

Man Sang Int'l



Foray into property development

Not Rated

Key points:

- Major pearl trader with proven track record
- Expanding into property development in China
- Specializing in trade-oriented development projects
- Property to start contributing in FY03/08A
- Consensus estimates of ex-cash FY03/09F P/E at 3.9x

Hong Kong Industrials

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From pearl trader to property developer. China is the world's largest fresh water pearl supplier, and Zhuji, in Zhejiang province, is its major production base. To capitalize on the absence of any well-established trade and exhibition facilities for the local jewelry industry, Man Sang International (Man Sang) is developing China Pearl & Jewelry City (CP&J City), a jewelry trade and exhibition center and physical market place. It will cover 1.2m m² and Man Sang Int'l's 55.0%-owned project company has already acquired land use rights to 296,503.0m² of the designated site. It has completed sold/leased units with an estimated GFA of 32,500.0m². The project will start contributing from FY03/08F, providing sales revenue and stable rental income.

Stock data

| | |
|-------------------|------------------------|
| Price | HK\$0.80 |
| 12 mth range | HK\$0.53-1.95 |
| Market cap. | US\$125.6m |
| No. shares o/s | 1,203.7m |
| Daily t/o, 3 mth | US\$0.11m |
| Free float % | 50.1% |
| Major shareholder | Cheng's Brother- 45.6% |
| Ticker | 938.HK/938 HK |

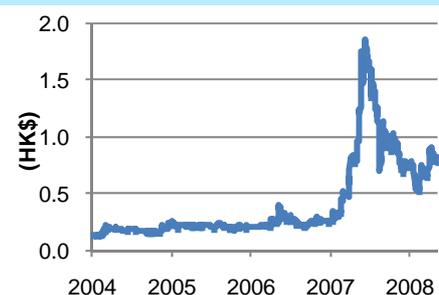
Man Sang's chairman and CEO, Ricky Cheng, is also the founder of China South City, one of China's trade and logistic centers. This gives the company necessary expertise in running specialized property projects for the jewelry industry.

Financial summary

| Year to Mar | 07A |
|----------------------|-------|
| Yield (%) | 3.8 |
| ROE (%) | 9.3 |
| Net gearing (%) | cash |
| Net cash/sh. (HK\$) | 0.295 |
| BV/sh. (HK\$) | 0.68 |
| Consensus EPS (HK\$) | |
| - 03/08F | 0.289 |
| - 03/09F | 0.122 |

The company's historic growth pattern is quite stable due to the steady nature of conventional pearl and jewelry trading. With contributions from property sales and rental income, the company's top line is expected to expand substantially in FY03/08F but its risk exposure will also increase. According to market consensus estimates, the group's FY03/08F net profit will rise 470.4% to HK\$342.0m. The counter is trading at FY03/08F P/E of 2.8x. At end-Dec 2007, the group was in a net cash position of HK\$385.4m.

Price Chart



Company background. Man Sang is engaged in the trading and assembling of pearl, pearls and non-pearl jewellery products. It is one of the world's largest pearl processors and merchants and a one stop shop for more than 600 jewelry merchants. Sales in North America, Europe and other Asia Countries accounted for 29.0%, 39.0% and 32.0% of the group's turnover in FY03/07A, respectively.

The group processes and assembles pearl and non-pearl jewelry products at its own production facilities, Man Sang Industrial City in Shenzhen, China.

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Proven track record. Between FY03/03A and FY03/07A, the group's net earnings increased at a CAGR of 25.0%, against a revenue CAGR of 5.4%, thanks for the expansion in gross and net profit margins as a result of higher sales of high-margin assembled jewelry products. Meanwhile, its return on equity (ROE) rose from 6.0% to 9.3%

Margin expansion. The company's gross profit margin improved from 25.1% in FY03/03A to 33.6% in FY03/07A. In FY03/07A, assembled jewelry products generated 51.0% of total turnover, from 46.0% in FY03/06A, while pearl trading generated 48.0%, from 53.0% in FY03/06A. As a result, its gross margin expanded to 33.6% from 27.8% in FY03/06A. The company uses gems to assembly jewelry, which ensures high gross margins. With all design and assembly done at its own facilities in China, manufacturing overheads are low. To protect itself from surging raw material costs, the group bases its ASPs on raw material prices on the day of order placement.

