

**BEA securities**

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**HONG KONG RESEARCH****12<sup>th</sup> June 2007****Analyst: Vincent Leung****Main Board Listing – Research**

嘉瑞國際控股有限公司

Ka Shui International Holdings Limited [Stock Code: 0822]**Sponsor, Bookrunner and Lead Manager** : CIMB-GK Securities (HK) Limited**Sector** : Capital Goods**Business** : Manufacture and sale of zinc, magnesium and aluminium alloy die casting components

<b>Total share offer:</b> <u>220,000,000</u> shares <b>(25% of the enlarged share capital)</b>	<b><u>Business of Ka Shui International</u></b>
<b>Public Offer:</b> 22,000,000 shares (10%)	Founded in 1980, Ka Shui is principally engaged in the manufacture and sale of zinc, magnesium and aluminium alloy die casting components. The Group's products can be broadly classified into 3 categories, namely metal components for household products, 3C (i.e. computer, communication and consumer electronics) products and automotive parts.
<b>Placing:</b> 198,000,000 shares (90%)	
<b>Greenshoe:</b> 33,000,000 shares	
<b>Price:</b> HK\$1.10 – HK\$1.35 per share	
<b>Market Cap:</b> HK\$968 million – HK\$1,188 million	
<b>Historical FY2006 P/E:</b> 8.8x – 10.8x	
<b>Adjusted NTA per share:</b> HK\$0.49 – HK\$0.56	
<b>Staffing:</b> 2,133 (as of 31 <sup>st</sup> December 2006)	
<b>Bookbuilding period:</b> 4 <sup>th</sup> June 2007 – 15 <sup>th</sup> June 2007 noon	
<b>HK Public Offer period:</b> 12 <sup>th</sup> June 2007 – 15 <sup>th</sup> June 2007 noon	
<b>Receiving bank:</b> Standard Chartered Bank (HK)	
<b>Share registrar:</b> Computershare Hong Kong Investor Services Limited	
<b>Listing date:</b> 27 <sup>th</sup> June 2007	The Group's self-operated production facility is located in Pinghu Town, Shenzhen, the PRC and has an annual production capacity of approximately 6,950 tonnes for FY2006. In addition, the Group's products are also produced in the Processing Factory* operated under a processing contract with an independent third party. For FY2006, the Group's self-operated production facility and the Processing Factory occupy a total GFA (annual production capacity) of approximately 31,200 m <sup>2</sup> (6,950 tonnes) and 9,900 m <sup>2</sup> (4,020 tonnes) respectively.
	The Group acquired 2 parcels of land in Daya Bay, Huizhou, the PRC, with an aggregate site area of approximately 209,000 m <sup>2</sup> in December 2006 for the construction of its new production facilities. The first phase of the new production facilities, which is scheduled to be completed by the end of 2007, will have a GFA of approximately 43,000 m <sup>2</sup> . Upon full completion of the expansion by 2012, the annual production capacity of the new facilities will reach approximately 9,800 tonnes.

*\*For FY2006, the actual production volume of the Processing Factory - Longgang Pinghu Ka Fung Metal Manufactory - amounted to approximately 2,900 tonnes, representing 34.7% of the total production volume of all die-casting products of the Group.*

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

Mr. Lee Yuen Fat (an executive director, chairman and founder)	69.0%
Mr. Wong Wing Chuen (an executive director)	2.1%
Dr. Keung Wing Ching (an executive director, vice chairman and CEO)	2.3%
Mr. Chan Tat Cheong, Alan (an executive director, company secretary and CFO)	0.8%
Mr. Zhao Jian (an executive director)	0.8%
Public	25.0%
	<u>100.0%</u>

**Use of Proceeds**

Net proceeds from the offer are estimated to be HK\$248 million (Assuming the over-allotment option is not exercised, and at an issue price of HK\$1.22 each, being the midpoint of the indicative price range)

