Goldman Sachs

Asia-Pacific Morning Summary

May 17, 2010

The Goldman Sachs Group, Inc.

This document contains comments related to the following stocks:

Acer (2353.TW)
Alibaba.com (1688.HK)
ASUSTeK Computer (2357.TW)
Biocon (BION.BO)
Cadila Healthcare (CADI.BO)
Cipla (CIPL.BO)
CITIC Pacific (0267.HK)
Compal Electronics (2324.TW)
COSCO Pacific (1199.HK)
Dongkuk Steel Mill (001230.KS)
Dr. Reddy's Laboratories (REDY.BO)
Dr. Reddy's Laboratories (ADR) (RDY)
EVA Airways (2618.TW)
Foxconn Int'l Holdings (2038.HK)
Genting Singapore Plc (GENS.SI)
Glenmark Pharmaceuticals (GLEN.BO)
Hon Hai Precision (2317.TW)
Hutchison Whampoa (0013.HK)
Indiabulls Real Estate Limited (INRL.BO)
IOI Corporation (IOIB.KL)
Li Ning Company (2331.HK)
Lupin (LUPN.BO)
Mahanagar Telephone Nigam (MTNL.BO)
Mahanagar Telephone Nigam (ADR) (MTE)
National Aluminium Company (NALU.BO)
Neptune Orient Lines (NEPS.SI)
Parkson Retail Group (3368.HK)
Piramal Healthcare (PIRA.BO)
Quanta Computer (2382.TW)
Ranbaxy Laboratories (RANB.BO)
Reliance Communications (RLCM.BO)
State Bank of India (SBI.BO)
Sun Pharmaceutical Industries (SUN.BO)
Thai Airways (THAI.BK)

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Global Investment Research

Focus Items

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Key Data Changes

Rating and price target changes

Company	Ticker	Rating/ Coverage view		Price Target			Estimates		
		New	Old	New	Old	% chg	Current Year	Next Year	Fiscal y/e
Alibaba.com	1688.HK	S/N	unch	↑ HK$14.00	HK$11.00	27.3%	HK$0.35	HK$0.46	Dec
Biocon	BION.BO	N/N	unch	↑ Rs338.00	Rs313.00	8.0%	Rs14.02	Rs14.10	Mar
Cadila Healthcare	CADI.BO	B/N	unch	↑ Rs621.00	Rs544.00	14.2%	Rs23.29	Rs27.84	Mar
Cipla	CIPL.BO	S/N	unch	↑ Rs276.00	Rs253.00	9.1%	Rs13.48	Rs15.18	Mar
Dr. Reddy's Laboratories	REDY.BO	N/N	unch	↑ Rs1,363.00	Rs1,115.00	22.2%	Rs59.04	Rs74.38	Mar
Dr. Reddy's Laboratories (ADR)	RDY	N/N	unch	↑ US$29.60	US$24.20	22.3%	Rs59.04	Rs74.38	Mar
Glenmark Pharmaceuticals	GLEN.BO	N/N	unch	↓ Rs296.00	Rs304.00	(2.6%)	Rs16.60	Rs20.05	Mar
IOI Corporation	IOIB.KL	N/N	unch	↓ RM4.60	RM4.90	(6.1%)	RM0.31	RM0.36	Jun
Lupin	LUPN.BO	B/N	unch	↑ Rs2,075.00	Rs1,685.00	23.1%	Rs76.34	Rs98.36	Mar
Mahanagar Telephone Nigam	MTNL.BO	S/N	unch	↓ Rs58.00	Rs64.00	(9.4%)	(Rs4.07)	(Rs13.27)	Mar
Mahanagar Telephone Nigam (ADR)	MTE	S/N	unch	↓ US$2.38	US$2.63	(9.4%)	(US$0.09)	(US$0.29)	Mar
Parkson Retail Group	3368.HK	B/N	unch	↓ HK$15.60	HK$15.90	(1.9%)	HK$0.47	HK$0.62	Dec
Piramal Healthcare	PIRA.BO	B/N	unch	↑ Rs625.00	Rs523.00	19.5%	Rs23.48	Rs30.52	Mar
Ranbaxy Laboratories	RANB.BO	S/N	unch	↑ Rs300.00	Rs293.00	2.4%	Rs10.59	Rs24.83	Dec
Sun Pharmaceutical Industries	SUN.BO	S/N	unch	↑ Rs1,225.00	Rs1,204.00	1.7%	Rs62.40	Rs72.49	Mar
Thai Oil	TOP.BK	B/N	unch	↓ Bt49.00	Bt51.00	(3.9%)	Bt5.71	Bt6.61	Dec

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Thai Oil (TOP.BK)
Wistron (3231.TW)

Estimate changes

Company	Ticker	Rating/ Coverage view	Current Year			Next Year			Fiscal y/e
			New	Old	% chg	New	Old	% chg	
Indiabulls Real Estate Limited	INRL.BO	B/A	↑ Rs6.91	Rs4.26	62.0%	↑ Rs10.85	Rs8.92	21.6%	Mar
IOI Corporation	IOIB.KL	N/N	↑ RM0.31	RM0.30	4.0%	RM0.36	unch	--	Jun
Mahanagar Telephone Nigam	MTNL.BO	S/N	↓ (Rs4.07)	(Rs3.83)	(6.2%)	↓ (Rs13.27)	(Rs5.27)	(151.5%)	Mar
Mahanagar Telephone Nigam (ADR)	MTE	S/N	↓ (US$0.09)	(US$0.08)	(6.2%)	↓ (US$0.29)	(US$0.12)	(151.5%)	Mar
Parkson Retail Group	3368.HK	B/N	↓ HK$0.47	HK$0.49	(4.2%)	↓ HK$0.62	HK$0.64	(2.2%)	Dec
Thai Oil	TOP.BK	B/N	↓ Bt15.71	Bt16.17	(7.6%)	↓ Bt16.61	Bt17.12	(7.2%)	Dec

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Focus Items

Asia Derivatives Kickstart: Vol markets de-coupling: G3 vol near highs while Asia remains near lows 1

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Asia implied vol still near lows
Our strategists expectation; of non-G3 markets outperforming has been felt in the vol markets, where Asia implied vol remains near its 1y bottom quartile, despite G3 equity implied vol returning to near 1y highs. US-listed ETF implied vol on Asia underliers has trended significantly higher as well, with FXI and EWY implied vol near 1y avg.
This disconnect creates opportunities to use Asia equity options to hedge further market weakness. KOSPI and NIFTY remain our favorite hedges.

