

Main Board Listing - Research

中國香精香料有限公司

China Flavors and Fragrances Company Limited [Stock Code: 3318]

Sponsor, Bookrunner and Joint Lead Manager : Sun Hung Kai International Limited

Sector : Consumer staples

Business : Manufacture and sale of flavours and fragrances

<p>Total share offer: <u>100,000,000</u> shares (25% of the enlarged share capital)</p> <p>Public Offer: 10,000,000 shares (10%) Placing: 90,000,000 shares (90%)</p> <p>Greenshoe: 15,000,000 shares</p> <hr/> <p>Price: HK\$1.00-HK\$1.20 per share Market Cap.: HK\$400 million – HK\$480 million</p> <p>FY2005E P/E: 7.1x-8.6x (pro-forma)</p> <p>Adjusted NTA per share: HK\$0.46-HK\$0.51</p> <p>Staffing: 364 (as of 28th November 2005)</p> <hr/> <p>HK Public Offer period: 30th November 2005 – 5th December 2005 noon</p> <p>Receiving bank: Standard Chartered Bank (Hong Kong) Limited</p> <p>Share registrar: Tricor Investor Services Limited</p> <p>Listing date: 9th December 2005</p>	<p><u>Business of CFF (“the Group”)</u></p> <p>The Group is principally engaged in the R&D, manufacture and sale of flavours and fragrances. The flavors and fragrances produced by the Group are used by its clients for making addition or improvement of flavours or fragrances in tobacco, food and other daily consumer goods.</p> <p>The Group’s products can be divided into three major categories: flavour enhancers, food flavours and fine fragrances. Flavour enhancers and food flavours are sold to manufacturers of tobacco, beverages, dairy foods, preserved foods, savoury and confectionary products, while fine fragrances are sold to manufacturers of cosmetics, perfumes, soaps, toiletries, hair care products, deodorant, detergent and air refreshers products.</p> <p>The Group’s production facilities are located in Nanshan District, Shenzhen City, occupying a total gross area of 9,969 square metres. The production base accommodated over 1,200 machines, with an annual production capacity of 1,300 tonnes flavour enhancers, 1,000 tonnes food flavours and 300 tonnes fine fragrances. The facilities were 71%, 82% and 33% utilised during the first five months of 2005, respectively.</p>
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Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Creative China – 52.45% owned by Mr. Wing Ming Bun, the Group’s chairman	75.0%
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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$99 million.

(Assuming the over-allotment option is not exercised and at an issue price of HK\$1.10, which is the mid point of the indicative price range.)

	HK\$ million
For the expansion in the Group's sale and distribution network	30
For the expansion in the Group's current production facilities	30
For the expansion of the Group's product development to cope with the ever-changing market demand	25
For strengthening R&D capabilities by expanding the Group's R&D department and cooperating with Shanghai Academy of Applied Technology (SAAT) and China Agricultural University (CAU) in R&D on new products and new technology	10
For general working capital	4

Financial Highlights

	Year ended 31 st December			5 months ended 31 st May 2005
	2002 RMB '000	2003 RMB '000	2004 RMB '000	RMB '000
Sales	106,601	130,331	158,539	81,685
Gross profit	65,626	81,164	103,744	52,612
Attributable profit	26,443	34,791	42,447	23,733
Basic EPS	RMB0.088	RMB0.116	RMB0.142	RMB0.079

Strengths/Opportunities

- ✓ Sales of products manufactured by the Group's clients had shown steady growth during the past. For example, sales of tobacco grew at a CAGR of 4% during 1998-2003. In fact, the growth trend accelerated in recent years, thanks to higher purchasing power and improved living standards in the Mainland. For packaged food and soft drinks, sales grew at a CAGR of 8% and 13% during 1998-2003, respectively.
- ✓ Pricing at 7.1x-8.6x FY2005E, valuation of CFF is not demanding, given the Group's steady profit growth, stable profit margins as well as an expected yield of 4.7% - 5.6% after the Group's management said it plans to propose a 40% dividend payout ratio next year.

Weaknesses/Threats

- × All the Group's products were sold in the mainland China. During 2002-2004 and 1H2005, more than 70% of the Group's turnover was generated from the sale of flavour enhancer, which is used extensively in tobacco processing. Therefore, any smoking campaigns, tobacco taxes or smoking restrictions would have an adverse impact on the Group's flavour enhancer business.
- × The Group's net debt-to-equity ratio was 56.9%, 57.8% and 49.3% as at the end of 2002, 2003 and 2004, respectively. During the first five months this year, the Group repaid bank borrowings of approximately RMB3.1 million and helped bring down the net gearing ratio. However, it remained high at 46.4% as of 31st May 2005.

Recommendation: Hit and Run