%)	39.7	45.5	47.6	51.7	54.1
WACC (%)	10.3	10.3	10.3	10.3	10.3
ROIC (%)	366.2	143.2	356.0	(505.6)	(368.2)
NOPAT (Bt m)	7,471	10,440	13,024	16,550	19,885

Source: Company, Thanachart forecasts

Jasmine International PCL (JAS TB)

Rating: **Buy [1]**
Share price: **THB6.30**
6-mth target price: **THB8.0** (27% potential upside)
3-year fair value: **THB11.2** (78% potential upside)

Beefed-up business momentum

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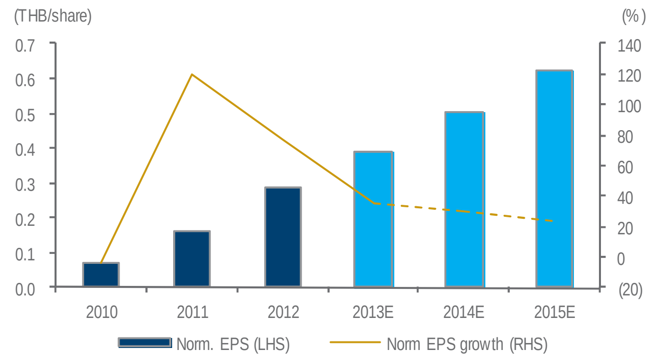
What is the three-year story?

We expect Jasmine International's (JAS) earnings growth to be quite strong over the next three years, and forecast an EPS CAGR of 29% for 2012-15.

■ JAS: EPS

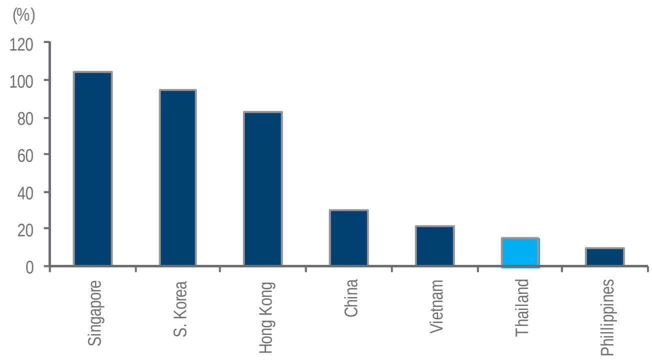


Sources: Company, Thanachart forecasts

Two key factors we expect to bolster JAS's earnings growth are as follows:

1) The broadband Internet penetration rate in Thailand is quite low compared with elsewhere in Asia, at only 19% at the end of 2011. We believe the development of high-speed Internet access throughout the country has only just begun and we see considerable room for broadband internet usage to increase, supported by a demand shift from narrow-band to broadband Internet, changes in people's lifestyles, more affordable technology, and rising incomes.

■ Thailand: broadband Internet penetration rate (2011)



Sources: True Corporation

2) JAS is now in a period in which it is enjoying more benefits from operating leverage. The company's investment in a core fibre-optic network has reached the point where we believe it will be able to support earnings growth for the next five years. JAS's capex has fallen by half from THB4bn a year in 2009-11 to THB2bn a year in 2012, and should remain at THB2bn a year out to 2023. The company has stated that capex will be focused mainly on its last-mile access network over the next 10 years. In addition, once the number of subscribers surpassed 1m, the company started enjoying economies of scale. International circuit costs, marketing expenses and other operating costs per subscriber have therefore declined since mid-2012. We forecast the leverage effect to boost the company's operating-profit margin from 30% for 2012 to 33% for 2013, 36% for 2014, and 39% for 2015.

What could the fair value be in 2015?

Given the sustained earnings and cash flows that we expect from JAS's broadband Internet business, we use a DCF methodology to value the stock. We have a 12-month target price of THB8.0, with a WACC of 11.8%, which implies a fair value of THB11.20/share in 2015E. Given our forecasts for stable cash flow from the company's broadband business and the strong earnings growth, we believe the stock deserves to trade at a PER of more than 20x. We consider the stock as cheap currently, trading at a 2013E PER of 16.3x. Symphony Communication Pcl (SYMC TB, THB19.40, SELL), JAS's direct peer, is trading currently at a 2013E PER of 20.3x.

