

Hong Kong/ China

Sector

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Defense becomes the best form of offense



Demand for defensive stocks. Demand for “defensive” stocks is currently rising, fuelled by the prospect of a global economic slowdown, extreme market volatility, credit de-leveraging and investors’ heightened risk aversion. Though investors invest in small/mid caps generally for their high growth profile, dividend payout ratio and dividend yield have become more of a consideration. The saying “cash is king” is now coming to mean “cash-in-hand is king”.

Industry characteristics vital. The outlook for China’s once unstoppable economic engine is clouded amid the weakening external demand, the country’s slowing property sector and the ripples of the global financial crisis on the mainland’s banking sector. Thus, it is imperative that our stock picks have some exposure to industries that are robust enough to weather or even benefit from any potential economic slowdown in China.

Defensive stocks can outperform peers. Our mini portfolio focuses on companies that can offer at least some of the following: 1) strong net cash positions; 2) balance of strong growth with dividend yield; 3) exposure to secure industries, with strong earnings visibility; 4) good solid track records and 5) good cash conversion efficiency relative to its industry peers. We have identified three counters (two rated calls and one conviction call) which, in our view, are good picks in this time of extreme uncertainty. We also note that historically, such stocks tend to outperform peers in a bearish market.

SBI E2-Capital’s defense strategy investment list

Company	Ticker	Recomm.	Share price*	Target price	Upside (%)
China Green	904 HK	BUY	4.58	8.17	78
Shandong Weigao	8199 HK	NR	9.19	n/a	n/a
Sino Techfibre	SINOT SP	BUY	0.20	0.70	250

* All prices are as of market close of 10 Oct 2008

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Defense becomes the best form of offense

Growing demand for defensive stocks

The current economic slowdown, extreme market volatility, credit de-leveraging and investors' increased risk aversion have fuelled demand for "defensive" stocks. Though investors invest in small/mid caps generally for their high growth profile, dividend payout ratio and dividend yield have become more of a consideration. The saying "cash is king" is now coming to mean "cash-in-hand is king". Investors' focus on capital appreciation has given way to capital preservation.

Industry characteristics vital

The outlook for China's once unstoppable economic engine is clouded amid the weakening external demand, the country's slowing property sector and the ripples of the global financial crisis on the mainland's banking sector. Thus, it is imperative that our stock picks have some exposure to industries that are robust enough to weather or even benefit from any potential economic slowdown in China. These sectors include healthcare, agriculture and domestic consumption staples. Their resilience is a result of favourable policies as the government's focus shifts to maintaining economic growth and boosting private spending.

Defensive stocks can outperform

We also note that historically, defensive stocks outperform peers amid bearish market sentiment as investors searching for a safe haven place a premium on their earnings visibility.

Selection criteria

In putting together our mini portfolio, we vetted the companies for one or a combination of the following:

- ❑ *Strong net cash position* – the current global credit crunch increases financing costs, requiring long-term balance sheet strength;
- ❑ *Balance of growth and dividend yield* – Our mini portfolio has a average 3-year CAGR of 29.1% and average yield of 3.9%;
- ❑ *Defensive industries* – degree of exposure to secure industries which remain robust in any slowdown in China's economic growth. This leads to improved earnings visibility;
- ❑ *Solid track record* – demonstrated continuous growth over the past few years, a sign of good corporate management and effective strategy execution;
- ❑ *Good cash conversion efficiency* – the companies selected generally outperform their peers in their industry with respect to cash conversion cycle.

Our picks

Our picks are **China Green (904 HK, HK\$4.58, BUY)**, a fresh agricultural produce and organic farming specialist, and **Sino Techfibre (SINOT, S\$0.20, BUY)**, a PU synthetic leather and microfibre synthetic leather maker with exposure to China's "uniformed" groups. Our mini portfolio also includes a conviction BUY call, **Shandong Weigao (8199 HK, HK\$9.19, NR)**, China's largest medical equipment supplier with an extensive distribution network.

Company Profiles

China Green

Green land

Key points:

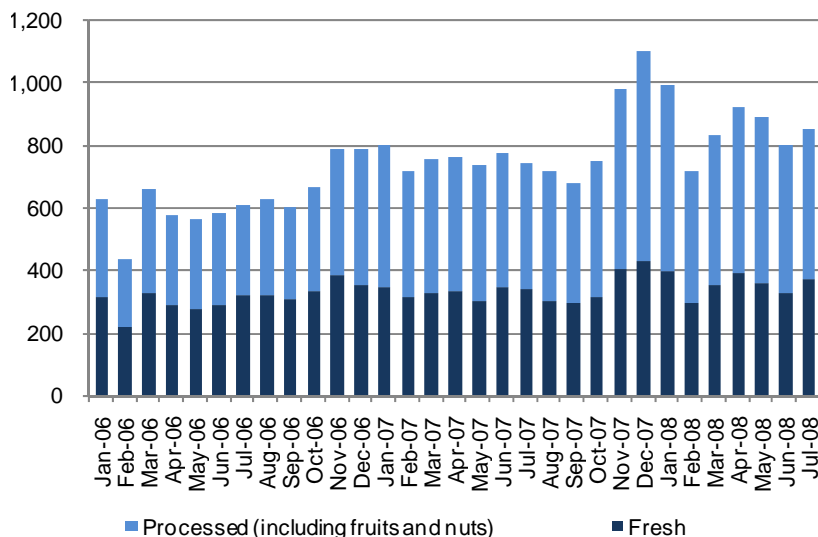
- Player in a defensive market.
- Steady growth of China's vegetable exports.
- Growth from geographical expansion.
- Booming green beverage & instant noodle business.
- Increased budget for A&P and R&D.
- BUY with target price at HK\$8.17.

Industry overview

Inelastic demand. We believe that in general food demand is little affected by macro environment changes. With rising food safety awareness, especially after the recent melamine-tainted milk scandal in China, we expect favorable market sentiment towards quality food producers.

