

MITA No. 010/06/2008

3 March 2009

# Li Heng Chem Fibre Tech

Maintain  
**BUY**

Previous Rating: BUY

**S\$0.115****Fair Value: S\$0.31**Stock Code: LHCF.SI  
Reuters: E9A  
ISIN Code: LHCF SP  
Bloomberg:

Event: Results

**General Data**

Issued Capital (m)	1,700
Mkt Cap (S\$m/US\$m)	196/126
Major Shareholder	Chen Jian Long (42.2%)
Free Float (%)	23.5%
NTA per share (RMB)	0.89
Daily Vol 3-mth ('000)	4,418
52Wk High (S\$)	0.827
52Wk Low (S\$)	0.115

**Incurs 4Q08 loss as guided**

**1H09 outlook remains murky.** Although Li Heng Chemical Fibre (LHCF) has seen a modest recovery in margins and stronger orders in Jan and Feb, management believes it is still too early to call a bottom yet, given the still sluggish global economy. As a recap, its gross margin plunged from 34.0% in 4Q07 and 31.0% in 3Q08 to just 9.3% in 4Q08, hit by rapidly declining ASPs (Average Selling Prices); we understand that ASPs have fallen by as much as 40% in the quarter alone. While customers are still ordering, LHCF notes that they are doing so in smaller quantities albeit more frequently as the ASPs are still on a decline. To combat this, management has greatly reduced its own inventory to less than one month from the usual two months to minimize exposure to falling raw material prices. Management has also decided not to keep to a strict margin policy (usually 30%) but will continue to work with both its suppliers and customers to ensure the longevity of the whole value chain.

**Expansion is likely to go ahead.** Meanwhile, management is likely to go ahead with the expansion plan of its nylon production capacity (decision is expected by end 1Q09), although it does not rule out a slight delay. LHCF is already in the process of building its PA (polyamide) chip plant and that is expected to be completed by 3Q09. LHCF says it is building for the future as the new capacity will take as long as nine months to come, meaning it will come online in 2010, which is when the nylon industry is expected to recover. With the expansion, capex could hit RMB450m (already covered using its IPO proceeds); otherwise it would just need to spend RMB100m or so. We are assuming that the expansion will go ahead in our earnings model.

**Maintain BUY with lower S\$0.31 fair value.** No doubt that we can expect to see more near-term volatility, but we continue to believe in the long-term viability of LHCF's business, its market leadership position and sound financial position. Nevertheless, in light of the slightly poorer near-term to medium-term business outlook, we cut our FY09 estimates by another 18-29%; this in turn lowers our DCF-based fair value from S\$0.44 to S\$0.31. Maintain **BUY** for its long-term potential; value is also emerging as it is trading at just 0.3x its FY08 NTA and at 21% discount to net cash/share.

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Year to 31 Dec	Turnover (RMB m)	EBITDA (RMB m)	Net Profit (RMB m)	EPS (RMB cents)	EPS Growth (%)	PER (x)	Div Yield (%)
FY 07	2,758.1	959.1	905.1	66.5	89.4	0.8	-
FY 08	3,700.9	1,070.0	814.5	47.9	-28.0	1.1	35.3
FY 09F	2,230.0	650.8	394.3	23.2	-51.6	2.3	15.3
FY 10F	3,040.3	896.8	595.9	35.1	51.1	1.5	23.2

Please refer to the important disclosures at the back of this document.

## Li Heng's Key Financial Data

Li Heng Results Year Ended 31 Dec (RMB m)	4Q07 (RMB m)	4Q08 (RMB m)	% Chg (YoY)	3Q08 (RMB m)	% Chg (QoQ)
Revenue	647.2	704.0	8.8%	1024.8	-31.3%
<b>Gross profit</b>	<b>220.3</b>	<b>65.2</b>	<b>-70.4%</b>	<b>318.0</b>	<b>-79.5%</b>
Gross margin	34.0%	9.3%		31.0%	
EBITDA	220.3	70.2	-68.1%	324.2	-78.3%
Depreciation & amortisation	-9.3	-24.1	159.5%	-22.6	6.6%
<b>Operating profit</b>	<b>211.0</b>	<b>46.1</b>	<b>-78.1%</b>	<b>301.6</b>	<b>-84.7%</b>
Net interest	-1.9	-2.9	51.7%	0.8	-474.7%
Forex	5.2	-48.1	nm	0.0	nm
Associates	0.0	0.0	nm	0.0	nm
Exceptionals	0.0	0.0	nm	0.0	nm
<b>Pre-tax profit</b>	<b>214.4</b>	<b>-4.8</b>	<b>-102.2%</b>	<b>302.4</b>	<b>-101.6%</b>
Tax	0.0	-3.9	nm	-43.7	-91.0%
Minority interests	0.0	0.0	nm	0.0	nm
<b>Net profit</b>	<b>214.4</b>	<b>-8.7</b>	<b>nm</b>	<b>258.7</b>	<b>-103.4%</b>
Net Margin	33.1%	-1.2%		25.2%	
<b>Core Earnings (excludes FX)</b>	<b>209.1</b>	<b>37.3</b>	<b>-82.2%</b>	<b>258.7</b>	<b>-85.6%</b>
Core Net Margin	32.3%	5.3%		25.2%	

