

## Sage International

### High-end funeral service provider

to summarize...

- To capture fast growing opportunity from quality cemetery projects
- Projects on hands include Suzhou, Zhaoqing and Bijie Cemetery
- Solid management team and participation of AXA Private Equity
- Currently loss-making yet management expects to turnaround
- Expect reasonable steady return over gradual sales of plots and niches
- Value of Sage heavily depends on pace of appreciation of plots and niches

**Engaging in funeral, cremation and cemetery services.** In Sep 2010, the listco acquired the first cemetery asset and entered cemetery business by RTO. Subsequently, the company changed its name to Sage International from Info Comm and acquired additional projects. Sage was in the progress of developing a portfolio of cemetery assets targeting mid-to-high end market. The management targets to grow Sage through a series of acquisitions. Note that the barrier to entrance of the business is relatively high. Normally State-owned Assets Supervision and Administration Commission of the State Council (SASAC) would not grant licenses especially to non-PRC individuals. Under the leadership of Chairman Andy Chui Bing Sun, Sage and management together holds 75% of Suzhou (Jiangsu) Cemetery, while Sage alone holds 70% of Huaiji (Guangdong) Cemetery as well as a 60% JV of Bijie Cemetery (Guizhou).

**Table 1. Current cemetery assets of Sage**

Name of project	Interest	Type of business	Available site
Suzhou, Jiangsu	37.5%	Cemetery	0.20m m <sup>2</sup>
Huaiji, Guangdong	70.0%	Funeral, Cremation & Cemetery	0.13m m <sup>2</sup>
Bijie, Guizhou	60.0%	Cemetery	0.13m m <sup>2</sup>

Source: SBI E2-Capital

**Solid management team and participation of AXA Private Equity.** The company has strong management team and shareholder base. Andy Chui Bing Sun, Chairman and CEO, has excellent political and business network in China and HK. Richard Connell, who is an advisory member to the board last month, served as Chairman of Dignity (DTY LN), Britain's largest single provider of funeral-related services. Master Yeung Tin Ming advises the company on "Feng Shui" matters and cemetery design. In fact, in Jan this year, AXA Private Equity invested in Sage through US\$12.5m 5-years CB with conversion price at HK\$0.787. Upon conversion of CB and warrants by all securities holders, Mr Chui and AXA Private would be the largest 2 shareholders, holding 25% and 24% enlarged shares of the company respectively. Table 2 shows a more detailed breakdown of shareholders of Sage.

**Table 2. Shareholders of Sage**

	Prior to derivative conversion	Upon derivative conversion
Chui Bing Sun, Chairman	10%	25%
AXA Private Equity	0%	24%
Kevin Duan, senior mgmt	12%	12%
Capital VC	17%	8%
Richard Connell, advisor	0%	2%
Public	61%	29%
Total	100%	100%

Source: SBI E2-Capital

<b>Ticker</b>	<b>8082 HK</b>
<b>Rating</b>	<b>Not Rated</b>
Price (HK\$)	1.64
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1.37-2.60
Market cap. (US\$m)	53.2
Daily t/o (US\$m)	0.4
Free float (%)	54.9

#### Financial summary

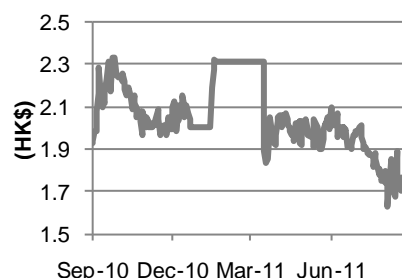
Year to Mar	09A	10A	11A
Turnover (HK\$m)	-	-	19.8
Net Profit (HK\$m)	-	-	(41.6)
EPS (HK\$)	-	-	(0.237)
P/E (x)	-	-	-
P/B (x) pre-CB	-	-	5.0
EV/EBITDA (x)	-	-	-
Yield (%)	-	-	-
ROE (%)	-	-	-
ROCE (%)	-	-	-
N. Gear. (%)	-	-	32.8

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 (%)	5.9	(6.9)	(17.5)
Actual price changes (%)	(6.3)	(20.0)	(20.4)



Source: Bloomberg

#### Research Team

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**Business model.** Sage setups area for plots, columbarium, roads and facilities in each of its cemeteries. The company is to provide burial plot and niches for cases after cremation. In compliance with regulations in China, the company sold leasing contracts for both plots and niches for 20-year terms and collected 20-year leasing fee upfront. For high-end market such as Suzhou Cemetery, revenue per plot and that per niche are both high. For plots, normally each plot occupies 1m<sup>2</sup> area and corresponding revenue would be RMB60,000+ per plot, which accounts for 20-year land usage fee, architecture fee, landscape fee, service fee and management fee. While for niches, corresponding revenue would be RMB4,000+ per niche, which includes niche price and management fee. That said, taking into account direct cost associated, gross profit margin could be between 60% and 80%, which is in line with high end segment of the industry. For instance, NV Multi Corp (NVMULTI SP) and its subsidiary Nirvana Memorial Park, which are largest bereavement care company in Asia and the world's largest privatized memorial park respectively, enjoyed ~60% gross margin. While only a small portion of Suzhou Cemetery and Huaiji Cemetery are sold, Sage is currently loss-making. The auditor of the company is Parker Randall CF.

