

Analyst: Kelvin Li

Main Board Listing – Research

稻香控股有限公司

Tao Heung Holdings Limited [Stock Code: 0573]

Bookrunner, Lead Manager and Sponsor : UOB Asia

Sector : Hotels, Restaurants & Leisure

Business : Operation of Chinese restaurants

<p>Total share offer: <u>124,000,000</u> shares (12.4% of the enlarged share capital)</p> <p>Public Offer: 12,400,000 shares (10%)</p> <p>Placing: 111,600,000 shares (90%)</p> <p>Greenshoe: 18,600,000 shares</p>	<p><u>Business of Tao Heung</u></p> <p>Tao Heung is a Chinese restaurant group in Hong Kong, operating 42 local Chinese restaurants under different brands and serving a variety of Chinese cuisine. Besides, Tao Heung also operates 7 restaurants in Southern China.</p>
<p>Price: HK\$2.40 – HK\$3.20 per share</p> <p>Market Cap: HK\$2.40 billion – HK\$3.20 billion</p> <p>Pro forma FY2006 PER: 15.1x to 20.2x</p> <p>Adjusted NTA per share: HK\$0.60 – HK\$0.70</p> <p>Staffing: 5,612 (as of 8th June 2007)</p>	<p>Tao Heung now operates its restaurants under 11 brand names, including <i>Tao Heung Seafood Hotpot Restaurant</i> (稻香海鮮火鍋酒家), <i>Tao Heung</i> (稻香), <i>Tao Heung Super 88</i> (稻香超級漁港), <i>Hak Ka Hut</i> (客家好棧), <i>Cheers Restaurant</i> (迎囍大酒樓), <i>Chao Inn</i> (潮樓/潮館), <i>Chung's Cuisine</i> (鍾菜), <i>Harbour Seafood Restaurant</i> (港灣海鮮量販飯店), <i>Shanghai Inn</i> (上樓), <i>TCT</i> (領鮮環球自助餐) and <i>Pier 88</i> (迎海漁港).</p>
<p>HK Public Offer period: 15th June 2007 – 21st June 2007 noon</p> <p>Receiving bank: Standard Chartered Bank (HK)</p> <p>Share registrar: Computershare Hong Kong Investor Services Limited</p> <p>Listing date: 29th June 2007</p>	<p>Tao Heung has a centralized food processing and logistics centre in Fo Tan, in which most of the food ingredients are prepared, allowing restaurants to focus on the dish-preparation.</p>

Shareholders after Listing (Assuming the over-allotment option, options granted under the Pre-IPO Share Option Scheme and any option that may be granted under the Option Scheme are not exercised)

Mr. W.P. Chung – chairman of the Group	35.82%
Mr. K.W. Wong – executive director of the Group	10.33%
Mr M.F. Chung – executive director of the Group	5.98%
Other directors and connected persons*	4.96%
Café de Coral Holdings (HKEx: 0341)	10.21%
Existing individual investors	20.30%
Other public investors	12.40%
	<u>100.00%</u>

Remark: (*) Other directors refer to Mr Ho Yuen Wah, an executive director, Mr. Ng Yat Cheung, an independent non-executive director, Mr. Lam Wai Pan, a director of a subsidiary and Ms. Chan Yung Foon, a director of a subsidiary. Connected persons include family members of Mr. W.P. Chung and Mr K.W. Wong.

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**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$320 million (Assuming an offer price of HK\$2.80, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
For the opening of two to three new restaurants in Hong Kong in each of the next two years.	64.0
For the opening of two to three new restaurants in China in each of the next two years.	64.0
For the settlement of the remaining capital expenditure in relation to the construction of the Dongguan Centre, its operations and the stocking-up of inventory.	128.0
For upgrading one to two of the existing restaurants in Hong Kong in each of the coming two years.	38.4
For general working capital.	25.6

Financial Highlights

(HK\$ '000)	2004	2005	2006
Revenue	1,137,243	1,377,836	1,574,381
Gross profit	722,587	917,577	1,073,594
Operating profit	76,661	111,114	182,233
Attributable profit to shareholders	58,802	77,969	138,839
Gross profit margin	63.3%	66.4%	67.8%
Operating profit margin	6.7%	8.0%	11.5%
Net profit margin	5.1%	5.6%	8.8%

Selected Operational ratios

	2004	2005	2006
Staff costs as a % of revenue	30.5%	30.9%	29.5%
Rental as a % of revenue	6.3%	6.4%	6.8%
Inventory turnover days	17.6 days	19.4 days	16.4 days

Breakdown of sales in terms of restaurant brands

	2004		2005		2006	
	HK\$' 000	%	HK\$' 000	%	HK\$' 000	%
Tao Heung Seafood Hotpot Res. (稻香海鮮火鍋酒家)/ Tao Heung (稻香)	242,818	21%	233,461	17%	222,080	14%
Tao Heung Super 88 (稻香超級漁港)	515,457	45%	554,410	40%	570,909	36%
Hak Ka Hut (客家好棧)	159,186	14%	162,438	12%	178,826	11%
Cheers Restaurant (迎囍大酒樓)	124,588	11%	166,837	12%	182,507	12%
Chao Inn (潮樓/潮館)	63,267	6%	160,221	12%	272,838	17%
Chung's Cuisine (鍾菜)	13,043	1%	28,588	2%	34,487	2%
Harbour Seafood Res. (港灣海鮮量販飯店)	-	-	55,670	4%	65,957	4%
Shanghai Inn (上樓)	-	-	2,593	0%	17,225	1%
TCT (領鮮環球自助餐)	-	-	-	-	15,303	1%
Subtotal	1,118,359	98%	1,364,218	99%	1,560,132	99%
Sale of food and other operating items	18,884	2%	13,618	1%	14,249	1%
Total	1,137,243	100%	1,377,836	100%	1,574,381	100%

Strengths/Opportunities

- ✓ With a network of 42 restaurant outlets in HK and 7 in Shenzhen and Guangzhou, Tao Heung is well positioned to ride on the consumption boom and growing demand for catering and cuisine dining in the region. Besides, Tao Heung's multi-branding strategy has been proved to be successful, as such strategy enables the Group to operate its restaurants under different brands and styles and promote variety of cuisine that fit its customers. At the same time, it also enhances the efficiency of resources allocation, as restaurants under different brands could share the same production facility.
- ✓ Tao Heung has established a centralised food processing and logistics centre in Fo Tan and is establishing another one in Dongguan. Leveraging on this platform, the Group could reduce the overall headcounts by streamlining part of the food preparation process in the centres. Besides, it could also enhance sales per restaurant floor area via saving space from storage and food processing in each outlet and promote control of food quality and standard.
- ✓ Despite rising rental pressure in Hong Kong, Tao Heung managed to keep contained the rental-to-revenue ratio, which ranged 6.3%-6.8% over the past three years. In fact, the Group experienced the most significant cost pressure in 2005, but it turned to stabilise last year.
- ✓ To be priced at 15x-20x historical price-earnings multiple, the counter's valuation is largely in line with sector peers.

Weaknesses/Threats

- × Staff cost was the second largest element of Tao Heung's total cost. It accounted for about 30% of total revenue over the past three years. As there is rising staff cost pressure in both HK and the Mainland, the Group's profit margin may be depressed. However, with the set-up of two centralised logistics centre, Tao Heung should be better equipped to weather such cost pressure when compared with other rivals in the industry.

Recommendation: Trading Buy

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