Various implied vol paradigm shifts
(1) KOSPI 200 3-mo implied vol fell 4 points this week to 20.9, a 20% discount to S&P 500 implied vol, near the sharpest discount to S&P 500 implied vol in ten years. KOSPI option volumes are near historical highs with almost triple the volumes of S&P 500.
(2) MSCI Korea (EWY) implied vol is higher than KOSPI 200 and USDKRW implied vol combined, implying nearly perfect FX/equity correlation. This is a result of higher realized volatility during US-hour trading, but presents an opportunity to sell EWY options to fund KOSPI options.
(3) NIFTY implied vol remains in its bottom quartile for the year and is at a discount to each of Nikkei 225, S&P 500, and EuroStoxx50.
(4) WTI 6-mo oil futures are around US$9 above current spot levels. As such Nov-10 puts struck at 95% of spot levels indicatively cost around 4.0%, a 40% discount to HSCEI Nov-10 95% puts.

EVA Airways (2618.TW) Buy: 2H frequency expansion schedule on track; reiterate Conviction Buy 2

2618.TW, NT$17.00		
Market cap		US$2,081 mn
Target price		NT$24.90
Fiscal y/e Dec	2010E	2011E
Net inc. (NT$)	4,907 mn	6,923 mn
EPS (NT$)	1.66	2.34
EPS growth	243.4%	41.1%
P/E	10.3X	7.3X
Dividend yield	0.5%	0.7%
Investment Lists		Asia Pacific Buy List Asia Pacific Conviction Buy List
Coverage view		Neutral

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Source of opportunity
According to China Times article on May 15, Taiwan and Chinese government officials will begin further negotiations on a potential increase in cross-straits flight frequency expansions in the second half of May. According to the Director of Civil Aeronautics Administration of Taiwan, conclusions may be reached by the end of May. The main areas covered in the negotiation would include: (1) The exact number of additional cross-straits flights; (2) details on additional destinations for cross-straits flights and; (3) the possibility of direct flights between Songshan (Taipei) and Hongqiao (Shanghai).

Catalyst
As mentioned in our previous reports, we believe cross-straits frequency expansion hinges on policy decisions. In our view, the upcoming negotiations affirm our view that flight frequency could be expanded to 300 per week in 2H10, up from 270 weekly flights currently (Exhibit 2). We estimate EVA's EPS to improve 10% for every 50 additional cross-straits flights increased in 2H10 (Exhibit 1). We reiterate our Buy (on Conviction List) rating on EVA as it is highly leveraged to cross-straits flight frequency increases.

Valuation
The stock is trading at attractive valuations of 0.94X current EV/FV and 1.4X 2010E P/B, representing a 24% and 13% discount to industry average EV/FV and 2010E P/B, respectively. Our 12-m SOTP target price of NT$24.90 (unchanged) is based on a target EV/FV multiple of 1.08X, underpinned by an average 2010E-11E

ROF of 8.9% over a WACC of 8.5%.

Key risks

Pricing uncertainty on announced recapitalization plans, technology inventory build-up and jet fuel price uncertainty.

National Aluminium Company (NALU.BO): First take: 4QFY10 above estimates; margins expand on cost control 3

NALU.BO, Rs408.40		
Market cap		US$5,820 mn
Target price		Rs305.00
Fiscal y/e Mar	2010E	2011E
Net inc. (Rs)	6,931 mn	8,565 mn
EPS (Rs)	10.76	13.29
EPS growth	(45.5%)	23.6%
P/E	38.0X	30.7X
Dividend yield	0.7%	0.9%
Investment Lists		
		Asia Pacific Conviction Sell List Asia Pacific Sell List
Coverage view		Neutral

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News

NALCO reported 4QFY2010 net income of Rs3,915mn, up 371% yoy, +152% qoq, 55% above GS and Reuters consensus expectations. For the quarter, revenue came in at 16,036mn, up 47% yoy, +16% qoq. At the operating level, cost control surprised on the upside - NALCO reported 4Q EBITDA of Rs5,411 mn (+83% qoq), implying a margin expansion of about 1200 bp to 34% on a sequential basis, primarily driven by lower material and fuel costs (-9% qoq), coupled with higher realizations (LME prices up 8% qoq).

FY10 net income was Rs8,326mn, down 35% yoy, 10% above consensus expectations. The 13% decline in average realizations was partially offset by record high aluminum metal production at 432k, up 19% yoy. Margins declined to 22% from 35% in FY09, on lower average realizations and higher cost coal imports.

Analysis

While NALCO's 4QFY10 results were above expectations, we believe that it would be difficult for the company to sustain such high margins going forward, against the backdrop of deteriorating aluminum fundamentals. Pullback in aluminum prices – LME prices are down 10% in May, coupled with periodic disruptions of coal supply to its captive power plant can potentially act as headwinds to NALCO's operating performance going forward.

We reiterate our Sell (Conviction List) on NALCO as NALCO's current valuation at 3.3X FY11E P/B do not justify its fundamentals (compared to sector average of 1.8X) – given its limited volume growth, muted aluminum outlook and frequent coal supply disruptions.

Implications

The better-than-expected results could pose upside risk to our earnings estimates. We put our estimates and target price under review, pending further details from management on the better-than-expected cost control and certain changes in the accounting policy.

Alibaba.com (1688.HK): Toward a new normal: measured Gold Supplier net adds, more VAS 4

1688.HK, HK$15.02		
Market cap		US$8,731 mn
Target price		HK$14.00
Fiscal y/e Dec	2010E	2011E
Net inc. (HK$)	1,377 mn	1,839 mn
EPS (HK$)	0.35	0.46
EPS growth	27.4%	33.6%
P/E	43.2X	32.3X
Dividend yield	--	--
Investment Lists		
		Asia Pacific Sell List
Coverage view		Neutral

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What's changed

We adjust our estimates to account for Alibaba.com's 1Q2010 results, which were inline with our forecast on revenue and 8% below on operating profit, though ahead of Bloomberg consensus estimates. Alibaba.com is settling into a "new normal" on its China Gold Supplier business, with stable net customer adds (we attribute 1Q deceleration mostly to normalized churn, rather than to seasonality) and slowly improving VAS (though ARPU was still down 4% qoq and 28% yoy due to mix-shift to the cheaper package).

