

Xiwang sugar: Tripled capacity

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Recommendation: Not Rated

China Agriculture

Price	HK\$4.10	Yield (12/06A)	3.4%
12 mth range	HK\$3.15-4.66	ROE (12/06A)	28.8%
Market cap.	US\$441.4m	Net gearing (12/06A)	20.7%
No. shares o/s	829.5m	Net debt/sh. (12/06A)	RMB0.25
Daily t/o, 3 mth	US\$1.1m	BV/sh. (12/06A)	RMB1.42
Free float %	37.3%	Consensus EPS	
Major shareholder	Wong Yong & Zhang Shufang – 64.7%	- 12/07F	RMB0.357
Ticker	2088.HK/ 2088 HK	- 12/08F	RMB0.458

Key points:

- Fully-integrated producer of crystallized glucose with around 40% of China's market
- Expanded capacity to 800k tonnes in FY12/07A from 250k in FY12/06A.
- Sales/production ratio at 1.08 in Jun 2007.
- Long-term contracts account for 35-40% of total orders.
- Falling corn prices since mid-2007 suggest a margin recovery in 2H.
- Mid-scale trial operation of crystallized fructose may become a new profit generator in FY12/09F.

Glucose producer. Based in Shandong, Xiwang Sugar (XS) is China's largest crystallized glucose producer (around 40% of the market) with fully integrated production facilities. The company uses corn to produce crystallized glucose and by-products including gluten meal and corn germ. Crystallized glucose generated 54.3% of the company's total revenue in 1H FY12/07A, gluten meal 10.8%, corn germ 9.2% and animal feed 8.6%.

Table 1: Production yield

Raw material	Corn refined products	Corn-based biochemical products
Corn (1m tonnes)	Starch paste* (700k tonnes)	Crystallised glucose (600k tonnes)
	Corn germ (70k tonnes)	Glucose syrup (120k tonnes)
	Corn gluten meal (60k tonnes)	Glutemic acids (70k tonnes)
	Corn fiber (100k tonnes)	
	Animal feed products (100k tonnes)	

Source: SBI E2-Capital

Note: * starch paste is used as raw material in producing corn-based biochemical products

Capacity expansion. XS expanded its crystallized glucose production capacity from 250,000 tonnes p.a. to 800,000 tonnes in Jan 2007. Its crystallized glucose sales doubled in 1H FY12/07A to 207,715 tonnes and monthly production volume increased from 20,590 tonnes in Jan 2007 to 53,260 tonnes in Jun. The company expects to reach around 90% utilization by end-2007.

Strong demand in 1H FY12/07A. Long-term contracts (6-12 months) represented 35-40% of all orders in Jun, from 15% at the beginning of this year. XS' economies of scale helped it to gain market share from smaller players. Its sales/production ratio of crystallized glucose improved from 0.95 in Jan 2007 to 1.08 in Jun, implying strong demand.

Gross margin recovery in 2H. Corn, the major raw material in glucose production, accounted for 78.3% of XS' cost of sales in 1H FY12/07A. During the same period, the corn price rose about 12%, eroding the blended gross margin by 6.7pcp YoY to 21.2%. The company expects the margin to recover in 2H FY12/07F as the corn price has

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softened recently.

Larger scale, better margins. Fixed costs, including depreciation, labor and other costs, represented 12.3% of the cost of sales in 1H FY12/07A. The sales expansion or utilization rate increase should result in margin improvement in coming future. According to our preliminary estimate, a 10% increase in turnover will boost the blended gross margin by near 1pcp.

Downstream move. The company plans to move into value-added downstream products. A mid-scale trial production of crystallized fructose is underway and commercial operation will probably start by end-2008. The move will likely make XS China's first crystallized fructose producer and should stimulate earnings in 2009.

Potential industry consolidation. Construction of new corn processing plants has been suspended in China after the government introduced in Dec 2006 measures to stem over-expansion of the industry. We expect the sector to consolidate shortly benefiting large players such as XS.

Valuation. According to consensus estimates, the company's EPS will be flat at RMB0.357 in FY12/07F and increase 28.3% YoY to RMB0.458 in FY12/08F. XS is trading at HK\$4.15 at present, representing a forward P/E of 11.3x for FY12/07F. Comparably, corn-refiner China Starch (3838 HK, HK\$3.88, NR) is trading at 13.8x historical P/E and glucose syrup maker Global Sweet (3889 HK, HK\$2.05, NR) at 9.2x.

Corporate governance. XS listed on HK exchange in Dec 2005 via a global offering of 280m shares at HK\$1.88 each. Substantial shareholders include Wang Yong (64.71%), chairman and executive director of the company, and Atlantis Investment Management Ltd (8.05%).

Table 2: P&L

Year to Dec (RMBm)	04A	05A	06A	1H06A	1H07A
Turnover	602.7	1,037.7	1,384.9	687.7	879.0
Cost of goods sold	(484.2)	(776.5)	(1,019.9)	(495.8)	(692.7)
Gross profit	118.5	261.2	365.0	191.9	186.3
Other gain – net	17.1	4.1	10.2	2.3	19.1
Selling and marketing costs	(15.0)	(28.7)	(35.8)	(17.8)	(15.1)
Administrative expenses	(10.0)	(8.3)	(23.0)	(6.4)	(16.0)
Operating profit	110.6	228.3	316.4	170.0	174.4
Finance costs	(16.1)	(18.4)	(26.2)	(11.2)	(16.0)
Profit before income tax	94.5	209.8	290.2	158.9	158.4
Income tax expense	(12.8)	0.0	0.0	0.0	(6.5)
Profit after tax	81.7	209.8	290.2	158.9	151.9
Minority interest	(2.8)	0.0	0.0	0.0	0.0
Net profit	78.8	209.8	290.2	158.9	151.9
Dividend	0.0	87.0	115.9	0.0	0.0
EPS - Basic (RMB)	0.141	0.365	0.356	0.198	0.183
EPS - Diluted (RMB)	0.141	0.365	0.352	0.194	0.183

Source: Company data