High-margin trading business. The pearl trading business has been commanding relative high gross margins as well since suppliers (pearl cultivators) offer Man Sang discounts because the company settles its purchases in cash. However, to make procurement in cash, the group has to maintain high level of cash as working capital.

Structure of the property vehicle. The company acquired 49.0% in the project development company of CP&J City in Feb 2006 for HK\$49.0 and an additional 6.0% for HK\$60.0m in Apr 2007. Since the shareholders finance the project company with a kind of a shareholder loan, they can recoup their investment and share of profit once the project company reports positive free cash flow. Other shareholders of the project company include Zhejiang Shanxiahua Pearl Co Ltd, Zhejiang Ruan's Pearl Holdings Co Ltd, Zhejiang Grace Pearl Jewellery Co Ltd, Zhejiang Sanshui Jewellery Co Ltd, Zhejiang Tears of Angel Jewellery Co Ltd and Dexing Pearl Co Ltd.

Strategically located. CP&J City is located in Shanxiahua town, Zhuji, within the world's sixth most prosperous urban cluster, the Yangtze Delta. With 16 cities and the total population of more than 200.0m, the Yangtze Delta covers Shanghai, Jiangsu province and Zhejiang province. In 1H 2007, their GDPs grew about 13.0% YoY, 15.0% and 14.7% to RMB556.2b, RMB1,175.4b and RMB834.4b, respectively. The weighting of the tertiary industry in the regional GDP has been increasing from 36.2% to 41.7% and 51.4% in 2007. Thanks to the robust economy, per capita annual disposable income of the urban population increased 16.6% YoY to RMB11,077.0 in Shanghai, 11.8% YoY to RMB11,235.0 in Jiangsu and 14.7% YoY to RMB12,278.0 in Zhejiang in the first eight months of 2007. In the same period, retail sales rose 17.0% YoY to RMB503.7b in Jiangsu, 16.2% to RMB397.2b in Zhejiang and 14.3% to RMB252.8b in Shanghai.

Established in 1970, freshwater pearl farming has earned Zhuji the title of China's "Capital of Pearl". China accounts for more than 70.0% of the world's freshwater pearl output, with Shanxiahua accounting for 73.0%, thanks to its suitable weather (substantial difference in summer and winter temperatures) and geographic (lake) conditions. A range of peripheral industries such as processing and jewelry assembling has helped to turn Zhuji into a major pearl trading center, accounting for about 90.0% of China's freshwater pearl trade.

Zhuji is 250.0km or a two-hour train journey from Shanghai. Once the planned Hu-Hang Maglev Railway is completed in the future, the trip will take about 30 min. Zhuji is also connected by the Hang-Jin Expressway, Hu-Hang Expressway and other major national highways. Shanghai Pudong International Airport, Hangzhou Xiaoshan International Airport, Yiwu Airport and Ningbo Dongshe International Airport are located within a 200.0km radius of Zhuji.

Jewelry trading center. CP&J City positions itself as the world-class jewelry trading and exhibition center in China. With its total planned site area of 1.2m m² and total investment of RMB3.0b the project is divided into five major zones, trade, exhibition, industrial park, commercial and supporting. A multi-complex building, shopping mall, two major jewelry markets, an exhibition hall, residential project, hotel and serviced apartment building will be built on the site in phases.