Implications

(1) We reduce 2Q2010 Gold Supplier net adds from 8,100 to 7,100 given lower than expected 1Q2010 net adds; management guided for 5,000-8,000 per quarter. Conversely we increase VAS revenue because the percentage of Gold Suppliers buying VAS has crept up above 20%.
(2) China TrustPass net adds exceeded our forecast, presumably due to customers buying the high-price Limited tier before it stopped becoming available at quarter-end.
(3) Management increased its operating margin guidance for 2010 from "around 30%" to "just over 30%", versus initially (late 2009) aiming for about 33%. We already modeled just over 30%, so no change to our costs.
Net, we leave our 2010E/11E/12E non-GAAP EPS estimates largely unchanged at HK$0.35 (down 1%)/ HK$0.46 (up 2%)/ HK$0.53 (up 2%).

Valuation

Given greater clarity on business trends and persistently greater free cash than earnings generation, we shift from P/E to an EV/FCF-based valuation. We apply a 25X multiple to 2010E FCF (1.5X premium to 17% free cash flow growth rate, similar to global internet peers) and add cash for a new 12-month target price of HK$14, up from HK$11 previously.

Key risks

Risks include the rate of net adds and VAS take-up.

Asia-Pacific Weekly Kickstart: A strong rebound in global markets; Asia gained 3% after four red weeks 5

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Price performance

• A strong rebound post positive news in Greece, MXAPJ +3%; Philippines, Indonesia (+5%) led, Thailand in red after 3 weeks of outperformance
• Cons disc and materials (+4%) outperformed
• Korea cons disc rallied 7% driven by autos
• Most commodities rallied; BDIY +8%, gold +3%

Flows, positioning and risk appetite

• Foreign funds pulled US$3bn further out of Asia, most in Korea (US$1.6bn)

• Cash turnover increased in Hong Kong, dropped in other regions
• Futures turnover rose across most exchanges, fell in Taiwan
• Massive foreign fund outflows drive risk appetite down further

Earnings and valuations
• MXAPJ P/E at 12.2X, P/B at 1.9X
• Australia, India and Hong Kong saw earnings revised down
• Tech earnings were further upgraded; defensive sectors were revised down

Rates and currency
• Asian currencies appreciated significantly: MYR +3%, PHP, IDR, KRW +2% vs. USD

Upcoming events
• US CPI (May 19), FOMC (May 20) HK Unemployment (May 18), CPI (May 20) SG NODX (May 17) TW export orders (May 20)
• Earnings: Reliance Infra, Reliance Power, Kookmin Bank (May 15), Bumi, Cipla, Hana Finl, LG Elec, NTPC, Samsung Elec (May 17), Unitech, Jaiprakash Associates (May 18), BoB, PNB, Lenovo (May 20), Sing Air, ITC (May 21)

Other Headlines

Portfolio Strategy

Korea Weekly Kickstart: KOSPI +2.9% this week on a sustained strong retail inflow 6

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Market performance
· KOSPI +2.9% this week, +0.8% ytd; KOSDAQ +5.1% this week, +2.2% ytd
· Medical & Precision +13.7%, Transport & Storage +10.8%, Paper & Wood +6.1% this week
· Machinery -4.3%, Construction -0.1%, Iron & Metal -0.0% this week

Valuation and earnings
· KOSPI consensus '10E PE at 9.4X up from 9.0X last week, '11E PE at 8.7X; '10E PB at 1.3X
· KOSPI consensus '10E EPS growth at 54.7% (up from 51.3% a week ago), '11E EPS growth at 8.1% (down from 8.7% a week ago)
· Earnings momentum (EM) for both 2010 and 2011 weakened

Fund flows, turnover and sentiment
· Foreigners W846bn outflow; Institutions W209bn outflow; Individuals W1,047bn inflow
· Foreign outflow continued, albeit at a decelerated pace
· Equity funds saw net inflows this week

FX, rates and commodities
· USDKRW 1,131, -2.1% this week
· Korea 3-yr Treasury bond yield increased to 3.78%, from 3.69% a week ago
· BDIY continued to increase, +12.9% this week, +30.4% from a month ago

Key events
· Department and discount store sales, May 17-18, 2010

China Weekly Kickstart: Your 5-minute investment guide for Chinese equity markets: May 10 - 14 7

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Performance summary and our latest views

Chinese equities saw a rebound this week with both H and A share markets gaining 2% and 1%, respectively, mainly on the back of the European rescue package and a temporary revival of global risk appetite (US: +4%, EU: +7%, APJ: +3%). While we envisage that markets may remain challenging in the near term over policy tightening concerns, we think we are in a well-advanced stage in the tightening process. In our view, market will begin to look through it in the next several months, with a potential rate hike sometime in 2Q to 3Q being a re-rating catalyst, most likely followed by a CPI breaching the 3% mark. The overall growth momentum looks robust, valuations look attractive (forward P/E at 15 / 13 month lows for A / H shares) and we think downside earnings risks are moderate at an aggregate market level. We recommend investors to focus on insurers, solid consumer brands, and upstream commodity names to position in a rising rate environment.

Sector performance and allocation

IT and cyclicals outperformed while Healthcare underperformed in the H share market. Our analyst has re-asserted her positive stance on Mindray (MR, Buy, on CL) due to (1) strong export momentum, (2) sustainable domestic growth, and (3) attractive valuations.

Our analyst has initiated coverage on the pesticide industry and expects demand for pesticides to stay robust in 2010-2011. Our top picks are Yangnong (600486.SS, Rmb 30.83, Buy) and Lier (002258.SZ, Rmb 17.50, Buy) for their large production scale and defensive margins from a solid client base.

Valuation

MXCN: 12.9X 10E P/E; 25.9% 10E EPS growth. CSI300: 15.8X 10E P/E; 32.4% 10E EPS growth.

Key events

HK: Unemployment (May 18), CPI (May 20); US: PPI (May 18), CPI (May 19); EU: CPI (May18).

Basic Materials

Dongkuk Steel Mill (001230.KS): Above expectations, while sequential outlook remains dim 8

001230.KS, W22,200		
Market cap		US$1,217 mn
Target price		W22,600
Fiscal y/e Dec	2010E	2011E
Net inc. (W)	37 bn	(43 bn)
EPS (W)	604	(693)
EPS growth	(24.7%)	(214.6%)
P/E	36.7X	--
Dividend yield	--	--
Investment Lists		
		Asia Pacific Sell List
Coverage view		Attractive

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1Q10 earnings came in above expectations on FX

Dongkuk Steel reported 1Q10 earnings results in line at the OP level, while NP was higher than Bloomberg consensus estimate. Primary drivers at the non-operating earnings side came from lower forex losses and equity method losses compared to a year earlier. At the operating level, margins were nearly halved qoq on higher raw material costs ytd, despite volume improvements. During 1Q10, the company partly passed through its raw material costs through ASP hikes on long products (rebars, sections), but plate margins deteriorated on later price hikes in April.

