

Global Sweeteners

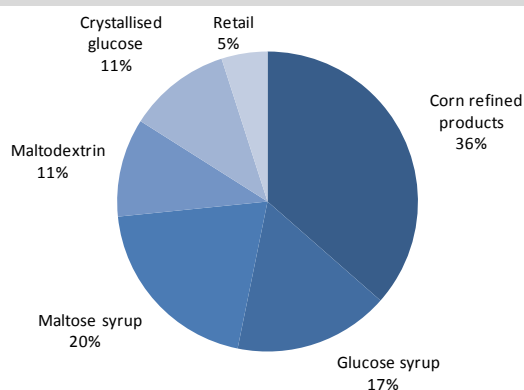
Strong sugar price to benefit earnings

to summarize...

- Sustainable growth of sugar consumption in China drives demand for sweeteners.
- The Chinese government stopped approval of new corn processing projects. We favour companies with sufficient upstream starch capacity (or supply) to accommodate their future growth.
- The company has its starch requirement well covered. It has been approved to build additional 300,000mt starch capacity in Jinzhou.
- Other downstream capacity expansion has been planned. We estimate its equivalent sugar capacity will increase from 694,000mt in 2010 to 1,054mt by 2013.
- ASP is expected to increase 25% in FY12/11F backed by the fact that sugar price surged 40% in 1H.
- As corn cost has been largely locked up at 15% higher than which of last year, gross margin may improve significantly. We are looking for doubled earnings for this year.
- The counter is trading at 11.5x FY12/11F P/E on market consensus.

The company supplies mainly sweeteners. Global Sweeteners (GS) is a corn processor. Major products are starch sweeteners, including glucose syrup, maltodextrin, high fructose corn syrup (HFCS) and crystallized glucose. The company has three plants, located in Changchun, Jinzhou and Shanghai, respectively. In FY12/10A, its revenue was HK\$3,356m, up 26% YoY, and net profit was HK\$89m, up 3.5% YoY.

Chart 1. Sales mix in FY12/10A



Source: Company data

Rising sugar consumption drives demand for sweeteners. China's sugar demand is estimated at ~15mmt this year, translating into ~12kg per capita consumption in year, which is far below the world's average of ~25kg. Given the country's rapid economy growth and rising living standard, we can reasonably expect a continuous increase in its sugar consumption. As an agricultural product, cane sugar's output has its natural limit. Thus, the increasing demand can only be satisfied by import or alternatives, mainly starch sweeteners. Between 1999 and 2010, China's production of sugar and starch sweeteners increased at 2.4% and 28% CAGR, respectively.

Ticker	3889 HK
Rating	Not Rated
Price (HK\$)	1.69
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1.25-2.05
Market cap. (US\$m)	249.1
Daily t/o (US\$m)	1.3
Free float (%)	47.8

Financial summary

Year to Dec	08A	09A	10A
Turnover (HK\$m)	1,694	2,669	3,356
Net Profit (HK\$m)	154.4	85.7	89.4
EPS (HK\$)	0.148	0.082	0.079
P/E (x)	11.4	20.6	21.4
P/B (x)	1.2	1.1	1.0
EV/EBITDA (x)	12.3	17.8	14.0
Yield (%)	0.0	0.6	0.0
ROE (%)	10.1	5.4	5.0
ROCE (%)	8.8	5.0	4.9
N. Gear. (%)	13.1	31.0	26.1

Source: SBI E2-Capital

	11F	12F	13F
Consensus EPS (HK\$)	0.147	0.193	0.260
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

Price performance

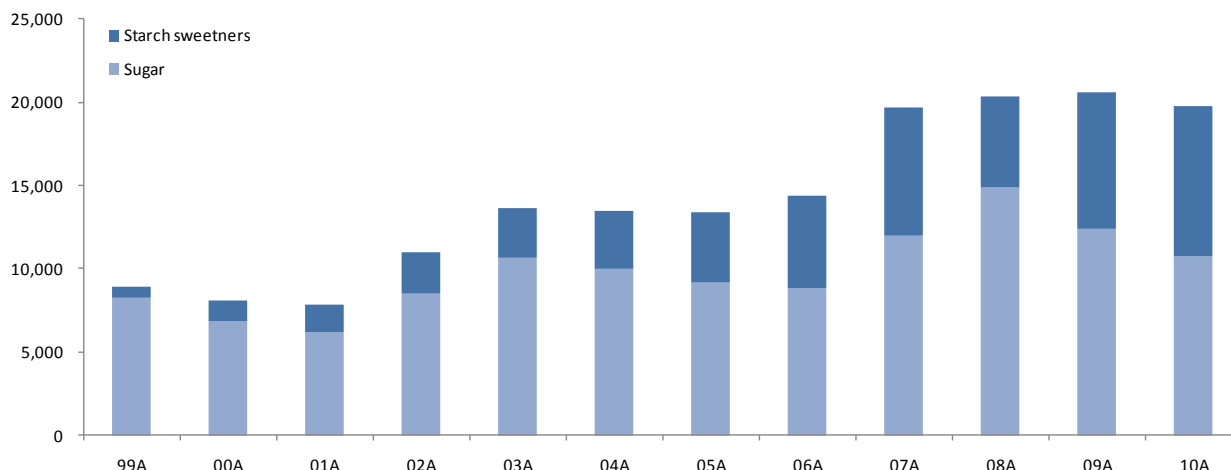
Year to Dec	1m	3m	12m
Relative to HSI (%)	(9.6)	+1.8	9.8
Actual price changes (%)	(11.1)	9.0	29.0