Healthy market. In 2007, China's exports of fresh and processed vegetable products (including fruits and nuts) increased 8.9% (to US\$4,044.7m) and 43.9% (to US\$5,442.5m), respectively. Despite unfavorable effects of snowstorms (February) and the Sichuan earthquake (May), they increased 7.2% (to US\$2,475.5m) and 18.5% (to US\$3,519.3m) in the first seven months of 2008.

Chart 1: China's export of vegetables (US\$m)



Source: Ministry of Commerce of the PRC (Department of Foreign Trade), SBI E2-Capital

Company discussion

Fresh produce. We expect steady high single-digit growth of this segment in the future, backed by organic growth of the overseas market and the company's domestic expansion. A logistic centre launched in May 2008 in Shanghai will serve mainly supermarkets, central kitchen and fast food restaurants chains, helping CG to penetrate in the end-user market.

Processed products. The processed product (including pickles)

BUY (unchanged)

China Agriculture

Mon, 13 Oct 2008

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Stock data

Price	HK\$4.58
Target price	HK\$8.17 (+78%)
12 mth range	HK\$4.15 -11.30
Market cap.	US\$520.4m
Daily t/o, 3 mth	US\$1.5m
Free float %	49.6%
Ticker	0904.HK/0904 HK

Financial summary

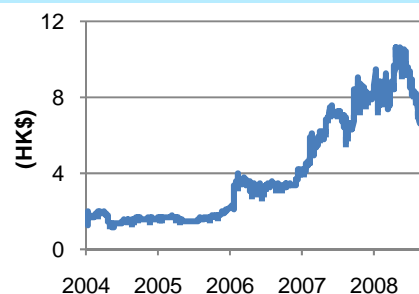
Year to Apr	06A	07A	08F	09F	10F
T/O (RMBm)	954.1	1,267.1	1,664.2	2,095.8	2,552.4
NP (RMBm)	346.0	471.0	515.2	582.1	700.8
EPS (RMB)	0.448	0.538	0.583	0.658	0.793
EPS Δ%	20.1	20.1	8.4	12.9	20.4
P/E (x)	9.0	7.5	6.9	6.1	5.1
P/B (x)	1.85	1.57	1.34	1.14	0.99
EV/EBITDA (x)	6.5	4.3	4.0	3.2	2.0
Yield (%)	2.4	3.1	3.9	4.8	5.7
ROE (%)	24.6	24.0	21.0	20.1	20.9
ROCE (%)	21.7	19.9	17.0	18.1	23.4
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-0.6	-20.3	6.8
Actual price changes (%)	-26.5	-46.0	-44.7

	09F	10F	11F
Consensus EPS (RMB)	0.600	0.725	0.780
Previous forecasts (RMBm)	515.2	582.1	700.8
Previous EPS (RMB)	0.583	0.658	0.793

Price Chart



segment remains robust and is driven mainly by the company's geographical expansion worldwide. According to the management, expansion attempts in Europe and the Middle East generated positive results, and are likely become a major driver in FY04/09F.

Beverages & instant noodles. In view of the positive market response, CG plans to expand its beverage & instant noodles business beyond its traditional markets of Fujian and Jiangxi provinces. Existing production facilities have been fully utilized. The company will add new capacity in FY04/09F, including 23,000tonnes of beverage (to 51,000tonnes) and 16,000tonnes of instant noodles (to 24,000tonnes).

Organic farming. The company allocated 10,000 mu (666.7 hectares) in Hubei for organic farming. The operation will be launched in 2011 because three years are needed to get the land qualified for growing organic plants.

Earnings forecasts. Turnover rose 32.8% YoY to RMB1,267.1m in FY04/08. The gross margin widened 1.2pcp to 53.4% mainly due to sales mix changes. Net profit increased 36.1% to RMB471.0m. For FY04/09F, the company budgets RMB92.0m for A&P and RMB40.0m for R&D in FY04/09F. With this substantial potential increase in operating expenses, we estimate its bottom line to go up 9.4% to RMB515.2m based on 31.3% improvement in top line to RMB1,644.2m. Our target price for the counter is HK\$8.17, representing 12.3x FY04/09F P/E. BUY.

Table 1: P&L statement

Y/F 30 Apr (RMBm)	FY07A	FY08A	FY09F	FY10F	FY11F
Turnover	954.1	1,267.1	1,664.2	2,095.8	2,552.4
Cost of sales	(456.2)	(590.5)	(774.7)	(951.7)	(1,147.3)
Gross profit	497.9	676.6	889.5	1,144.1	1,405.0
Other revenue	23.8	58.3	58.9	40.0	36.0
Gain arising from changes in fair value less estimated point-of-sale costs of biological assets	15.2	19.9	23.7	28.6	33.8
Selling and distribution expenses	(92.9)	(125.2)	(192.5)	(267.1)	(306.9)
General and administrative expenses	(83.8)	(119.4)	(173.4)	(218.4)	(240.4)
Operating profit	360.1	510.3	606.2	727.1	927.5
Finance cost	(14.4)	(26.6)	(58.0)	(58.0)	(29.0)
Profit before taxation	345.8	483.7	548.1	669.1	898.5
Income tax	0.2	(12.8)	(32.9)	(87.0)	(197.7)
Net profit	346.0	471.0	515.2	582.1	700.8
EPS - basic (RMB)	0.448	0.538	0.583	0.658	0.793
EPS - diluted (RMB)	0.417	0.506	0.580	0.645	0.785