We are still cautious on the plates outlook in the longer term

We maintain our Sell rating on Dongkuk Steel and our 12-month P/B-based target price of W22,600. We maintain a cautious stance on plates, a significant part of the company's operations, based on 1) plate capacity additions by all three major steel makers in Korea in 2010E, 2) customer demand outlook remains weak, consequently leading to 3) lower pricing and margins. Also we have seen the limitations in companies' ability to pass through cost burdens for the plate products. Plate exports are already near break-even levels due to the narrowed gap between ASP and slab prices. Notably, plate exports have surged already in 1Q10, a trend that we believe would deteriorate the profitability levels in the longer run. Key risks to our view are FX fluctuations and lower scrap prices.

IOI Corporation (IOIB.KL): Below expectations: weak FFB production, high CPO costs; cut TP 9

IOIB.KL, RM5.39		
Market cap		US$10,665 mn
Target price		RM4.60
Fiscal y/e Jun	2010E	2011E
Net inc. (RM)	2,024 mn	2,318 mn
EPS (RM)	0.31	0.36
EPS growth	4.3%	14.5%
P/E	17.1X	15.0X
Dividend yield	2.9%	3.3%
Investment Lists		
		Neutral
Coverage view		Neutral

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What surprised us

IOI Corp's 9MFY10 net profit was 75% of our full-year forecast, 63% of Bloomberg consensus. After adjusting for unrealized forex gains, 9M core net profit of RM1.1 bn was 62% of our full-year forecast. While we expect a stronger 4Q on higher crude palm oil (CPO) prices and seasonally higher fresh fruit bunch (FFB) production, we think that our forecasts may still not be achievable. Plantation earnings were weaker than we expected, mainly due to lower-than-expected FFB production (down 7% yoy in 9M10) and higher CPO cost of production. Meanwhile, property and manufacturing earnings were largely in line with our expectations.

What to do with the stock

We expect a negative market reaction to this set of results. Post the results, we are reducing our FY2010E core EPS by 8% to RM0.26 and fine-tune our 2011E-12E EPS, as we account for lower FFB production and high CPO costs. However, on a reported EPS basis, this is more than offset by unrealized forex gain. We also reduce our 12-month Director's Cut-based target price to RM4.60 (prior RM4.90). We maintain our Neutral rating on the stock. Key risks: Stronger or lower-than-expected rise in CPO prices.

Consumer Cyclicals

ASEAN: Gaming: GENS 1Q results offer an early read on Singapore's gaming market 10

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GENS results suggest S$2.4-2.5bn initial gaming market size

As the first ever casino to operate in Singapore, Genting Singapore (GENS) 1QFY2010 results provides an early indication of the potential for the Singapore gaming market. Although GENS did not provide full details of its casino operations (ie table/slot wins).

However, using management's broad guidance, estimating 90-95% of Resorts World Sentosa (RWS) revenues are from casino, and annualizing its first 46 days of casino operations (to end-March), we estimate Singapore has an initial gaming market size of S$2.4-2.5bn. This compares with Macau at S$21 bn last year. Interestingly, GENS said half its 1Q casino revenues was mass market, implying S$3.3-3.5mn daily mass market gaming revenues — not far from our estimate of S$3.6mn for RWS (see 'Marina Bay Sands competition risk; reiterate Conviction Sell', March 24). While it could be argued that it is still early days — with the RWS casino still ramping up, Marina Bay Sands only recently opened, and junket operators still being licensed — it is not certain the Singapore gaming market can reach US$3bn (S$4.2 bn), as we currently expect. We estimate it would need to expand 69-78% to reach our forecast.

High margins mitigate downside risk, but competition could bite

Offsetting top-line risk, however, is GENS' relatively healthy margins in 1QFY2010. Adding back S$70 mn in pre-operating expenses, we estimate RWS had an EBITDA margin in excess of 50%, above our forecast. Though this partly reflects RWS' monopoly position (this has since ended with Marina Bay Sands opening) — where for example with VIP rebates can be kept low — we believe margins may have been boosted by a larger proportion of the more lucrative slot revenues (GENS said it is not far off Las Vegas Sands' recent mention of US$400-900 slot win/unit/day). While we think some of these better margins will hold, some will narrow in the competition with Marina Bay Sands. GENS has said margins will come down when it starts offering higher rebates in its junket VIP business.

Conv Sell on Genting Singapore, still earnings downside risk

We retain our Conviction Sell on GENS, with a 12-month NAV-based target price of S$0.79, as we see strong earnings downside risk on competition from Marina Bay Sands. Upside risk: better Singapore/UK casino performance.

Parkson Retail Group (3368.HK): In line with expectation in 1Q operations; momentum to accelerate 11

3368.HK, HK$11.42		
Market cap		US$4,119 mn
Target price		HK$15.60
Fiscal y/e Dec	2010E	2011E
Net inc. (HK$)	1,324 mn	1,751 mn
EPS (HK$)	0.47	0.62
EPS growth	27.3%	32.2%
P/E	24.2X	18.3X
Dividend yield	1.9%	2.5%
Investment Lists		
		Asia Pacific Buy List
Coverage view		Neutral

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What surprised us

Parkson reported 1Q10 net income of Rmb270mn, up 4.4% yoy, largely in line with our estimates. Excluding a one-off Rmb40mn share option expense, earnings were up 20%. Gross sales was slightly weaker than expected, up 11.7% yoy, driven by 10.8% comps, slightly below our forecast of 12%. No new stores were opened during the period. However, concessionaire margin recovered, growing 0.7pp yoy to 19%, the first yoy increase since 4Q08. The company saw strong operating leverage in the quarter, with recurring operating expenses up just 10.4% yoy and recurring EBIT up 18.1%. Including the share option expenses, operating expenses and EBIT were up 21% and 7.2% respectively.

What to do with the stock

Maintain Buy. We think Parkson remains well-positioned to extract strong operating leverage this year and improve its returns. In addition, we believe the company can complete 2-3 managed store injections from the parent company in 2H, further accelerating the earnings growth in the coming 12 months. We continue to see valuation attractive at 12-m fwd P/E of 22X, 12% premium to sector vs. historical premium of c.35%. We tweak our 2010E/11E/12E EPS by -4%/-2%/-3% factoring in the share option charge, and slightly lower sales growth. Our new 12-month TP is now HK$15.6 (from HK$15.9), still based on 25X '11E P/E. Key risks: Delay in new store openings, comps weaker-than-expected.

