

Company analysis

Hong Kong

Guoco

An offer you can refuse

Diversified financials

29/3/04

HK\$61.10

Guoco's controlling shareholder has purchased the Kuwait Investment Office's (KIO) 21.6% stake in the company, triggering a general offer to the remaining shareholders. We do not expect the offer to succeed in delisting Guoco.

Quek expresses confidence. After years of fractious relations, Guoco and the KIO have gone their separate ways, with the company's major shareholder agreeing to buy out the Kuwaitis at HK\$58, a 5.1% discount to the current market price and a 33% discount to trailing NAV.

Pro-forma offer. Exchange rules require Guoco's parent to make a general offer for all remaining shares at the same price or higher; the company has stated that investors should be prepared for a formal offer for all Guoco shares at HK\$58. We do not believe that this offer is intended to be successful as it is below market, and do not expect any investors to accept the offer, barring a severe decline in Hong Kong share prices during the open period.

Keeping the war chest full. Note that the general offer is not being made by the company itself (as with JCG Holdings), but by the major shareholder, who will have to use fresh cash to buy the KIO's stake and any shares tendered under the offer. This means that Guoco's large cash hoard – some HK\$20bn, or HK\$61 per share – remains intact. We believe that the shareholding clean-up presages a renewed effort to acquire a Hong Kong or China banking franchise.

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Not rated

29 March 2004

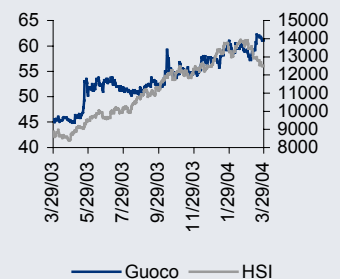
Est fair value

N/A

Bloomberg

53 HK

Share price performance



Source: Bloomberg

Share purchase triggers general offer

Guoco and Hong Leong group controlling shareholder Quek Leng Chan have reached an agreement to purchase the 21.6% stake in listed holding company Guoco Holdings Limited (53 HK) held by the Kuwait Investment Office, for a total consideration of HK\$4.1bn (US\$529m), or HK\$58 per share.

As Quek, and his byzantine web of affiliated entities – omitted for clarity – are already over the 30% minimum control threshold outlined in the Hong Kong Takeover Code and have increased their stake further with this purchase, a mandatory general offer to all shareholders is required; the controlling group's intention to make such an offer was disclosed on Friday as well.

The Quek interests are required to make an offer at least as favourable as the price of the new shares purchased – but are not required to offer at market or any specific premium. The disclosed offer price is the same HK\$58 price paid to the KIO.

Pricing and valuation

The offer amounts to a 5.1% discount to Guoco's last traded price (shares were suspended Friday morning). As such, we believe that this offer is made as a matter of form only, and we do not expect any other shareholders to accept this offer, barring a substantial slide in markets during the offer period.

As the offer for Guoco shares is also being made not only at a discount to NAV but at a discount to the actual net cash on hand, we do not believe that the Quek interests are running any major market risk with this offer; indeed, we feel that they would be overjoyed to have the market fall enough to make the offer successful.

Guoco trades cheaply versus other Hong Kong financials, at 9.5x FY04 and 12.1x FY05 EPS consensus estimates (FY05 declines due to the projected lack of securities gains). However, the possibility of M&A, which may be expensive and dilutive, also raises the potential for Guoco to return to its former – and steeper – discount to NAV.

Fig 1 Guoco valuation summary

	Last	6/04	6/05
EPS (HK\$)	3.69	6.47	5.07
P/E (x)	16.6	9.5	12.1
NAV (HK\$)	90.58	95.95	99.91
P/NAV	0.67	0.64	0.61
DPS (HK\$)	1.10	1.10	1.10
Yield (%)	1.8%	1.8%	1.8%

All forward figures based on I/B/E/S consensus.

Source: Company data, I/B/E/S, ING estimates

Second offer since Dao Heng sale

The exit of the KIO is significant as they have been a very active shareholder in calling for Guoco to distribute its cash to shareholders. To placate shareholders, Guoco did buy back approximately 25% of outstanding shares in late 2001 through a tender offer at HK\$50 per share.

