

Global Sweeteners: Aggressive expansion

Norman Zhang
(852) 2533 3715
normanzhang@sbie2capital.com

Recommendation: Not Rated

China Agriculture

Price	HK\$1.14	Yield (12/06A)	n.a.
12 mth range	HK\$1.20-2.50	ROE (12/06A)	57.5%
Market cap.	US\$152.7m	Net gearing (12/06A)	316.3%
No. shares o/s	1,045.0m	Net debt/sh. (12/06A)	HK\$1.17
Daily t/o, 3 mth	n.a.	BV/sh. (12/06A)	HK\$0.51
Free float %	33%	Consensus EPS	
Major shareholder	Global Bio-chem – 67%	- 12/07F	HK\$0.225
Ticker	3889.HK/ 3889 HK	- 12/08F	HK\$0.300

Key points:

- Customers' geographical expansion to drive glucose/maltose syrup growth.
- Stable gross margin despite corn price hikes.
- New HFCS client.
- HK\$1.5b to be spent on capacity expansion in 2007 and 2008.
- Intends to reduce connected transactions with parent.

Company background. Global Sweeteners Holdings (GSH), with manufacturing bases in Jilin and Shanghai, was spun off from Global Bio-chem Technology (GBT) (809 HK, HK\$2.45, NR) via a global offering this September. GSH produces corn sweeteners, including glucose and maltose syrup, high fructose corn syrup (HFCS), crystallized glucose, maltodextrins and sorbitol. Glucose and maltose syrup together generated 74.2% of the company's total revenue in 1H FY12/07A.

Table 1: Principal products

Major products	Application	Turnover (HK\$m)	% of total sales	% YoY change
Glucose syrup	Food & beverage, fermentation, pharmaceutical	346	47.5	25.8
Maltose syrup	Food & beverage, fermentation, pharmaceutical	194	26.6	37.6
HFCS	Food & beverage, confectionery	64	8.8	18.5
Crystallized glucose	Food & beverage, fermentation, pharmaceutical	70	9.6	775.0
Maltodextrins	Food & beverage, dairy products	52	7.1	108.0
Sorbitol	Food & beverage, pharmaceutical, cosmetics, chemical	2	0.3	(50.0)

Source: Company data

Close relationship with clients. The company normally supplies glucose/maltose syrup within a 200km-radius, which on the one hand restricts its ability to reach distant clients but on the other hand strengthens its relationship with customers. More than 50% of the company's contracts are for more than one year. GSH plans to expand its glucose/maltose syrup capacity to cope with the geographic expansion of its major clients.

Stable margin. Though the price of corn, its major raw material, surged around 20% YoY in 1H 12/07A, the gross margin of glucose syrup remained stable at around 22% and that of maltose syrup widened 2.4pcp YoY to 24.0%. The reasons, according to the company, include: (1) transport constraints which make customers rely on GSH's supply in certain regions and enable the company to pass on some extra costs and (2) cornstarch sourced from its parent, which keeps around four-month corn inventory in hand.

New customer for HFCS. GSH is one of the two suppliers of HFCS to a well-known beverage producer. Its HFCS sales increased 18.5% YoY in 1H FY12/07A to HK\$64m and the company has sealed a sales contract with a new

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other primary businesses with the companies in this report.

Analyst certification: the views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer: the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

client, a famous beverage maker, which should drive growth of this segment. The selling price of HFCS, which is a cane sugar substitute, was affected by weak sugar prices and a change of its pricing formula with a major client, which eroded its gross margin by 12pcp YoY to 22.0% in 1H FY12/07A. The new formula pegs the selling price to material costs instead of the sugar price, which should stabilize its gross margin.

Capacity expansion. The company will invest HK\$1.5b in each 2007 and 2008 to expand its maltodextrin and crystallized glucose capacity. Its new crystallized glucose plant in Jinzhou should be launched in Jan 2009 and focus on overseas markets such as Korea and Japan.

Table 2: Capacity expansion plan

Designed capacity ('000 tonnes p.a.)	2007	2008	2009
Glucose/maltose syrup	580.0	780.0	1,180.0
Crystallized glucose	200.0	400.0	500.0
Maltodextrin	20.0	120.0	120.0
HFCS	100.0	220.0	340.0
Sorbitol	60.0	60.0	60.0
Total	960.0	1,580.0	2,200.0

Source: Company data

Exploring the retail market. GSH also plans to extend its business chain to retailing in the future to take advantage of higher retail prices of some products such as corn oil. The move should improve its overall profit margin.

Connected transactions. In FY12/06A, GSH purchased HK\$723.8m worth of cornstarch, representing 81.1% of the company's total cost of sales, from its parent, GBT. Meanwhile sales of corn sweeteners to GBT accounted for 39.9% of GSH's total turnover in FY12/06A. To reduce connected transactions, GSH plans to set up its own cornstarch production facilities, either by building from scratch or acquiring plants from its parent. As GBT is also expanding its corn refining, we think the company will more likely build new factories itself.

Industry overview. Corn, tapioca and potato are the major raw materials used in the commercial production of starch. Starch sweeteners are mainly used in the food and beverages, pharmaceutical and paper manufacturing industries. According to a research report from DRC (a service platform under the Development Research Center of the State Council), China's per capita annual starch sweetener consumption was about 3.8kg in 2005 compared with 64kg in the US, suggesting ample expansion potential.

Valuation. According to market consensus, the counter is trading at 5.1x P/E for FY12/07F and 3.8x for FY12/08F, which is at the lower-end of industry average.

Corporate governance. The company issued 300.0m new shares at HK\$2.04 each during its global offering in September. Its major shareholder is GBT with 67.0%.

Table 3: P&L

Year to Dec (HK\$m)	04A	05A	06A	1H06A	1H07A
Revenue	265.0	825.0	1,144.1	509.8	727.5
Cost of sales	(210.1)	(645.0)	(892.6)	(400.0)	(581.8)
Gross profit	54.9	179.9	251.6	109.8	145.7
Other income	2.3	2.2	5.6	1.9	5.3
Selling and distribution costs	(20.4)	(50.1)	(48.3)	(19.7)	(22.2)
Administrative expenses	(6.7)	(10.7)	(15.0)	(5.4)	(9.1)
Other expenses	(3.0)	(8.5)	(3.8)	(0.3)	(0.7)
Finance costs	(0.9)	(5.7)	(13.4)	(5.7)	(7.4)
Profit before tax	26.4	107.2	176.7	80.7	111.7
Tax	(3.1)	(11.5)	(20.0)	(7.6)	(12.1)
Profit for the period	23.2	95.7	156.7	73.1	99.6
Attributable to					
Equity holders of the company	18.5	80.7	156.7	73.1	99.6
Minority interests	4.8	15.0	-	-	-
Dividends	-	-	-	-	-
EPS - basic (HK\$)	0.026	0.204	0.224	0.104	0.142

Source: Company data