

# Yip's Chemical



**BUY (unchanged)**

## Macro headwind effect

### Key points:

- Minimal exposure to Smart Union's wind up/liquidation with receivables at <0.1% of overall turnover
- Short-term macro headwind effect but a new solvents plant in Jiangsu will facilitate geographic and customer-base diversification
- Apr 2008 fundraising allows expansion without stretching the balance sheet
- Net profit estimates cut by 11.3% for FY03/09F and FY19.5% for FY03/10F
- Resetting the target price at HK\$3.50, representing 6.0x FY3/09F P/E

**Minimal impact from Smart Union.** Yip's receivables exposure to Smart Union (2700 HK, HK\$0.099) is minimal, at less than 0.1% of overall revenue or less than 0.5% of coatings revenue, according to the company.

**Facing macro headwind.** China's slowing export growth will undoubtedly have some negative impact on Yip's, as around 10% of its customers manufacture products for overseas markets. With reported closures of manufacturing businesses in the Pearl River Delta, we believe the company's business risks will increase. However, as we detailed in our "Paving the Way for Sustainability" (19 May) report, the company is focused on establishing its presence in a new geographical region such as Huadong. Its recently acquired wholly-owned subsidiary Taixing has commenced construction of its new solvents plant in Jiangsu. When completed in Jul 2009, the plant will produce 100,000 tonnes of ethyl acetate and 20,000 tonnes of butyl acetate. In our view, it will allow Yip's to: 1) build a new client base away from its main southern China region; 2) capitalize on the trend of many plants relocating from southern China to eastern and northern China.

**Some policy relief.** However, there is some policy relief in sight. Chinese government announced an increase in export tax rebates for some 3,486 items. Among these, export tax rebates for some toys, textiles and garments will be raised to 14%, while there will be a 9% rebate for certain plastic products. This should help manufacturers raise profitability and facilitate business sustainability.

**Timely fund raising.** Yip's raised HK\$269.0m by way of a top-up placement in Apr 2008, which was a well-timed move considering the current state of the market and concerns about highly geared companies. The additional capital has financed the company's expansion (through M&As or production capacity) without over stretching its balance sheet. We project the company's net gearing ratio at a comfortable 11.7% by end-FY03/09F.

**Pressure on competitors.** Given the tougher economic conditions, we expect Yip's to slightly lower the pricing of its solvents to: 1) sustain/protect its customer base; 2) put pressure on

## Hong Kong Industrials

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### Stock data

<b>Price</b>	<b>HK\$2.12</b>
<b>Target price</b>	HK\$3.5 (+65%)
<b>12 mth range</b>	HK\$2.11-6.27
<b>Market cap.</b>	US\$146.5m
<b>Daily t/o, 3 mth</b>	US\$0.15m
<b>Free float %</b>	43.0%
<b>Ticker</b>	0408.HK/408 HK

### Financial summary

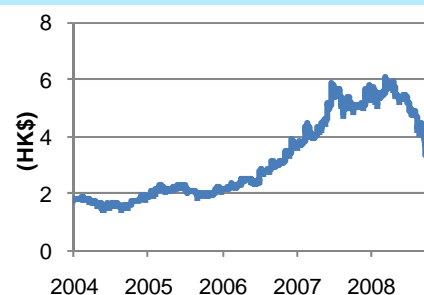
Year to Mar	06A	07A	08F	09F	10F
Turnover (HK\$m)	3,329.7	3,913.8	4,648.4	5,459.6	6,113.8
Net Profit (HK\$m)	168.4	223.6	275.2	286.8	313.9
EPS (HK\$)	0.335	0.466	0.567	0.527	0.577
EPS Δ%	35.0	31.5	21.5	(7.0)	9.4
P/E (x)	6.0	4.5	3.7	4.0	3.7
P/B (x)	1.13	0.93	0.71	0.72	0.64
EV/EBITDA (x)	4.5	3.1	2.6	2.7	2.6
Yield (%)	6.6	9.4	10.4	10.4	11.4
ROE (%)	20.4	22.4	21.6	18.9	18.6
ROCE (%)	17.5	21.3	19.0	16.4	16.0
N. Gear. (%)	27.7	14.0	10.0	11.7	13.2

### Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-28.7	-33.6	-18.2
Actual price changes (%)	-44.5	-55.6	-58.3

	08F	09F	10F
Consensus EPS (HK\$)	0.627	0.727	-
Previous forecasts (HK\$m)	265.7	323.2	390.0
Previous EPS (HK\$)	0.554	0.601	0.725

### Price Chart



its competitors and take market share. The company has scope to do this given its scale and raw material sourcing advantages, which allow it to derive EBIT margins of 9-11%, above the industry's average.

**Resetting target price to HK\$3.50.** We have cut our projections for Yip's to take into consideration: 1) moderating operating environment, 2) rising uncertainties and 3) margin contraction. However, we believe its long-term prospects are positive and we expect Yip's to emerge from the current economic downcycle with a larger market share. We estimate its net profit growth in FY3/09F-10F to be single digits before returning to double digits in FY03/10F. For FY03/09F, we have cut our revenue estimate to HK\$5,495.6m (from HK\$5,661.7m) and net profit to HK\$286.8m (from HK\$323.2m). We also cut our FY03/10F net profit estimate by 19.5% to HK\$313.9m as well as introduce our FY03/11F net profit estimate at HK\$358.3m. We reset our target price for Yip's at HK\$3.50, representing 6.0x FY3/09F P/E.

**Table 1: Earnings model**

Year to Mar (HK\$m)	06A	07A	08F	09F	10F
<b>Turnover</b>					
Solvents	1,973.6	2,194.7	2,681.9	3,165.4	3,504.3
Coating	1,196.0	1,398.7	1,616.5	1,902.0	2,169.3
Lubricants	219.3	205.1	247.1	284.2	326.8
Others	64.0	115.4	102.9	108.0	113.4
Elimination	(123.3)	-	-	-	-
	<b>3,329.7</b>	<b>3,913.8</b>	<b>4,648.4</b>	<b>5,459.6</b>	<b>6,113.8</b>
% chg	24.4	17.5	18.8	17.5	12.0
Cost of sales	(2,667.2)	(3,121.2)	(3,788.2)	(4,467.2)	(4,996.0)
Gross profit	662.5	792.6	860.2	992.4	1,117.8
Other revenue	16.2	26.4	97.3	54.6	55.0
Selling expenses	(98.6)	(106.4)	(129.2)	(152.9)	(183.4)
Administrative expense	(340.1)	(364.7)	(401.3)	(447.5)	(504.6)
Other operating expenses			(13.9)		
Operating profit	240.0	348.0	413.0	446.7	484.9
Interest expense	(21.5)	(26.3)	(30.2)	(36.7)	(36.1)
Associates	-	-	-	-	-
Jointly-controlled entit.	-	-	-	-	-
<b>Pre-tax profit</b>	<b>218.4</b>	<b>321.7</b>	<b>382.8</b>	<b>410.0</b>	<b>448.7</b>
Tax	(21.7)	(52.0)	(63.4)	(66.4)	(72.7)
Minority interests	(28.3)	(46.1)	(44.3)	(56.8)	(62.2)
<b>Net profit</b>	<b>168.4</b>	<b>223.6</b>	<b>275.2</b>	<b>286.8</b>	<b>313.9</b>
% chg	36.7	32.6	23.1	4.2	9.5
Dividends	(66.8)	(81.7)	(107.0)	(120.5)	(131.8)

Source: Company data & SBI E2-Capital

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