

Analyst: Kelvin Li

Main Board Listing – Research

中國糧油控股有限公司

China Agri-Industries Holdings Limited. [Stock Code: 0606]

Sole Global Coordinator and Sole Sponsor : Goldman Sachs
Joint Bookrunners and Joint Lead Managers : Goldman Sachs BOCI

Sector : Food, Beverage & Tobacco
Business : Production of processed agricultural products

<p>Total share offer: <u>860,911,545</u> shares (25% of the enlarged share capital)</p> <p>Public Offer: 86,092,000 shares (10%)</p> <p>Placing: 774,819,545 shares (90%) (including 611,754,000 new and 163,065,545 sale shares)</p> <p>Greenshoe: 104,677,000 shares</p> <p>Price: HK\$3.10 – HK\$3.72 per share</p> <p>Market Cap: HK\$10.8 billion – HK\$13.0 billion</p> <p>Pro-forma FY06 PER: 17.4X – 20.9X</p> <p>Adjusted NTA per share: HK\$2.07 – HK\$2.19</p> <p>Staffing: 10,860 (as of 30th September 2006)</p>	<p><u>Business of China Agri-Industries</u></p> <p>China Agri-Industries, a spin-off from COFCO Int'l (HKEx: 0506), is the overseas listed flagship of COFCO's agri-industrial business. The Company has 5 key product and service divisions, namely (i) bio-fuel and biochemical, (ii) oilseed processing, (iii) rice trading and processing, (iv) brewing materials and (v) wheat processing.</p> <p>According to China Customs and industry statistics, China Agri-Industries is the largest export of rice in the PRC, accounting for nearly 75% of the country's total rice export in 2005. The Company is also one of the largest oilseed processors and wheat processors in China.</p> <p>China Agri-Industries sells its products on the Mainland mainly via its extensive sales and distribution network. Sales in the Mainland accounted for about 90% of its total revenue in 2005. The Company also exports rice to overseas markets in Japan, South Korea, Southeast Asia, the Middle East and Africa.</p>
<p>HK Public Offer period: 8th March 2007 – 13th March 2007 noon</p> <p>Receiving bank: BOC (Hong Kong), Standard Chartered, ICBC (Asia)</p> <p>Share registrar: Progressive Registration Ltd.</p> <p>Listing date: 21st March 2007</p>	

Major Shareholders after Listing (Assuming the over-allotment option is not exercised and no shares are retained by COFCO (HK) pursuant to the Backstop Mechanism*)

COFCO (HK), parent company of HK-listed COFCO International (HKEx: 0506)	59.4%
Public investors [^]	40.6%
	<u>100.0%</u>

Remarks: (*) Qualifying COFCO Int'l shareholders will have the option to elect to receive a cash alternative for the scrip dividend announced on 8th Feb 2007, of which they will receive one share of China Agri-Industries for every COFCO Int'l share held. In order to avoid excessive supply of shares on excessive take-up, COFCO (HK) will retain such shares ("the Backstop Mechanism"), such that its interest in the Company will not exceed 75%. (^) Mitsubishi Corporation, a corporate investor, agreed on 24th Feb 2007 to pay up to 7.9 billion Japanese yen for 3.93% to 4.72% of the issued shares of China Agri-Industries upon completion of the Global offering.

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**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$2,246.6 million (Assuming an offer price of HK\$3.41, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
For planned fuel ethanol projects in Hebei Province, Liaoning Province, Guangxi Zhuang Autonomous Region, Hubei Province and Heilongjiang Province.	898.6
For biochemical projects currently under development and construction in Gongzhuling, Jilin Province and other planned projects in the eastern China region and Yushu, Jilin Province.	1,011.0
For oilseed processing business, rice trading and processing business, and brewing materials business.	337.0

Financial Highlights

(HK\$ million)	Year ended 31 st December			Nine months ended 30 th Sep	
	2003	2004	2005	2005	2006
Revenue	12,529.2	16,050.1	16,300.4	12,080.7	13,837.2
Gross profit	736.0	742.8	989.6	740.9	1,111.1
Profit before tax	386.7	206.5	354.3	274.8	714.0
Attributable profit to the Company's shareholders	247.2	130.7	254.9	224.5	506.7
Gross margin	5.87%	4.63%	6.07%	6.13%	8.03%
Net margin	1.97%	0.81%	1.56%	1.86%	3.66%
Net debt to shareholders' equity ratio	150%	128%	147%	N/A	86%

Revenue Breakdown (% of Total Revenues)