Contribution from CP&J. The group's 55.0%-owned project company has acquired 296,503.0m² of the site for RMB223.5m and will add 73,060.0m² in the near future, bringing the total to 369,563.0m² for the development of the Phase I market place, industrial park, multi-purpose building and residential block. The project company developed 168,552.0m² into Phase I market with an effective GFA of 129,545.0m² (gross GFA: 168,552.0m²), which was opened in Apr 2008. We estimate all-in development costs of Phase I at about HK\$630.0m, or HK\$4,848.0/m². By end-1Q 2008, about 16,500.0m² of GFA at Phase I was sold at the

ASP of about HK\$15,849.0/m² and about 16,000.0/m² leased at monthly rate of HK\$105.0/ m². Excluding land appreciation tax (LAT) and other non-cash items but including business tax, the development margin of the saleable area at Phase I is estimated at about 64.0%. Including LAT, the development margin is estimated at 37.9%. We expect Phase I to boost the company's bottom line by about HK\$30.0m in FY03/08F. However, there is a number of uncertainties such as LAT and a revaluation gain by the project company.

Gross value of CP&J. The residual GFA at Phase I is estimated at 97,045.0m² currently. Assuming the all-in development cost per m² at HK\$4,848.0, ASP/m² at HK\$15,849.0, and LAT at 17.4% of the total value of the residual units at Phase I, the gross asset value is estimated at about HK\$800.0m. However, since the project company's gearing ratio is unknown at the moment, we cannot estimate the net asset value of the project.

Development in the pipeline. The project company is developing another 100,000.0m² of the site. Under the blueprint, 41,000.0m² is earmarked for an industrial park with four five-story blocks, 26,000.0 m² for a 12-floor multi-purpose building, and 33,000.0m² for a 21-floor residential block and 2. They will be completed this June, July and 1H09, respectively.

Table 1: Summary of development of Phase I CP&J City

| | Phase I market | Industrial park | Multi-complex building | Residential area |
|--|----------------|-------------------------------|------------------------|--------------------|
| Site area (m ²) | 160,000.0 | 41,000.0 | 26,000.00 | 33,000.00 |
| Salesable GFA (m ²) | 129,456.0 | 41,000.0 | 26,000.00 | 33,000.00 |
| Number of units | 2,380.0 | 4 blocks of 5-story buildings | 12-floor buildings | 21-floor buildings |
| Estimated development cost (RMB/m ²) | 4,000.0 | 2,000.0 | 3,000.00 | 3,000.00 |
| Estimated completion date | Mar-08 | Jun-08 | Jul-08 | 1H09 |
| Sales/leasing date | Aug-07 | 4Q 08 | 4Q 08 | 1H09 |

Source: Company, SBI E2 Capital

Unique. Specialized complex development projects, such as trade and exhibition centers, logistic centers and industrial parks, are vital to a regional economy. The Dalian Tiandi Software Hub, co-developed by SOCAM, Shui On Land and Yida Group and Cyberport developed by PCDP are good examples. They cover large areas, are developed in phases, carry relative large development costs and are supported by local industries. For example, Dalian Tiandi Software Hub will be developed in 10 phases with total investment of US\$3.0-4.0b.

Table 4: Counterpart comparison

| Name of trade center | Location | ASP (RMB/m ²) | Average monthly rental rate (RMB/m ²) |
|------------------------|-----------|---------------------------|---|
| Jieyang Market Center | Chaozhou | 20,000.0 -100,000.0 | 1,300.0-1,400.0 |
| Pingzhou Market Center | Guangzhou | Not for sale | about 200.0 |
| Calfu Building | Yiwu | 100,000.00 | about 100.0 |
| Yiwu Futian Market | Yiwu | Not for sale | 200.0-300.0 |

Source: SBI E2-Capital

Quarterly results. US-listed Man Sang Holdings Inc, which owns about 41.1% of Man Sang Int'l, saw its 3Q FY03/08F net profit increase 33.1% YoY to HK\$11.4m. in the first nine months of FY03/08F, its bottom line rose 48.5% YoY to HK\$49.4m, representing 82.5% of the group's net profit of HK\$60.0m for FY03/07A.

