

Wealth Glory Holdings

Strategic Resources Trading Hub

to summarize...

- To acquire 100% interest in iron sand concentrate trading company at a consideration of HK\$156.3m announced Feb this year.
- Favourable contract terms, gross profit is locked at US\$3 per tonnes.
- Company repositioned as resources trading company since acquisition of 33% equity interest of a China coal trading company in Sep 2012.
- Upon full completion of the acquisition, two resources trading business may contribute up to HK\$133.0m net profit per annum, two businesses together value up to HK\$362.1m.

Assets to be acquired at consideration HK\$156.3m. On 6 Feb 2013, Wealth Glory entered into the agreement in relation to the acquisition of a newly set up resources trading company. The company is to be engaged in trading of iron sand concentrate with secured off-take agreement with sizable Philippines miners. The acquisition consideration of HK\$156.3m is payable HK\$108m by cash and HK\$48.3m by issue of consideration share to the vendors at price HK\$0.25 (equivalent to 20% premium of pre-announcement closing price HK\$0.208).

Favourable terms, gross profit is locked at US\$3 per tonnes of iron ore supply. Pursuant to the announcement, trading company to be acquired has entered into three off-take agreements with Philippines iron sand suppliers that suppliers agree to sell total 23.5m tonnes of iron sand concentrate (+/- 10% fluctuation) over the period from March 2013 to Dec 2018 and further automatically be extended to Dec 2019 to supply not less than 5m tonnes of iron sand concentrate. Meanwhile, the trading company has entered into the letter of intent (LOI) with PRC customer that the customer has agreement to purchase equal amount of iron sand concentrate under the off-take agreement period. Selling price of concentrate is to be based on the 20% discount of the average daily 62% iron ore concentrate spot price (plus minor adjustment according to the quality of the iron sand concentrate) during the month of the issue of the bill of lading after the completion of loading, whereas the purchase price from suppliers is to be based on the selling price minus US\$3/t. Hence, US\$3/t gross profit is locked.

The acquiring target is value up to HK\$202.8m, consideration represents 23% discount to target NPV. According the management, they expect 0.5m tones and 3m tones of iron sand concentrate to be delivered in the first two years and 5m tones from the third year onwards over the contract period. Based on the locked profit at US\$3/t, the trading company would generate up to HK\$9.3m, HK\$55.7m and HK\$92.8m net profit in the first three years orderly. Based on the discount rate of 25%, the Philippines iron sand trading contract is value up to HK\$202.8m, equivalent to HK\$0.15 per diluted number of share upon completion of transaction. Table 1 shows the trading company earnings estimate and valuation.

Table 1. Financial projection of the acquisition target

HK\$m	FY03/14F	FY03/15F	FY03/16F
Iron sand concentrate (mt)	0.5	3	5
Iron project gross profit	11.7	70.2	117.0
Iron project OPEX	0.8	4.7	7.8
Iron project EBT	10.9	65.5	109.2
Iron project net profit	9.3	55.7	92.8

Source: SBI E2-Capital

Ticker	8269 HK
Rating	Not Rated
Price (HK\$)	0.224
Target Price (HK\$)	-
12m Price Range (HK\$)	0.12 – 0.27
Market cap. (US\$m)	28.7
Daily t/o (US\$m)	0.3
Free float (%)	63.6

Financial summary

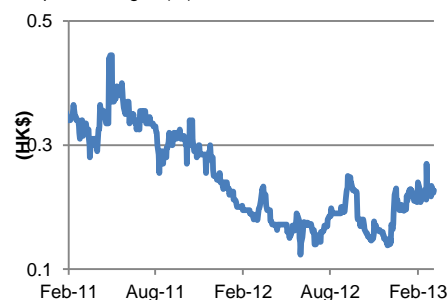
Year to Mar	10A	11A	12A
Turnover (HK\$m)	102	125	104
Net Profit (HK\$m)	17	25	8
EPS (HK\$)	0.02	0.03	0.01
P/E (x)	13	9	28
P/B (x)	9	4	2
EV/EBITDA (x)	16	10	37
Yield (%)	5%	8%	0%
ROE (%)	85%	58%	9%
ROCE (%)	86%	58%	12%
N. Gear. (%)	N. Cash	N. Cash	N. Cash

Source: SBI E2-Capital

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

Price performance

	1m	3m	12m
Relative to HSI (%)	8.6	26.9	1
Actual price changes (%)	3.2	30.2	11.4



Source: Bloomberg

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Table 2. Shareholding Structure of the company.

