

Pei Lian overhang removed

China Consumer

China Seven Star (245 HK, HK\$0.53)

BUY (unchanged)

Target price: HK\$1.10 (+108%)

Pei Lian share dilution announced. After much speculation, Seven Star finally announced the consideration shares to be issued for the completion of the acquisition of Shanghai Pei Lian. The total number of consideration shares paid to the vendor amounted to 1,471.7m shares, which was calculated based on 3.0x the audited consolidated net profits of Pei Lian for the first full financial year after completion of the acquisition, which took place on 11 Apr 2006. The consideration shares inferred that the audited net profit of Pei Lian for the period of 11 Apr 2006 to 10 Apr 2007 amounted to HK\$50.3m.

Total consideration for Pei Lian HK\$125.3m. The total consideration of Pei Lian (consisting cash consideration, deferred cash consideration and consideration shares) therefore amounted to HK\$125.3m, representing 2.5x P/E based on the audited net profit figure of HK\$50.3m.

Table 1: Pei Lian acquisition consideration breakdown

Item	HK\$m
Cash consideration	25.0
Deferred cash consideration	50.0
Consideration shares (3x audited net profit for first full year after acquisition @ HK\$0.1025 per share)	50.3
Total	125.3

Source: Company data

Share dilution greater than expected. The share dilution of 1,471.7m shares was higher than expected. In our diluted shares calculation, we had previously assumed 878.0m shares.

Pei Lian overhang finally removed. Despite the share dilution being greater than expected, we still see the announcement in a positive light. With the announcement, uncertainty of the Pei Lian consideration shares has finally been removed. In our view, a major overhang on the stock has been lifted, clearing the way for the counter to realize its true value going forward.

Re-iterate BUY call, revised target price HK\$1.10. We maintain our net profit estimates of HK\$186.1m for FY12/07F and HK\$293.7m for FY12/08F respectively. Seven Star is still one of our top picks in the China consumer space with its scalable business model and out-and-out growth in its TV home shopping niche sector. We re-iterate our BUY call on Seven Star, with a revised target price of HK\$1.10 (from previously HK\$1.20), representing 27.0x FY12/08F P/E (fully diluted) after taking into consideration the Pei Lian dilution. We again re-iterate that the current sell down represents an opportune time to accumulate the stock, given that it is only trading at 13.0x FY12/08F P/E (fully diluted), and at a substantial discount to other China retail plays, which are trading at an average of around 30.0x next year earnings (based on consensus estimates).

Table 2: Financial summary

Year to Dec	Net profit HK\$m	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	(16.6)	(0.004)	na	na	na	na	9.0	na	na	na
06A	29.6	0.007	na	76.7	9.3	68.7	-	14.4	20.2	Cash
07F	186.1	0.028	308.0	20.5	5.3	6.3	-	42.7	74.2	Cash
08F	293.7	0.044	57.8	13.0	4.9	3.8	-	37.9	58.8	Cash
09F	347.8	0.053	18.4	11.0	19.5	2.8	-	33.5	49.0	Cash

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Table 3: P&L

Year to Dec (RMBm)	04A	05A	06A	07F	08F	09F
Turnover	31.1	23.2	92.4	2,127.3	2,661.0	3,251.8
% chg	220.8	(25.5)	300.1	2201.6	25.1	22.2
Cost of sales	(18.5)	(13.9)	(26.0)	(873.6)	(1094.5)	(1,394.5)
Gross profit	12.6	9.3	66.4	1,253.7	1,566.5	1857.3
Other revenue	-	-	4.2	5.1	8.1	10.2
Gain on disposals	-	-	6.3	-	-	-
Selling and distribution expenses	(9.0)	(5.0)	(11.2)	(626.2)	(723.6)	(914.8)
Administration expenses	(7.3)	(14.9)	(17.7)	(259.3)	(295.7)	(295.7)
Other operating expenses	(0.4)	(1.0)	(3.0)	(3.2)	(3.2)	(3.3)
Operating profit	(4.1)	(11.6)	45.1	370.1	552.1	653.7
Finance costs	(3.4)	(0.5)	(0.9)	(0.9)	(0.9)	(0.9)
Exceptionals	111.3	(3.4)	-	-	-	-
Share of profits/(losses) of an associate	-	-	-	-	-	-
Share of profits/(losses) of JCE	-	-	-	-	-	-
Profit before taxation	134.5	(15.4)	44.1	369.2	551.2	652.8
Taxation	-	(2.0)	(11.9)	(110.8)	(143.3)	(169.7)
Profit after taxation	133.7	(17.4)	32.2	258.4	407.9	483.1
Minority interests	(0.9)	0.8	(2.6)	(72.3)	(114.2)	(135.3)
Profit attributable to shareholders	133.6	(16.7)	29.6	186.1	293.7	347.8
% chg	n/a	n/a	n/a	529.6	57.8	18.4
Dividend	-	-	-	-	-	-

Source: SBI E2-Capital

Disclosure of interests: SBI E2-Capital acted as the sole bookrunner and joint placing agent for the China Seven Star top-up placement of 832.2m new shares at HK\$0.188 per share on 28 September 2006 and as the sole bookrunner and placing agent for the China Seven Star top-up placement of 500m new shares with over-allotment option of 75m shares at HK\$0.68 per share on 12 February 2007.