Are there any near-term hurdles?

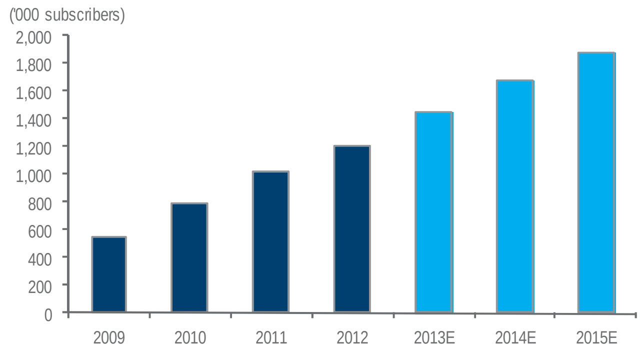
In our view, a key risk for JAS's earnings is provisioning. The state-owned enterprise TOT (Not listed) still owes JAS's subsidiary, Jasmine Submarine Telecommunication (Not listed), money for services under a co-investment contract. The companies are unable to agree on the revenue-sharing amount, but JAS has already booked THB2.5bn as revenue and accounts receivable from when the service started in 2008 and ended in October 2011. TOT is unlikely to default, in our view, but there is still a provisioning risk given the large gap between what TOT expects to pay and the revenue amount JAS has booked. If the auditor forces JAS to set aside a provision for this accounts receivable, it could affect the company's earnings. However, it would be a one-time non-cash item and would not affect our target price.

How to monitor progress

JAS aims for its number of broadband subscribers to reach 2m by the end of 2015, up from 1.2m at the end of 2012. The company aims to maintain its ARPU in the next three years at the same level of last year.

We forecast the number of broadband subscribers to reach 1.4m, 1.6m and 1.9m, respectively, by the end of 2013, 2014, and 2015, respectively. Our forecast for 2015 is slightly below management's target due to our concerns about rising competition from new entrants. Investors can monitor the number of broadband subscribers and pricing from the quarterly investor bulletins on the company's website.

■ **JAS: broadband subscribers**

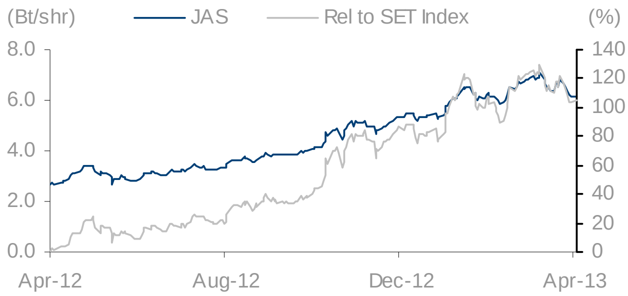


Sources: Company, Thanachart forecasts

What could go wrong?

At present, there are three key players in Thailand's broadband business – TOT, True Corporation (TRUE TB, THB7.35, SELL), and JAS. Given this and decent demand growth, we consider competition for broadband Internet services in the retail market as mild. This is also supported by the fact that TOT is a state-owned enterprise while TRUE is loss-making. Competition is not on pricing but on the speed of service. There are aggressive marketing campaigns but the emphasis is on Internet speed (at the same price). Should competition in the future be greater than we expect or demand growth slower, JAS may adopt a pricing policy to stimulate consumer demand, which could have a negative impact on its EBITDA margins.

Cable Thai Holding (CTH) (Not listed) plans to offer a 1Gb Internet service within 1-2 years. The company consists of a group of provincial cable-TV operators and recently won the bid to broadcast English Premier League (EPL) football matches in Thailand, while it aims to become a major cable company with a broadband Internet service. It has stated that it will launch with the EPL matches in the cable-TV business and invest in broadband Internet later. In our view, it will take CTH 2-3 years to invest in its broadband network.



