

## Brilliant Circle

### Stand out from the crowd

#### to summarize

- In terms of production volume, BC has become the largest cigarette packaging manufacturer in 2011.
- Cigarette industry is a mature market that sales volume increases at a stable volume rate of roughly 4% per annum.
- Industry is undertaking consolidation, number of brands dropped from 1,049 in 2001 to 118 in 2010, while the number of manufactures dropped from 185 to 18.
- BC targeted to further penetrate the market via horizontal M&A, and completed first acquisition of cigarette packaging producer since RTO in 2011.
- Preliminary 2H estimate, two factors guide the positive outlook in second half.

**Company Overview.** Brilliant Circle (BC) is the leading cigarette packaging manufacturer listed since 2007. The company was originally engaged in paper manufacturing business at the name of CT Holdings. Major shareholder, Mr Tsoi Tak repositioned the company as a cigarette package printing company via capital injection in 2011 at the share consolidation of HK\$2,400m. The cigarette package printing segment was established in 1990 with first printing factory in Shenzhen. With over 20 years of development, BC has established deep coverage to 10 of top 15 cigarette brands. Its production base located in Anhui, Hubei, Hunan and Guangdong provinces with annual attributable cigarette packs production capacity of 9.8b packs.

**Table 1. BC's top five brands sales revenue breakdown for 2011**

Brands	%
Double Happiness	9.6
Hongtashan	9.5
Yuanyan	8.7
Baisha	8.0
Furongwang	7.6

Source: SBI E2-Capital, BC

**Suppliers Industry consolidation.** Since 2001, the cigarette industry has been consolidating by the order of China National Tobacco Corporation (CNTC). CNTC is the sole cigarette manufacturer found under the jurisdiction of State Tobacco Administration (STMA) in 1982. CNTC is managed in province level that each province independently operates in accordance to CNTC guidance. Prior to the consolidation, the industry was fragmental led to industry management and counterfeiting. Since the consolidation, the number of cigarette brands dropped substantially from 1,049 to 118, and the number of cigarette manufacturer decreased from 185 to 18 in 10 years. The consolidation is on-going. Table 2 show the latest policy announced by STMA to further speed up industry consolidation:

**Table 2. '532' plan & '461' plan**

Plan	2015 Target
532 Plan	<ul style="list-style-type: none"> <li>5 brands with annual sales of over 2m cases</li> <li>3 brands with annual sales of over 3m cases</li> <li>2 brands with annual sales of over 5m cases</li> </ul>
461 Plan	<ul style="list-style-type: none"> <li>12 brands with annual sales of over RMB40b</li> <li>6 brands with annual sales of over RMB60b</li> <li>1 brand with annual sales of over RMB100b</li> </ul>

Source: SBI E2-Capital, BC

As a result of market consolidation, ASP per pack gradually increased. Industry sales revenue increased by CAGR 17% at faster pace than volume was up by CAGR 4% from 2001 to 2011.

Ticker	1008 HK
<b>Rating</b>	<b>Not Rated</b>
Price (HK\$)	5.32
Target Price (HK\$)	-
12m Price Range (HK\$)	5.02-6.95
Market cap. (US\$m)	499.6
Daily t/o (US\$m)	0.1
Free float (%)	26.38

#### Financial summary

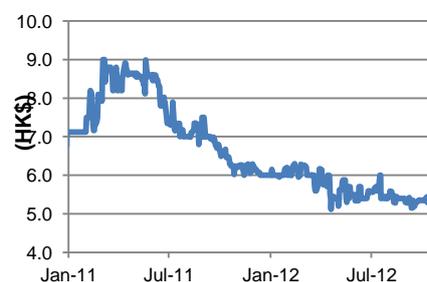
Year to Dec	09A	10A	11A
Turnover (HK\$m)	362.8	370.0	1,689.5
Net Profit (HK\$m)	22.7	7.7	387.6
EPS (HK\$)	0.04	0.12	0.55
P/E (x)	133.5	44.5	9.7
P/B (x) pre-CB	14.0	13.6	2.0
EV/EBITDA (x)	142.4	84.4	6.9
Yield (%)	-	-	1
ROE (%)	9	3	24
ROCE (%)	4	10	20
N. Gear. (%)	N.Cash	N.Cash	19

Source: SBI E2-Capital

	12F	13F	14F
Consensus EPS (HK\$)	0.6	0.8	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(3.9)	(11.9)	(30.1)
Actual price changes (%)	0.4	(1.5)	(16.7)



