

Tontine Wines Group Ltd.

Volume increase from new production capacity

to summarize...

- Tontine's FY12/11A results were in line with our expectations. Revenue was RMB830.1m, representing a 18.0% YoY increase while net profit came in at RMB188.8m, down 9.3% YoY. EPS decreased 21.0% to RMB9.4 cents from RMB11.9.
- The decrease in net profit was mainly attributable to the share option expenses and exchange loss due to RMB exchange rate fluctuation. Excluding the onetime lost, pre-tax profit should be around RMB331.5m which is a 10.3% yoy increase over RMB300.6m from FY12/10A.
- Total volume increased 17.5% from 20,014 tonnes to 23,506 tonnes. Sweet wines contributed 69.1% of total sales in FY12/11A, slightly down from 70.8% a year ago, with dry wine contributing the remaining 30.9%.
- The gross margin decreased 0.1pcp to 56.0%. The increase in COGS was due to increased in labor cost, production capacity expansion, the consumption tax the newly imposed city construction tax and education surcharged by the local government.
- We maintain a buy rating with target price of HK\$1.54. Our target price represents 11.9x FY12/12F and 11.1x FY12/13F P/E.

FY12/11A results: Tontine's FY12/11A results were in line with our expectations. Revenue was RMB830.1m, an increase of 18.0% YoY, while net profit came in at RMB188.8m, down 9.3% YoY. EPS decreased 21.0% to RMB9.4 cents from RMB11.9. Proposed final dividend of HK2.88 cent (2010: HK3.0 cents). The decrease in net profit was mainly attributable to the share option expenses and exchange loss due to RMB exchange rate fluctuation.

Table 1. FY12/11A

6 months to Dec	Turnover (RMBm)	Gross Profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)
FY11A	830.1	479.1	57.7	289.7	34.8	188.8
FY10A	703.5	413.9	58.8	300.6	30.8	208.1
YoY(%)	18.0	15.8		(3.6)		(9.3)

Source: Company data

One time expenses: Share option expense and RMB exchange lost are one time lost. The share option expense of was around RMB21.4m. And the foreign exchange lost was RMB20.4m. The cash on-hand is now in the denomination of RMB, therefore should not recurred again. If add back the onetime lost, pre-tax profit should be around RMB331.5m which is a 10.3% yoy increase over RMB300.6m from FY12/10A.

Sweet wine vs. dry wine: Tontine continues to focus on sales of sweet wine products. Sweet wines contribute 69.1% of total sales in FY12/11A, (down from 70.8% a year ago), with dry wine contributing the remaining 30.9%. Revenue from sweet wine represented 15.1% YoY growth to RMB573.7m with ASP increasing to RMB38.7 per tonne (FY12/10A: RMB38.3 per tonne). The increase in the average selling price of sweet wine products was the result of changing product mix to higher price product. Meanwhile, dry wine sales grew 24.9% YoY growth to RMB256.4m. ASP for this segment increased from RMB29.3 to RMB29.5 per tonne.

GP Margin: The gross margin for sweet wine decreased 0.1pcp to 56.0% (1H FY12/11A: 55.7%, FY12/10A: 56.1%). Gross margin for dry wine decreased 3.6pcp to 62% (1H FY12/11A: 60.1%, FY12/10A: 65.6%) due to selling more products that

Ticker	0389 HK
Rating	BUY
Price (HK\$)	0.96
Target Price (HK\$)	1.54 (+60.4%)
12m Price Range (HK\$)	0.6-1.73
Market cap. (US\$m)	247.8
Daily t/o (US\$m)	0.9
Free float (%)	59.9

Financial summary

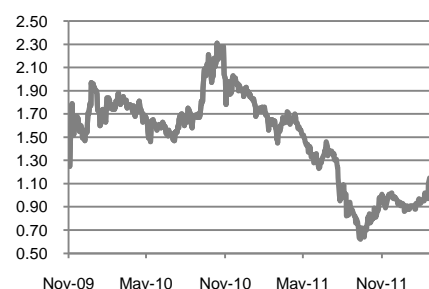
Year to Dec	09A	10A	11A	12F	13F
Turnover (RMBm)	584.3	703.5	830.1	914.4	1,026
Net Profit (RMBm)	174.1	208.2	188.8	211.7	226.3
EPS (RMB)	0.127	0.119	0.094	0.105	0.112
P/E (x)	6.1	6.6	8.3	7.4	6.9
P/B (x)	1.10	0.83	0.69	0.69	0.69
EV/EBITDA (x)	1.4	0.6	2.8	2.1	1.7
Yield (%)	3.3	2.7	2.7	2.7	2.9
ROE (%)	26.0	15.9	9.6	9.2	9.9
ROCE (%)	37.0	22.7	14.4	13.3	14.2
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI

	12F
Consensus EPS (RMB)	0.177
Previous EPS (RMB)	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	-2.6	-8.0	-32.9
Actual price changes (%)	-5.9	2.1	-39.2



Source: Bloomberg

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are priced in the mid range.