Financial position. At end-Dec 2007, the group was in a net cash position of HK\$385.4m. In Jul 2007, it issued and allotted 200.0m new shares at HK\$1.48 each raising gross and net proceed of HK\$296.0m and HK\$289.1m, respectively. Currently, the company has 1,203.7m shares outstanding.

Valuation. Based on FY03/07A net profit of about HK\$60.0m and the total issued share capital of 1,203.7m, Man Sang Intl is trading at historical P/E of 16.1x. Its net profit is expected to surge thanks to its property development business and, according to market consensus estimates, hit HK\$342.0m in FY03/08, up 470.4% YoY. Based on consensus forecasts, Man Sang is trading at ex-cash (cash/share at HK\$0.32 as of end-Dec 2007) FY03/08F P/E of 1.7x and FY03/09F P/E of 3.9x. Whether the company can sustain its bottom line growth depends on the sales and completion schedule of other sections of CP&J City.

| P & L (HK\$m) | 05A | 06A | 07A | Cash Flow (HK\$m) | 05A | 06A | 07A |
|------------------------------|---------------|---------------|---------------|---|-----------------------|--------------|-------------|
| Year to Mar | | | | Year to Mar | | | |
| Turnover | 412.3 | 378.3 | 398.3 | EBIT | 40.7 | 36.0 | 53.8 |
| % chg | 7.9 | (8.2) | 5.3 | Depre./amort. | 6.7 | 7.3 | 7.8 |
| Gross profit | 117.2 | 105.9 | 112.7 | Net int. paid | (0.9) | (6.7) | (9.0) |
| | | | | Tax paid | (5.8) | (9.0) | (5.2) |
| EBITDA | 47.5 | 43.3 | 61.6 | Dividends received | (0.2) | (0.3) | (0.4) |
| Depre./amort. | (6.7) | (7.3) | (7.8) | Gross cashflow | 40.6 | 27.4 | 47.1 |
| EBIT | 40.7 | 36.0 | 53.8 | Chgs. in working cap. | 40.7 | 25.9 | 4.3 |
| Net int. income/(exp.) | 0.9 | 6.7 | 9.0 | Operating cashflow | 81.3 | 53.3 | 51.4 |
| Exceptionals | 0.3 | 4.1 | 4.3 | Capex | (10.0) | (11.8) | (8.9) |
| Associates | - | - | - | Free cashflow | 71.3 | 41.5 | 42.5 |
| Jointly-controlled entit. | - | - | - | Dividends paid | - | - | - |
| Pre-tax profit | 41.9 | 46.8 | 67.2 | Net distribution to MI | - | - | - |
| Tax | 0.1 | (3.8) | (7.2) | Investments | - | (1.7) | (84.9) |
| Minority interests | - | - | - | Disposals | 71.9 | 2.8 | 9.7 |
| Net profit | 42.0 | 43.0 | 60.0 | New shares | - | - | - |
| % chg | 13.0 | 2.3 | 39.5 | Change in loans | (11.6) | - | - |
| Dividends | - | - | 30.1 | Others | 18.8 | 14.6 | 42.5 |
| Retained earnings | 42.0 | 43.0 | 90.1 | Net cashflow | 150.5 | 57.2 | 9.8 |
| EPS (HK\$) - Basic | 0.042 | 0.043 | 0.060 | Net (debt)/cash - Beg. | 78.9 | 229.4 | 286.6 |
| EPS (HK\$) - F.D. | 0.042 | 0.043 | 0.059 | Net (debt)/cash - End. | 229.4 | 286.6 | 296.4 |
| DPS (HK\$) | - | - | 0.030 | | | | |
| No. sh.s o/s (m) - W.A. | 1,000.7 | 1,000.7 | 1,001.2 | Interim Results (HK\$m) | 06A | 07A | |
| No. sh.s o/s (m) - Y.E. | 909.8 | 1,000.7 | 1,003.7 | Six months to Sep | | | |
| No. sh.s o/s (m) - F.D. | 1,000.7 | 1,000.7 | 1,019.6 | Turnover | 193.3 | 210.1 | |