Source: Company, SBI E2-Capital estimates

P & L (RMBm)	07A	08A	09F	10F	11F	Cash Flow (RMBm)	07A	08A	09F	10F	11F
Year to Apr						Year to Apr					
Turnover	954.1	1,267.1	1,664.2	2,095.8	2,552.4	EBIT	345.3	481.4	566.2	692.1	896.5
% chg	39.0	32.8	31.3	25.9	21.8	Depre./amort.	70.5	94.2	154.8	217.3	244.3
Gross profit	497.9	676.6	889.5	1,144.1	1,405.0	Net int. paid	0.4	2.4	(18.0)	(23.0)	2.0
						Tax paid	0.0	(25.5)	(54.9)	(32.9)	(87.0)
EBITDA	415.8	575.6	721.0	909.4	1,140.8	Dividends received					
Depre./amort.	(70.5)	(94.2)	(154.8)	(217.3)	(244.3)	Gross cashflow	416.2	552.5	648.0	853.5	1,055.8
EBIT	345.3	481.4	566.2	692.1	896.5	Chgs. in working cap.	21.5	34.5	(34.5)	(27.2)	(28.1)
Net int. income/(exp.)	0.4	2.4	(18.0)	(23.0)	2.0	Operating cashflow	437.7	587.0	613.6	826.3	1,027.8
Exceptionals						Capex	(190.9)	(235.0)	(1,016.1)	(849.3)	(110.2)
Associates						Free cashflow	246.9	352.0	(402.5)	(23.1)	917.6
Jointly-controlled entit.						Dividends paid	(83.7)	(103.1)	(141.0)	(174.3)	(209.6)
Pre-tax profit	345.8	483.7	548.1	669.1	898.5	Net distribution to MI					
Tax	0.2	(12.8)	(32.9)	(87.0)	(197.7)	Investments	0.0	(139.5)	0.0	152.8	0.0
Minority interests						Disposals	0.3	0.0	0.0	0.0	0.0
Net profit	346.0	471.0	515.2	582.1	700.8	New shares	43.7	34.6	0.0	0.0	0.0
% chg	27.5	36.1	9.4	13.0	20.4	Others	227.7	124.8	30.2	55.6	(26.4)
Dividends	(91.3)	(125.1)	(159.1)	(194.5)	(229.8)	Net cashflow	434.8	268.9	(513.3)	11.0	681.6
Retained earnings	254.7	345.8	356.1	387.6	471.0	Net (debt)/cash - Beg.	551.1	985.9	1,254.8	741.5	752.5
EPS (RMB) – Basic	0.448	0.538	0.583	0.658	0.793	Net (debt)/cash - End.	985.9	1,254.8	741.5	752.5	1,434.1
EPS (RMB) - F.D.	0.417	0.506	0.580	0.645	0.785						
DPS RMB)	0.109	0.144	0.180	0.220	0.260	Interim Results (RMBm)	06A	07A	08A		
No. sh.s o/s (m) - W.A.	847.0	847.0	884.0	884.0	884.0	Six months to Oct					
No. sh.s o/s (m) - Y.E.	772.5	875.5	883.3	884.0	884.0	Turnover	262.5	387.2	533.7		
No. sh.s o/s (m) - F.D.	864.8	983.1	989.0	992.0	892.8	% chg		47.5	37.8		
						Profit from operations	106.4	148.0	218.5		
Margins (%)						Interest expenses		(6.4)	(1.1)		
Gross	52.2	53.4	53.5	54.6	55.0	Associates					
EBITDA	43.6	45.4	43.3	43.4	44.7	Jointly-controlled entit.					
EBIT	7.0	38.0	34.0	33.0	35.1	Pre-tax profit	106.4	141.5	217.3		
Pre-tax	36.2	38.2	32.9	31.9	35.2	Tax			(9.5)		
Net	36.3	37.2	31.0	27.8	27.5	Minority interests					
						Net profit	106.4	141.5	207.8		
						% chg		33.0	46.8		
						EPS (RMB) - Basic	0.150	0.190	0.240		
						DPS (RMB)	0.040	0.048	0.063		
Balance Sheet (RMBm)	07A	08A	09F	10F	11F	Shareholding Structure				Shares o/s (m)	%
Year to Apr						Sun Shaofeng				413.7	46.8
Fixed assets	475.5	523.4	1,039.6	1,385.4	1,219.4	Kwok Kin Kwok				45.0	5.1
Intangible assets	176.8	265.4	600.7	876.7	899.4	Investco				44.8	5.1
Other LT assets						McCarthy Kent				40.0	4.5
Cash	1,050.5	2,098.0	1,642.7	1,711.7	1,434.1	Others				340.6	38.5
Accounts receivable	50.6	34.7	45.6	57.4	70.0	Total				884.0	100.0
Other receivables											
Inventories	14.3	26.2	49.8	62.7	76.3	Background					
Due from related co.s						Established in 1998, China Green is a vertically-integrated food producer with headquarter in Fujian province. The company has three buesiness segments: fresh produce, processed products and branded beverage and instrant noodle products. The company listed in Hong Kong exchange in 2004.					
Other current assets	73.3	220.1	251.8	119.9	140.5						
Total assets	1,841.0	3,167.8	3,630.3	4,213.8	3,839.7	Key Ratios	07A	08A	09F	10F	11F
Accounts payable	(22.4)	(24.1)	(31.6)	(38.8)	(46.7)	Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Other payable						Net ROE (%)	24.6	24.0	21.0	20.1	20.9
Tax payable	(67.6)	(54.9)	(32.9)	(87.0)	(197.7)	EBIT ROCE (%)	21.7	19.9	17.0	18.1	23.4
Due to related co.s						Dividend payout (%)	26.4	26.6	30.9	33.4	32.8
ST debts						Effective tax rate (%)	(0.1)	2.6	6.0	13.0	22.0
Other current liab.	(0.8)	(6.0)	(6.6)	(7.5)	(9.0)	Net interest coverage (x)	na	na	31.4	30.1	na
LT debts	(64.6)	(843.2)	(901.2)	(959.2)	0.0	A/R turnover (days)	21.2	12.3	8.8	9.0	9.1
Other LT liabilities	0.0	0.0	0.0	0.0	0.0	A/P turnover (days)	7.4	6.7	6.1	6.1	6.1
Total liabilities	(155.4)	(928.2)	(972.3)	(1,092.5)	(253.4)	Stock turnover (days)	8.8	12.5	17.9	21.6	22.1
Share capital	88.9	92.1	92.3	92.3	92.3						
Reserves	1,596.6	2,147.5	2,565.7	3,029.1	3,494.0						
Shareholders' funds	1,685.5	2,239.6	2,658.0	3,121.4	3,586.2						
Minority interest											
Total	1,685.5	2,239.6	2,658.0	3,121.4	3,586.2						
Capital employed	1,750.1	3,082.8	3,559.2	4,080.6	3,586.2						
Net (debt)/cash	985.9	1,254.8	741.5	752.5	1,434.1						