Source: Bloomberg

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Chart 2. Production volume of sugar and starch sweeteners in China (mt '000)



Source: compiled by the company

Upstream capacity matters during expansion. ~85% starch sweeteners are made from corn starch, which, in turn, is processed from corn. We estimated sweetener consumed ~8% of China's total corn output in 2010. Due to stretching food grain supply, the Chinese government has suspended approval of new non-food (or -feed) processing projects using corn as direct raw material since end-2010. This policy doesn't apply to sweeteners but it forbids sweeter producers from building new starch plants. Sweetener producers can either procure from outside or acquire existing plants in order to obtain necessary corn starch supply to support their expansion. We reckon this will turn starch supply into sort of scarce resource. Therefore, companies with spare starch capacity may enjoy a better position in expanding.

Table 1. GS's capacity expansion plan

(mt '000)	10A	11F	12F	13F	Raw material
Est. equivalent sugar capacity	694	754	854	1,054	
Est. available-for-sale corn starch	68	184	27	288 short	
Est. available-for-sale corn refined products	180	270	270	270	
Aggregate capacity					
Corn starch	420	630	630	630	Corn
Corn refined products	180	270	270	270	Corn
Glucose / maltose syrup	820	820	820	820	Corn starch
Maltodextrin	20	20	20	20	Syrup
HFCS	120	180	280	480	Corn starch
Sorbitol	60	60	100	100	Syrup
Crystallised glucose	240	240	340	340	Syrup
Changchun					
Glucose / maltose syrup	500	500	500	500	
Maltodextrin	20	20	20	20	
Sorbitol	60	60	60	60	
Crystallised glucose	240	240	240	240	
Jinzhou					
Corn starch	420	630	630	630	
Corn refined products	180	270	270	270	
Glucose / maltose syrup	200	200	200	200	
HFCS			100	300	
Sorbitol			40	40	
Crystallised glucose	0		100	100	
Shanghai					
Glucose / maltose syrup	120	120	120	120	
HFCS*	120	180	180	180	

Source: compiled by SBI E2-Capital

* including 120,000mt capacity from JV

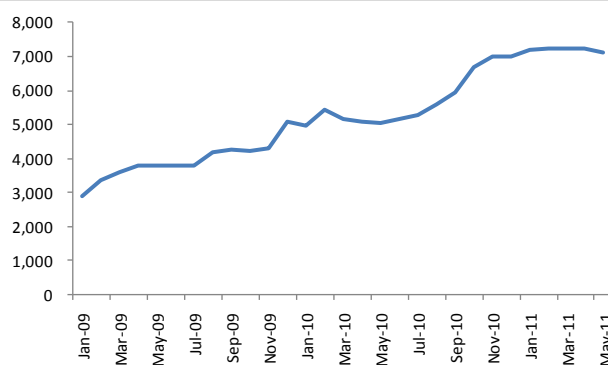
HK\$600m capex has been planned for 2011. GS's Changchun plant sources starch from its nearby parent, **Global Bio-Chem (0809 HK, HK\$2.18)**. The Jinzhou plant has 600,000mt corn processing capacity (420,000mt starch), covering both Jinzhou and Shanghai plants' need (350,000mt starch in aggregate) well. With approval obtained already, another 300,000mt corn processing capacity will be added in Jinzhou this year, bringing the total to 900,000mt (630,000mt starch). On the downstream, two HFCS lines, one (100,000mt) in Jinzhou and another (60,000mt) in Shanghai, will be built, consuming additional 250,000mt starch in our estimates. Meanwhile, the company will construct also 40,000mt maltodextrin and crystallized glucose in Jinzhou to further process its existing glucose syrup.

