

AddChance Holdings

Factory land re-development in progress

to summarize...

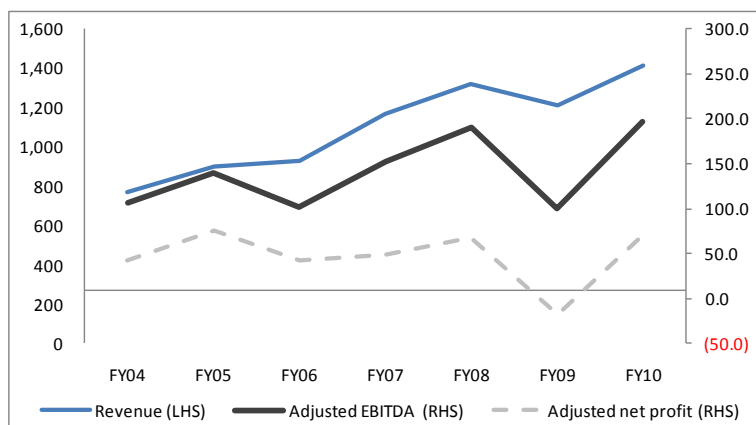
- Long-established brand name in textile industry; customers include M&S, H&M
- Factory land rezoning approved to be redeveloped as residential (三旧项目)
- Residential and commercial complex project summary
- Financial status summary – annual cash flow and current gearing
- Strong shareholder background by Dr. SUNG Chung Kwun

Long established brand name in textile industry with world-class customers.

AddChance positions itself as a one-stop service provider in textile industry. Chairman Sung Chung Kwun started its business in Oct 1980 by acquiring part of a dyeing business in HK from his family. In 1981 Mr Sung started his own dyeing business in HK. After production facilities relocation in 1991 to Luoding, Guangdong, the company gradually started producing cotton yarns and knitted sweaters in 1990s and 2000s. According to the management, company's major customers include famous brand names such as Marks & Spencer (M&S) and H&M, whom they have been serving for 7-8 years. Current major production facilities are located in Guangdong, Jiangsu, Anhui, Guangxi and Xinjiang in China as well as in Cambodia.

1H FY12/10A results summary. For 1H FY12/11A, revenue was HK\$617m, of which knitted sweaters contributed 44.3%, dyed yarns contributed 41.1%, cotton yarns contributed 9.3% and other contributed the remaining ~5%. Gross margin and net margin were 23.3% and 5.2% for the period respectively, which has been relatively stable since listing in 2005. Chart 1 shows revenue, adjusted EBITDA and adjusted net profit 2004 to 2010 on annual basis (adjusted for one-off gain).

Illustrate 1. Revenue, adjusted EBITDA and adjusted net profit



Source: SBI E2-Capital

Factory land rezoning approved to be redeveloped as residential (三旧改造项目). In mid of this year, the company applied to rezone its Luoding parcel of land from factory use into residential and commercial complex and being 1 of 14 projects recognized in the redevelopment project (三旧改造项目). Luoding government at city level also approved its development draft. Upon receiving approval and 4 required permits (国有土地使用证, 建设用地规划许可证, 建设工程规划许可证, 建筑工程施工许可证), the company would be able to develop the 133,903 sqm land piece with planned plot ratio of 4.2x at small land cost of RMB100m, according to the management. The project is at south of Long Jiang (瀧江) with expected ASP up to RMB4,000+ per sqm.

Please refer to important disclosures at the end of this report

| | |
|------------------------|------------------|
| Ticker | 3344 HK |
| Rating | Not Rated |
| Price (HK\$) | 0.77 |
| Target Price (HK\$) | n.a. |
| 12m Price Range (HK\$) | 0.73-1.61 |
| Market cap. (US\$m) | 43.6 |
| Daily t/o (US\$m) | 0.1 |
| Free float (%) | 29.2 |

