

A high-end linen yarn manufacturer**China Textile****Kingdom Holdings Ltd. (528 HK)****Not Rated**

Company profile. Kingdom is engaged in the manufacturing of linen yarns under its two major subsidiaries, Zhejiang Jinyuan and Jiangsu Jinyuan in the PRC. It is the 2nd largest linen yarns exporter in the PRC, accounting for over 30% of total PRC export in terms of sales volume, second to Zhejiang Golden Eagle (600232 CH). Kingdom's productions are based in Jiangsu and Zhejiang provinces with a total floor area of 76,752 sq.m. Total annual production capacity amounted to 10,000 tonnes of linen yarn with capacity utilization close to 90%. Products are sold under three brands, namely “紫微(Zi Wei)”, “Crape Myrtle” and “Kingdom”. Most of the production is exported to EU and sold domestically in the PRC, which accounted for 40.8% and 39.6% of total sales in 1H FY12/06A respectively. The remaining is sold to other countries including Turkey, Russia, Korea, India and Japan. Kingdom is able to produce diverse yarns with counts ranging from 8.5 Nm to 60 Nm, which allows flexible applications for a wide variety of apparel and textile products, such as bedspread, cushion cover and high-end ladies fashion.

Market growth potentials. **1) Wide applicability of linen.** Linen is an environmental-friendly fabric. It is soft, lucent and anti-bacteriostatic with high absorptance and permeability. In the past, linen yarn was used to produce linen fabrics alone but currently there is a growing trend that linen is being mixed with other fibers, such as cotton, silk and wool to produce a mixture of fabrics. **2) Room for domestic growth.** Linen fabrics only accounted for 1% of the RMB900b total PRC sales value for textile and apparel products in 2005, which is very small compared with cotton yarns. Thus, there is more room for linen to grow domestically. **3) Lower export tax on linen fabrics.** The export tax on fabrics with linen accounting for 50% of its total content is 3%, which is very low compared with 18% levied on cotton fabrics in the PRC.

EU market outlook. In 2005, linen yarns export from the PRC surged c.1.8x due to the complete uplift of quotas on linen yarns export from the PRC to EU, compared with an average growth rate of 18% in 2003 and 2004. However, due to the sudden surge in exports from the PRC after the quota uplift, the EU has re-imposed a quantity limitation on 115 kinds of linen yarn and ramie yarn from China since 1H06, and it considers the implementation of anti-dumping measures on Chinese exports of linen fabric currently. There is no quota on linen imposed by the U.S. currently. This matched well with Kingdom's sales growth in 2005 and 1H06. In FY12/05, sales rose by 54% YoY but it slowed down to 0.9% in 1H FY12/06A.

Expansion plans. Kingdom expects to increase current linen yarn production capacity by another 20,000 tonnes by constructing a 3rd production base next to its current plant. It also plans to acquire or establish flax fibers production base in the future.

Table 1: Offer statistics

Price range	HK\$1.4-1.75
No. of shares offered	150m
Fund raised:	HK\$210m-262.5m
Offer P/E (2005A F.D.)	9.2x-11.6x
Market cap	US\$108-135m
IPO open	21 Nov
IPO close	5 Dec
Listing	12 Dec

Source: Company data

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Table 2: Use of proceeds

	(HK\$m)
Construction of production base	128.1-160.1
Build or acquire existing flax fibers production facilities	54.6-68.3
Repay existing bank loans	10.5-13.1
General working capital	16.8-21.0

Source: Company data

Valuation. There are no direct comparables listed in H.K. since most of the peers are engaged in cotton yarn and knitted fabrics. They are trading at an average 10x historical P/E in 2005 and 7.4x forward P/E in 2006. We believe one of the close comparables is Zhejiang Golden Eagle, which is listed in Shanghai. It is trading at 12.3x historical 2005 P/E. Zhejiang Golden Eagle also engaged in the production of machineries and parts for manufacturing, weaving and spinning, printing and dyeing of wool silk, spun silk and ramie apart from the manufacture and sale of textile products, including silk, flax, wool silk and apparel. Zhejiang Golden Eagle's net profit margin was 8.1% in FY12/05A, which is lower than Kingdom's 20.3%. For cotton yarn and knitted fabrics manufacturers, their net margin is usually below 10%. The prospectus is not available yet, therefore detail financials are not available. However, we believe the Group is in a net debt position since 5% of its total fund raised will be used to repay debt.

Table 3: Key financials

Year end Dec (RMBm)	2003A	2004A	2005A	1H05A	1H06A	2H05A
Sales	100.8	293.7	452.3	217.7	219.6	234.7
Net profit	11.9	68.6	91.7	38.0	39.4	53.7
YoY%						
Sales (%)	-	191.4	54.0	-	0.9	
Net profit (%)	-	475.0	33.8	-	3.7	
Net margin (%)	11.8	23.3	20.3	17.5	17.9	22.9

Source: SBI E2-Capital/Source: Company data

Table 4: Peer comparisons

Company Name	Ticker	Price (HK\$)	Mkt cap. (US\$m)	FY05A		FY06F		ROA ROE		Margins		Major products
				P/E (x)	P/E (x)	(%)	(%)	Op. (%)	Net (%)			
H.K.												
Texhong	2678	1.64	165.5	7.5	5.4	15.2	27.2	10.5	9.4	Spandex stretch yarn & grey fabrics		
Texwinca	321	5.27	870.6	*14.5	**10.8	9.5	17.5	5.7	6.2	Knitted fabrics, apparel retail		
Fountain Set	420	2.23	234.1	10.7	5.7	2.6	6.0	4.3	2.4	Knitted fabrics		
Weiqiao	2698	9.71	1,512.9	7.3	7.9	6.1	15.6	12.9	9.1	Cotton yarn, grey fabrics & denim		
Average				10.0	7.4	8.4	16.6	8.3	6.8			
PRC												
Zhejiang Golden	600232	5.95	166.5	12.4	n.a.	6.7	13.4	12.3	8.1	Linen yarn, silk, flax, wool silk and manufacture of textile machineries		
Luthai	000726	7.43	375.2	10.2	9.5	7.5	19.1	21.2	14.1	Yarns, grey cloth, dyed fabrics for shirts		
Fujian Fengzhu	600493	3.78	82.7	13.5	n.a.	7.3	8.9	13.4	10.3	Woven cotton cloth, dyed textile, water treatment services		
Wujiang Silk	000301	2.56	399.3	25.8	n.a.	0.9	2.2	5.8	1.1	Silk fabrics, synthetic fiber products, also operates electric power generation, real estate services		
Average				15.5	9.5	5.6	10.9	13.2	8.4			

*FY06A figures, **FY07F figures, RMB/HK\$:0.9908

Source: SBI E2-Capital