Source: Bloomberg

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**M&A opportunity driven from industry consolidation.** As mentioned, the domestic tobacco market is growing but with declining number of brand names, which implies increasing competition between brands. The escalating competition between brands demands better quality package with higher technique requirement to differentiate their products. BC offers one stop solution services for its customers from package design to manufacturing with appended printing services such as anti-counterfeit label. Stable supply with high standard products leads BC to stand out from the peers, while increasing quality demand might accelerate BC's new order exceed against industry growth. Yet, small to mid cigarette package printing companies might not have the capacity and technique to offer integrated services, might suffer from the consolidation. Such companies with healthy operation can be a good acquisition targets to BC, while the acquisition is mutually beneficial. BC is set to capture higher market share via M&A so as to deepen relationship with existing clients while expand its clients base. Illustration 1 shows some of BC's package products:

**Illustration 1. Examples of BC's package products**



Source: SBI E2-Capital, BC

**Yangfeng acquisition.** In July 2012, BC completed first horizontal acquisition of 60% interest in Yangfeng printing at an aggregate cash consideration of RMB720m. Yangfeng printing is a cigarette printing company located in Zhenzhen with annual capacity of 1.5b packs (effectively 0.9b packs attributable to the group). Yangfeng's clients include Baisha, Double Happiness, Nanjing and Suyan. Pursuant to the acquisition agreement, there is a 4 years profit guarantee of RMB100m at the first year (i.e. 12F) with annual growth rate of 5% for the next years. Table 3 shows share the target company's financial and the acquisition valuation at base case at the profit guarantee. Upon completion, BC's market share in terms of production volume will increased 0.7% to 7.8% and adding CNTC Zhejiang and CNTC Shaanxi to group's client portfolio.

**Table 3. financial of Yangfeng printing & BC acquisition valuation**

HK\$m	FY12/10A	FY12/11A	FY12/12F	FY12/13F	FY12/14F
Turnover	367	505			
Net profit	88	136	122*	128	135
Attributable to BC	53	82	73	77	81
Implied project P/E	13.7x	9.3x	9.8x	9.3x	8.9x

Source: SBI E2-Capital, BC, \* profit guarantee of RMB100m at the first year

**Cash position upon completion.** Pursuant to 1H FY12/12A result, company had cash and cash equivalent of RMB552.5m. Assuming one off payment for the acquisition, the 2H cash position would be RMB552.5m + RMB300m (Cash inflow from June 12 senior notes issue) – RMB720m (Yangfeng acquisition) + RMB240m (potential operation cash inflow) = RMB372m. Hence, there is indicator of short term liquidity issue upon full payment; however, BC might need external financing for future M&A activities. Table 4 shows the key item of the BC historical B/S:

**Table 4. Key B/S items**

HK\$m	FY12/10A	FY12/11A	1H FY12/11A	1H FY12/12A
Cash	269	403	312	552
Debt	417	800	525	871
Total Equity	1,962	1,962	2,037	2,008
Total Assets	3,001	3,213	2,913	3,283
Total Liabilities	1,039	1,244	876	1,275

Source: SBI E2-Capital, BC

**Short-term catalysts on year-end result.** We expect two catalysts driving up BC's 2H result; 1) normalizing earning from 1H policy distortion, 2) Completed acquisition of 60% interest in Yangfeng in July 12.

**1) 1H 12 earning distortion.** On 1 April 2012, STMA imposed new regulation on cigarette packaging. Pursuant to new requirement, cigarette packs require to show clear health warning labels (similar to the health warning sign on cigarette packs in Hong Kong). As a result, the cigarette manufacturer began destocking their existing inventory; and hence, BC's 1H FY12/12A was impacted. As shown in table 4, sales of cigarette packages segment dropped by 3% YoY to RMB571.8m, while the segment profit was dropped by 10%:

**Table 4. BC's financial performance on cigarette pack printing segment**

HK\$m	1H FY12/10A	2H FY12/10A	1H FY12/11A	2H FY12/11A	1H FY12/12A	YoY	HoH
Printing of cigarette packages							
Turnover	475.7	624.1	592.2	780.3	571.8	-3%	-27%
Segment profit	146.1	194.6	184.8	247.3	166.6	-10%	-33%
*Share of profit of an associate	64.1	86.5	70.3	86.1	100.0		

Source: SBI E2-Capital, BC \*35% interest in CD Goldroc

According to the management, the number of orders has fully recovery to pre-regulation by the end of July. We expect the cigarette packages business segment performance can be restore to 'pre-policy level'.