Financial summary

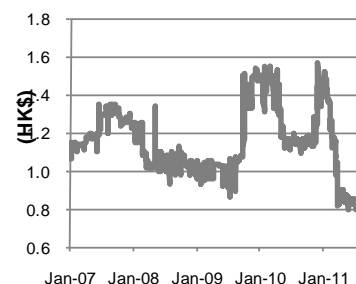
| Year to Mar | 08A | 09A | 10A |
|--------------------|-------|-------|-------|
| Turnover (HK\$m) | 1,317 | 1,214 | 1,418 |
| Net Profit (HK\$m) | 68 | 50 | 71 |
| EPS (HK\$) | 0.169 | 0.125 | 0.167 |
| P/E (x) | 4.6 | 6.2 | 4.6 |
| P/B (x) | 0.46 | 0.43 | 0.37 |
| EV/EBITDA (x) | 5.0 | 3.2 | 2.4 |
| Yield (%) | 0.0 | 2.6 | 3.9 |
| ROE (%) | 9.2 | 6.4 | 7.8 |
| ROCE (%) | 9.2 | 6.4 | 7.8 |
| N. Gear. (%) | 83.2 | 68.4 | 51.0 |

Source: SBI E2-Capital

| | 11F | 12F | 13F |
|---------------------------|-----|-----|-----|
| Consensus EPS (HK\$) | - | - | - |
| Previous earnings (HK\$m) | - | - | - |
| Previous EPS (HK\$) | - | - | - |

Price performance

| Year to Dec | 1m | 3m | 12m |
|--------------------------|-------|-------|--------|
| Relative to HSI (%) | 0.4 | 11.0 | (22.5) |
| Actual price changes (%) | (2.5) | (6.1) | (31.9) |



Source: Bloomberg

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Project summary and cash flow items projection of residential segment. Base on the draft plan, the company expects to construct a 4-phase residential project followed by a 2-phase commercial project in Luoding (all existing factory buildings are to be demolished). At planned plot ratio of 4.2x, the company could develop 562,392 sqm gross floor area (GFA) with 507,252 sqm residential. Table 1 shows key parameters of the project. By the time the company fulfill all necessary conditions and start construction, we expect the company needs RMB400m in the first year before cash sales occurring in the second year. Table 2 shows a preliminary cash flow illustration of residential segment of the project. With sufficient funding with the support of its existing textile business of between HK\$100m and HK\$200m EBITDA a year, the company could enjoy a high IRR of 55.6% upon project delivery. Table 3 shows profit and loss estimation for residential segment.

Table 1. Draft plan of Luoding land project

| Usage | Size |
|-----------------|-------------------------------|
| Land size | 133,903 sqm @ 4.2x plot ratio |
| Residential GFA | 507,252 sqm @ 4 phases |
| Commercial GFA | 55,139 sqm @ 2 phases |
| Other GFA | 133,520 sqm |

Source: AddChance

Table 2. Cash flow illustration of residential segment of the project

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---------------------------------------|---------|---------|---------|---------|--------|
| Contract sales (RMBm) | 0 | 540 | 990 | 750 | 480 |
| ASP (RMB per sqm) | 0 | 4,500 | 5,500 | 6,000 | 6,000 |
| GFA (sqm) | 0 | 120,000 | 180,000 | 125,000 | 80,000 |
| Development costs (RMBm) | (300) | (473) | (345) | (232) | (0) |
| All-in development cost (RMB per sqm) | (2,500) | (2,625) | (2,756) | (2,894) | (0) |
| GFA (sqm) | 120,000 | 180,000 | 125,000 | 80,000 | 0 |
| Land cost (RMBm) | (100) | (0) | (0) | (0) | (0) |
| Tax expenses @25% (RMBm) | (0) | (60) | (129) | (101) | (62) |
| Cash flow (RMBm) | (400) | 8 | 516 | 417 | 418 |
| IRR | 55.6% | | | | |

Source: SBI E2-Capital

Table 3. Profit and loss estimation for residential segment of the project

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 |
|---------------------------------------|--------|--------|---------|---------|---------|---------|
| Revenue | 0 | 0 | 540 | 990 | 750 | 480 |
| ASP (RMB per sqm) | 0 | 0 | 4,500 | 5,500 | 6,000 | 6,000 |
| GFA (sqm) | 0 | 0 | 120,000 | 180,000 | 125,000 | 80,000 |
| Development costs (RMBm) | 0 | 0 | (318) | (501) | (365) | (245) |
| All-in development cost (RMB per sqm) | 0 | 0 | (2,650) | (2,783) | (2,922) | (3,068) |
| GFA (sqm) | 0 | 0 | 120,000 | 180,000 | 125,000 | 80,000 |
| Tax expenses @25% (RMBm) | 0 | 0 | (56) | (122) | (96) | (59) |
| Net profit | 0 | 0 | 167 | 367 | 289 | 176 |