Shareholders	Current		Immediately after completion of the trading company acquisition and the issue of all the consideration share		Immediately after completion and full conversion of the CB shares	
	No. of Shares (m)	%	No. of Shares (m)	%	No. of Shares (m)	%
Ms. Lee Yau Lin (Chairman)	306.9	30.7	306.9	25.7	306.9	22.9
Mr. Wong Wing Fat (CEO)	35.8	3.6	35.8	3.0	35.8	2.7
Vendors			193	16.2	193	14.4
CB holders					150	11.2
Public	656.5	65.7	656.5	55.1	656.5	48.9
Total	999.2		1,192.2		1342.2	

Source: SBI E2-Capital

Company overview. Listed in 2010, Wealth Glory (WG) was initially engaged as sales and manufacturing of dried and fresh noodles business in China. Majority of the sales revenue was derived from overseas customers (91% of total sales). The noodles business generated a turnover of HK\$104.4m and a net profit of HK\$7.7m in FY03/11A. In September 2012, company has completed an acquisition of 33% equity interest in a coal trading business for a cash consideration HK\$100m. The coal trading company has secured off-take agreements with coal miners as well as supply agreement with SOE to trade up to around 2.5m tonnes of thermal coal per annum over the agreed period. Since then, WG has repositioned as a resources trading company; with its noodles sales and manufacturing business would be maintained to generate stable income. Illustration 1 shows the WG corporate structure prior to the completion of iron sand trading business acquisition:

Illustration 1. Wealth Glory corporate structure



Source: SBI E2-Capital

Coal trading associate. The acquired coal trading entity, namely Royal Dragon (RD), is incorporated in Hong King since Jan 2010, who is in the process of setting up a wholly owned foreign enterprise (WFOE) in China as well as in the process of obtaining a coal operation certificate for coal trading. For the time being, Royal Dragon has entered into 3 years joint corporation agreement with Zhangjiang Energy (ZE) who has an authorised coal trading business license in China valid from 28 June 2010 to 27 June 2013. Under the corporation agreement, RD has granted 2% profit sharing to ZE in relation to the coal trading business to be carried in China as a handling fee for the temporary arrangement. It is estimated that the WFOE structure is to be completed in 6 months.

Illustration 2. Coal supply and purchase agreement structure



Source: SBI E2-Capital

Generate up to HK\$40.2m from share result of associate per annum. The acquired coal trading platform has secured two coal supply off-take agreements with two coal mining companies in Qinghai province in China. Meanwhile, RD has entered into coal purchase agreement with the customer to sell coal that meet the coal supply under the off-take agreement. The customer is a subsidiary of Tianjin Material. Tianjin Material is a state-owned material circulating enterprise with a register capital of RMB2.46b. The customer is one of the coal supplies to the state-owned power plants and coal processing plants located mainly in the Qinghai province (around 180km to 250km away from the coal mines). Details of the coal supply and purchase agreement:

- **Coal Purchase Agreement.** Under the purchase agreement, the customer has agreed to buy an aggregate of **1.25m tonnes** of coal at the indicative contract price (**agreed price**) adjusted for coal quality during the term for first six months and can be renewed subject to the then indicated price and quantities to be agreed by both parties. The indicated contract price is to be determined based on the 1) prevailing market price of the coal, 2) quality of the coal, 3) location of the delivery, 4) payment terms and 5) the quantity of coal ordered. Yet, customer shall pay in advance a deposit of RMB65m to the company.
- **Coal Supply Agreement 1.** Under the supply agreement 1, the supplier has agreed to sell total **6.5m tonnes** of coal over the 2.5 years contact terms commencing from 7 May 2012 and is automatically renew for another 2.5 years unless either parties disagree. The selling price is set at a price discount to the 'agreed price' under the 'coal purchase agreement'. **2.5m tonnes** of coal will price at **RMB25/t** below the agreed price, whereas remaining **4m tonnes** of coal will price at **RMB22/t** below the agreed price. Yet, buyer shall pay in advance RMB80m refundable securities deposit within 3 months after the issue of first delivery.
- **Coal Supply Agreement 2.** Under the supply agreement 2, the supplier has agreed to sell 0.5m tonnes of coal each year a term of 5 years commencing from 7 May 2012 and is automatically renew for another 5 years unless either parties disagree. The selling is set at **RMB120/t** below the agreed price, similar to agreement 1. Buyer shall pay in advance RMB53m refundable securities deposit within 3 months after the issue of first delivery.