Segments (RMB m)	4Q07	4Q08	% YoY
HOY/POY	526.4	379.5	-27.9%
FDY	57.0	275.8	383.8%
DTY	63.8	48.7	-23.7%
<b>Total</b>	<b>647.2</b>	<b>704.0</b>	<b>8.8%</b>

  

Gross Margin	4Q07	4Q08	PPT
HOY/POY	33.0%	9.0%	-23.9
FDY	40.4%	10.0%	-30.4
DTY	37.2%	6.7%	-30.5
<b>Total</b>	<b>34.0%</b>	<b>9.3%</b>	<b>-24.8</b>

**EARNINGS FORECAST**

<b>Year Ended 31 Dec (RMB m)</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09F</b>	<b>FY10F</b>
Revenue	2,758.1	3,700.9	2,230.0	3,040.3
EBITDA	959.1	1,070.0	650.8	896.8
Depreciation & amortisation	-46.9	-85.8	-187.9	-203.6
Operating Profit	912.2	984.2	462.9	693.2
Net interest	-18.4	-8.1	-5.4	-1.9
Associates	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0
Pre-tax profit	905.1	945.2	457.5	691.3
Tax	0.0	-130.7	-63.1	-95.4
Minority interests	0.0	0.0	0.0	0.0
Net profit	905.1	814.5	394.3	595.9
Earnings per share (cents)	66.5	47.9	23.2	35.1
Fully diluted earnings per share (cents)	66.5	47.9	23.2	35.1

**BALANCE SHEET**

<b>As at 31 Dec (RMB m)</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09F</b>	<b>FY10F</b>
Cash	752.4	1,332.8	1,268.1	1,642.1
Other current assets	371.3	442.2	358.8	458.0
Fixed assets	760.8	1,851.8	2,114.2	2,061.0
Other long term assets	171.3	234.2	214.5	214.2
Total assets	2,055.8	3,861.0	3,955.6	4,375.2
Current liabilities less debt	270.0	246.0	179.3	228.0
Debt	262.5	181.0	162.9	146.6
Other long term liabilities	0.0	0.0	0.0	0.0
Total liabilities	532.6	427.0	342.3	374.6
Shareholders equity	1,523.2	3,434.0	3,613.3	4,000.7
Minority interests	0.0	0.0	0.0	0.0
Total equity and liabilities	2,055.8	3,861.0	3,955.6	4,375.2
NTA per share (cents)	88.7	201.1	211.7	234.5

**CASH FLOW**

<b>Year Ended 31 Dec (RMB m)</b>	<b>FY07</b>	<b>FY08</b>	<b>FY09F</b>	<b>FY10F</b>
Operating profit before working cap. changes	970.4	1,089.9	650.8	896.8
Working capital changes	-97.3	-98.7	22.8	-50.6
Interest and tax	-18.4	-134.9	-68.6	-97.3
Net cash from operations	854.7	856.3	605.0	748.9
Capex	-252.8	-1,020.3	-450.0	-150.0
Other investing flows	-141.0	-186.3	13.4	0.0
Investing cash flow	-393.8	-1,206.6	-436.6	-150.0
Change in equity	175.3	1,395.7	0.0	0.0
Net change in debt	-27.6	-81.5	-18.1	-16.3
Dividends paid	0.0	-245.7	-138.0	-208.6
Others	0.0	-53.7	-77.0	0.0
Financing cash flow	147.7	1,014.8	-233.1	-224.9
Forex adjustments	0.0	-51.0	0.0	0.0
Net cash flow	608.6	613.5	-64.7	374.0
Cash at beginning of year	80.5	689.1	1,302.5	1,237.8
Restructuring Exercise	0.0	0.0	0.0	0.0
Cash at end of year	689.1	1,302.5	1,237.8	1,611.9
Fixed deposits pledged	63.3	30.2	30.2	30.2
Cash balance	752.4	1,332.8	1,268.1	1,642.1

**Key Ratios**

PER (x)	0.8	1.1	2.3	1.5
Price/NTA (x)	0.6	0.3	0.2	0.2
EV/EBITDA (x)	0.4	-0.2	-0.3	-0.7
Dividend yield (%)	0.0	35.3	15.3	23.2
ROIC (%)	50.7	22.5	10.4	14.4
ROE (%)	59.4	23.7	10.9	14.9
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash
PE to growth (x)	0.0	0.0	0.0	0.0

*Source: Company data, OIR estimates*

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**SHAREHOLDING DECLARATION:**

The analyst/analysts who wrote this report holds NIL shares in the above security.

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