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HONG KONG RESEARCH
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Main Board Listing- Research

中盛糧油工業控股有限公司
China Force Oil & Grains Industrial Holdings Co., Ltd. - [Stock Code: 1194]

Global Coordinator, Bookrunner, Lead Manager and Sponsor : DBS Asia Capital Limited

Sector : Fast moving consumer goods
Business : Fractionation, refining, sale and trading of edible oil products in the PRC

Total share offer: *240,000,000* shares
(30% of the enlarged share capital)

International placement: *216,000,000* shares (90%)
Hong Kong public offer: *24,000,000* shares (10%)

Greenshoe: *36,000,000* shares

Price: HK$1.03-HK$1.35 per share
Market cap: HK$824 million-HK$1,080 million

Staffing: 522

Prospective 2004 P/E: 8.0x-10.5x (fully-diluted)
Adjusted NAV per share: HK$0.63-HK$0.73

Book opens: 24th September 2004
Book closes: 4th October 2004

IPO commences: 28th September 2004
IPO ends: 5th October 2004

Share registrar: Computershare Hong Kong Investor Services
Receiving bank: Bank of China (Hong Kong)

Listing date: 12th October 2004

Business of China Force Oil & Grains

Established in 1998, the Company is principally engaged in fractionation, refining, sales and trading of edible oil products (mainly soyabean and palm oil) in the PRC. Customers include food producers and edible oil distributors in the PRC.

According to the statistics of the China National Grain & Oils Information Center, the company's sales volume in 2003 accounted for approximately 7.3% and 8.7% of the PRC's consumption of soyabean oil and palm oil respectively.

Currently, the company operates two production plants in Tianjin and Zhenjiang with a total annual production capacity of approximately 1.0 million tonnes of edible oil. Each of these production plants is strategically located in coastal areas adjacent to third-party external port facilities. The newly constructed production plant in Dongguan is expected to commence commercial operation in October 2004. It will raise the total annual production capacity to 1.4 million tonnes and extend the reach of the company to Southern China.

Major Shareholders after Listing
(Assuming the over-allotment option is not exercised)

Aswell Group (BVI) – wholly owned by Mr. Lim Wa, Chairman and CEO	63.0%
Best Key (BVI) – wholly owned by Mr. Lam Cham, Deputy CEO	7.0%
	70.0%

Use of Proceeds
Net proceeds from the offer are estimated to be HK$263 million
(Assuming the over-allotment option is not exercised, and at an issue price of HK$1.19 each, which is the mid-point of the indicative price range)

	HK$ million
To finance the construction payment of production plant in Dongguan (HK$ 4 million land cost)	80
To build a private berth with storage and ancillary facilities for Zhenjiang plant (HK$ 20 million land cost)	90
To establish a production plant for fatty acids and related products in Zhenjiang (HK$ 11 million land cost)	30
To establish a production plant for protein related products in Zhenjiang (HK$ 12 million land cost)	40
General working capital	23

Financial Highlights

	Year ended 31st December			
	2001	2002	2003	30 April 2004
	HK$'000	HK$'000	HK$'000	HK$'000
Turnover	313,837	1,854,640	3,308,859	1,454,871
Cost of sales	(280,942)	(1,747,621)	(3,126,660)	(1,369,280)
Gross profit	32,895	107,019	182,199	85,591
Other revenue	449	8,758	3,625	1,595
Other net (loss)/income	(2)	1,506	(43)	(30)
Selling and distribution costs	(3,722)	(16,894)	(25,753)	(15,551)
Administrative expenses	(14,250)	(18,040)	(22,510)	(11,356)
Profits from operations	15,370	82,349	137,518	60,249
Finance costs	(2,408)	(11,275)	(22,155)	(10,110)
Profit before taxation	12,962	71,074	115,363	50,139
Income tax	(1,171)	874	(11,647)	(5,409)
Net profit	11,791	71,948	103,716	44,730
EPS – fully diluted	2.1	12.8	18.5	8.0

Selected Balance Sheet Data

	Year ended 31st December			
	2001	2002	2003	30 April 2004
	HK$'000	HK$'000	HK$'000	HK$'000
Inventories	70,429	153,211	255,104	284,506
Trade and other receivables, deposits and prepayment	105,618	172,480	312,936	455,147
Pledged bank deposits	31,359	27,162	28,154	113,577
Cash and cash equivalents	10,067	39,588	208,559	122,623
Trade and other payables	195,261	118,008	296,850	344,435
Bank borrowings–due within 1 year	136,020	344,130	545,392	663,353
Owners' equity	49,638	178,763	235,519	280,249

Strengths/ Opportunities

- ✓ The company's production plants are located in coastal areas adjacent to port facilities and within regions with high consumer spending for edible oil products. These locations reduce transportation costs, i.e. the most dominant direct cost, for the import of raw materials and delivery of products to customers by river and road transportation.
- ✓ The company enjoys economies of scale through the production plants in Tianjin and Zhenjiang, being the two largest in China. This advantage will be further enhanced after the operation of a new production plant in Dongguan to raise the total production capacity by 40%.
- ✓ China Force has implemented a comprehensive risk management system to monitor and manage the company exposure to price fluctuation in oil prices through hedging instruments such as commodities futures and options.
- ✓ The company is priced at a prospective 2004E P/E of 8x-10.5x, which is not too demanding compares to other international comparables ranging from 7x-14X.

Weaknesses/ Threats

- × This is a low margin business coupled with a high operating leverage, i.e. gross margin was around 5%-6% and major portion of the cost are fixed cost. Even though the company has risk management system to manage its exposure from the fluctuation of the commodity prices, price competition and any future industry overcapacity might adversely affect the profitability of the company.
- × The PRC edible oil market is gradually opened to foreign companies as China enters the World Trade Organisation (WTO). Annual quota on imports is gradually lifted and tariffs are also lowered as a result. These would attract multinationals to enter this fragmented market, further intensifying the competition.
- × China Force is highly geared, i.e. the net gearing was over 130% in FY 2003. It was mainly due to the heavy capital expenditure to boost capacity over the past couple of years. In order to achieve profit growth, further increase of capacity seems necessary. Thus, gearing of the company should remain high in the foreseeable future.

Recommendation: Trading buy