

China Powerplus Ltd

21 Nov 2007
Steady growth ahead

Snapshot		P&L				Key ratios (FY08F)	
Recomm	Buy	(Y/E Dec)	FY06	FY07F	FY08F	PER	7.5x
Current Price	S\$0.235	Sales (RMB m)	322.2	397.7	440.0	P/BV	1.6x
Target Price	S\$0.34	Gross profit	102.3	119.3	140.8	Div yield	3.6%
No of Shares	424.8m	Earnings	63.6	65.4	92.2	ROE	20.6%
Market Cap	S\$102m	EPS (RMB cts)	18.0	18.0	21.7	Gearing	0%
Year Hi/Lo	S\$0.175/0.445	EPS growth (%)	(11.6)	0.00	21	Cur ratio	3.4x

Source: SIAS Research

3Q07 Results Review

RMB m	3Q07	3Q06	Change
Revenue	95.5	78.8	21.2%
Gross Profit	29.1	20.7	40.5%
Pretax Profit	19.8	16.2	22.2%
Earnings	16.1	13.5	19.5%
Gross Margin	30.5%	26.3%	-
PBT Margin	20.7%	20.6%	
Net Margin	16.9%	17.1%	-
EPS (RMB cts)	3.8	3.8	0%

Source: Company, SIAS Research

- **Higher Revenue & Profits:** 3Q07 revenue jumped 21.2% YoY to RMB 95.5m, powered by the company's expansion into overseas markets as well as further penetration of the China market.
- For 9M07, Total turnover grew 24% to RMB 297.7m YoY. Leading the growth was the Gardening and Lawn segment (with anchor products of Mist Duster and Brush Cutter), which grew 48%. But the Agriculture & Forestry sector posted a moderate growth rate of 3%, which may indicate sluggish growth going forward.

Net profit grew 19.5% YoY to RMB 16.1m, in line with our expectation and market consensus. Meanwhile 9M07 net profit rose 14.3% YoY to RMB 55.8m.

- **Healthy Margin:** In 3Q07, gross margin climbed 4 percentage points to 30.5% from 26.3% in 3Q06. The higher margin was mainly due to product refinements and upgrades of its two main products, which led to a higher selling price.

Another reason was better economies of scale as evidenced by a higher utilization rate of 89% for 9M07 compared to 73% for 9M06.

- PBT margin and net margin were both comparable to 3Q06 levels. The increase in distribution and administrative cost was in line with the increase in revenue. Management has indicated that the effective tax rate will stay around 15% level in the near future due to the favourable tax policy for the agriculture related industry.
- **Better Cash Management Expected:** Since 2004, the company has been maintaining a huge cash balance of more than RMB 130m, which made up more than half of its total assets. As of 31 Oct 2007, the company held a cash balance of RMB 230m.
- In 4Q07, the company announced a RMB 155.3m cash offer for 50% stake of China Steel. We expect this move would improve the ROA of China Powerplus.

Industry Outlook

- **Outlook Optimistic:** In its 3Q result briefing, the management expressed optimism about the long term prospect of the China market and the company is committed to further buttress its presence. Meanwhile, markets with strong potential such as Europe, Australia and South America remain the focus.

- In our view, the management's optimism is reasonable due to the strong performance of its major markets since early this year. In Australia and Europe, the company has seen strong demand with revenue surging fivefold compared to the same period last year (See Figure 1 & 2).
- The success comes from its strong competitive advantage. The company manufactures at lower costs than those international players, while maintaining quality standard. Located in Shandong, which is the second fastest growing province for the past three years in terms of GDP growth, the company enjoys a relatively high skilled workforce at relatively low labour costs.
- For the reasons mentioned above, we believe the company should be able to generate steady recurring revenues from its core business.

