



Huaku Construction (2548 TT)

BUY

Materials: Property Developers

Company Update

ML Research Team**Non-tech Analyst**

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Recommendation

BUY

Date: 13 January 2005
Share Price (NT\$): 35.8
Price Target (NT\$): 43.0
Percent Change: 20.1%
52-wk range (NT\$): 40.1/16.0
TWSE: 5942.85

Company Data

Capital Size (NT\$):	1.36bn
Market Cap (NT\$):	4.86bn
Market Cap (US\$):	152.5mn
Outstanding Shrs:	135.8mn
Free Floating Shrs:	7.38mn
PER ('05E):	4.57x
PBR ('05E):	1.96x
Foreign Ownership:	2.79%
Major Shareholder:	%

Performance (%)	1-m	3-m	6-m
Absolute	46.12	19.33	21.36
Relative to TAIEX	39.14	21.56	21.87

Key Changes	Current	Prev.
Recommendation	BUY	NA
Price Target (NT\$)	43	NA
Revenue (NT\$ bn)	5.83	NA
Gross Margin (%)	28.0	NA
Oper. Margin (%)	19.2	NA
EPS (NT\$)	7.82	NA

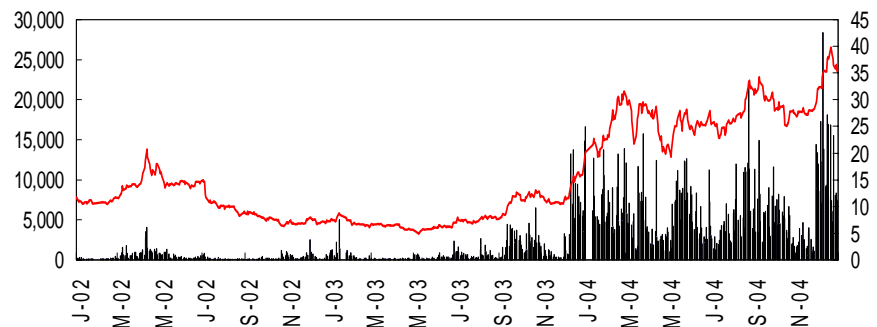
Price Catalysts (+,-)

(+) Major projects booked in 2005
(+) High cash dividend yield

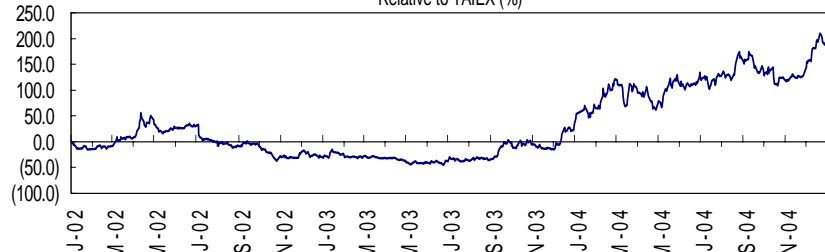
Related Research**Substantial improvements in earnings in 2005**

- **Strong 2004 and 2005 results.** Due to strong real estate sales in 2004, Huaku's 2004 revenue reached NT\$2.32bn, up 41.7% YoY, with earnings of NT\$402mn, up 2771.4% YoY, suggesting an EPS of NT\$2.96. Given many of the projects currently on hand would be completed this year, we believe Huaku's sales in 2005 could reach NT\$5.83bn, up 151.6% YoY, with earnings of NT\$1.06bn, up 164.2% YoY, indicating an EPS of NT\$7.82.
- **Lucrative high cash dividend yield.** Historically, Huaku paid out 70-80% of total earnings as cash dividend. We believe Huaku would payout NT\$2.5 per share as cash dividend for last year's earnings. Based on the current share price of NT\$35.8, this indicates a cash dividend yield of 7.0%. In addition, since sales and earnings would also see enhancements in 2005, cash dividend for 2006 could possibly reach NT\$4.5-5.0 per share, implying a cash dividend yield of 12.6-14.0%.
- **BUY with a target price of NT\$43.** Due to high cash dividend yield and strong 2005 performance, we have a BUY recommendation for Huaku with a target price of NT\$43, which is based on by 5.5x our 2005E EPS.