**2) M&A contribution.** As mentioned, BC completed 60% of Yangfeng printing in 30 June 2012. i.e. BC will consolidate 5/6 of 60% of Yangfeng's profit in the group second half result. If we assumed equal allocation of Yangfeng earning into each month, the net profit to the group in the 2H would be HK\$19m (net of additional interest expense raise from the RMB300m senior notes), as shown in table 5 below.

**Table 5. Yangfeng printing acquisition contribution**

Printing of cigarette packages (HK\$m)	FY12/11A	1H 12A adjustment	Consolidation Adjustment	FY12/12F
Net Profit	388	+8		
Yangfeng contribution			+31	
Additional Interest expense			-12	
Net upside				+27

Source: SBI E2-Capital, BC

**Valuation.** Pursuant to Bloomberg consensus, 11A P/E and 12F P/E of BC are currently trading at 8.6x and 8.8x respectively.

**Table 6. Peer valuation table**

Name	Ticker	Market Cap (HK\$m)	10A P/E	11A P/E	12F P/E	13F P/E	11A P/B	11A ROE
AMVIG	2300 HK	2,224.8	3.9	4.1	5.8	5.4	0.5	12%
Sheen Tai	1335 HK	614.2	10.1	7.5	-	-	1.6	21%
Shenzhen Jinjia	002191 CN	7,901.3	21.1	16.5			3.1	15%
Average			11.7	9.4	5.8	5.4	1.7	16%
<b>Brilliant Circle</b>	<b>1008 HK</b>	<b>3,896.9</b>	<b>14.5</b>	<b>8.6</b>	<b>8.8</b>	<b>6.8</b>	<b>2.0</b>	<b>23%</b>

Source: SBI E2-Capital

## Financial Information:

Table 7. Full year profit and loss summary

HK\$m	FY12/09A	FY12/10A	FY12/11A
Revenue	1,413	1,503	1,690
COGS	(990)	(1,061)	(1,174)
Gross Profit	423	442	515
Other income	10	12	15
Other gains and losses		6	8
Selling and distribution expenses	(64)	(60)	(47)
Administrative expenses	(96)	(83)	(98)
Other expenses	(11)	(8)	(21)
Finance costs	(24)	(23)	(29)
Share of profit of an associate	115	151	156
Loss on disposal of associate		(115)	
Profit before taxation	353	322	500
Taxation	(49)	(58)	(81)
Profit	304	265	418
Profit to shareholder	254	195	388

Source: SBI E2-Capital, BC

Table 8. Half year profit and loss summary

HK\$m	1H FY12/10A	2H FY12/10A	1H FY12/11A	2H FY12/11A	1H FY12/12A
Revenue	676	828	734	955	693
COGS	(480)	(581)	(518)	(656)	(496)
Gross Profit	196	246	216	299	197
Other income	8	4	7	7	6
Other gains and losses	(1)	6	8	0	11
Selling and distribution expenses	(32)	(27)	(20)	(27)	(19)
Administrative expenses	(32)	(51)	(34)	(64)	(47)
Other expenses		(8)	(2)	(19)	(11)
Finance costs	(12)	(11)	(11)	(18)	(17)
Share of profit of an associate	64	87	70	86	100
Loss on disposal of associate	(115)	-		-	
Profit before taxation	76	246	235	265	218
Taxation	(31)	(26)	(34)	(47)	(24)
Profit	45	220	201	217	194
Profit to shareholder	15	180	184	203	192

Source: SBI E2-Capital, BC

Table 9. Sales allocation on year basis

HK\$m (Consolidated)	09A	%	10A	%	11A	%
Printing of cigarette packages	1,025.4	73%	1,099.9	73%	1,372.5	81%
Provision of printing services	362.8	26%	370.0	25%	283.3	17%
Manufacturing of laminated papers	25.3	2%	33.3	2%	33.8	2%
Total	1,413.4	100%	1,503.2	100%	1,689.5	100%

Source: SBI E2-Capital, BC

Table 10. Sales allocation on semi-annual basis

	1H 10A	%	2H 10A	%	1H 11A	%	2H 11A	%	1H 12A	%
Printing of cigarette packages	475.7	70%	624.1	75%	592.2	81%	780.3	82%	571.8	83%
Provision of printing services	182.4	27%	187.7	23%	128.1	17%	155.1	16%	109.2	16%
Manufacturing of laminated papers	17.5	3%	15.8	2%	14.0	2%	19.8	2%	11.5	2%
Total	675.6	100%	827.6	100%	734.3	100%	955.2	100%	692.6	100%

Source: SBI E2-Capital, BC

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