Based on the announcement, the determined first indicative contract price (agreed price) is RMB385/t based on thermal coal grading at 5,000 kcal/kg. Under the above coal supply and purchase agreement, the agreed price has priced in the majority of logistic cost and varied in coal grading, while the price difference between sales and purchase are fully hedged. In other words, the price difference between selling and purchase price can fully recognized in gross profit regardless of the change in spot price. Yet, operating expenses are trivial. Table 3 shows our financial forecast of the coal trading business. We expect the acquired associate coal trading business will contribute net of tax profit of HK\$20.1m in FY03/13F and HK\$40.2m in FY03/14F onwards. If we assume contract length of 10 years, the coal trading business value up to HK\$537.2m base on 25% discount rate, i.e. HK\$159.3m attributable to the listco or equivalent to HK\$0.12/ share.

Table 3. Financial forecast of the coal trading business.

RMBm	(Consolidated in 2H FY03/13F)FY03/13F	FY03/14F	FY03/15F	FY03/16F	FY03/17F
Coal supply 1 (mt)	2.6	2.6	2.6	2.6	2.6
Coal supply 2 (mt)	0.5	0.5	0.5	0.5	0.5
	3.1	3.1	3.1	3.1	3.1
Project gross profit					
- supply agreement 1	60.2	60.2	60.2	60.2	60.2
- supply agreement 2	60.0	60.0	60.0	60.0	60.0
	120.2	120.2	120.2	120.2	120.2
Project OPEX	4.1	4.1	4.1	4.1	4.1
PBT	116.1	116.1	116.1	116.1	116.1
Tax	17.4	17.4	17.4	17.4	17.4
Net profit	98.7	98.7	98.7	98.7	98.7
- Net profit to RD	96.7	96.7	96.7	96.7	96.7
- Share result of associate, net of tax to WG	16.1	32.2	32.2	32.2	32.2
- Share result of associate, net of tax to WG(HK\$m)	20.1	40.2	40.2	40.2	40.2

Source: SBI E2-Capital

Our view and valuation. Upon completion of the iron sand trading company acquisition, Wealth Glory would potentially record around HK\$20.1m, HK\$49.5m and HK\$95.9m net profit contribution from resources trading business in FY03/13F, FY03/14F and FY03/15F. In our view, the acquired business has entered into favourable sales and purchase terms with customers and suppliers. Effectively the commodity price risks are fully hedged under the contract agreement, while the logistic costs are mostly transferred to the customers. Hence, gross profit is mostly locked with limited OPEX to be incurred.

Table 3. P&L financial summary

(HK\$m)	FY03/10A	FY03/11A	FY03/12A	1-3Q FY03/12A
Revenue	102.3	125.1	104.4	43.5
Cost of goods sold	(75.4)	(87.6)	(78.8)	(35.5)
Gross profit	26.9	37.5	25.6	8.0
Other income	0.0	0.1	0.5	0.4
Selling and marketing expenses	(3.7)	(2.3)	(3.3)	(1.3)
Administrative expenses	(5.3)	(8.2)	(14.5)	(9.4)
Other operating expenses	(0.5)	(2.1)	(0.6)	(4.4)
Operating profit	17.4	25.0	7.7	(6.7)
Profit before tax	17.4	25.0	7.7	(6.7)
Income tax expense	(0.2)	-	-	-
Total profit	17.2	25.0	7.7	(6.7)

Source: SBI E2-Capital

Table 4. B/S financial summary

(HK\$m)	FY03/10A	FY03/11A	FY03/12A	1H FY03/13A
Non-current assets	2.8	2.4	10.2	110.3
Fixed assets	2.8	2.4	10.2	10.3
DTA	-	-	-	100.0
Current assets	31.8	70.3	105.1	51.3
Inventories	0.7	1.6	0.7	0.6
Trade and other receivables	15.7	20.8	17.2	5.4
Prepayments, deposits and other receivables	0.6	1.1	0.5	6.1
Bank balances and cash	14.8	46.8	86.7	39.1
Current liabilities	10.8	10.5	10.5	9.7
Accruals and other payable	1.4	1.3	2.3	3.2
Trade payable	9.4	9.2	8.2	6.5
EQUITY	23.8	62.2	104.8	151.9
Issued capital	0.2	5.5	6.6	9.5
Reserves	23.6	56.7	98.2	142.4

Source: SBI E2-Capital

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