Shandong Weigao

Leader in defensive sector

Not Rated

Key points:

- Three-year bottom line CAGR 67.2%
- Guidance for 50%+ net profit growth
- Operating in the fastest growing subsectors in China's pharmaceutical industry (in Jan-Aug 2008, sales 30.0% YoY)
- Industry consolidation to reinforce its leadership
- Cash infusion of around RMB885.4m from Medtronic expected
- Strong fundamentals with sustained growth momentum
- Good entry point as the counter is trading at 26.7x historical P/E (2-year P/E band of 30.0x-70.0x). In forward value terms, the counter is trading at 18.0x FY12/08F P/E and 12.9x FY12/09F P/E on consensus.

China Medical Devices

Mon, 13 Oct 2008

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Stock data

Price	HK\$9.19
Target price	N/A
12 mth range	HK\$7.32-19.38
Market cap.	US\$1173.7m
Daily t/o, 3 mth	US\$1.5m
Free float %	31.4%
Ticker	8199.HK/8199 HK

Industry overview

Medical equipment - surging subsector. China's medical equipment sector is one of the fastest growing subsectors in the pharmaceutical industry. In Jan-Aug 2008, the subsector grew 30.0% YoY, compared with a 22.2% YoY increase in 2007. The overall pharmaceutical industry grew 27.9% and 24.9% in the same periods.

Defensive sector, with strong government support. Medical equipment is one of our favourite defensive sectors. Chinese government policies continue to promote and underpin its growth, led by the broadening of rural medical coverage and improving urban medical standards. According to the Ministry of Finance (MoF), the central government invested RMB66.4b in China's healthcare industry in 2007 and plans a budget of RMB83.1b in 2008, up 25.2% YoY. The sector's consolidation is starting to centralize products and distribution power within the leaders and creating export opportunities.

Company fundamentals

Company background. China's leading medical device maker, Shandong Weigao (Weigao), manufactures: 1) consumable medical products, including syringes, blood bags, infusion sets, dental and anesthetic products, and blood sampling products; 2) orthopaedic products; 3) blood purification consumables, drug-eluted stents (DES) and PVC granules.

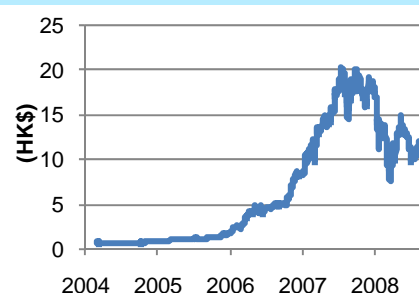
High growth prospects. Between FY12/04A and FY12/07A, Weigao recorded a three year top line CAGR of 39.0% to RMB 1,095.1m and bottom line CAGR 67.2% to RMB308.1m. In 1H FY12/08A, its revenue increased 48.2% YoY to RMB697.8m and net profit 72.0% YoY to RMB190.7m. The gross margin widened 4.1pcp YoY to 46.9% and net margin 3.8pcp YoY to 27.3%. The company expect demand to strengthen and has guided for 50%+ net profit growth.

Consumables. A large proportion of Weigao's product portfolio are consumables, which will be less affected by potential decreases in investment spending, should China's economic growth moderate. Consumable medical products have been the cash cow underpinning Weigao's transition to the manufacture of high-end

Financial summary

Year to Dec	05A	06A	07A	08F	09F
T/O (RMBm)	570.0	786.9	1,095.1	1,507.5	2,166.3
NP(RMBm)	101.2	170.9	308.1	434.0	609.2
EPS (RMB)	0.113	0.177	0.312	0.449	0.626
EPS(Δ%)	37.5	57.2	76.5	43.9	39.4
P/E (x)	74.2	47.2	26.7	18.0	12.9
P/B (x)	13.3	11.5	6.3	3.7	2.8
EV/EBITDA (x)	56.4	37.2	24.0	16.6	11.2
Yield (%)	0.4	0.4	0.7	1.4	2.0
ROE (%)	17.9	27.0	30.4	24.5	24.2
ROCE (%)	12.3	16.8	20.2	-	-
N. Gear. (%)	35.0	33.2	cash	-	-

Price Chart



products such as artificial joints and trauma products. Sales of consumable medical products were up 45.7% YoY to RMB531.9m in 1H FY12/08A, accounting for 76.2% of its total sales.

Wide customer network in China. Weigao possesses one of the largest medical equipment distribution networks in China. At the end of 2Q FY12/08A, the company's distribution network spanned 2,817 hospitals, 413 blood stations, 689 other medical units and 1,471 distributors. It covered 80.2% of first tier city hospitals, 23.9% of second tier city hospitals and 6.1% of third tier city hospitals in China. Weigao's future growth will come, in part, from increased penetration into the hospital networks in second and third tier cities.

Established reputation. Weigao is China's leading medical devices manufacturer. It offers superior quality and enjoys low cost advantages compared with overseas brands.

