Corporate Snippet

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Further strengthening of value chain — China Consumer

China Seven Star (245 HK, HK$0.59) — BUY (unchanged)

Target price: HK$0.71 (+20%)

Move to acquire leading handset-sourcing company. As expected, China Seven Star (CSS) has taken further steps to strengthen its supply chain. The company announced that it has signed an MOU to acquire 50% of Uniscope Technologies, one of China's leading handset-sourcing companies. Based in Shanghai, Uniscope designs mobile phone motherboards and sources overall mobile phone solutions. Its capabilities include 2G/2.5G GSM, GPRS and 3G terminals. Formed in 2002, Uniscope serves many of China's leading handset brands.

Consideration equals to 5x earnings. The deal involves the acquisition of three entities: 1) 50% of Hong Kong-incorporated Uniscope Electronics Co., from Party A (顧新惠); 2) 50% of Shanghai Co. 1 (上海優思通信有限公司) by acquiring 25% each from Party A and Party B (熊碧輝) and 3) 50% of Shanghai Co. (上海浦歌電子有限公司) by acquiring 25% each from Party A and Party B. This arrangement is due to restrictions imposed on M&As by Chinese companies that came into effect on 8 September 2006. The consideration will be 5x the average of the Uniscope group's total net profit for three years from the date of the formal agreement. No details have yet been announced with respect to the composition of the consideration, ie. all cash or cash and shares. The MOU has an exclusivity of 90 days.

Strengthening the value chain. The move will further strengthen CSS' handset supply chain. Together with its JV with Longcheer, CSS will now have access to handset platform designs and manufacturing sourcing, allowing it to secure supply of handsets to meet strong demand on its TV home shopping platform. CSS has been working to build its the supply chain and the planned acquisition of Uniscope is another example of this. We expect similar tie-ups for its other key product lines going forward.

Catching up with Acorn. We await details of the acquisition and financial details of Uniscope before incorporating the numbers into our P&L model. After our recent revision of estimates (see "Operating metrics better than Acorn" dated 25 Sep 2007), we now project CSS' FY12/07F net profit at HK$137.6m. Note that Acorn has guided for a FY12/07F net profit of US$24-26m (HK$187.4-201.9m), meaning that CSS will still gain substantial market share ground on Acorn in 2007.

Valuation. Our target price for CSS is HK$0.71, representing 25.0x FY12/08F P/E.

Risks. 1) Not completing the acquisition and 2) increased exposure to China's handset industry.

Table 1: 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	85.4	10.3	76.8	-	14.4	20.2	Cash
07F	137.6	0.019	176.2	37.2	5.0	13.5	-	27.9	36.8	Cash
08F	205.5	0.028	49.4	24.9	5.4	8.5	-	27.0	38.4	Cash
09F	246.7	0.034	20.0	17.3	99.3	6.3	-	26.9	37.3	Cash

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.