

Analyst: Kelvin Li

Main Board Listing – Research

Rainbow Brothers Holdings Limited [Stock Code: 0033] 十友控股有限公司
Sponsor

: Asian Capital (Corporate Finance) Limited

Asian Capital (Corporate Finance) Limited

Co-lead Managers and Co- Bookrunners

: Phillip Securities (HK) Limited

Sun Hung Kai International Limited

Sector : Consumer goods

Business : Designing, developing, merchandising of mainly party and festivity products to retail stores which sell inexpensive items.

Total share offer: <u>50,000,000</u> shares (25% of the enlarged share capital) Public Offer: 5,000,000 shares (10%) Placing: 45,000,000 shares (90%)	<u>Business of Rainbow Brothers</u> Established in 1996, Rainbow Brothers was originally a toy trading company. Later, it expanded its business to provide a variety of products to customers through designing, developing and merchandising. Products are mainly party and festivity items. Yet, there are also stationery, gift, household, garden products and toys. They are predominantly distributed to North America and Asia. In the past three financial years, on average, the Group generated over 80% of the sales from North America. The Dollar Tree and the Second Largest Customer, which are the largest dollar store chains in the US are the Group's two largest customers, where they have contributed to nearly two-third of the Group's turnover on average in the past three financial years. To broaden its customer base and widen its supply source, the Group had two acquisitions in 2005 and 2006. After the first acquisition, instead of entirely sourced its products from external suppliers, the Group's wholly-owned subsidiary-Silver Lining, enhanced its sourcing activities substantially through the Processing Agreement with an independent third party- Mei Yi. To provide better customer services and enhance competitiveness, the Group also offers ancillary customers services including product design and development, raw material sourcing, factory sourcing, production, order tracking and logistics. In July 2007, the Group was awarded a vendor appreciation award by Dollar Tree in US.
Price: HK\$1.12 – HK\$1.50 per share Market Cap: HK\$224 million– HK\$300 million Pro forma FY2007E PER: 6X – 8X Adjusted NTA per share: HK\$0.44 – HK\$0.54 Staffing: 68 (as of 31 st July 2007)	
HK Public Offer period: 6 th November 2007 – 9 th November 2007 Receiving banker: Standard Chartered Bank Principal Share registrar & transfer office: Butterfield Fund Services (Cayman) Limited HK branch share registrar & transfer office: Tricor Investor Services Limited Listing date: 19 th November 2007	

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**Shareholding Structure after Listing** (Assuming the over-allotment option is not exercised)

Direct Value (70% owned by Mr. Hui Kwan Wah, Hugo and 30% owned by Mr. Ng Chi Man)	75.00%
Public Investors	25.00%
	<u>100.00%</u>

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$54.5million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$1.31 each, being the midpoint of the indicative price range)

	HK\$ million
To repay short-term bank borrowings	25
To develop new licensing business, for the payment of franchise fees for the producing and marketing of party products featuring well-known brand names and icons in the PRC	10
For purchase of new machineries and equipment	7
For future expansion including possible acquisitions	10
For general working capital purposes	2.5

Financial Highlights

	Year ended 31 st March		
	2005 HK\$'000	2006 HK\$'000	2007 HK\$'000
Turnover	185,154	210,496	314,837
Gross profit	25,672	44,659	65,302
Profit from operations	17,489	28,714	43,603
Profit before taxation	17,309	27,940	42,464
Project attributable to equity holders of the Company	14,199	22,998	37,273
Gross profit margin	13.9%	21.2%	20.7%
Net profit margin	7.7%	10.9%	11.8%
Current ratios	1.2	1.1	1.4
Inventory turnover days	N/A	11.0	13.4
Debtors' turnover days	36.3	34.1	31.3
Creditors' turnover days	39.2	39.6	14.4
Gearing ratio	37.1%	38.4%	34.3%
ROE	166.9%	116.7%	65.4%
EBITDA (in HK\$'000)	18,028	32,420	48,044

Products Breakdown

	Year ended 31 st March					
	2005		2006		2007	
	HK\$'000	%	HK\$'000	%	HK\$'000	%
Party and festivity products	141,350	76.3	171,501	81.5	272,243	86.5
Stationery and gift	17,728	9.6	18,086	8.6	9,657	3.1
Household and garden products	13,758	7.4	10,551	5.0	22,396	7.1
Toys and others	12,318	6.7	10,358	4.9	10,541	3.3
Total	185,154	100.0	210,496	100.0	314,837	100.0



Strengths/Opportunities

- ✓ **Defensive business:** Less vulnerable to the business cycle amid of weak sentiment in the US economy, as the products are not expensive.
- ✓ **Successful balanced growth business model:** The Group has organic growth for sustainability while looking for acquisition opportunities.
- ✓ **With plan to increase sales to the European market:** Currently, the Groups has customers in Spain, Italy and United Kingdom. It plans to make use of the acquired clientele to achieve further penetration in Europe.
- ✓ **Inexpensive:** Pro forma FY2007E PER range from 6X to 8X.
- ✓ **Good trading debut time:** The trading time falls in its peak sales' season before Christmas which help increase its shares' liquidity to a certain extend.

Weaknesses/Threats

- × **Reliance on a few major customers:** Top five customers account for nearly 75% of the Group's turnover. Yet, any unexpected cessation of and substantial reduction in the volume of business from them, could adversely affect the Group's business and financial performance.
- × **Reliance on processing arrangement:** The tenure of such processing arrangement will expire in 2008. If it cannot be renewed, the Group has estimated that it needs to spend not more than HK\$1million to establish alternative processing arrangement.
- × **Close to 50% of the IPO proceeds (or HK25 million) will be used for repayment of bank loans** and not for business expansion purposes.
- × **Reliance on the North America market:** In the past three financial years, on average, the Group generated over 80% of the sales from North America.
- × **Additional spending on maintaining consumer goods' safety going forwards:** To abide by the international standards and new regulations on product quality and safety imposed by the PRC government, it is expected that the Group needs to spend additional money to maintain the quality of the products.

Recommendation: Trading buy

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