12-month range	7.1/2.6
Market cap (US$ bn)	1,548.9
3m avg daily turnver (US$ m)	20.8
Share outstanding (m)	7,137.4
Major shareholder	Potharamic family 25.5%

Y/E Dec (Bt m)	2012A	2013F	2014F	2015F
Sales	10,369	11,411	13,031	14,612
Operating profit	6,100	7,230	8,473	9,932
Net profit	2,137	2,778	3,597	4,435
Consensus NP	—	2,862	3,614	4,384
Diff frm cons (%)	—	(2.9)	(0.5)	1.2
Norm profit	2,065	2,778	3,597	4,435
Norm EPS (Bt)	0.3	0.4	0.5	0.6
Norm EPS grw (%)	76.9	35.3	30.2	23.3
Norm PE (x)	22.0	16.3	12.5	10.1
Div yield (%)	1.4	3.1	4.4	5.9
DPS (Bt/sh)	1.4	1.9	2.5	3.3
P/BV (x)	5.2	4.4	3.7	3.2
EV/EBITDA (x)	10.1	8.7	7.0	5.8
ROE (%)	26.1	29.5	32.4	33.8

Sources: Company, Thanachart forecasts

INCOME STATEMENT					
FY ending Dec (Bt m)	**2011A**	**2012A**	**2013F**	**2014F**	**2015F**
Sales	9,498	10,369	11,411	13,031	14,612
Cost of sales	4,638	4,686	4,825	5,210	5,646
Gross profit	**4,860**	**5,683**	**6,586**	**7,821**	**8,967**
% gross margin	51.2%	54.8%	57.7%	60.0%	61.4%
Selling & administration expenses	2,504	2,558	2,796	3,088	3,317
Operating profit	**2,356**	**3,126**	**3,790**	**4,733**	**5,650**
% operating margin	24.8%	30.1%	33.2%	36.3%	38.7%
Depreciation & amortization	1,851	1,715	1,724	1,804	1,910
EBITDA	**4,207**	**4,841**	**5,514**	**6,537**	**7,560**
% EBITDA margin	44.3%	46.7%	48.3%	50.2%	51.7%
Non-operating income	85	61	58	63	76
Non-operating expenses	(337)	(266)	(50)	(50)	(50)
Interest expense	(468)	(404)	(326)	(249)	(132)
Pre-tax profit	**1,636**	**2,516**	**3,473**	**4,497**	**5,544**
Income tax	494	530	695	899	1,109
After-tax profit	**1,143**	**1,987**	**2,778**	**3,597**	**4,435**
% net margin	12.0%	19.2%	24.3%	27.6%	30.4%
Shares in affiliates' Earnings	(0)	0	0	0	0
Minority interests	27	78	0	0	0
Extraordinary items	(97)	71	0	0	0
NET PROFIT	**1,073**	**2,137**	**2,778**	**3,597**	**4,435**
Normalized profit	**1,170**	**2,065**	**2,778**	**3,597**	**4,435**
EPS (Bt)	0.1	0.3	0.4	0.5	0.6
Normalized EPS (Bt)	0.2	0.3	0.4	0.5	0.6

BALANCE SHEET					
FY ending Dec (Bt m)	**2011A**	**2012A**	**2013F**	**2014F**	**2015F**
ASSETS:					
Current assets:	7,312	7,284	7,804	8,210	9,212
Cash & cash equivalent	1,581	1,479	1,500	1,500	2,000
Account receivables	3,970	3,685	4,064	4,284	4,604
Inventories	70	49	50	54	59
Others	1,691	2,072	2,189	2,371	2,550
Investments & loans	38	685	685	685	685
Net fixed assets	11,573	11,078	11,354	11,550	11,640
Other assets	537	354	389	445	499
Total assets	**19,460**	**19,401**	**20,232**	**20,890**	**22,036**
LIABILITIES:					
Current liabilities:	9,852	5,868	6,006	5,808	5,510
Account payables	5,760	2,656	2,644	2,855	3,093
Bank overdraft & ST loans	547	487	1,099	739	369
Current LT debt	2,659	1,189	886	463	184
Others current liabilities	886	1,536	1,377	1,752	1,864
Total LT debt	**1,320**	**3,236**	**2,410**	**1,260**	**501**
Others LT liabilities	188	585	644	736	825
Total liabilities	**11,360**	**9,690**	**9,060**	**7,804**	**6,835**
Minority interest	985	1,020	1,020	1,020	1,020
Preferreds shares	0	0	0	0	0
Paid-up capital	3,622	3,622	3,569	3,569	3,569
Share premium	(225)	(225)	(468)	(468)	(468)
Warrants	0	0	0	0	0
Surplus	308	(40)	(40)	(40)	(40)
Retained earnings	**3,409**	**5,335**	**7,092**	**9,006**	**11,121**
Shareholders' equity	7,114	8,692	10,152	12,066	14,181
Liabilities & equity	**19,460**	**19,401**	**20,232**	**20,890**	**22,036**