China: Retail: Key takeaways from China hi-end retail summit 12

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News

We attended the China hi-end retail summit in Shanghai (May 13-14). Nearly 200 retail industry participants attended the event, including over 20 presentations and panel discussions by shopping mall operators, representatives from industry associations, global brands and their Chinese distributors, and industry consultants.

Analysis

We have two key takeaways from the summit:

1. T1 city presence establishes the brands, but the real opportunity lies in T2/3 cities: Panelists agreed that having retail stores in Beijing/Shanghai puts the brand on the map. This is important as Chinese consumers have limited knowledge in brands. But almost all companies present at the conference agreed that real growth and profitability opportunities are in T2/3 cities, as: 1) Good real estates are difficult to obtain in Beijing/Shanghai, but easier to access in T2/3 cities; 2) In Beijing/Shanghai, although sales per store can be 20-30% higher than in T2 cities, better sales are more than offset by higher rental and staff cost. 3) Top 1 percentile purchasing power is more relevant than average income in the China market, as high-end brands target only a small percentage of the population.

2. Shopping mall versus department stores: Modern shopping mall is an attractive retail format as it provides a one-stop experience often including shopping, restaurants, spas, theatres. At the moment, department store is the preferred anchor tenant at shopping malls, while general merchandisers and specialty retailers are underdeveloped in China. Mall operators usually offer the lowest rent to department stores to attract them. Besides, mall design and operation are often not optimal or even suitable for retailers, as they are run by China property companies with limited experience in retailing.

Implications

We view the analysis of shopping mall vs. dept stores as a positive read-across, which confirms our view that

department store is likely to remain the winning retail format in the next decade. (See our report on April 30 2010, Battle of retail formats: 3 decades of lessons from Japan and Korea).

Li Ning Company (2331.HK): SSS confirms average growth; valuation premium unsupported 13

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News

Li Ning released recent SSS data before market open on Friday, May 14. 1Q SSS was up 5% yoy, and May weekend (May 1 to May 3) SSS improved to 6.6%. During 1H09, Li Ning reported 0% yoy growth in SSS. For the full year 2010, management kept its SSS target of 10% growth (2009: -2.3%).

Analysis

We view Li Ning's SSS data as evidence the brand is performing in line with the industry trend. 1Q SSS was up 4% yoy at Dongxiang (3818.HK, Buy, on CL, May13: HK$4.94) and in the Belle (1880.HK, Buy, May 13: HK$10.00) sportswear segment. While the China sports industry is gradually recovering from post-Olympic slump, YTD retail trends seem to suggest the recovery pace is slower than expected. An unusually cold spring in East and North China partially contributed to the sluggish retail performance. But we think the slowdown may be more structural in nature, as domestic brands are not greatly differentiated in their product offering, brand positioning, and marketing techniques. Growth contributed by space expansion could continue to drive wholesale revenue growth, but the growth rate is unavoidably slowing down as the store base gets larger. Other brands like Peak (1968.HK, NC) reported 15% retail SSS growth in 1Q10, but as this is based on retail performance of only 261 out of the more than 6,200 store network, direct comparison may not be meaningful.

Implications

While the full year SSS target looks stretched on YTD trend, we do not expect earnings miss as Li Ning is largely a wholesaler. The Jan-Sept 2010 order book is up about 16% yoy. Li Ning will hold a 4Q10 sales fair from this weekend. We forecast FY10E Li Ning brand wholesale revenue growth of 18%, and see little upside/downside around this. Li Ning has ind. avg. growth/return, but is trading at a 58% premium to Dongxiang on 2010E P/E. We think the stock is fully valued and could be a relative underperformer. Maintain Sell rating, 12-m TP of HK$ 25, based on 20x 10E PE. Key risks: Better than expected profitability in non Li-Ning brand business.

Energy

Thai Oil (TOP.BK): Below expectations: Strong GRM, but weak petrochem, reduce TP 14

TOP.BK, Bt46.75		
Market cap		US$2,949 mn
Target price		Bt49.00
Fiscal y/e Dec	2010E	2011E
Net inc. (Bt)	11,642 mn	13,486 mn
EPS (Bt)	5.71	6.61
EPS growth	11.0%	15.8%
P/E	8.2X	7.1X
Dividend yield	5.9%	6.8%
Investment Lists		
		Asia Pacific Buy List
Coverage view		Neutral

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What surprised us

1Q10 net profit of Bt2 bn was 16% of our full-year forecast and 17% of Bloomberg consensus. However, we expect subsequent quarters to be stronger on higher volumes and inventory gains. Earnings contribution from TPX (Thai Paraxylene) was below expectations, driven by lower margins and lower sales volumes (due to maintenance shut down in January). Thai Oil's achieved market GRM (gross refining margin) was ahead of our expectations, coming in at US$2.7/bbl, but this was partly offset by lower refining throughput (down 9% yoy), again due to maintenance shutdown. Meanwhile, earnings contributions from TLB (Thai Lube Base) remained stable, in line with our expectations.

What to do with the stock

We reduce our 2010E-12E EPS estimates by 5%-8% on the back of results – we have cut our petrochem earnings, but this is partly offset by slightly stronger GRM assumptions as we account for ytd average GRM. As a result we cut our 5.8X 2010E EV/EBITDA 12-m target price to Bt49 (prior Bt51). We maintain our Buy rating. Key risks: lower-than-expected refining margins and lower-than-expected inventory gains.

Financial Services

Indiabulls Real Estate Limited (INRL.BO): Execution progress; maintain Buy 15

INRL.BO, Rs168.05		
Market cap		US$1,496 mn
Target price		Rs214.00
Fiscal y/e Mar	2011E	2012E
Net inc. (Rs)	2,774 mn	4,358 mn
EPS (Rs)	6.91	10.85
EPS growth	1,253.7%	57.1%
P/E	24.3X	15.5X
Dividend yield	1.2%	1.8%
Investment Lists		
		Asia Pacific Buy List
Coverage view		Attractive

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What's changed

Indiabulls Real Estate's FY10 results provided an update on progress with construction activity. This was encouraging in our view as it indicated that IBREL has about 9 mn sq ft under construction in cities including Ahmedabad, Chennai, Gurgaon, Hyderabad, Madurai and Mumbai (Panvel). It plans to complete a significant proportion of these projects and recognize about Rs10.25 bn of revenue in FY11.