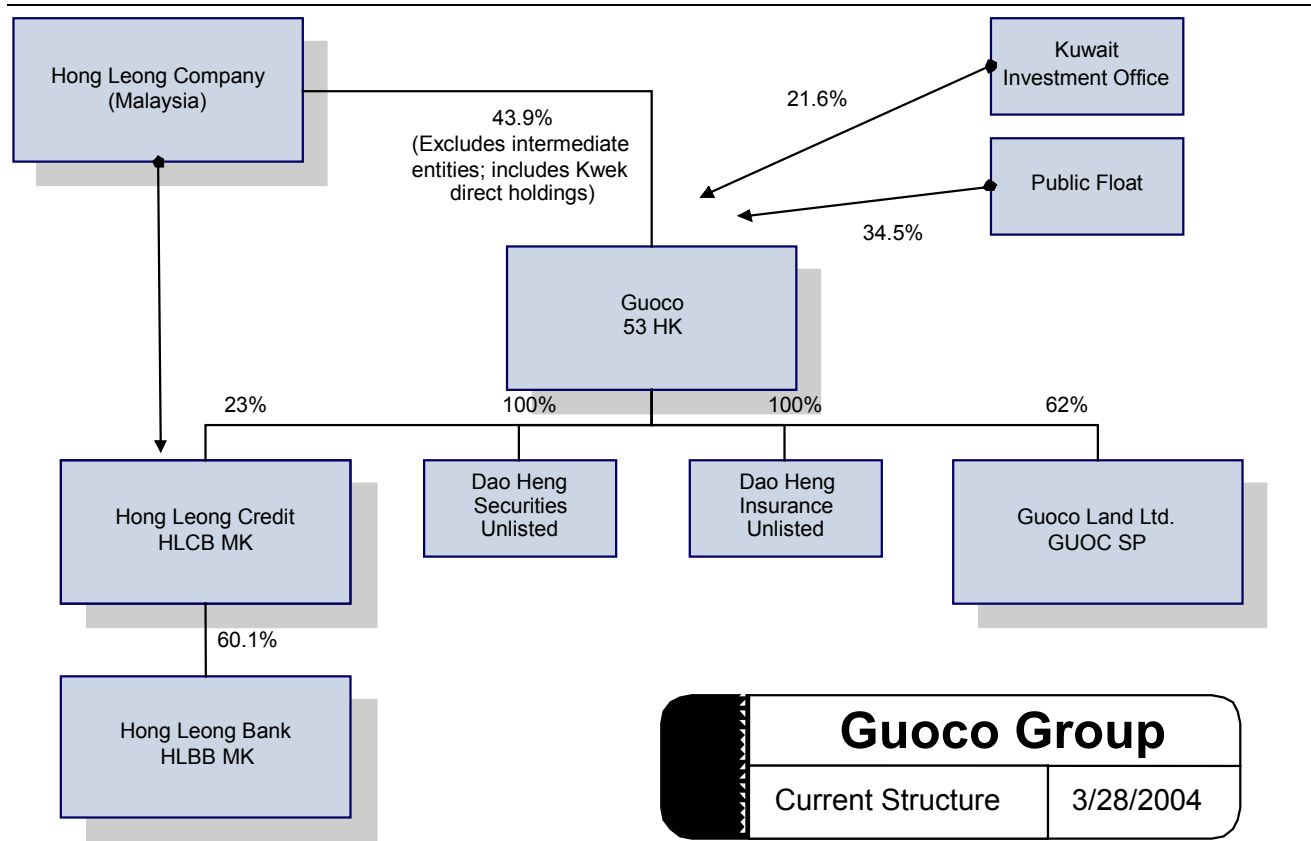
Guoco corporate structure

Guoco is essentially a bag of cash post the sale of its 71.2% stake in Dao Heng Bank to Singapore's DBS Bank for HK\$29.8bn in mid-2001, still a landmark for richly priced Hong Kong bank acquisitions.

The company does retain its (relatively small) securities and insurance operations, which were retained after the sale of the bank. In addition, Guoco owns 62% of Singapore-listed Guoco Land and 23% of Malaysian-listed Hong Leong Credit, the parent of Hong Leong Bank.