Company Updates

- **China Steel Acquisition:** Management says the key reason for the deal is to cater to high-end customers who require stainless steel instead of iron steel to be used in the products it manufactures. Once acquired, China Steel can virtually act as a logistics centre and provide steel to China Powerplus. The deal also opens opportunity for China Powerplus to go upstream in the supply chain and have better control over raw material prices. Furthermore, China Steel registered a net profit of RMB 45.7m in FY06. Going forward, China Steel could contribute positively to the bottom line of the Group.
- There is a debate on the direction of the steel industry in China after booming for the past five years. On the grounds of a favourable demand and supply environment, we think greater profits are likely to be made by China Steel in the years to come. This view is in line with a report from Bank of China International. In its Steel Industry Outlook Report, Bank of China predicted that China steel

industry will continue to post a healthy growth in the next three years (2007-2009) due to higher demand and lower production output in China.

Key Risk

- **Operational Risk:** We identify adverse weather and possible further hikes in raw material and labour costs as major business risks to China Powerplus going forward.
- **Risks related with M&A:** Every M&A has its risks. By acquiring China Steel, the Group will take on business risks related to the steel business, which include fluctuation in nickel prices and China central government policies constraining fixed asset investment. In addition, the cyclical nature of construction and steel industry can bring extra volatility to the bottom line.

Valuation/Recommendation

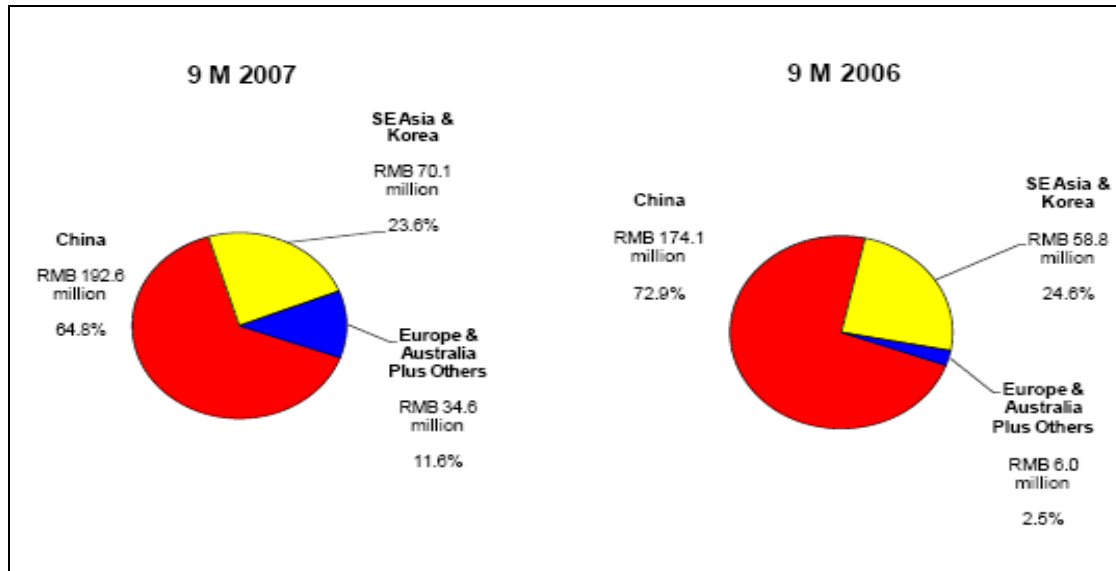
- We have revised upwards our earnings forecasts to RMB 92m for FY08, more than 20% up from our previous estimates. This is to factor in profit contribution from China Steel.
- As the steel industry trades at an average PE ratio of 11-13x globally, higher than gardening and agriculture tools, we believe in the long run, the company's stock price could command a higher PE than currently 6.8. Using a target PE of 7.5, we arrive at our one year target price of 33 cents. This represents a 40% upside from its current price of 23.5 cents. We recommend **BUY** on the counter. (SIAS Research)

Revenue Contribution Forecast

RMB m	FY06	FY07F	FY08F
Revenue	322	398	440
Profit from core business	64	65	74
Profit from associate	0	0	18
EPS- Fully Diluted (RMB cts)	18	18	22