	HK\$ million
For the acquisition of additional die-casting and ancillary machinery & equipment for the existing production facilities	52
For the first phase construction of a new industrial complex in Daya Bay, Huizhou	70
For the acquisition of new machinery & equipment for die casting & surface finishing treatment for the new manufacturing plant in Daya Bay, Huizhou	90
For the enhancement of die manufacturing capability	20
For the research & development of production technologies	5
For the repayment of bank borrowing	10
For general working capital	1

**Financial Highlights**

	Year ended 31 <sup>st</sup> December		
	2004 HK\$'000	2005 HK\$'000	2006 HK\$'000
Turnover	375,691	348,377	645,588
Gross profit	99,795	66,264	180,912
Operating profit	62,182	20,149	130,398
<b>Attributable profit</b>	<b>53,662</b>	<b>13,031</b>	<b>109,562</b>
Gross margin	26.6%	19.0%	28.0%
Operating margin	16.6%	5.8%	20.2%
Net margin	14.3%	3.7%	17.0%

**Turnover Breakdown by Product Applications (% of Total Turnover)**

	Year ended 31 <sup>st</sup> December		
	2004 %	2005 %	2006 %
Household products	71.2%	69.2%	67.3%
3C products	22.6%	25.3%	28.7%
Automotive parts	6.2%	5.5%	4.1%
Total	100.0%	100.0%	100.0%

**Turnover Breakdown by Metal Types (% of Total Turnover)**

	Year ended 31 <sup>st</sup> December		
	2004 %	2005 %	2006 %
Zinc alloy	87.9%	89.2%	83.8%
Magnesium alloy	9.9%	6.9%	10.4%
Aluminium alloy	2.2%	3.9%	5.8%
Total	100.0%	100.0%	100.0%

**Strengths/Opportunities**

- ✓ According to Guangdong Mechanical Engineering Association's Die Casting Branch, the overall PRC die casting production is expected to grow by a CAGR of 14.3% during 2006-2010 to 1.79 million tonnes, of which magnesium alloy die casting is expected to grow at a CAGR of 48.5% to 86,000 tonnes. Being one of the reputable and a first mover in magnesium-alloy die-casting in the PRC, the Group is well positioned to capture the expected growth in this fast-growing segment in the die-casting industry.
- ✓ The Group has established an internationally-renowned client base. Its customer portfolio for household products comprises IKEA, Schick, Stihl and Fennel, while that for 3C products include HP, JBL, Epson, Lenovo, Creative, Panasonic, Velbon and SanDisk. Its automotive parts clients include Honda and Hella. Among them, Schick has been the Group's customer since 1986 and IKEA since 1996.
- ✓ The Group has been accredited numerous certifications, including ISO9001:2000 for its Quality System on the manufacture of die-casting products since 1998, ISO/TS16949:2002 for its Quality System on the manufacture of die-casting products for automobile industry and ISO14001:1996 for its Environmental Management System since 2001.
- ✓ To be priced at its historical FY2006 P/E of 8.8x-10.8x, Ka Shui's valuation is not demanding when compared with metal component producers China Metal International (stock code: 0319), EVA Precision (stock code: 0838), IPE Group (0929) and United Metal (stock code: 2302), which are trading at historical FY2006 P/E of 10.7x-19.7x.

**Weaknesses/Threats**

- × Price volatility of metal alloys, which accounted for 22.5% of total turnover in FY2006, will adversely affect the Group's profitability should it fail to pass on the increase in raw material costs to its customers. In fact, the decline in revenue and profitability in 2005 was mainly due to the surge in zinc price during the year that prompted customers to adopt a wait-and-see stance, dragging down the top line, and raised cost of sales.
- × The Group has been reliant on a few customers. The top 5 customers accounted for approximately 64.2% of the total FY2006 turnover, while the two largest customers, IKEA and Schick, accounted for a combined 49.8%. As the Group has not entered into any long-term sales contract with any of its major customers, cessation or reduction of orders from these major customers will adversely affect its financial results.
- × The Group's sales receipts are mostly settled in USD or HKD while its costs are at large denominated in RMB. Further RMB appreciation will have negative impacts on its bottom line.

**Recommendation:     Speculative Subscribe**

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