More cash injection from Medtronic. Weigao is presently in a net debt position of RMB161.5m. However, the company is expected to receive around RMB885.4m from Medtronic (MDT US) as part of a 15% equity stake sale to the global medical conglomerate. The deal is expected to close at the end of FY12/08 and the cash infusion will significantly bolster Weigao's balance sheet. The company is expected to benefit from this deal through: 1) technology transfer of Medtronic's medical device technology and tapping into global market by under-taking OEM for Medtronic orthopaedic medical device products; 2) 49:51 JV with Medtronic (started in Sep 2008) to distribute exclusively several of Medtronic's orthopaedic medical device products in China. We are confident that the deal will be completed as the parties have already started cooperating on several fronts (such as the JV), giving a strong indication of commitment.

Valuation. Entrenched as a leader of a defensive sector, and underpinned by its strong top and bottom line growth momentum, we like Weigao's fundamentals. The company is defensive in terms of industry and stock price. We see a good entry point at the moment as the counter is currently trading at 26.7x historical P/E, at the low end its 2-year P/E band range of 30.0x-70.0x historical P/E. In forward value terms, the counter is trading at 18.0x FY12/08F P/E and 12.9x FY12/09F P/E on consensus.

Table 1: P&L

Year to Dec (RMBm)	05A	06A	07A
Turnover	570.0	786.9	1,095.1
Cost of sales	(335.7)	(451.6)	(594.8)
Gross profit	234.3	335.3	500.3
Other net (loss)/income	14.8	18.2	31.5
Selling and distribution costs	(87.4)	(115.4)	(152.7)
Administrative expenses	(40.1)	(59.8)	(88.0)
Operating profit	121.6	178.3	291.1
Financial costs	(17.0)	(21.5)	(17.9)
Share of loss of a jointly controlled entity	(1.5)	32.5	59.0
Share of loss of an associate	(0.5)	-	-
Pre-tax profit	102.6	189.3	332.1
Tax	(0)	(6.7)	(2.7)
Minority interests	(1.4)	(11.7)	(21.2)
Net profit	101.2	170.9	308.1

Source: Company data

P & L (RMBm)	05A	06A	07A	Cash Flow (RMBm)	05A	06A	07A
Year to Dec				Year to Dec			
Turnover	570.0	786.9	1,095.1	EBIT	121.0	177.7	289.3
% chg	39.8	38.1	39.2	Depre./amort.	(23.9)	(43.3)	(47.1)
Gross profit	234.3	335.3	500.3	Net int. paid	(16.4)	(20.8)	(16.2)
				Tax paid	(1.9)	(0.3)	(10.4)
EBITDA	144.9	221.0	336.4	Dividends received	0.0	10.0	11.1
Depre./amort.	(23.9)	(43.3)	(47.1)	Gross cashflow	78.8	123.3	226.7
EBIT	121.0	177.7	289.3	Chgs. in working cap.	(79.7)	(51.3)	(68.0)
Net int. income/(exp.)	(16.4)	(20.8)	(16.2)	Operating cashflow	(1.0)	72.0	158.8
Exceptionals	-	-	-	Capex	(163.3)	(110.4)	(282.9)
Associates	(0.5)	0.0	0.0	Free cashflow	(164.3)	(38.3)	(124.1)
Jointly-controlled entit.	(1.5)	32.5	59.0	Dividends paid	(20.4)	(38.6)	(69.1)
Pre-tax profit	102.6	189.3	332.1	Net distribution to MI	-	-	-
Tax	(0.0)	(6.7)	(2.7)	Investments	-	-	-
Minority interests	(1.4)	(11.7)	(21.2)	Disposals	5.5	0.8	0.8
Net profit	101.2	170.9	308.1	New shares	74.3	0.0	387.8
% chg	53.6	68.9	80.3	Others	148.1	36.3	(55.2)
Dividends	(28.4)	(31.9)	(58.7)	Net cashflow	43.3	(39.9)	140.4
Retained earnings	72.8	139.1	249.4	Net (debt)/cash - Beg.	111.7	155.0	115.1
				Net (debt)/cash - End.	155.0	115.1	255.6
EPS (RMB) - Basic	0.113	0.177	0.312	Interim Results (RMBm)	06A	07A	08A
EPS (RMB) - F.D.	0.113	0.177	0.312	Six months to Jun			
DPS (RMB)	0.032	0.033	0.060	Turnover	352.5	470.7	697.8
No. sh.s o/s (m) - W.A.	899.0	965.6	986.5	% chg	41.2	33.5	48.2
No. sh.s o/s (m) - Y.E.	899.0	965.6	995.6	Profit from operations	78.2	108.8	184.3
No. sh.s o/s (m) - F.D.	899.0	965.6	986.5	Interest expenses	(9.9)	(11.5)	(12.2)
				Associates			
Margins (%)				Jointly-controlled entit.	4.6	24.6	32.4
Gross	41.1	42.6	45.7	Pre-tax profit	72.9	121.9	204.5
EBITDA	25.4	28.1	30.7	Tax	(2.6)	(2.6)	(14.8)
EBIT	21.2	7.0	26.4	Minority interests	(5.9)	(8.4)	1.0
Pre-tax	18.0	24.1	30.3	Net profit	64.4	110.9	190.7
Net	17.8	21.7	28.1	% chg	61.2	72.1	72.0
				EPS (RMB) - Basic	0.067	0.114	0.192
Balance Sheet (RMBm)	05A	06A	07A	DPS (RMB)	0.020	0.034	0.057
Year to Dec				Shareholding Structure			
Fixed assets	518.2	591.9	816.0		Shares o/s (m)	%	
Intangible assets	0.0	0.0	0.0	Domestic shares	648.2	65.1	
Other LT assets	66.6	142.7	245.5	Atlantis	76.2	7.7	
Cash	177.6	137.5	343.1	JP Morgan	21.1	2.1	
Accounts receivable	250.3	355.8	487.0	Others	250.1	25.1	
Other receivables	-	-	-	Total	995.6	100.0	
Inventories	119.4	166.2	248.9				
Due from related co.s	-	-	-	Background			
Other current assets	0.0	0.0	0.0	Shandong Weigao is a leading medical devices manufacturer in China.			
Total assets	1,132.2	1,394.1	2,140.5	Weigao manufactures: 1) consumable medical products, including syringes, blood bags, infusion sets, dental and anesthetic products, and blood sampling products; 2) Orthopaedic products; 3) blood purification consumables, drug-eluted stents (DES) and PVC granules. Weigao was listed in HK GEM in Feb. 2004.			
Accounts payable	(147.0)	(253.8)	(410.2)				
Other payable	-	-	-	Key Ratios	05A	06A	07A
Tax payable	0.0	(6.4)	(5.4)	Net gearing (%)	35.0	33.2	Cash
Due to related co.s	-	-	-	Net ROE (%)	17.9	27.0	30.4
ST debts	(177.2)	(105.0)	(127.6)	EBIT ROCE (%)	12.3	16.8	20.2
Other current liab.	0.0	0.0	(1.5)	Dividend payout (%)	28.1	18.6	19.1
LT debts	(210.0)	(281.0)	(210.8)	Effective tax rate (%)	0.0	3.6	0.8
Other LT liabilities	0.0	0.0	0.0	Net interest coverage (x)	7.4	8.6	17.9
Total liabilities	(534.2)	(646.3)	(755.5)	A/R turnover (days)	160.3	140.6	140.5
Share capital	96.6	96.6	99.6	A/P turnover (days)	94.1	93.0	110.7
Reserves	469.9	602.2	1,228.2	Stock turnover (days)	129.8	115.4	127.4
Shareholders' funds	566.4	698.7	1,327.8				
Minority interest	31.6	49.1	57.2				
Total	598.0	747.8	1,385.0				
book value per share							
Capital employed	985.2	1,133.9	1,723.4				
Net (debt)/cash	(209.6)	(248.6)	4.6				