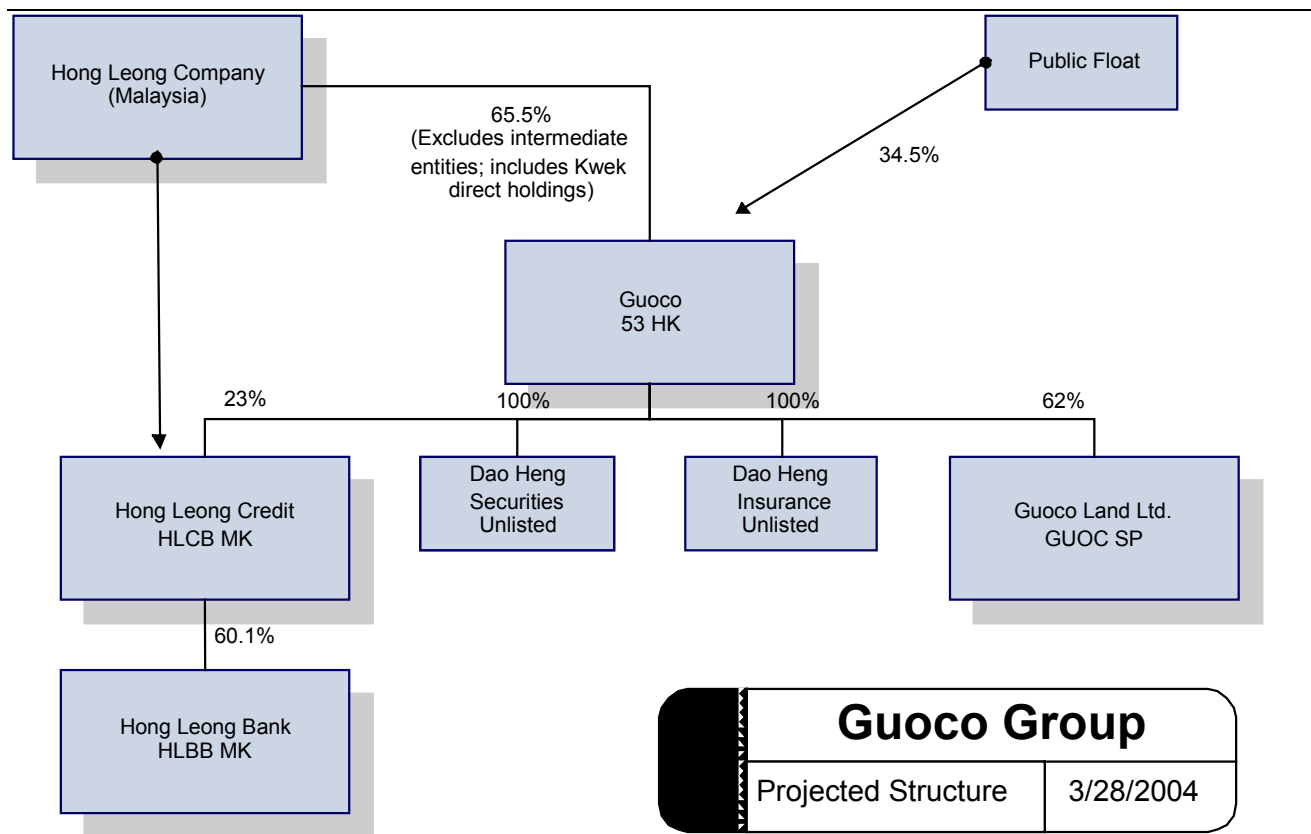
Guoco's top-tier parent is Hong Leong Co (Malaysia), which holds its stake through a complex network of other unlisted entities and which itself is unlisted. In effect, Quek Leng Chan controls Guoco along with most of its affiliates.

Fig 2 Guoco group structure: current



Source: Company data, ING estimates

Fig 3 Guoco group structure: assuming minority investors reject the offer



Source: Company data, ING estimates

Shareholder structure

The Quek family and related interests currently hold approximately 43.9% of Guoco, which has been enough for firm control over the group. The KIO now holds a 21.6% stake, which it has agreed to sell to Quek, leaving a 34.5% public float.