Implications

We upgrade revenue/EPS forecasts for FY11E-FY12E as we expect P&L revenue recognition based on percentage completion to be faster than what we had previously anticipated. We raise EPS by 62% to Rs6.91 (from Rs4.26) for FY11E and by 22% to Rs10.85 (from Rs8.92) for FY12E. Although we raise EPS, our 12-month target price is unchanged at Rs214 reflecting a lower than expected FY10-end net cash position. While visibility on IBREL's earnings may not be as high as some of its peers given the nascent stage of projects, we believe the market may get better evidence of improving execution over the next 12 months, which could help the stock re-rate. We maintain our Buy rating. We have updated our FY10 numbers for the preliminary information released by the company in its press release. We also introduce FY13 estimates.

Valuation

Our target price is set at a 30% discount to FY11E RNAV, which is at the deeper end of the 10%-30% discount range we use for our coverage. IBREL currently trades at close to a 45% discount to FY11E RNAV.

Key risks

Downside risks to our view include limited signs of improvement in the pace of residential sales and office leasing, execution delays with real estate and power and low earnings visibility, aside from policy tightening.

State Bank of India (SBI.BO): First Take: Provisions, Costs disappoint; Remains Sell 16

SBI.BO, Rs2,315.15		
Market cap		US$32,609 mn
Target price		Rs1,940.00
Fiscal y/e Mar	2010E	2011E
Net inc. (Rs)	101,224 mn	109,931 mn
EPS (Rs)	159.44	173.15
EPS growth	10.9%	8.6%
P/E	14.5X	13.4X
Dividend yield	1.4%	1.5%
Investment Lists		
		Asia Pacific Sell List
Coverage view		Neutral

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Estimates Under Review

News

State Bank of India reported 4QFY10 net profit of Rs18.7bn, down 32% yoy and 34% lower than our estimate and 28% below Bloomberg consensus.

Analysis

SBI's NII grew 39% yoy and was 3% ahead of our estimate at Rs67.2 bn. It appears that the company might have had some tax refund included in the 4Q number leading to the difference. Non-interest income was down 4% yoy but 2% ahead of our estimate at Rs45 bn; we await details on fees and other income. Expenses were significantly higher with employee cost increasing 53% yoy and other cost 26% yoy exceeding our estimates by 30% and 12% respectively. This could possibly be explained by provisions for wage hike, pension and increase in number of employees. This along with the high provisions of Rs23.5 bn (46% ahead of our estimate) led to the lower profit number. Note that we await additional details on provisions as to how much of this was on account for NPLs, investment depreciation.

Gross NPA's came in at Rs195.3bn up 4% qoq and now stand at 3.1% of advances while Net NPA's came in at Rs108.7bn down 4% qoq likely due to higher provisions taken during the quarter, at 1.7% of loans.

Implications

Our estimates and target price are under review and we shall revisit them post the analyst meet today.

Healthcare

India: Healthcare: Pharmaceuticals: Rolling forward to FY2012-based valuations and target prices 17

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Rolling forward to FY2012-based target prices

We roll forward our valuation framework to our FY2012 forecasts. Hence, we revise our 12-month Director's Cut-based target prices for nine stocks under our pharmaceutical coverage by -3% to 23%. We apply the Director's Cut framework to value the stocks with a sector EV/GCI to CROCI/WACC multiple of 1.45x. Please refer to the exhibit below for detailed Director's Cut methodology for each stock under our coverage.

There is no change to our investment thesis or ratings for any of the individual companies in our coverage group. We believe that the healthcare sector is on a fundamentally robust growth trajectory, driven by a stable domestic Indian market and generic growth opportunities in the US and other emerging generic markets. We forecast revenue CAGR of 15.5% over FY2010E-FY2012E and EPS CAGR of 15.9% (excluding Ranbaxy).

Director's Cut valuation of our coverage group implies a FY2012E P/E of 17X, which we believe reflects the fundamentally stable outlook.

Key risks for our sector includes: (1) Currency volatility and significant appreciation in USD; (2) regulatory overhang including potential actions by FDA; (3) any adverse changes in the NPPA policy affecting drug prices in the domestic market.

Industrials

Asia Pacific: Conglomerates: Conglo Catch-up: Your 2-min guide to estimates, valuations, events 18

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Stocks of the week: CITIC Pacific and China ports

CITIC Pacific (0267.HK, Buy): CITIC Pacific announced that it has agreed to pay an extra US$835 mn to MCC Mining, its JV partner and contractor for the Sino Iron Ore project, raising the budgeted capex by 20% to US$4.9 bn. According to the company, the increase is driven by higher construction and labor costs, corresponding to the rise in iron ore price since the original contract was signed in Aug-2007. One of the recurring questions from investors is whether its Sino Iron Ore project will still be profitable. Our analysis suggests it could still generate a 12% IRR (vs. 8% WACC), even if the long-term iron ore price trends down to US$80/ton (from US$180/ton now). Judging from its progress thus far, the management believes the mill line is on track to start production in Dec-2010.

After factoring in this higher capex and the Resource Super Profit Tax the Australia government proposes to levy from July 2012, we cut CITIC's 2010E NAV to HK$25.7 (from HK$27.7). With the stock now trading at 46% discount to our 2010E NAV and 0.8X 2010E P/B (vs. historical averages of 13% discount and 1.3X), we believe the recent correction is overdone. Reiterate Buy with a 12-m TP of HK$22.4, based on CITIC's mid-cycle NAV discount of 13%. Risk: Failure to pass on cost increase to special steel customers.

China ports: The latest Spring Canton Fair, which concluded on May 5, recorded export orders of US$34.3 bn. This represents a 12.6% increase over the Autumn Fair in 2009 and a 31% yoy improvement. As the Canton Fair is one of the largest trade fairs in China and its turnover has historically correlated well with throughput growth (R-Squared = 0.9), we believe the solid export orders would support further throughput growth in the following months. We retain our positive stance on the China ports sector and estimate throughput will only need to rise by 9% from April to December in order to reach our projected 12% yoy increase in 2010E. In fact, COSCO and SIPG both registered strong improvement in April throughput, growing 19% yoy and 21% yoy, respectively.

Within our port coverage, we prefer Hutchison (0013.HK, Buy) and COSCO Pacific (1199.HK, Buy). We believe both stocks are attractively valued. Hutch is trading at 35% discount to 2010E NAV vs. historical average of 18%. COSCO is trading at 14X 2010E P/E, a 36% discount to China Merchants (vs. 10% average discount historically). Key risks: Double dips of US/European economies.

