

Analyst: Kelvin Li

Main Board Listing – Research

中國澱粉控股有限公司

China Starch Holdings Limited [Stock Code: 3838]

Sponsor, Bookrunner and Lead Manager

: CCB International

Sector : Food, Beverage & Tobacco

Business : Manufacture of cornstarch

<p>Total share offer: <u>150,000,000</u> shares (30.0% of the enlarged share capital)</p> <p>Public Offer: 15,000,000 shares (10%)</p> <p>Placing: 135,000,000 shares (90%)</p> <p>Greenshoe: 22,500,000 shares</p> <p>Price: HK\$1.85 – HK\$2.31 per share</p> <p>Market Cap: HK\$925 million–HK\$1,155 million</p> <p>Pro forma FY2006 PER: 13.9x to 17.3x</p> <p>Adjusted NTA per share: RMB0.92 – RMB1.05</p> <p>Staffing: 1,497 (as of 5th September 2007)</p>	<p><u>Business of China Starch</u></p> <p>China Starch is mainly engaged in the manufacture of corn-starch in the Mainland. According to the China Starch Industry Association, the Group was ranked the 3rd largest corn-starch producer in the PRC in term of sales in 2005. In addition to corn-starch, the Group also produces 98.5% L-lysine hydrochloride salt, other ancillary corn-refined and corn-based products such as corn slurry, corn germ, corn fibre, corn gluten meal and agricultural fertilizers.</p> <p>The Group also engages in the sales of steam and electricity in Shouguang city (壽光市). The Group's co-generation power plant consists of three power generation systems, supplying power both to external clients and for internal use. Steam was sold to over 80 customers, including hotels, hospitals, schools, etc.</p> <p>The Group's production facilities are located in Shouguang City, Shandong province, which is one of the top corn-producing provinces in the PRC. At the end of 2006, the Group had a corn-starch production capacity of 450,000 tonnes.</p>
<p>HK Public Offer period: 12th September 2007 – 17th September 2007</p> <p>Receiving bank: Bank of Communications HK, Standard Charter Bank</p> <p>Share registrar: Tricor Investor Services Limited</p> <p>Listing date: 27th September 2007</p>	

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

Merry Boom*	70%
Public Investors	30%
	<u>100%</u>

Remark: (*) Merry Boom is 54.5833% owned by chairman Mr Tian Qixiang, 25.00% by CEO Mr Gao Shijun, 16.67% by Mr Guo Zhibo, a founding shareholder, and 3.7467% by other 9 founding shareholders (each holding a 0.4163% stake).

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$284 million (Assuming an offer price of HK\$2.08, being the mid-point of the indicative offer price range, and the over-allotment option is not exercised)

	HK\$ million
For acquisitions of other manufacturers and/or capital injections for the forming of operating subsidiaries and/or join ventures with other manufacturers to subcontract or acquire production facilities	177
To acquire new machineries and equipment and conduct production technology enhancements on the newly acquired production facilities	73
To acquire new machineries and equipment for expanding the existing corn starch and lysine production facilities	20
For general working capital	14

Financial Highlights

	Year ended 31 st Dec			4 months ended	
	2004	2005	2006	30 th Apr 2006	30 th Apr 2007
	RMB '000	RMB '000	RMB '000	RMB '000	RMB '000
Revenue	975,754	948,205	1,031,506	294,971	402,984
Gross profit	122,851	120,555	195,239	56,762	77,645
Operating profit	93,942	88,099	152,990	45,913	58,335
Profit attributable to shareholders	31,979	40,918	66,574	15,688	50,685*
Gross profit margin	12.59%	12.71%	18.93%	19.24%	19.27%
Operating profit margin	9.63%	9.29%	14.83%	15.57%	14.48%
Net profit margin	3.28%	4.32%	6.45%	5.32%	12.58%*
	31/12/2004	31/12/2005	31/12/2006	30/4/2006	30/4/2007
Net debt/(cash) to Equity	184.59%	161.05%	158.62%	N/A	140.90%

Remark: (*) Net profit for the period has not yet taken into account of the tax expense during FY2007.

Strengths/Opportunities

- ✓ Corn-starch is used extensively in the manufacture of agricultural fertilizers and also the food and beverage industry like beer brewery. Thanks to the fast-growing PRC economy and rising consumer spending in the Mainland, the demand for corn starch kept surging over the last couple of years.
- ✓ The Group's revenue from steam and electricity sale dropped 28.5% y-o-y in FY06, as it had to suspend sales of electricity since Oct 06 amid the Group restructuring. The restructuring-related issue was completed by Jun 07 and the Group has restarted its sales of electricity since Aug 07. As such, the segment is expected to produce better contributions in the second half of this year. For the first four months in 2007, revenue from the segment was up 24% y-o-y and accounted for 10.6% (Jan-Apr 06: 11.7%) of the total, as the Group has switched its output capacity and increased its steam sales.

Weaknesses/Threats

- × Corn kernel is the key raw material for the production of the Group's corn-related products. Owing to tight supply in the Mainland, corn prices have surged over the last couple of years. As a result, corn purchase costs as a % of the Group's cost of goods sold surged to 72.0% in FY06 and 70.3% in Jan-Apr 07 from 63.3% in FY05 and 65.0% in FY04. The rapidly rising food prices on the Mainland may further heat up corn prices in the future, which would depress the profit margin of the Group's core corn starch manufacturing business.
- × The Group's electricity generation business is also facing the risk of rising raw material costs. The Group will expose to the risk of fluctuation in coal prices in the future, as it revealed that it does not intend to hedge against its coal purchase.

Recommendation: Unattractive

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