Sources: Company, Thanachart forecasts

CASH FLOW STATEMENT					
FY ending Dec (Bt m)	**2011A**	**2012A**	**2013F**	**2014F**	**2015F**
Earnings before tax	1,636	2,516	3,473	4,497	5,544
Tax paid	(432)	(536)	(657)	(871)	(1,069)
Depreciation & amortization	1,851	1,715	1,724	1,804	1,910
Chg In working capital	(1,197)	(2,798)	(393)	(13)	(86)
Chg In other CA & CL / minorities	488	920	(314)	164	(106)
Cash flow from operations	**2,346**	**1,817**	**3,833**	**5,580**	**6,194**
Capex	(3,067)	(1,220)	(2,000)	(2,000)	(2,000)
ST loans & investments	(179)	(530)	0	0	0
LT loans & investments	(15)	(648)	0	0	0
Adj for asset revaluation	(66)	(49)	0	0	0
Chg In other assets & liabilities	636	580	23	36	35
Cash flow from investments	**(2,691)**	**(1,868)**	**(1,977)**	**(1,964)**	**(1,965)**
Debt financing	466	457	(517)	(1,933)	(1,409)
Capital increase	108	0	(297)	0	0
Dividends paid	(327)	(202)	(1,021)	(1,684)	(2,320)
Warrants & other surplus	(241)	(308)	0	0	0
Cash flow from financing	**6**	**(52)**	**(1,835)**	**(3,616)**	**(3,729)**
Free cash flow	**(720)**	**597**	**1,833**	**3,580**	**4,194**

VALUATION	**2011A**	**2012A**	**2013F**	**2014F**	**2015F**
Normalized PE (x)	38.9	22.0	16.3	12.5	10.1
Normalized PE - at target price (x)	49.4	27.9	20.7	15.9	12.9
PE (x)	42.5	21.3	16.3	12.5	10.1
PE - at target price (x)	53.9	27.0	20.7	15.9	12.9
EV/EBITDA (x)	11.5	10.1	8.7	7.0	5.8
EV/EBITDA - at target price (x)	14.4	12.6	10.9	8.9	7.4
P/BV (x)	6.4	5.2	4.4	3.7	3.2
P/BV - at target price (x)	8.1	6.6	5.6	4.7	4.0
P/CFO (x)	19.4	25.0	11.8	8.1	7.3
Price/sales (x)	4.7	4.3	3.9	3.5	3.1
Dividend yield (%)	0.4	1.4	3.1	4.4	5.9
FCF Yield (%)	(1.6)	1.3	4.1	8.0	9.3
(Bt)					
Normalized EPS	0.2	0.3	0.4	0.5	0.6
EPS	0.1	0.3	0.4	0.5	0.6
DPS	0.0	0.1	0.2	0.3	0.4
BV/share	1.0	1.2	1.4	1.7	2.0
CFO/share	0.3	0.3	0.5	0.8	0.9
FCF/share	(0.1)	0.1	0.3	0.5	0.6