	Year ended 31 st December			Nine months ended 30 th Sep	
	2003	2004	2005	2005	2006
Biofuel and biochemical	-	-	-	-	6.7%
Oilseed processing	71.8%	71.5%	71.6%	71.3%	66.5%
Rice processing and trading	9.9%	6.4%	8.1%	7.7%	8.7%
Brewing materials	4.6%	5.0%	5.3%	5.8%	5.1%
Wheat processing	8.2%	9.6%	10.2%	10.3%	8.9%
Consumer-pack edible oil	10.3%	11.4%	11.7%	11.7%	9.7%
Non-rice trading	4.2%	6.4%	3.5%	3.7%	3.0%
Inter-segment elimination	(9.0%)	(10.3%)	(10.4%)	(10.5%)	(8.6%)
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Gross Profit Breakdown (% of Total Gross Profit)

	Year ended 31 st December			Nine months ended 30 th Sep	
	2003	2004	2005	2005	2006
Biofuel and biochemical	-	-	-	-	14.1%
Oilseed processing	49.4%	31.1%	34.7%	31.1%	36.7%
Rice processing and trading	5.4%	11.9%	15.2%	19.3%	12.7%
Brewing materials	5.7%	9.7%	11.7%	12.5%	10.9%
Wheat processing	10.2%	13.0%	10.5%	9.5%	6.0%
Consumer-pack edible oil	22.8%	23.9%	20.5%	19.3%	15.6%
Non-rice trading	6.5%	10.3%	7.5%	8.3%	4.0%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Strengths/Opportunities

- ✓ Preferential government policies such as preferential tax treatment and subsidy are put in place to encourage the use of ethanol gasoline. **Fuel ethanol** producers enjoy a waiver of 5% consumption tax and the full refund of VAT. Subsidy for all the 4 Mainland ethanol producers was set at RMB1,373 per ton for 2007 and 2008. Also, use of ethanol gasoline has become mandatory in 9 provinces in the PRC where normal gasoline is not being supplied.
- ✓ China Agri-Industries has stakes in 2 of the 4 fuel ethanol producers in the Mainland. Besides, it is acquiring a stake in Anhui BBKA Biochemical. Upon completion, the Company will have interest in 3 of the 4 fuel ethanol producers in China, further enhancing its leading position in the fast-growing industry.
- ✓ China Agri-Industries is one of the Mainland's top oilseed processors, accounting for about 15% of the aggregate soybean crushing capacity in China as of the end of 2005, while **oilseed processing** is the Company's largest business segment in terms of revenue and earnings contribution. Thanks to strong economic growth, we saw solid growth in demand for edible oil in the Mainland. For the period from 2001 to 2005, total edible oil consumption grew at a CAGR of 9.2%, with soybean oil consumption growing at a strong CAGR of 19.5%.
- ✓ COFCO is one of the only two licensed **rice** exporters in China via the quota held by its parent COFCO Group, controlling about 70%-80% of total rice exports from the country.
- ✓ China Agri-Industries owned the single largest malt production facility in China, providing malt to major beer breweries like Tsingtao, Budweiser, Asahi, etc. Beer sales in the Mainland reported a healthy growth over the past few years amid strong demand and rising market penetration, posting a CAGR of 6.7% during 2001-2005. And thanks to the strong demand for malt from beer brewing companies, the **brewing materials** segment reported solid profit growth and contribution, with the highest gross profit margin among different business operations in the Company during the first three quarters of 2006.
- ✓ A valuation of 17.4x-20.9x FY2006E P/E is not demanding, given the pleasant outlook and strong profitability of the Company's biofuel and biochemical segment.

Weaknesses/Threats

- × Agricultural commodities like soybean are China Agri-Industries' key raw materials, and accordingly the Company's profitability is adversely affected by commodity prices. Besides, the Company is also engaged in commodity exports. Unparallel movement in domestic and export prices would lead to pressure on the Company's profit margins. And due to changes in the world's commodity demand & supply conditions, we saw volatile profit margins of the Company over the past years.
- × Fuel ethanol production is still in the infant but a fast-growing industry in the Mainland. Fuel ethanol producers in China now enjoy a waiver of 5% consumption tax, refund of all VAT, and financial subsidy from the government. During the first nine months of 2006, the Company received a government grant of HK\$131 million for its fuel ethanol output. Termination of such preferential policy or removal of government grants on fuel ethanol production would lead to adverse impact on the Company's earnings.

Recommendation: Subscribe

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