

## ASIA BIO-CHEM GROUP

ABC-TSX V: \$0.480 — BUY

TARGET PRICE: \$1.40; PROJECTED RETURN: 191.7%

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### Q1 RESULTS – WEAK MARGINS, BUT PRICES ARE REBOUNDED

#### EVENT – Q1 RESULTS INLINE, BUT MARGINS WEAK

Asia Bio-Chem reported Q1 EPS of \$(0.01) versus our estimate of \$0.00. Sales of \$19 million were modestly lower than our \$19.8 million estimate. Gross margins (ex. D&A) were soft at 14.4% versus our expectations of 20.5%. Lower volumes and pricing were the main drivers for the shortfall in sales and margins.

#### IMPACT – REBOUND IN PRICES SHOULD BOOST MARGINS GOING FORWARD

**Soft volumes across all product lines:** Volumes sold for the quarter were ~61,000 tonnes, below 66,000 tonnes we had estimated and 66,000 tonnes recorded in Q4/08 and 70,000 tonnes a year ago. ABC cited inventory destocking, which took place in late 2008 and which continued into Q1/09, as a factor for the decline in sales volumes. As a result, ABC extended the closure of its plant during China's spring festival in response. Management did note that demand is still there.

**Pricing pressure did spill into Q1, but is rebounding:** Prices were \$313/tonne, higher than the \$300 we had forecasted, but down from \$326 recorded in Q4/08. Prices were weak across all product lines (in local currency) with the exception of gluten, which saw flat Y/Y pricing. The company has seen a rebound in starch prices, as well as with most of its by-products since mid/late Q1/09.

**Margins were weak for the quarter, but should rebound:** Despite prices coming in better than expected, margins were down considerably due mostly to the starch/corn price spread narrowing. Margins were also negatively impacted by lower production volumes. However, the company has seen the price spread widen over the last several weeks, which, if this trend continues, should result in a boost to starch margins.

**New plant and financing update:** The new 600,000-tonne plant is progressing on budget and on schedule (fully ramped up by Q4). ABC currently has \$3 million in cash on hand and has drawn down \$10 million of a \$25 million debt facility. ABC continues to be in deep discussions to finalize the last instalment of debt (~+\$30 million) needed to complete the construction of the new facility. Management expects a deal to be finalized within a few months. Lastly, the company announced that it was entitled to a one-time government subsidy given high prices of corn, which were driven mainly by government purchase programs. The amount is likely to be just under \$1 million and should be granted within the next six months.

#### VALUATION – CONSERVATIVE MULTIPLE OFFERS A LOT OF UPSIDE

ABC is trading at 4.4x 2009 EPS. Our target multiple is only 4x.

#### RECOMMENDATION – SELLOFF OVERDONE. WE ARE A BUY.

We believe that the sell-off in the stock price following Q1 results (down 30% last Friday) is overdone. We expect margins to rebound going forward as starch prices (and the spread over corn prices) improves. We remain a **BUY** with a \$1.40 target price.

#### Financial Metrics (C\$)

Share Price	\$0.48	Market Cap (mm):	\$36.9
Target Price	\$1.40	Basic Sh O/S (mm)	76.8
Return	191.7%	FD shares (mm)	76.8
52 Wk. High:	\$2.40	52 Wk. Low:	\$0.38

FY December 31	2007A	2008A	2009E	2010E
Prod'n (000 tonnes)	273.7	279.0	414.0	801.0
Sales (mlns)	\$75.9	\$84.4	\$128.0	\$224.3
EPS		\$0.17	\$0.11	\$0.33
P/EPS	N/A	2.8x	4.4x	1.5x
CFPS		\$0.20	\$0.15	\$0.39
P/CFPS	N/A	2.4x	3.2x	1.2x
2009 Quarterly	Q1A	Q2E	Q3E	Q4E
EPS	-\$0.01	\$0.00	\$0.03	\$0.10
CFPS	\$0.01	\$0.00	\$0.03	\$0.10

#### Target Valuation Parameter

4.0x Forward EPS (Q2/10 - Q1/11)



Courtesy of BigCharts.com

#### Key Risks

Declining demand from a slowing economy could be a risk to the company's top line. A narrowing in the price gap between corn prices (input) and corn starch prices (output) would squeeze the company's margins. Finally, if the company is unable to secure funding for expansion plans going forward, its growth would be.

#### Corporate Profile

Asia Bio-Chem Group is a China-based manufacturer and distributor of corn starch and related products (corn gluten, germ and fiber) to the domestic market.

#### Upcoming Events

May 27. Annual General Meeting at the Board of Trade

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	Actual	Forecast		
	09Q1	09Q1e	08Q1	08Q4
EPS	(\$0.01)	\$0.00	\$0.06	\$0.01
Sales, \$mm	19.03	19.80	19.89	21.64
Margins				
Gross (ex. D&A)	14.4%	20.5%	26.4%	20.4%
Gross (incl. D&A)	12.7%	17.9%	25.6%	19.0%
EBITDA	5.5%	12.2%	21.7%	12.7%
Operating	3.8%	9.6%	20.8%	11.4%
EBT	-3.6%	1.6%	18.6%	5.2%
Net	-4.4%	1.1%	15.7%	3.3%
Tax rate	-23.1%	35.0%	15.4%	nm
Selling / Sales	3.76%	3.80%	2.14%	3.4%
G&A / Sales	5.13%	4.50%	2.64%	4.2%
SG&A	8.89%	8.30%	4.78%	7.6%
D&A	0.310	0.511	0.176	0.291
Volumes	60,852	66,000	69,875	66,412
Pricing / tonne	\$313	\$300	\$285	\$326

Figure 1. Actual Results vs. Research Capital Estimates  
Source. Company reports, Research Capital

	Q2/09		2009		2010	
	New	Old	New	Old	New	Old
EPS	(\$0.00)	\$0.00	\$0.11	\$0.13	\$0.33	\$0.33
Sales, \$mm	19.13	18.48	127.90	125.64	224.31	227.22
Margins						
Gross (ex. D&A)	17.5%	21.5%	19.6%	22.1%	22.5%	22.8%
Net	-1.4%	0.0%	6.4%	6.2%	11.6%	9.1%
Tax rate	35.0%	35.0%	27.5%	25.3%	15.0%	15.0%
Selling / Sales	3.60%	3.80%	2.23%	2.67%	2.50%	2.50%
G&A / Sales	4.90%	4.50%	3.04%	2.88%	3.00%	3.00%
Volumes	63,750	66,000	414,102	444,000	801,102	811,500
Pricing / tonne	\$300	\$280	\$308	\$285	\$280	\$280

Figure 2. New Forecast  
Source. Research Capital



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