

## Well connected

## China Consumer

## Huabao Int'l (336 HK, HK\$3.43)

## Not Rated

Major takeaways of our recent telephone conference with management:

**Well-connected.** Chairperson Ms. Chu Lam Yiu has established strong relationship with the leading tobacco companies in China, which are Huabao's customers or industry partners, to explore the lucrative industry.

**Strong clientele.** The leading tobacco companies listed in the following Table 3 (except ICI) are Huabao's key customers, accounting for over 70% of its total turnover. After the recent market consolidation, the top ten tobacco companies in China are expected to account for over 80% of market share.

**Fast mover in F&B segment.** After the acquisition of Shanghai Kongque, Huabao entered the food flavours market in 2005. Its revenue contribution from food flavours segment grew 26.2% to reach RMB80.6m in FY03/06, contributing around 10% of its total turnover.

**Brand name.** Huabao possesses two PRC registered trademarks that are well recognized in Shanghai. "Kongque" is a long-established food flavours brand name in the PRC, while "Xideng" is a renowned and leading tobacco flavour brand name.

**Growth momentum.** Turnover is expected to grow 40% in 1QFY12/07. Strong R & D support and upstream production expansion will further expand its margins. Its current annual production capacity amounts to 15,000 tonnes.

**Valuation.** Huabao is well positioned to capture the strong global demand for fast moving consumer goods. The counter is trading at market consensus P/E of 24x FY03/07F and of 17.7x FY03/8F. Huabao deserves to trade at a premium compared with its peers due to its leading position in the tobacco flavour market (over 30% market share in China).

**Table 1 Turnover breakdown\***

Year end Mar	2004 RMBm	2004 % of total turnover	2005 RMBm	2005 % of total turnover	2006 RMBm	2006 % of total turnover
Tobacco flavours	561.8	100	685.1	91.5	714.8	89.9
Food flavours	Na	Na	63.9	8.5	80.6	10.1
Total	561.8	100.0	749.0	100.0	795.4	100.0

Source: Company data\* based on the unedited financial statement of the new acquired target company

**Table 2: Peer comparisons**

Company	Ticker	Hist. P/E (x)	FY05F P/E (x)	FY06F P/E (x)	Gross margin (%)	ROE (%)	PEG (x)
International Flavors & Fragrances	IFF US	19.7	18.0	15.1	41.4	21.2	2.0
Givaudan	GIVN. VX	16.0	16.3	15.6	48.9	14.5	2.7
T Hasegawa	4958.JP	19.1	19.8	18.5	34.1	7.2	NA
Takasago	4914.JP	20.3	20.0	18.2	28.5	5.4	1.5
China F & F	3318 HK	15.5	16.9	14.0	63.8	37.5	1.6

Source: Bloomberg & SBI E2-Capital

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**Table 3 : Top ten tobacco companies in China in 2005**

Ranking	Name of F&F companies
1.	Hongta*
2.	Baisha*
3.	Honghe*
4.	Huanguoshu*
5.	Changde*
6.	Quest International Shanghai (a subsidiary of Imperial Chemical Industries UK PLC)
7.	Chuxiong*
8.	Xiamen*
9.	Hongyun*
10.	Hangzhou*

Source: 2004 China Chemical Industrial Year book, \*Their clients

**Table 4 : Turnover of the top F&F companies in China in 2005**

Ranking	Name of F&F companies	Ticker	(RMBm)
1.	Huabao	336 HK	795
2.	Givaudan	GIVN VX	*592
3.	International Flavor and Fragrance	IFF US	*566
4.	Firmenich	NA	*378
5.	China F&F	3318 HK	222
6.	Quest International Shanghai (a subsidiary of Imperial Chemical Industries UK PLC)	ICI UK	*173
7.	T. Hasegawa Co. Ltd.	4958 JP	*158

Source: 2004 China Chemical Industrial Year book \*2005 Turnover in China