| | | | | % chg | (8.7) | 8.7 | |
| Margins (%) | | | | Profit from operations | 27.2 | 37.8 | |
| Gross | 28.4 | 28.0 | 28.3 | Interest expenses | - | - | |
| EBITDA | 11.5 | 11.5 | 15.5 | Associates | - | - | |
| EBIT | 9.9 | 9.5 | 13.5 | Jointly-controlled entit. | - | - | |
| Pre-tax | 10.2 | 12.4 | 16.9 | Pre-tax profit | 27.2 | 37.8 | |
| Net | 10.2 | 11.4 | 15.1 | Tax | (2.5) | (4.4) | |
| | | | | Minority interests | - | 4.6 | |
| | | | | Net profit | 24.7 | 38.0 | |
| | | | | % chg | 3.1 | 53.8 | |
| | | | | EPS (HK\$) - Basic | 0.025 | 0.035 | |
| | | | | DPS (HK\$) | - | - | |
| | | | | | | | |
| Balance Sheet (HK\$m) | 05A | 06A | 07A | Shareholding Structure | | | |
| Year to Mar | | | | | Shares o/s (m) | % | |
| Fixed assets | 218.0 | 229.9 | 237.2 | Man Sang Intl. (BVI) | 494.4 | 41.1 | |
| Intangible assets | - | - | - | MCheng Chung Hing | 106.8 | 8.9 | |
| Other LT assets | 3.4 | 6.8 | 90.7 | Cheng Tai Po | 76.1 | 6.3 | |
| Cash | 229.4 | 286.6 | 296.4 | Public | 526.4 | 43.7 | |
| Accounts receivable | 54.6 | 58.5 | 69.2 | Total | 1,203.7 | 100.0 | |
| Other receivables | - | 1.5 | 1.6 | | | | |
| Inventories | 82.7 | 55.9 | 46.2 | Background | | | |
| Due from related co.s | - | - | - | Man Sang International is engaged in the trading and assembling of pearl, pearls and non-pearl jewellery products. The group processes and assembles pearl and non-pearl jewellery products in its self-owned production facilities in Shenzhen, China. Further, via-its 55.0%-owned project company, the company develops China Pearl & Jewellery City, the pearl and jewellery trading-oriented property development project in Zhuji, Zhejiang Province. | | | |
| Other current assets | 8.4 | 15.6 | 8.4 | | | | |
| Total assets | 596.4 | 654.7 | 749.7 | Key Ratios | 05A | 06A | 07A |
| Accounts payable | (30.6) | (33.3) | (39.9) | Net gearing (%) | Cash | Cash | Cash |
| Other payable | - | - | - | Net ROE (%) | 7.6 | 7.4 | 9.3 |
| Tax payable | (1.7) | - | (0.2) | EBIT ROCE (%) | 7.4 | 6.2 | 8.4 |
| Due to related co.s | - | - | - | Dividend payout (%) | - | - | (50.2) |
| ST debts | - | - | - | Effective tax rate (%) | (0.2) | 8.2 | 10.7 |
| Other current liab. | - | - | - | Net interest coverage (x) | na | na | na |
| LT debts | - | - | - | A/R turnover (days) | 48.4 | 54.6 | 58.5 |
| Other LT liabilities | (11.2) | (13.0) | (30.6) | A/P turnover (days) | 27.1 | 30.8 | 33.5 |
| Total liabilities | (43.4) | (46.2) | (70.6) | Stock turnover (days) | 102.3 | 92.8 | 65.2 |
| Share capital | 91.0 | 100.1 | 100.4 | | | | |
| Reserves | 462.0 | 508.4 | 578.7 | | | | |
| Shareholders' funds | 553.0 | 608.4 | 679.0 | | | | |
| Minority interest | - | - | - | | | | |
| Total | 553.0 | 608.4 | 679.0 | | | | |
| Capital employed | 553.0 | 608.4 | 679.0 | | | | |
| Net (debt)/cash | 229.4 | 286.6 | 296.4 | | | | |