Sino Techfibre

Uncovering the beauty beneath

Key points:

- Unique exposure to China's uniformed groups mitigate concerns about slowing domestic demand
- Cost pressure to ease off as commodity prices fall sharply
- New government measures to support the export-oriented textile industry
- Strong product innovation to help the company moves up the value chain
- Maintain BUY recommendation with 12-month target price of S\$0.70

Industry overview

Challenging external environment. According to industry reports, China's textile sector's profit declined 27.0% YoY to RMB4.0bn in 1H08, with the slowing consumer demand, cost pressure and strengthening RMB affecting producers' margins. About 24.0% (up 3.5pcp YoY) of chemical fibre companies recorded losses totaling RMB2.0bn, double the year-earlier level. While Sino Techfibre is not competing in the same space, we believe investors' confidence has been undermined by the sector's negative newsflow.

Outlook is improving. In Aug 2008, the Chinese government raised export tax rebates from 11% to 13%. This is likely to provide some relief to textile exporters which are finding it increasingly hard to survive amid razor thin margins as a result of RMB appreciation and higher production costs. In our view, the new initiative will also convey a strong message that the government still promotes the local garment industry.

Company fundamentals

Summary. Based in Longkou City, Shandong province, Sino Techfibre (STF) is principally engaged in the production and sale of PU synthetic leather and microfibre synthetic leather in China. It sells mainly to trading companies and manufacturers operating in downstream industries. It also supplies some government departments.

Sustained demand from government-related bodies. Sales to the PLA and other government agencies represented about 19.1% of total revenue in 2Q08 (down from 19.4% in 1Q08). The key growth driver will be the company's PMP segment, which started commercial production in Jun 2008 and contributed about RMB5.0m (1.4% of 1H08 revenue) in the first month alone. PU sales accounted for 55.7% of revenue and microfibre 42.9%.

Cost pressure easing as commodities fall. The overall gross margin was relatively stable YoY at 46.4% in 2Q but down 0.2pcp sequentially. The gross margin of PMP products was 42.2% in 2Q and we expect it to widen as the company ramps up production to achieve greater economies of scale. With the recent sharp retreat in crude oil prices, we expect cost pressure to ease off in the next few quarters.

New capability. The company plans to launch its own production of non-woven fabric (to replace imports from South Korea), which can be

BUY (unchanged)

Singapore Industrial

Mon, 13 Oct 2008

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MICA (P) 156/10/2007

RCB. No. 200413424G

Stock data

Price	S\$0.200
Target price	S\$0.70 (+250%)
12 mth range	S\$0.20-1.55
Market cap.	US\$128.3m
Daily t/o, 3 mth	US\$2.5m
Free float %	31.4%
Ticker	SINOT SP

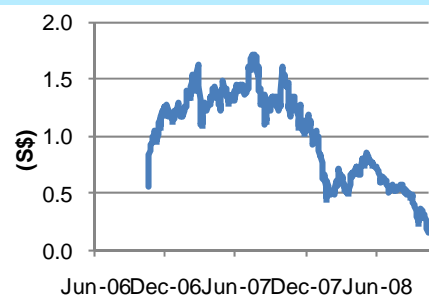
Financial summary

Year to Dec	06A	07A	08F	09F	10F
T/O (RMBm)	944.5	1,275.5	1,553.0	1,956.2	2,454.5
NP (RMBm)	345.8	470.6	513.1	651.3	822.3
EPS (RMB)	0.467	0.506	0.552	0.700	0.884
EPS chg (%)	48.3	36.1	9.0	26.9	26.2
P/E (x)	2.1	2.0	1.8	1.4	1.1
P/B (x)	0.7	0.6	0.5	0.4	0.3
EV/EBITDA (x)	4.6	3.7	2.7	1.7	1.0
Yield (%)	5.1	6.0	5.5	7.0	8.8
ROE (%)	44.0	32.1	27.2	27.0	26.6
ROCE (%)	30.2	33.3	32.5	31.9	31.4
N. Gear. (%)	cash	cash	cash	cash	cash

Price Performance

	1 mth	3 mth	12 mth
Relative to FSSTI (%)	-17.6	-30.1	-39.0
Actual price changes (%)	-38.9	-58.0	-83.9
	08F	09F	10F
Consensus EPS (RMB)	0.605	0.830	0.960
Previous forecasts (RMB)	632.3	872.3	1024.3
Previous EPS (RMB)	0.663	0.917	1.080

Price Chart



used for 1) insulation lining for winter coats and jackets, targeting mainly the PLA and the Ministry of Public Security; 2) high-end PU for shoes and sports equipment. We understand the company has placed a deposit of about RMB75m for the purchase of non-woven machines, which are expected to be delivered and installed in 4Q FY12/08. The new factory is under construction and the total cost, including production lines, will reach RMB150m. According to management, commercial production is should start by 2Q09. Sino Techfibre claims to be China's first domestic manufacturer with such capability.