Technology

Taiwan: Technology: Hardware: NB: Orders pushed back to June, but we see April as the bottom 19

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Lower 2Q shipment forecast to 6% qoq on further order pushback

NB ODMs guided 2Q more conservatively to avoid a further miss in May after missing April guidance. Our supply chain checks indicate some OEMs pushed back orders from May to June (after already pushing them back a month in April), with 2Q forecasts unchanged. We see April as the bottom, but the May uptick is muted with further pushbacks. OEMs must rely on an uptick in June when China demand starts warms up

before summer. We note Acer was the first OEM to cut orders (since late March) and its May orders show higher growth than peers. We will monitor if other OEMs would follow the same pattern. Nevertheless, we lower our 2Q forecast to 6% qoq from 7.5% qoq on increasing uncertainty.

1H/2H is unlikely to return to 40/60 split due to seasonality change

Acer/Compal guided 2H sales/shipments to grow only 10% hoh, on market concerns on 2H seasonality. Given low 2H visibility, we believe OEMs and ODMs are likely to deliver conservative guidance. Besides, our supply chain checks suggest Hon Hai has been taking market share in 2H; yet we have not factored in Hon Hai's shipment in our forecast model. Lastly, we think the increasing contribution from China will help smooth seasonality.

Increasingly negative on NB ODMs from Hon Hai's ramp-up in NB

In our May 3 NB note we highlighted Hon Hai's impact on ODM may pull in to 4Q10 from 2011. Our latest supply chain checks indicate Hon Hai may further gain share in HP's mainstream NB, on top of its original netbook and NB orders — by our estimate raising Hon Hai's share of HP's total shipment in 2011 to 20%-25%, from 10% in 2010. Also, after successfully entering HP's NB supplier list, Hon Hai is targeting Dell aggressively as Hon Hai currently only supplies Dell's NB model with small volume. In our view, Hon Hai's chance of winning Dell NB order has increased with its purchase of Dell's Poland plant last October, as this plant is configured to assemble parts for DT/NB.

Buy on the dip as share prices have gradually factored in bad news

2Q demand slowdown is in line with seasonality, but the weakening euro making the situation more complex. We maintain our U shape view for Taiwan tech stocks this year and recommend investors buy stocks on any market pullback. Our top picks: Wistron on its low NB exposure; Hon Hai on its market share gain.

Foxconn Int'l Holdings (2038.HK) Sell: Recovery or returning to loss? We think the latter; reiterate Sell 20

2038.HK, HK$7.02		
Market cap		US$6,374 mn
Target price		HK$5.90
Fiscal y/e Dec	2010E	2011E
Net inc. (US$)	240.2 mn	282.7 mn
EPS (US$)	0.03	0.04
EPS growth	522.5%	17.7%
P/E	26.5X	22.5X
Dividend yield	--	--
Investment Lists		Asia Pacific Sell List
Coverage view		Neutral

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Source of opportunity

Hon Hai, the parent company and a 71% shareholder of Foxconn Int'l (FIH), reported 1Q10 consolidated results on May 13. Its minority interest, surprisingly, swung back to negative territory after a positive result in the past 2 quarters. This suggests that FIH could post losses in 1Q10, which could surprise the market as consensus expects a sharp earnings recovery in 2010E. We believe FIH's potential poor profitability echoes our view that the handset market recovery has limited positive impact on FIH, due to (1) customer weakness on market share shift to other OEMs; (2) severe pricing erosion; (3) a paradigm shift to an in-sourcing model in the smartphone era.

Catalyst

We reiterate our Sell rating, and believe FIH's continued earnings misses amid serious structural challenges (such as the in-sourcing trend) could exacerbate when smartphone penetration accelerates and consolidates: (1) We believe FIH's continued weak customer revenue momentum, in clients such as Nokia, Motorola's feature phone, Sony Ericsson, and Palm, will remain the fundamental headwind in the coming quarters. (2) We don't think FIH has strong potential to engage with Tier-1 smartphone clients (iPhone/iPad rev belongs to Hon Hai, while RIM, HTC, and Motorola are not facing near-term pressure to outsource smartphone design and/or production). (3) Its smartphone design wins from marginal customers (such as Acer, Dell, Garmin-Asus, emerging brands in emerging markets) will offer limited revenue momentum, and add a substantial R&D burden, but without a promising growth outlook in the long term, in our view.

Valuation

We maintain our EPS forecasts and 12-month TP of HK$5.9, based on 1.4X 2010E BVPS and derived from PB-ROE matrix, implying 22X NTM EPS.

Key risks

Upside risk: Stronger-than-expected handset demand.

Telecom Services

Reliance Communications (RLCM.BO): Below expectations on revenue/EBITDA, but net profit beat 21

RLCM.BO, Rs144.50		
Market cap		US$6,596 mn
Target price		Rs172.00
Fiscal y/e Mar	2010E	2011E
Net inc. (Rs)	41,163 mn	37,823 mn
EPS (Rs)	18.95	17.41
EPS growth	(29.2%)	(8.1%)
P/E	7.6X	8.3X
Dividend yield	0.6%	0.7%
Investment Lists		Neutral
Coverage view		Neutral

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What surprised us

RCOM's 4QFY10 net revenues/EBITDA were 4%/6% below our estimates (and 12%/14% below Bloomberg consensus estimates), mainly due to weaker than expected revenues and margins at Global/Broadband businesses. Net profit however was 93% higher than our estimate and 77% higher than consensus, primarily due to higher than expected net interest income of Rs8.1 bn (vs. our estimate of net expense of Rs555 mn). Company declared a full-year dividend of Rs0.85/shr (higher than our estimate of Rs0.80/shr). Wireless revenues were up 2% qoq (vs. up 3% qoq for Bharti and 4% for Idea) and were 3% above our estimate due to lower-than-expected decline in ARPU. RCOM's MOU/sub was down 4% qoq (vs. up 5%/2% for Bharti/Idea). Revenues from Broadband segment declined 4% qoq and missed our estimate by 8%, mainly due to lower-than-estimated subscriber net adds. Although revenues from Global business showed slight improvement (up 2% qoq), they missed our estimate by 3%. Overall EBITDA margin was lower at 31.5% (down 268bp qoq and 73bp below our estimates) mainly due to higher license fees (up 7% qoq and 10% above our estimate), partially offset by a reduction in network operations costs (down 9% qoq). Wireless capex in 4QFY10 was down 82% qoq at Rs2 bn (3QFY10: Rs11 bn). We think this may be due to recent impact on equipment procurement from vendors.