Selling price on rising. It might be difficult to predict long-term sugar price, although we stand at positive side in view of rising demand, limited supply and inflation impact in general. Nevertheless, we reckon there is a good chance to observe a strengthening of sweeter price this year. As a substitute of cane sugar, sweeter price is correlated with the prior's (correlation coefficient was 0.7 based on GS's glucose syrup ASP and China No. 1 sugar ex-warehouse spot price between 2005 and 2010). Sugar price rose 40% YoY in 1H 2011 or 15% HoH. The management anticipates 25% price increase in 2011.

Margin expansion is likely to happen. On the cost side, corn price increased too, 15% YoY in 1H. The Jinzhou plant has a warehouse capacity of 300,000mt, which has been filled with corn (similar situation in Changchun by its parent). Therefore, the full-year corn cost (~70% of COGS) has been locked in, which is 15% higher than last year. Amid the backdrop of 25% price enhancement, gross margin seems to widen considerably in FY12/11F.

Earnings are expected to double. Combining the ~9% enhancement in equivalent sugar capacity (table 1), ~25% ASP increase and ~10pcps gross margin improvement, we can roughly calculate that the company may have 25%+ top line growth in FY12/11F with 100%+ jump at bottom line (street: HK\$3,883 sales, HK\$161m net profit). P/E multiple is 11.5x one-year forward on market consensus, which is higher than other corn processors, justified by the company's better expansion potential.

Chart 3. China No. 1 sugar ex-warehouse spot price (RMB/mt)



Source: Bloomberg

Table 2. Valuation matrix

Company	Ticker	Fiscal year end	Market cap (US\$m)	Historical PER (x)	1-year PER (x)	2-year PER (x)	P/BV (x)	ROE (%)
Global Sweeteners	3889 HK	12/2010	249.1	21.2	11.5	8.8	1.0	5.0
Fufeng Group	0546 HK	12/2010	1,176.6	7.7	7.1	5.7	2.4	34.9
Global Bio-Chem	0809 HK	12/2010	907.3	18.7	9.5	8.2	0.8	4.1
Xiwang Sugar	2088 HK	12/2010	263.2	7.9	7.1	6.0	0.9	12.2
China Starch	3838 HK	12/2010	359.4	14.2	n.a.	n.a.	1.6	13.4

Source: Bloomberg

Risks. We highlight the major market risk. Fluctuation of sugar and corn prices might substantially affect the company's profit at both up and down side.

Table 3. Key financials

Year to Dec (Rmbm)	08A	09A	10A
Revenue	1,694.0	2,668.8	3,356.3
Gross profit	282.4	307.2	378.2
Operating profit	209.5	137.8	175.3
Net profit	154.4	85.7	89.4
EBITDA	199.1	137.0	174.3
Inventories	241.4	367.2	586.0
Receivables	297.3	508.2	554.2
Payables	164.6	181.5	256.4
Cash	423.1	296.6	377.6
Short-term debt	341.6	679.8	614.9
Long-term debt	280.9	121.3	264.4
Shareholders' fund	1,525.5	1,630.1	1,919.5
Total equity	1,525.5	1,635.8	1,926.9
Net cash from operating activities	365.1	(1.9)	(62.8)
Net cash used in investing activities	(427.1)	(133.4)	(26.7)
Net cash from financing activities	(456.4)	7.7	157.2
Net change in cash and cash equivalents	(518.5)	(127.7)	67.7

Source: Company data

Table 4. P&L

Year to Dec (Rmbm)	07A	08A	09A
Revenue	1,694.0	2,668.8	3,356.3
Cost of sales	(1,411.5)	(2,361.6)	(2,978.0)
Gross profit	282.4	307.2	378.2
Other income and gains	30.9	18.6	28.6
Excess over the cost of a business combination	23.7		
Operating expenses	(127.6)	(188.1)	(231.5)
Selling and distribution expenses	(70.4)	(108.9)	(157.6)
Administrative expenses	(58.9)	(75.9)	(70.4)
Other expenses	1.8	(3.3)	(3.5)
Profit from operations	209.5	137.8	175.3
Finance costs	(39.2)	(34.2)	(51.6)
Share of profits of jointly controlled entities	5.7	3.3	1.2
Profit before taxation	175.9	106.8	124.8
Income tax expenses	(21.5)	(20.6)	(33.8)
Profit for the period	154.4	86.2	91.1
Attributable to:			
Owners of the Company	154.4	85.7	89.4
Non-controlling interests	-	0.5	1.7
EPS - Basic (HK\$)	0.148	0.082	0.079
EPS - Diluted (HK\$)	0.148	0.082	0.079

Source: Company data

Table 5. Shareholding structure

Shareholders	Interest
Global Bio-Chem	52.24%
Others	47.76%
Total	100.00%

Source: HKEx

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