FINANCIAL RATIOS					
VALUATION	**2011A**	**2012A**	**2013F**	**2014F**	**2015F**
Growth Rate					
Sales (%)	(1.3)	9.2	10.0	14.2	12.1
Net profit (%)	61.7	99.2	30.0	29.5	23.3
EPS (%)	70.4	99.5	30.8	30.2	23.3
Normalized profit (%)	108.8	76.6	34.5	29.5	23.3
Normalized EPS (%)	120.1	76.9	35.3	30.2	23.3
Dividend payout ratio (%)	16.9	30.5	50.0	55.0	60.0
Operating performance					
Gross margin (%)	51.2	54.8	57.7	60.0	61.4
Operating margin (%)	24.8	30.1	33.2	36.3	38.7
EBITDA margin (%)	44.3	46.7	48.3	50.2	51.7
Net margin (%)	12.0	19.2	24.3	27.6	30.4
D/E (incl. minor) (x)	0.6	0.5	0.4	0.2	0.1
Net D/E (incl. minor) (x)	0.4	0.4	0.3	0.1	(0.1)
Interest coverage - EBIT (x)	5.0	7.7	11.6	19.0	42.9
Interest coverage - EBITDA (x)	9.0	12.0	16.9	26.3	57.3
ROA - using norm profit (%)	6.0	10.6	14.0	17.5	20.7
ROE - using norm profit (%)	17.1	26.1	29.5	32.4	33.8
WACC (%)	11.8	11.8	11.8	11.8	11.8
ROIC (%)	19.1	24.5	25.0	29.0	34.7
NOPAT (Bt m)	1,645	2,468	3,032	3,786	4,520

Sources: Company, Thanachart forecasts

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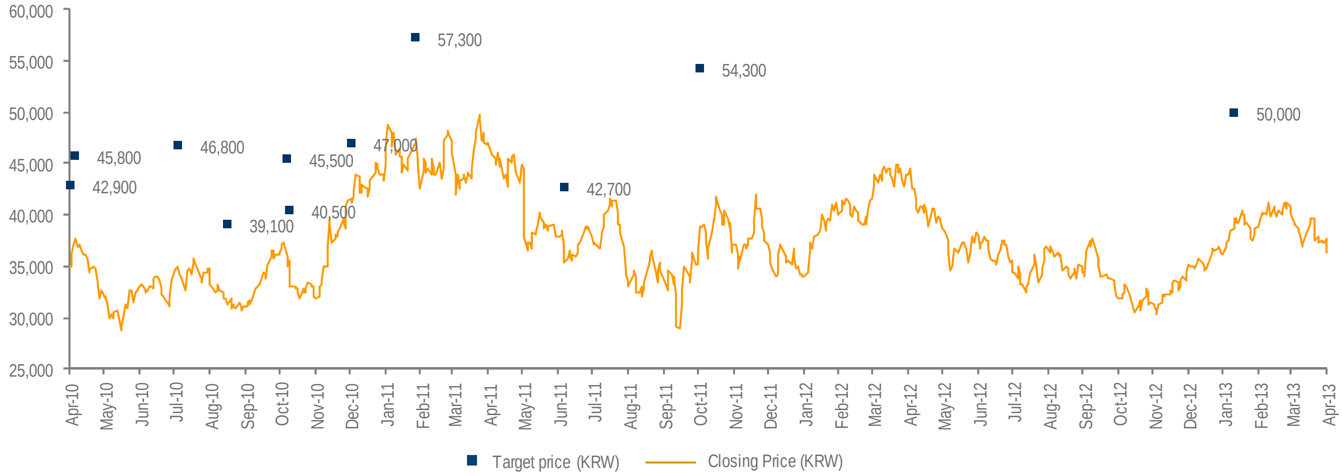
Share price and Daiwa recommendation trend

Hana Financial Group: share price and Daiwa recommendation trend

Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
15/07/10	46,800	Outperform	20/10/10	40,500	Outperform	17/06/11	42,700	Outperform
27/08/10	39,100	Outperform	13/12/10	47,000	Outperform	13/10/11	54,300	Buy
18/10/10	45,500	Outperform	07/02/11	57,300	Buy	19/01/13	50,000	Buy