What to do with the stock

We maintain our Neutral rating and 12-m SOTP based target price of Rs172. We see higher downside risk to RCOM consensus estimates due to 3G costs (such as higher D&A, higher interest expense and higher spectrum charges) related to ongoing 3G auctions. Better than expected recovery from price wars is upside risk. Higher than estimated 3G capex is downside risk.

Mahanagar Telephone Nigam (MTNL.BO): Below expectations: One-offs add to mounting operational losses 22

MTNL.BO, Rs65.80		
Market cap		US$819.7 mn
Target price		Rs58.00
Fiscal y/e Mar	2011E	2012E
Net inc. (Rs)	(2,566 mn)	(8,357 mn)
EPS (Rs)	(4.07)	(13.27)
EPS growth	23.1%	(225.7%)
P/E	--	--
Dividend yield	1.5%	1.5%
Investment Lists		
		Asia Pacific Sell List
Coverage view		Neutral

MTE, US$2.97		
Market cap		US$1,871 mn
Target price		US$2.38
Fiscal y/e Mar	2011E	2012E
Net inc. (US$)	(55.4 mn)	(184.7 mn)
EPS (US$)	(0.09)	(0.29)
EPS growth	19.1%	(233.3%)
P/E	--	--
Dividend yield	0.7%	0.7%
Investment Lists		
		Asia Pacific Sell List
Coverage view		Neutral

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Results highlights

MTNL reported 4QFY10 revenue of Rs8.5 bn (-20% yoy; -6% qoq) and was 5% lower than our estimate due to weaker than expected ARPUs (down 17% yoy). EBITDA loss/normalized net loss of Rs6.14 bn/Rs7.30 bn were worse than our estimates of –Rs765 mn/-Rs1.40 bn mainly due to increased staff costs (up 33% qoq). 4QFY10 results had following one-offs: (1) Wage revision expenses for the period Jan-2007 to Mar-2009 of Rs4.84 bn (2) Retirement charges related to increase in actuarial valuations of Rs15.79 bn; (3) Interest income on tax refunds of Rs7.2 bn and income tax reversal of Rs4.98 bn under section 80IA.

What to do with the stock

We revise our FY11E/FY12E revenue estimates by 1%/1% to factor-in lower than estimated revenue. Our EBITDA estimates decrease by 4%/6% due to higher staff costs. Our FY11E/FY12E/FY13E EPS changes from -Rs3.83/-Rs5.27/-Rs3.58 to -Rs4.07/-Rs13.27/-Rs11.39 mainly due to EBITDA reduction and higher D&A expenses. We model in 3G upfront fee assumption to Rs55.7 bn as we factor in the 3G provisional bid for Mumbai and Delhi circles at end of Day 29 (May 13, 2010). Consequently, we revise our 12-month DCF-based target price downward for the local share/ADR to Rs58/US$2.38 from Rs64/US$2.63. We reiterate our Sell rating. Key risks include better than expected broadband uptake.

Transportation

Thai Airways (THAI.BK): Above expectations, but political unrest may snap recovery trend 23

THAI.BK, Bt26.50		
Market cap		US$1,392 mn
Target price		Bt26.50
Fiscal y/e Dec	2010E	2011E
Net inc. (Bt)	4,921 mn	9,860 mn
EPS (Bt)	2.90	5.80
EPS growth	4.6%	100.4%
P/E	9.1X	4.6X
Dividend yield	2.0%	2.2%
Investment Lists		
		Neutral
Coverage view		Neutral

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What surprised us

On May 13, Thai Airways (THAI) reported 1Q10 pre-exceptional net profit of Bt4.8 bn, ahead of our forecast of Bt2.5 bn. This excludes exceptional gains of Bt5.7 bn from foreign exchange translations, above our expectation of Bt0.2 bn. At the pre-exceptional level, the surprise was mainly attributable to stronger than expected passenger load factors of 81%, above our expectations of 74%.

What to do with the stock

While results were better than expected, we expect political unrest to weigh on 2Q results. In addition, the volcanic eruption in Europe also caused THAI to suspend flights to Europe for six days in April. According to an official statement, THAI's load factors for the first four months fell to 78.4%, which would imply load factors of only 70.5% in April, below historical average levels of 73.9% from 2001-2009. In our view, limited visibility on Thailand's political environment remains an overhang for the stock and it is possible that THAI may book 2Q10 losses, which may persist into 3Q10 if the disruption of travel services continues.

Valuations

We maintain our Neutral rating and 12-m SOTP-based target price of Bt26.50, based on a target EV/FV of 0.94X on an average 2010E-2011E ROF of 8.2% over a WACC of 8.5%. The stock is trading at 0.94X current EV/FV and 0.8X 2010E P/B, which appear appropriate against our forward return expectations. Upside risk: Stronger-than-expected leisure travel demand. Downside risk: Pricing uncertainty on potential recapitalization plans.

Neptune Orient Lines (NEPS.SI): In line with expectations: A year of two halves, profits to come 2H 24

NEPS.SI, S$2.14		
Market cap		US$3,993 mn
Target price		S$2.80
Fiscal y/e Dec	2010E	2011E
Net inc. (US$)	179.3 mn	566.6 mn
EPS (US$)	0.07	0.22
EPS growth	119.0%	216.1%
P/E	22.3X	7.0X
Dividend yield	1.1%	3.5%
Investment Lists		
		Asia Pacific Buy List
Coverage view		Neutral

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What surprised us

After market close on May 14, Neptune Orient Lines (NOL) reported a narrower pre-exceptional loss of US$96mn for 1Q10, as compared to –US$215mn at 4Q09. We were not surprised by the inline pre-exceptional losses, given that NOL's volume mix is skewed by its c.32% exposure to Transpacific (TP) and limited Asia/Europe contribution of 15%. We still expect NOL to break even in 2Q and post a strong profit from 3Q once the new TP rates have been implemented.

What to do with the stock

We reiterate our Buy on the stock, as the market still appears to be expecting losses for 2010, given that Bloomberg consensus estimates still assume a net loss of US$95mn. We expect consensus upgrades to come 2H.

Valuations

The stock is trading at 1.06X 2010E EV/Fleet Value (FV) and 1.3X 2010/E P/B, which looks attractively valued on mid-cycle return of 12.0% against mid-cycle multiple of 1.32X. Our 12-month SOTP-based target price of S$2.80 is based on a target EV/FV multiple of 1.31X, underpinned by a 2010E-11E average ROF of 12.0% against a WACC of 10.0%.

Risks

Capacity and pricing discipline are the key risks to our view.

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