Some operational hiccups. The company recently announced that they are experiencing some operational hiccups with relating to irregular power supply (the Chinese government reduced electricity supply to all industrial users in Shandong/Hebei to cut emissions during the Olympics Games in August), which affected its production output. In addition, management has halved its earlier guidance with regard to the estimated annualized utilization of its PMP capacity for FY12/08 from 20% (or 8m metres) to 10% (or 4m metres) due to the delay in the installation of its second production line. The company now expects to start commercial production from Jan 2009.

No change in outlook. We remain positive on the company's prospects going forward. Based on industry reports, synthetic leather manufacturers in China are still adding capacities to cope with the rising demand. This augurs well for its PMP business as the company's is the only PMP producer in China (there are only six others in the world). There are some concerns from the market regarding its capex level for FY12/08, which stands at around RMB600m. However, we are comfortable with the company's balance sheet as we project the company to have a net cash position of RMB267.5m at end-FY12/08F after considering the investment. No major additional capital expenditure is planned in the next few years.

Compelling valuation. Based on the last closing price of S\$0.20, the market values the stock at only 1.8x FY12/08 and 1.4x FY12/09 P/E. We reiterate our BUY recommendation with a 12-month price target of S\$0.70, pegged at an undemanding 5x forward P/E.

Table 1: Peer comparison

Name	Ticker	Price (local)	Mkt Cap (US\$ 'm)	P/E (x)			P/B (x)	ROE (%)	Yield (%)
				FY08	FY09	FY10			
China Sky	CSCF SP	S\$0.31	174.2	1.6	1.2	1.1	0.4	24.7	8.5
Fibrechem	FBCM SP	S\$0.28	174.4	2.4	1.8	1.7	0.5	24.2	7.1
Li Heng	LHCF SP	S\$0.295	345.9	2.2	1.8	1.6	0.7	33.0	10.0
Toray	3402 JP	¥396	5,494.4	13.1	n.a	n.a	1.0	8.1	2.5
Kuraray Co	3405 JP	¥793	3,005.7	11.3	n.a	n.a	0.8	7.3	3.1
Kolon Industries	002020 KS	KRW22400	278.7	8.3	7.4	5.0	0.7	9.7	1.1
San Fang Chemical	1307 TT	TWD19.5	157.9	8.4	n.a	n.a	1.4	13.7	4.5
Yantai Wanhua	600309 CH	CNY10.21	2,491.3	8.8	7.3	5.9	2.8	36.3	4.1
Simple average			1,515.3	7.0	3.9	3.1	1.0	19.6	5.1

Source: SBI E2-Capital, Bloomberg

Table 2: P&L statement

Year to Dec (RMBm)	FY06A	FY07A	FY08F	FY09F	FY10F
Revenue	944.5	1,275.5	1,553.0	1,956.2	2,454.5
Cost of sales	(517.4)	(686.0)	(826.7)	(1,035.4)	(1,287.0)
Gross profit	427.1	589.5	726.4	920.9	1,167.5
Other income	0.2	2.1	0.0	0.0	0.0
Distribution expenses	(11.8)	(17.4)	(22.5)	(30.3)	(40.5)
Administrative expenses	(31.0)	(21.7)	(17.1)	(25.4)	(36.8)
Profit from operations	384.5	552.6	686.8	865.1	1,090.2
Finance costs, net	(2.1)	1.4	(2.6)	(2.5)	(1.2)
Profit before tax	382.3	554.0	684.2	862.7	1,089.1
Tax	(36.5)	(83.4)	(167.6)	(211.4)	(266.8)
Net Profit	345.8	470.6	513.1	651.3	822.3
Gross margin (%)	45.2	46.2	46.8	47.1	47.6
EBIT margin (%)	40.7	43.3	44.2	44.2	44.4
Net margin (%)	36.6	36.9	33.0	33.3	33.5