Source: SBI E2-Capital

Financial status summary. Table 4 shows balance sheet of AddChance while Table 5 shows key financial ratios of the existing business of AddChance. By the end of 1H FY12/11A, the company has PP&E of HK\$767.2m and total equity of HK\$933.5m. On the liability side, the company has total borrowings (including long-term borrowings, short-term borrowings and OD) of HK\$704.3m, which was equivalent to 91.8% PP&E and 75.4% total equity. That said, we believe the company has received relatively large amount of financing and further financing with its existing assets of its textile business segment may not be very likely. The company needs to secure funding for the property project externally, in our view. It is expected that the property development project would largely improve profitability of the company.

Table 4. Balance sheet summary

| HK\$m | FY12/08A | FY12/09A | FY12/10A | 1H FY12/11A |
|--------------------------------------|--------------|--------------|--------------|--------------|
| Total assets | 1,780.1 | 1,658.6 | 1,779.8 | 2,181.4 |
| Property, plant and equipment | 768.9 | 758.0 | 734.1 | 767.2 |
| Inventories | 586.1 | 466.1 | 540.5 | 778.2 |
| Trade and other receivables | 226.9 | 248.6 | 295.3 | 453.7 |
| Bank balances and cash | 95.6 | 85.5 | 99.1 | 79.3 |
| Other assets | 102.6 | 100.4 | 110.7 | 103.1 |
| Total liabilities | 1,045.3 | 871.9 | 866.1 | 1,247.9 |
| Bank borrowings (ST) | 684.2 | 581.8 | 490.9 | 563.1 |
| Bank borrowings (LT) | 0.0 | 30.1 | 74.5 | 117.7 |
| Bank overdrafts | 22.9 | 12.0 | 0.0 | 23.5 |
| Trade and bill payables | 298.1 | 216.2 | 277.8 | 505.4 |
| Other liabilities | 40.1 | 31.8 | 23.0 | 38.2 |
| Total equity | 734.8 | 786.7 | 913.6 | 933.5 |

Table 5. Cash flow illustration of residential segment of the project

| HK\$m | FY12/08A | FY12/09A | FY12/10A | 1H FY12/11A |
|---------------------------|----------|----------|----------|-------------|
| Leverage | | | | |
| Total borrowings / PP&E | 92.0% | 82.3% | 77.0% | 91.8% |
| Debt-to-equity | 96.2% | 79.3% | 61.9% | 75.4% |
| Net debt-to-equity | 83.2% | 68.4% | 51.0% | 67.0% |
| Liquidity | | | | |
| Current ratio (x) | 0.9 | 1.0 | 1.3 | 1.2 |
| Quick ratio (x) | 0.3 | 0.4 | 0.5 | 0.5 |
| EBITDA / finance cost (x) | 4.3 | 3.5 | 7.8 | 7.3 |
| Profitability | | | | |
| Adjusted EBITDA margin | 15% | 8% | 14% | 16% |
| Adjusted net margin | 5% | -1% | 5% | 5% |
| Adjusted ROE (annualized) | 9% | -2% | 8% | 6% |

Source: SBI E2-Capital

Strong shareholder background. Dr. SUNG Chung Kwun is the Chairman of the Group. Dr. Sung has over 30 years of experience in the textile dyeing industry and he was a committee member of the Chinese People's Political Consultative Conference of 1) Fujian Province; 2) Yunfu City, Guangdong Province; and 3) Wuzhou City, Guangxi Province. Dr. Sung is also the honorary chairman of the Hong Kong Association for the Foochow Association (福州十邑旅港同鄉會名譽會長). Dr. Sung holds 70% shares of the company.

Table 6. Shareholding structure of AddChance

| | Shareholding |
|------------------------------|--------------|
| Chairman Dr. SUNG Chung Kwun | 70% |
| Public | 30% |
| Total | 100% |

Source: SBI E2-Capital

Risk factors. AddChance is expected to gain from re-development project. However, there are risks including 1) whether the company would be granted all required licenses as scheduled; 2) execution risk in connection to property development which is largely different from existing textile business; 3) the availability of funds to put re-development plan into action once approved.

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