Average daily volume ('000, LHS) and share price (NT\$, RHS)



Relative to TAIEX (%)

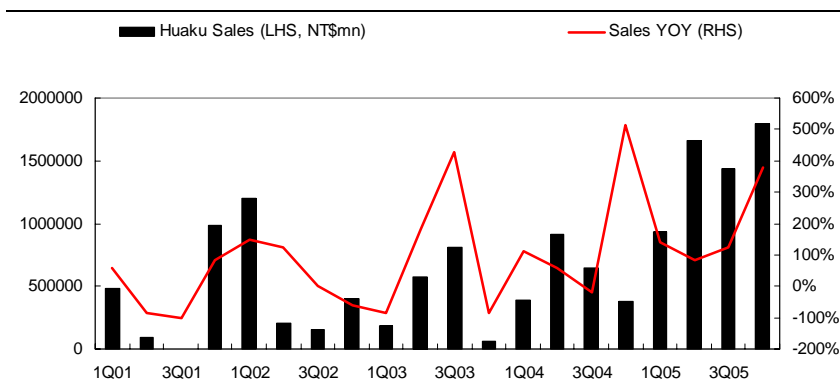


Investment Keynotes

- **Huaku's 2004 earnings should see a big improvement**

Due to hot selling projects such as Amazon Garden and NTU Beauty, Huaku's sales saw a surge in 2004. In addition, since Huaku's projects are concentrated in Taipei City and its suburbs, Huaku could usually sell its real estates in a short period of time, with gross margin sustaining at high levels of 25-40%, and a norm of 30%. Overall, Huaku's 2004 sales reached NT\$2.32bn, up 41.7% YoY, with earnings estimated to be NT\$402mn, up 2771.4% YoY, suggesting an EPS of NT\$2.96.

Figure 1: Huaku's monthly sales and YoY growth



Source: TEJ; MasterLink Securities

- **2005 performance should continue to be strong**

Since most of the projects currently on hand would be completed this year, we believe Huaku's sales in 2005 could reach NT\$5.83bn, up 151.6% YoY, with earnings of NT\$1.06bn, indicating an EPS of NT\$7.82. We believe Huaku's gross margin should sustain at 2004 levels, with an overall average of close to 30%. Also, thanks to 1) Huaku's high customer service standards and 2) project concentrations in Taipei City and its suburbs, Huaku should continue its hot selling trend for its new projects, and to sell 70-90% of the total project value.

Figure 2: Projects launched by Huaku in 2005

	Amazon Garden	NTU Beauty	VISION	Vanilla Cottage	Vancouver Villa	Vanilla Villa	Total
Total number of housing (units)	112	48	60	110	163	60	553
Project value (NT\$mn)	1,301	1,153	370	2,700	1,900	1,070	8493
Gross margin	30%	40%	30%	30%	30%	25%	
Percentage to be sold in 2005	100%	80-90%	80-90%	80-90%	70-80%	70-80%	
Time of completion	1Q05	4Q05	4Q05	4Q05	1Q06	4Q05	
Method of booking	Percentage of completion	Percentage of completion	Percentage of completion	Percentage of completion	Percentage of completion	Percentage of completion	
Amount to be booked in 2005 (NT\$mn)	325	979	279	2,160	1235	856	5,834

Source: Company data; MasterLink Securities

An inventory/shares outstanding ratio in the property developers industry would define the profitability that would be generated over the next few quarters; high ratio, in a real estate upswing cycle, would guarantee strong sales in the upcoming year. Huaku's ratio, currently at 3.32 times, is ranked at the upper range among its peers, therefore, we believe Huaku's sales would be strong in 2005.

Looking forward, we believe real estate sales will remain strong in 2005, albeit a slight drop in GDP growth in Taiwan. Moreover, we believe Huaku's sales should grow the fastest among its peers in 2005. The company currently still has over NT\$4.5bn worth of projects unsold, which underpins its high sales growth momentum in 2005.

Figure 3: Comparison table for property developers

Ticker	Company name	Projects currently unsold (NT\$m)	Outstanding shares (mn)	Inventory / shares outstanding	2004 sales (NT\$m)	2005E sales (NT\$m)	Sales (E)	YoY
2501 TT	Cathay Construction	9,515	16,565	0.57	1,852	1,963	5.99%	
2520 TT	Kindom Construction	4,469	4,894	0.91	1,711	2,281	33.31%	
2524 TT	KTC Construction	5,443	1,487	3.66	4,323	7056	63.22%	
2536 TT	Hung Poo Construction	7,543	2,827	2.67	3,150	4,418	40.25%	
2542 TT	Highwealth Construction	5,043	2,640	1.91	3,289	6,147	86.96%	
2545 TT	Huang Hsiang Construction	9,357	1,524	6.14	2,731	5,894	115.82%	
2547 TT	Radium Construction	3,500	2,440	1.43	3,138	3,215	2.45%	
2548 TT	Huaku Construction	4,503	1,358	3.32	2,319	5,834	151.57%	
5534 TT	Chong Hong Construction	4,006	1,000	4.01	2,009	2,902	44.45%	

Source: Company data; MasterLink Securities

- **High cash dividend yield for the next two years**

Historically, Huaku pays out 70-80% of total earnings as cash dividend. We believe Huaku would payout NT\$2.5 per share as cash dividend for last year's earnings, and based on the current share price of NT\$35.8, this indicates a cash dividend yield of 7.0%. In addition, since sales and earnings would also see enhancements in 2005, cash dividend for 2006 could reach NT\$4.5-5.0 per share, implying a cash dividend yield of 12.6-14.0%.