Source: Daiwa

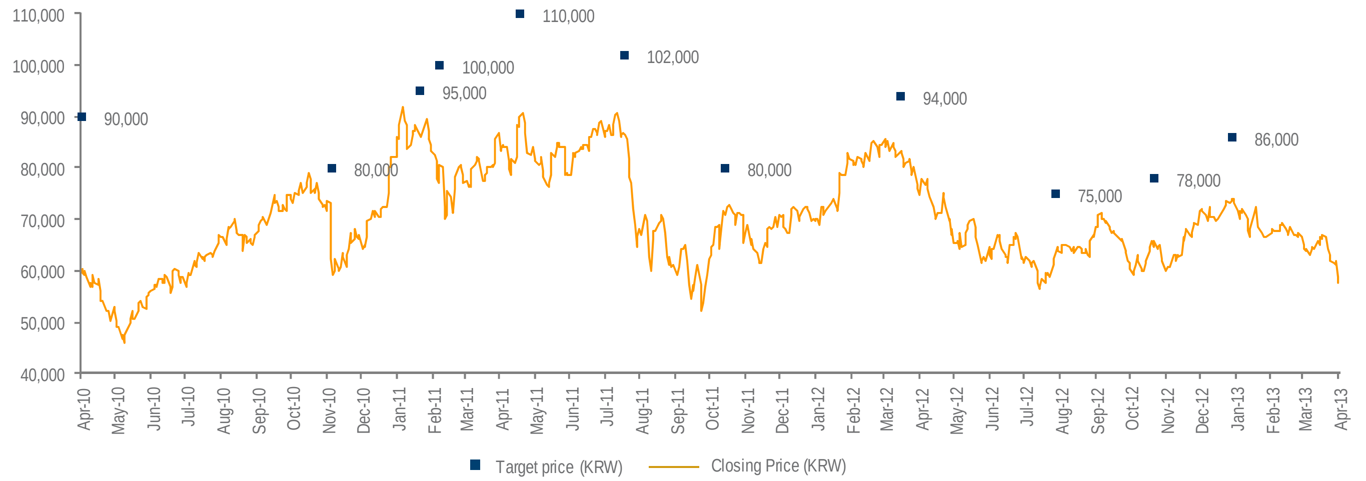
Korea Exchange Bank: share price and Daiwa recommendation trend

Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
27/08/10	15,000	Outperform	07/02/11	11,000	Hold	21/12/11	7,000	Underperform
02/12/10	13,000	Outperform	09/05/11	9,600	Hold	20/03/12	10,000	Outperform

Source: Daiwa

Hyundai Engineering & Construction: share price and Daiwa recommendation trend

Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
01/02/11	95,000	Buy	29/07/11	102,000	Buy	08/08/12	75,000	Outperform
18/02/11	100,000	Buy	25/10/11	80,000	Outperform	02/11/12	78,000	Outperform
29/04/11	110,000	Buy	26/03/12	94,000	Outperform	09/01/13	86,000	Outperform



Source: Daiwa

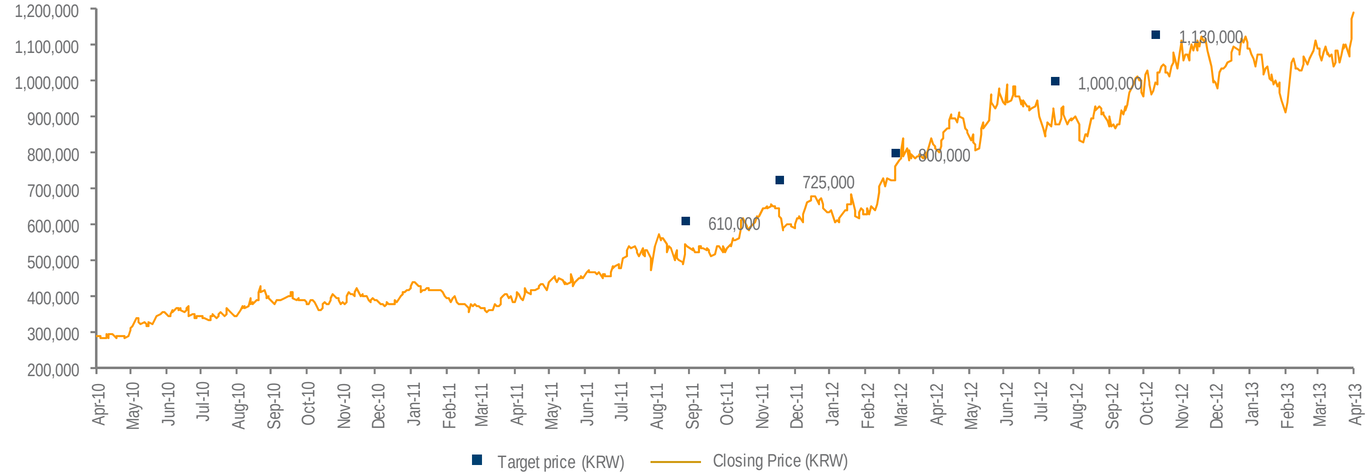
Hyundai Motor: share price and Daiwa recommendation trend

Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
22/04/10	160,000	Outperform	27/04/11	300,000	Buy	08/10/12	310,000	Buy
14/05/10	180,000	Outperform	28/07/11	330,000	Buy	14/01/13	290,000	Buy
20/10/10	200,000	Outperform	05/01/12	300,000	Buy	02/04/13	270,000	Buy
15/11/10	230,000	Outperform	09/04/12	330,000	Buy			

Source: Daiwa

■ Orion: share price and Daiwa recommendation trend

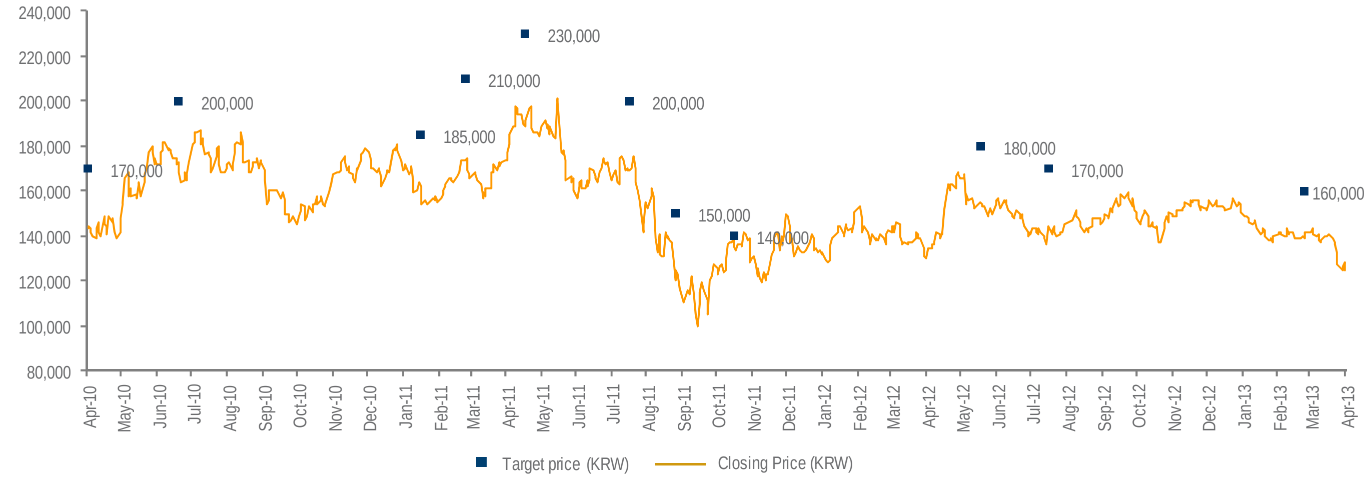
Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
08/09/11	610,000	Outperform	09/03/12	800,000	Outperform	22/10/12	1,130,000	Outperform
29/11/11	725,000	Outperform	26/07/12	1,000,000	Outperform			



Source: Daiwa

■ Samsung SDI: share price and Daiwa recommendation trend

Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
27/01/11	185,000	Outperform	06/09/11	150,000	Outperform	07/03/13	160,000	Outperform
07/03/11	210,000	Outperform	27/10/11	140,000	Hold	12/04/13	160,000	Buy
28/04/11	230,000	Outperform	28/05/12	180,000	Outperform			
28/07/11	200,000	Outperform	27/07/12	170,000	Outperform			



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