**Table 3. Summary on P&L and balance sheet items (continuing operations)**

HK\$m	FY03/11A	Q1 FY03/12A
Revenue	19.8	2.7
Gross profit	3.2	2.2
Reported net loss	(34.9)	(9.1)
Total assets	158.7	-
Goodwill	126.8	-
PP&E	14.1	-
Cash and cash equivalent	6.0	-
Total liabilities	98.2	-
CB	44.6	-
Other borrowings	40.4	-
Total equity	60.5	-
Shareholders' equity	67.3	-

Source: SBI E2-Capital

**Case study of Suzhou Cemetery.** The management indicates that the site is at hillside location surrounded on 3 sides by water, which is of excellent "feng shui". For a total available land of 0.2m m<sup>2</sup> in Suzhou Cemetery, 0.07m m<sup>2</sup> is developed and being acquired by the company. Acquisition cost was HK\$107.65m, including HK\$67.65m CB and HK\$40.0m cash, for 37.5% effective controlling interest. Currently, the developed area has 3 columbarium providing 300,000 niches as well as 180,000 burial plots, only 7%-8% was sold. While it is 120km from Shanghai and 80km from Wuxi, it represents a good opportunity to capture customers in Metropolitan areas. To sell the remaining 92%, total accumulative sales revenue is up to RMB11b and net profit up to RMB2.8b at 25% net margin at current pricing, of which the company is entitled to 37.5% interest. While in 2010, annual deaths in Shanghai and Suzhou were 173,592 with cremation rate of 95%+. The management targets to capture 0.5% market share in the first year and eventually 1.0% in 3 years. Table 4 shows our consolidated profit estimation for Suzhou Cemetery with 0.5% market share to Shanghai and Suzhou market. Note that management indicates bull sales mix is more likely for first few years as difference in plots fee and niches fee may not be as significant as it seems.

**Table 4. Profit model of Suzhou Cemetery at 0.5% market share to Shanghai and Suzhou market**

RMBm	Bull sales mix	Intermediate sales mix	Bear sales mix
Total number of sales from Suzhou Cemetery	868	868	868
Number of sales of burial plot	868	434	0
Sales revenue of burial plot	52.1	26.0	0.0
Number of sales of niches	0	434	868
Sales revenue of niches	0.0	1.7	3.5
Total sales revenue from Suzhou Cemetery	52.1	27.8	3.5
Estimated gross profit margin	60%	60%	60%
Gross profit from Suzhou Cemetery	31.2	16.7	2.1
Estimated other operating cost	15.0	15.0	15.0
EBT / LBT	16.2	1.7	(12.9)

Source: SBI E2-Capital

**Case study of Huaiji Cemetery.** The management indicates it is a one-stop funeral service provider that monopolizes Huaiji County, Zhaoqing City for its 1.1m population with annual death rates of 7,000 to 8,000 cases. For a total available land of 0.13m m<sup>2</sup> in Huaiji Cemetery, 0.02m m<sup>2</sup> is developed and being acquired by the company. Acquisition cost was merely HK\$17.8m cash for 70% effective controlling interest. Currently, the developed area has 1 columbarium providing 100,000 niches as well as 20,000 burial plots, only 7%-8% was sold. At RMB5,000 per plot and RMB500 per niche, to sell the remaining 92%, total accumulative sales revenue is up to RMB138m and net profit up to RMB28m at 20% net margin at current pricing, of which the company is entitled to 70% interest. While in 2010, annual death in the County was 7,000 to 8,000. The management targets to capture 30% market share in the first year and eventually 60% in 7 years. Table 5 shows our profit estimation for Huaiji Cemetery with 30% market share to begin with.

Table 5. Profit model of Huaiji Cemetery at 30% market share in the County

RMBm	Bull sales mix	Intermediate sales mix	Bear sales mix
Total number of sales from Suzhou Cemetery	2,100	2,100	2,100
Number of sales of burial plot	4,200	1,050	0
Sales revenue of burial plot	21.0	5.3	0.0
Number of sales of niches	0	1,050	2,100
Sales revenue of niches	0.0	0.5	1.1
Total sales revenue from Suzhou Cemetery	21.0	5.8	1.1
Estimated gross profit margin	60%	60%	60%
Gross profit from Suzhou Cemetery	12.6	3.5	0.6
Estimated other operating cost	10	10	10
EBT / LBT	2.6	(6.5)	(9.4)

Source: SBI E2-Capital

**Our view.** The counter is currently trading at 5.0x P/B prior to CB conversion. We believe the company has solid management that could identify quality projects and promote growth for the company through acquisitions. Upon acquisitions of undervalued projects, NAV of the company should increase accordingly. Theoretically, plots and niches unsold would appreciate as well. On the other hand, while death rates are relatively stable and in short-term Chinese still prefer to stay where they were born after death, we believe cemetery business could capture a stable and steady income at good profit margin. The value of Sage largely depends on whether the management makes an excellent balance between short-term revenue recognition and long-term asset appreciation.

**Risk factors.** Sage strategically acquires undervalued cemeteries and plans to benefits from future cash flows. However, there are risks including 1) pace of plots and niches appreciation not as fast as management anticipated; 2) potentially unfavorable government policy that affects current business planning; 3) execution risks in connect to development and sales that affects market share and cash flows.

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