Despite this free float and a decent market cap of HK\$20bn (US\$2.6bn), Guoco is a relatively illiquid stock, trading an average of US\$3.2m per day, lower than the trading volume of Wing Hang Bank (302.HK, HK\$49.10, Not rated) despite a market cap fully a third larger.

The offering will probably do nothing to reduce the float, however, leaving Quek interests with 65.5% and no other significant shareholders.

Guoco NAV

Guoco's stated NAV at 31 December 2003 (the company has a 6/30 FYE) was HK\$90.58, with over two-thirds of this representing cash per share of HK\$60.63. The remainder is various investment properties (not including head office premises, which are included under 'other assets'), Guoco's stakes in listed affiliates Guocoland and Hong Leong Credit, and other equity securities and investments.

We believe that this NAV is likely to be conservative rather than overstated.

Fig 4 Guoco NAV components

	Total (HK\$m)	Per share (HK\$)
Cash and equivalents	19,839	60.63
Investment property	4,383	13.40
Guocoland stake	2,061	6.30
Hong Leong Credit Stake	2,455	7.50
Other securities and investments	5,155	15.75
Other	2,905	8.88
Less: debt and other liabilities	7,159	21.88
Net NAV	29,639	90.58

Source: Company data, ING estimates

Based on our calculated trailing NAV figures, Guoco is now trading at approximately the cash value per share of the company, and at a 33% discount to net NAV. Although there are many instances where the company has traded at a 50%+ discount to NAV, these are mainly when Guoco's NAV was primarily comprised of its stake in Dao Heng Bank, and not cash as it is today.

We believe that cash balances should be higher now than at year-end due in part to Guoco's sale of Dao Heng Asset Management to Principal Group in February.

Fig 5 Guoco NAV discount

Guoco share price (HK\$)	61.1
Discount to NAV	-33%
Discount to cash + listed affiliates	-18%
Premium to cash only	0.8%

Source: Company data, ING estimates

M&A ramifications

So what is Guoco doing?

There are only a few things to do with a cash-rich holding company: liquidate or buy something. So far, Guoco has chosen a third way — the wait-and-see approach. Although management should be given serious credit both for having built Dao Heng into a good business and for turning on a dime and selling it for a king's ransom, our sense is that investors would like to see some concrete action to return cash or alternatively put it to good use.

As management has not made a real attempt at privatisation here, we suspect that liquidation is not on the cards — if it were, there would be a real incentive to pay a premium to the market (but still a discount to NAV) and reap a greater gain to NAV.

This means that, in our opinion, acquisition is becoming more likely. But of what?

Not so keen on Malaysia

We have been tremendous bulls on the Malaysian banks for almost a year now and continue to see the sector as exciting, particularly as consolidation comes to the fore once again. Guoco does have excellent operating skills, which should be in demand in the Malaysian market — why not expand here?

Although it makes sense to us, a meeting with Guoco management late last year disclosed relatively little enthusiasm for valuations and operating prospects in the Malaysian financial sector. It may be that as the larger group is already well entrenched in the country, there is no great incentive to add assets except at real fire sale prices.

Returning to property?

Guoco and the family have long had property interests throughout the region and in the UK. In addition, Guocoland has intimated that it may begin acquiring parcels in Singapore again after a multi-year hiatus. However, this is hardly evidence of a major move in the direction of real estate investment for the group.

Banks: Back where we started

The most likely use of Guoco's excess funds in the end continues to be what it has always been: the acquisition of a Hong Kong or mainland China bank or other finance company. This is management's core competence, and the company retains much of the operating talent and relationships that helped it to build Dao Heng.

Buying a Chinese bank is well-nigh impossible, and even taking a minority stake would be difficult, especially as Guoco does not currently own a bank.

We suspect that any grand plan would start with a return to the Hong Kong banking market, through the acquisition of **Liu Chong Hing** (1111 HK, HK\$12.05, Not Rated), **Wing Lung**^[a] (302 HK, HK\$53.50, Not Rated), **Wing Hang** (96 HK, HK\$49.50, Not Rated), **Shanghai Commercial**, or **Bank of America (Asia)**.

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In Asia ex-Japan our recommendations are defined as follows:

Buy: At least 10% share price upside is expected over our 12-month view.

Hold: Share price movement of between -10% and +10% is expected on a 12-month view.

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