KTC (2524TT, NT\$54.5), another high sales growth company in 2005, also guides a 70-80% cash dividend payout ratio, indicating a cash dividend yield of 12.8-14.7% in 2006. However, compared to KTC, Huaku is currently trading at a more attractive valuation, and Huaku's sales and earnings growth momentum should be higher than KTC's in 2005, which is why we believe Huaku's share price should see some upside potential within the next three months.

Figure 4: Huaku vs. KTC

Ticker	Company	2004	Sales (NT\$m)		EPS (NT\$)		Current PER	Reasonable PER range
			2005E	YoY	2004E	2005E		
2548 TT	Huaku Construction	2319	5834	152%	2.96	7.82	4.57	5.0-6.5
2524 TT	KTC Construction	4323	7056	62%	8.01	10.24	5.32	5.5-6.5

Source: TEJ; MasterLink Securities

- **Unaffected by the incremental land tax**

While other construction companies are negatively impacted by the uncertainties of the new land taxation law, Huaku should only be trivially affected by this uncertainty. In our view, most of the land Huaku acquired for its projects were recently purchased, and thus have a value very close to the announced current land value. We believe Huaku's recent stock price correction is justified by a wrong reason.

Although the land taxation law of permanently decreasing the incremental land tax has yet to be passed by the Legislative Yuan, we believe Huaku, would not be affected by this issue. A decrease of incremental land tax would only benefit and affect companies whose land assets are booked at substantially lower than fair market value or lower than the government announced current land value.

- **CB dilution could possibly dilute estimated earnings and add volatility to share price**

Last year, Huaku issued a NT\$600mn domestic convertible bond that would expire in June 2009. Since the bond had a convertible price of NT\$22.5 per share, Huaku's total outstanding shares would expand to 148.6mn shares from the current 135.8mn shares once the CB is fully converted, or a dilution of 9.4%. According to the company, only 52% of the CB is currently converted, and we believe the remainder of the unconverted CB would be converted in 2005 due to arbitrage opportunities. Moreover, the conversion would also represent more shares waiting to be sold in the market, which adds volatility to the company's share price.

Our earnings forecast is based on the current total outstanding shares of 135.8mn shares. However, if the CB is fully converted in 2005, our EPS estimate would drop to NT\$7.15, compared to the present EPS estimate of NT\$7.82. However, looking from another perspective, once the CB is fully converted, this would ensure Huaku has adequate cash on hand, and be capable of paying out NT\$4.5-5.0 per share as cash dividends in 2006.

In our view, the CB conversion would have a minimum impact on Huaku's share price performance since 1) a dilution of less than 10% would not revise down our EPS forecast by a great magnitude and add too much volatility to the share price, 2) the company's high cash dividend payout policy would support the share price and 3) Huaku's remaining CB, we believe, would not be converted until the late of 2H05, and in the short term, would not affect the stock price.

Valuations and recommendation

- **BUY with a target price of NT\$43**

Huaku historically traded between 2.0-8.0x P/E and now trades at 4.57x our 2005E EPS and we believe Huaku is currently trading at a low valuation. Due to high cash dividend yield and strong 2005 profitability performance, we give our BUY recommendation to Huaku with a 3-month target price of NT\$43, based on 5.5x our 2005E EPS, implying a 20.1% upside potential from the current price level.

Figure 5: P/E band graph



Source: TEJ; MasterLink Securities

Figure 6: Consolidated Statement of Operations (mn NTD)

Item/Year	2002	2003	2004E	2005E
Revenue	1,958	1,636	2,319	5,834
Cost of Goods Sold	1,777	1,533	1,630	4,201
Gross Profit	182	103	689	1,633
Oper. Exp.	89	98	195	514
Oper. Income	93	6	494	1,199
Other Income	-48	13	-60	58
Pretax Income	45	18	434	1,178
Net Income	31	14	402	1,062
EPS (NT\$)	0.29	0.13	2.96	7.82

Source: MasterLink Securities

Figure 7: Income Statement (%)

Item/Year	2002	2003	2004E	2005E
Gross Profit	9.3%	6.3%	29.7%	28.0%
Oper. Exp.	4.6%	6.0%	8.4%	8.8%
Oper. Income	4.7%	0.3%	21.3%	19.2%
EBIT	2.3%	1.1%	18.7%	20.2%

Source: MasterLink Securities

Figure 8: Income Statement (Growth)

Item/Year	2002	2003	2004E	2005E
Revenue	25.8%	-16.4%	41.7%	151.6%
Operating Income	-67.1%	-93.9%	8133.3%	142.7%
Pretax Income	-83.1%	-59.0%	2264.5%	171.5%

Source: MasterLink Securities

MasterLink Securities – Stock Rating System**BUY:** Total return expected to appreciate 10% or more over a 3-month period.**HOLD:** Total return expected to be between 10% to -10% over a 3-month period.**SELL:** Total return expected to depreciate 10% or more over a 3-month period.

Additional Information Available on Request

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