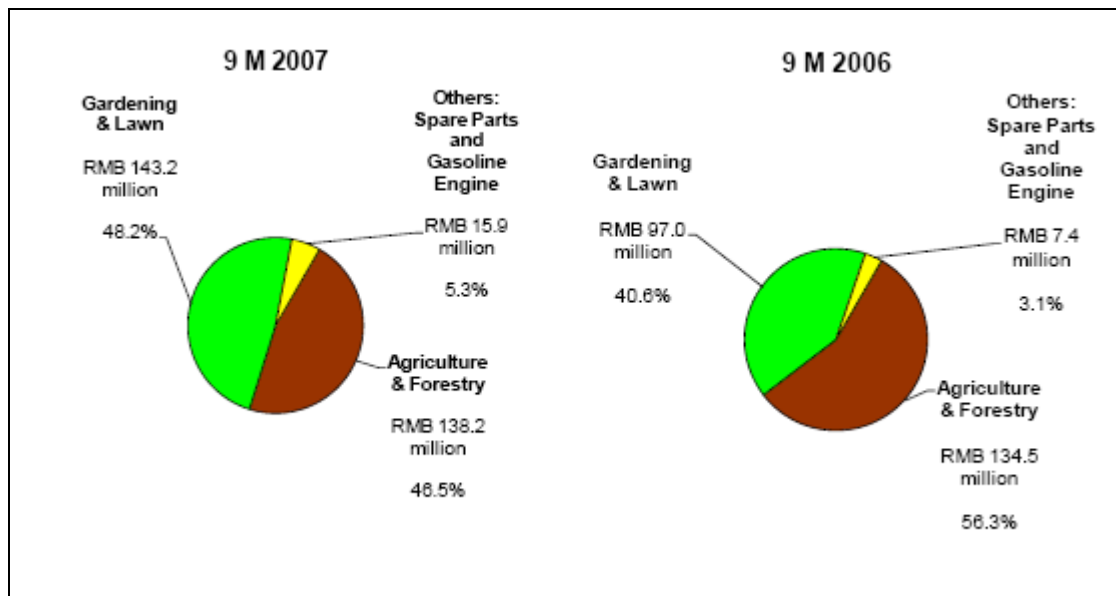
Source: SIAS Research

Figure 1: Sales by Geographic Regions



Source: Company Results

Figure 2: Sales by Product Segments



Source: Company Results

KEY FINANCIALS AND RATIOS

RMB Millions

Ratios	2005	2006	2007F	2008F
Revenue	290.9	322.20	397.70	440.00
Gross Profit	100.9	102.30	119.31	140.80
Pre-tax profit	85.9	75.40	77.89	88.00
Net Profit	71.7	63.60	65.43	92.22
EPS (Cents)	0.2	18.00	18.00	21.71
Growth	2005	2006	2007F	2008F
Revenue Growth (%)	(1.50)	11.00	23.43	10.64
EPS Growth (%)	(34.30)	(11.60)	0.00	0.21
PER/EPS Growth (x)	(0.18)	(0.61)	NA	36.40
Margins	2005	2006	2007F	2008F
Gross margin (%)	34.69	31.75	30.00	32.00
Pre-tax Margin (%)	29.53	23.40	3.31	20.00
Net Profit Margin (%)	24.65	19.74	16.45	20.96
	2005	2006	2007F	2008F
ROE (%)	27	19.40	19.20	18.20
PE (Historical)	6.3	7.10	7.00	7.80
Net cash per share (S\$)	0.13	0.08	0.03	0.06
Gearing (%)	Cash	Cash	Cash	Cash

Source: SIAS Research

About the Company

China Powerplus Ltd is principally engaged in the design, production and sale of portable power tools in gardening and agriculture industry. Its anchor products are brush cutter and mist duster. New product blower was pushed to the market in 2007. Its products are distributed in more than 25 countries including Australia, China, Indonesia, Italy, Malaysia, Singapore, South Africa, South Korea and Thailand. The company has a dominant market position in China with over 360 distributors located in more than 30 provinces. Its factory in Shandong Province of China has a design annual production capacity of approximately three million units per year.

Figure: Price/Volume Chart of China Powerplus



Source: Bloomberg

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As of the date of the report, the analyst and his immediate family do not hold positions in the securities recommended in this report.

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