

Expansion in capacity and blended margin**China Conglomerate****Guangnan Holdings (1203 HK, HK\$1.68)****Not Rated**

Strong growth in operating income. Guangnan Holdings reported a 31.0% YoY drop in net profit to HK\$121.3m, or HK\$0.135 per share, due to the absence of exceptional items (write back of liabilities and recovery of bad debts generated HK\$59.7m in FY12/05A) and a 15.2pcp increase in the effective tax rate due to the absence of tax refunds for reinvestment (which amounted to HK\$19.9m in FY12/05A). Its turnover and operating profit increased 32.6% YoY and 37.9% YoY to HK\$1,221.2m and HK\$110.8m, respectively.

Stable dividend policy. The group proposed a final dividend of HK\$0.02, bringing its full year dividend to HK\$0.035, with a payout ratio of 26.0%. The company's resumption of dividend payouts in FY12/05A (no dividends between FY12/99A and FY12/04A) and stable dividend policy imply that the management is confident in its business prospects. As of the end of FY12/06F, the group was in a net cash position of HK\$76.2m and had no long-term debts.

Stellar performance in tinplating. Due to a 66.6% surge in production capacity and sufficient supply of black-plates, the raw material of tinplate, the tinplating segment's turnover increased 39.0% YoY to HK\$1,108.9m or 90.8% of the group's total turnover. Operating profit soared 48.5% YoY to HK\$81.8m, or 73.8% of the group's total operating profit. After stripping off the impairment loss of HK\$9.4m from the closure of power plant operations, the divisional operating profit increased 65.4%. The group produced 164,986 tons of tinplate and sold 171,254 tons, representing an annualized growth rate of 43.8% and 67.6%, respectively.

Margins wide on capacity boost. The production capacity of its tinplate manufacturing arm, Zhongshan Zhongyue Tinplate Industrial Co., increased from 120,000 t.p.a. to 200,000 t.p.a. and the utilization rate reached 83.5%. We estimate that the company's gross profit margin of tinplating improved 0.6pcp to 12.2% on better economies of scale. Zhongyue's electrolytic tin-coated steel plate and electrolytic chromium-coated steel plate were awarded the title of "China Renowned Packaging Brand Products" in April 2006, making Zhongyue the only tinplate-manufacturing recipient of the title in the country.

Catalysts. Capacity expansion and margin enhancement from vertical integration will be the catalysts in tinplating. The group has formed a 66:34 JV with POSCO to establish a tinplate manufacturing plant with a production capacity of 250,000 t.p.a. in Qinhuangdao, Hebei province. The plant, to start operation between 4Q 2007 and 1Q 2008, will boost the group's tinplate production capacity to 450,000 t.p.a.. After the launch of the group's black-plate plant, with a production capacity of 150,000 t.p.a. in 1Q 2007, the company will be able to meet 75% of its black-plate needs in FY12/07F and 33.3% in FY12/08F, which should boost margins.

Other operations. Turnover and operating profit at the property leasing division dropped 0.3% YoY and 6.2% YoY to HK\$25.5m and HK\$16.7m, respectively, and at the foodstuffs distribution and trading division 11.3% YoY and 2.4% YoY to HK\$86.9m and HK\$16.6m, respectively, mainly due to avian flu concerns. At the end of 2006, the group successfully expanded its business into the trading and distribution of chilled pork in Hong Kong. Its 40.0%-owned associate, Yellow Dragon Food Industry, reported a 15.3% YoY rise in turnover to HK\$1,124.2b on a 4.6% YoY increase in cornstarch sales to 403,484 tons. Still, Yellow Dragon's net profit fell 0.8% YoY to HK\$50.3m. The group received a dividend of RMB19.5m from the associate in FY12/06A and another dividend of RMB16.8m is expected in FY12/07F.