Source: Company, SBI E2-Capital estimates

P & L (RMBm)						Cash Flow (RMBm)					
	06A	07A	08F	09F	10F		06A	07A	08F	09F	10F
Year to Dec						Year to Dec					
Turnover	944.5	1,275.5	1,553.0	1,956.2	2,454.5	EBIT	384.3	550.4	686.8	865.1	1,090.2
% chg	44.7%	35.0%	21.8%	26.0%	25.5%	Depre./amort.	24.6	31.9	51.4	87.0	104.6
Gross profit	427.1	589.5	726.4	920.9	1,167.5	Net int. paid	2.1	(1.4)	2.6	2.5	1.1
						Tax paid	(33.8)	(70.7)	(171.0)	(211.4)	(266.8)
EBITDA	359.6	518.6	635.4	778.1	985.6	Translation difference	(5.3)	(7.7)	0.0	0.0	0.0
Depre./amort.	24.6	31.9	51.4	87.0	104.6	Gross cashflow	371.9	502.6	569.6	743.2	929.1
EBIT	384.3	550.4	686.8	865.1	1,090.2	Chgs. in working cap.	(220.8)	(77.4)	(24.6)	(42.4)	(64.6)
Net int. income/(exp.)	(2.1)	1.4	(2.6)	(2.5)	(1.1)	Operating cashflow	151.2	425.2	545.1	700.8	864.5
Exceptionals	0.2	2.1	-	-	-	Capex	(38.4)	(320.4)	(600.0)	(500.0)	(400.0)
Associates	-	-	-	-	-	Free cashflow	112.7	104.8	(54.9)	200.8	464.5
Jointly-controlled entit.	-	-	-	-	-	Dividends paid	(103.0)	(75.3)	(55.8)	(51.3)	(65.1)
Pre-tax profit	382.3	554.0	684.2	862.7	1,089.1	Net distribution to MI	-	-	-	-	-
Tax	36.5	83.4	171.0	211.4	266.8	Investments	-	(360.5)	-	-	-
Minority interests	-	-	-	-	-	Disposals	(1.9)	3.5	(2.6)	(2.5)	(1.1)
Net profit	345.8	470.6	513.1	651.3	822.3	New shares	735.2	0.0	0.0	0.0	0.0
% chg	48.3%	36.1%	9.0%	26.9%	26.2%	Others	(35.1)	9.8	6.9	(2.5)	(1.1)
Dividends	(47.4)	(55.8)	(51.3)	(65.1)	(82.2)	Net cashflow	708.0	(317.7)	(106.4)	144.6	397.1
Retained earnings	298.4	414.8	461.8	586.2	740.0	Net (debt)/cash - Beg.	(25.4)	708.6	390.9	274.5	419.1
EPS (RMB) - Basic	0.467	0.541	0.552	0.700	0.884	Net (debt)/cash - End.	708.6	390.9	274.5	419.1	816.2
EPS (RMB) - F.D.	0.372	0.506	0.552	0.700	0.884	Interim Results (RMBm)					
DPS (RMB)	0.051	0.060	0.055	0.070	0.088	1H07		1H08			
No. sh.s o/s (m) - W.A.	740.0	869.9	930.0	930.0	930.0	Six months to June					
No. sh.s o/s (m) - Y.E.	930.0	930.0	930.0	930.0	930.0	Turnover	583.8	690.9			
No. sh.s o/s (m) - F.D.	930.0	930.0	930.0	930.0	930.0	% chg	18.3%				
Margins (%)						Profit from operations	247.8	310.4			
Gross	45.2	46.2	46.8	47.1	47.6	Interest expenses, net	1.8	(1.1)			
EBITDA	38.1	40.7	40.9	39.8	40.2	Associates	-	-			
EBIT	40.7	43.2	44.2	44.2	44.4	Jointly-controlled entit.	-	-			
Pre-tax	40.5	43.4	44.1	44.1	44.4	Pre-tax profit	249.6	309.3			
Net	36.6	36.9	33.0	33.3	33.5	Tax	(37.5)	(86.3)			
Balance Sheet (RMBm)						Minority interests	-	-			
Year to Dec						Net profit	212.1	222.9			
Fixed assets	248.6	537.2	1,086.0	1,499.2	1,794.8	% chg	5.1%				
Intangible assets	6.0	5.8	5.7	5.5	5.3	EPS (RMB) - Basic	0.228	0.240			
Other LT assets	-	-	-	-	-	DPS (RMB)	-	0.010			
Cash	758.6	440.9	334.5	479.1	876.2	Shareholding Structure					
Accounts receivable	170.2	231.2	264.0	313.0	374.3	Shares o/s (m)					
Other receivables	128.9	479.6	479.6	479.6	479.6	Merit Asia International	564.8				
Inventories	86.5	106.1	120.4	132.0	153.4	UOBAM	63.9				
Due from related co.s	-	-	-	-	-	Public	301.3				
Other current assets	12.9	4.5	5.0	5.0	5.0	Total	930.0				
Total assets	1,411.8	1,805.3	2,295.2	2,913.4	3,688.7	Total	100.0				
Accounts payable	(13.3)	(22.4)	(37.2)	(49.2)	(61.1)	Background					
Other payable	(31.2)	(40.7)	(45.5)	(51.8)	(57.9)	Sino Techfibre produces polyurethane (PU) and microfibre synthetic leather. The Company markets its products to manufacturers of fashion apparel, footwear, sports apparel and equipment, luggage and travel accessories, and upholstery for furniture and automobiles.					
Tax payable	(11.2)	(23.9)	(23.9)	(23.9)	(23.9)	Key Ratios					
Due to related co.s	-	-	-	-	-	Net gearing (%)	(90.2)	(26.7)	(14.5)	(17.3)	(26.4)
ST debts	(50.0)	(50.0)	(60.0)	(60.0)	(60.0)	Net ROE (%)	44.0	32.1	27.2	27.0	26.6
Other current liab.	(34.4)	(9.0)	(12.0)	(12.0)	(12.0)	EBIT ROCE (%)	45.3	36.3	35.3	34.9	34.6
LT debts	0.0	0.0	0.0	0.0	0.0	Dividend payout (%)	13.7	11.9	10.0	10.0	10.0
Other LT liabilities	-	-	-	-	-	Effective tax rate (%)	(9.6)	(15.1)	(25.0)	(24.5)	(24.5)
Total liabilities	(140.1)	(146.0)	(178.6)	(196.8)	(214.9)	Net interest coverage (x)	179.1	na	268.1	350.8	980.7
Share capital	466.9	466.9	466.9	466.9	466.9	A/R turnover (days)	54.6	57.4	58.2	53.8	51.1
Reserves	804.8	1,192.4	1,649.8	2,249.7	3,006.9	A/P turnover (days)	8.9	5.1	7.0	8.1	8.2
Shareholders' funds	1,271.7	1,659.3	2,116.6	2,716.6	3,473.7	Stock turnover (days)	49.8	51.2	50.0	44.5	40.5
Minority interest	-	-	-	-	-						
Total	1,271.7	1,659.3	2,116.6	2,716.6	3,473.7						
Capital employed	1,321.7	1,709.3	2,176.6	2,776.6	3,533.7						
Net (debt)/cash	708.6	390.9	274.5	419.1	816.2						



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