

## Largest bag manufacturer in Jilin Province

## China Industrials

### DeTeam (8112 HK, HK\$1.57)

### Not Rated

**Company background.** Formerly known as Angels Technology, DeTeam is engaged in the production and sales of woven plastic bags through its 100.0%-owned subsidiary Yicheng Packaging. It returned to the black in FY12/06A with a net profit of HK\$10.1m, or HK\$0.038 per share, and a 9.3x surge in turnover to HK\$69.7m, thanks to the four-month contribution of Yicheng Packaging. As of the end of FY12/06A, it was in a net debt position of HK\$4.05m, against shareholders' equity of HK\$21.2m, representing a net debt-to-equity ratio of 19.1%.

**Yicheng Packaging – Jilin's largest bag manufacturer.** The group acquired Yicheng Packaging in August 2006 for HK\$10.0m, or FY12/05A P/E of 5.7x. Based in Changchun, Yicheng was established in 1999 and commenced its full-scale production in 2002. It currently has 425 staff and provides over 50 varieties of bags to manufacturers of corn modified products, animal feed products and amino acid products. Its manufacturing plant covers 17,461 sq m.

**Strategic location.** Jilin is the heart of China's corn production belt, which accounted for 13.0% of the country's corn output in 2005. In 2006, Jilin produced 5.0m tons of modified corn products and over 2.2m tons of modified soya products. Most of the group's clients are renowned corn modified products producers. They include China's second largest corn producer Global Bio-chem (809HK, HK\$3.46, NR).

**Competitive edge.** The woven plastic bag market is highly competitive, due to its relatively low entry barriers. Yicheng's proximity to its clients, well-established production facilities and superior product quality differentiate it from competitors. Traditionally, most bags manufacturers are concentrated in Yantai in Shandong, far from Jilin, where customers are located, so transportation costs are about RMB3.50/unit. Not many bag manufacturers have a daily production capacity that exceeds 100,000 units. Yicheng also holds an export certificate, demonstrating its superior product quality. Last but not least, its management is innovative. For example, they devised ways to combine three different machines into one to increase efficiency.

**Earnings catalysts.** With three eight-hour shifts per day, Yicheng is running at its full production capacity of 50.0m units of 25.0 kg bag per annum. In order to expand and cater to clients' requests for bigger bags, the group is constructing a new manufacturing plant on its original site. After its completion by the end of this year, Yicheng will be able to produce 1.0m 1.0 ton bags per annum. The ASP of 1.0 ton bag and 500.0 kg bag are RMB110.0/unit and RMB70.0/unit, respectively, compared with RMB3.0 per 25.0 kg bag. It allocated HK\$60.0m in its capex for the construction of the plant, which will be financed by bank loans and internal resources.

**Immune to fluctuations in raw material prices.** Its major raw materials are PE and PP. Their prices have been volatile due to fluctuations in the crude oil price. Yicheng was able to transfer higher raw material costs to its customers, as the bags account for a very small proportion of clients' manufacturing costs. Since the content value is much higher than that of the bag, the users are reluctant to take quality risks for tiny cost savings. There is a half-month time lag between raw material cost increases and bag price hikes by Yicheng.

**Prospects.** Major packaging material manufacturers are trading at an average one-year forward P/E of 17.9x and two-year forward P/E of 13.9x. At the closing price of HK\$1.57, the group is trading at FY12/06A P/E of 41.3x. Nevertheless, its historical P/E is not relevant in our opinion, since the group's FY12/06A results reflect only four months of Yicheng's contribution. The group will streamline its business by exiting from the transportation solution system operations, which was left by its old major shareholder. We expect DeTeam to position itself as a peripheral services provider of corn/grain processor and seek related investment opportunities to take advantage of Yicheng's location.

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