Cost structure: Total raw material as a percentage of COGS drop from 72.5% to 68.7%. The production overhead increased to 3.5% from 2.6% due to increase in labor cost and as a result of the production capacity expansion. The consumption tax increased to 27.8% from 24.9% due to newly imposed city construction tax and education surcharged by the local government.

Table 2. Cost structure breakdown

	FY 10A (RMBm)	%	FY 11A (RMBm)	%	YoY (%)
Raw material					
Grape and grape juice	132.8	45.8	149.9	42.7	13
Yeast & others	8.6	3.0	9.3	2.7	8
Packaging	67.9	23.5	81.2	23.1	20
Others	0.7	0.2	0.8	0.2	14
Subtotal	210.0	72.5	241.2	68.7	15
Others					
Prod'n o/heads	7.6	2.6	12.2	3.5	60
Tax	71.9	24.9	97.6	27.8	36
Subtotal	79.5	27.5	109.8	31.3	38
Total	289.6	100.0	351.0	100.0	21

Source: Company data

Table 3. Sales volume, ASP and revenue breakdown

	FY 10A	FY 11A	YoY (%)	% of total
Sweet wine				
Vol (tonnes)	12,997	14,823	14.0	63
ASP(RMBk/t)	38.3	38.7	1.0	
Revenue (RMBm)	498.2	573.7	15.2	69
Dry wine				
Vol (tonnes)	7,017	8,683	23.7	37
ASP(RMBk/t)	29.3	29.5	0.1	
Revenue (RMBm)	205.4	256.4	24.8	31
Total				
Vol (tonnes)	20,014	23,506	17.4	100.0
ASP(RMBk/t)	35.2	35.3	0.1	
Revenue (RMBm)	703.5	830.1	18.0	100.0

Source: Company data

Future Prospect

New products planned FY2012: The group plan to introduce around five new products in the second half of 2012. In 2011, no new product was introduced in the 1H FY2011, but three new products is in plan for 2H FY2011, two sweet wines and one dry wine. During 2010, Tontine introduced several premium products in the sweet wine category.

Capacity expansion: Tontine has completed the installation of the production capacity expansion, where the annual production capacity can increase up to ~39,000 tonnes from the previous ~19,000 tonnes. The actual capacity in use will slowly ramp up and with target to reach 23,000 tonnes in 2011. For 2012, target capacity is estimated to be around 28,000 tonnes. The first half of year is usually a slower season, we estimate about 40% of total capacity is used in 1H and 60% of total capacity will be used the second half.

Wine Estate: The wines estate will produce premium range of estate bottle wine labeled under "Estate Bottled" from higher quality of grapes. The grapes use will be from their self-operated vineyard where the size will be up to approximately 2,000 mu (667 square metres). The annual yield expected to be around 500 tonnes which is approximate 600,000 bottles of 750ml size. The start of construction for Estate Wine was commence was in the middle of 2011 and expect to complete by 2H of 2012, the first batch of 200,000 bottles expect to sell in 2H 2013.

Wine Cellar: The completion of Wine Cellar is expected to be in the 2H of 2012. The wine cellaring capabilities where they can store wines with properly controlled environment to undergo an ageing process. The storage capacity of the cellar is expected to accommodate up to 600,000 bottles of 750ml in size. The first batch of 200,000 bottles is expected to sell in 1H 2013.

Retail shops: The group plans to establish 20 Tontine retails shops in selective cities across the PRC over the next three years. So far, there are total 8 shops in Beijing, Chengdu, Dengfeng, Jian, Shanghai, Shenyang, Wuhan and Xiangtan. The cost for each shop is estimated to be around 2 million RMB for three years of operation. For 2012, the group plan to open an additional 5 retail shops. The retail shops will serve as asles and marketing platforms.

Possible acquisition: The company announcement in November 2011 regards to the possible acquisition of equity interest in Yantai Baiyanghe Winery). In February 2012, the company enters into a 2nd supplemental agreement to modify and supplement the first MOU.

The new modifications were: 1) the exclusivity period to negotiate will be extended to December 31st, 2012 and 2) They will pay to the target company an additional amount of RMB16m as earnest money. They initial paid earnest money of RMB20m. In the case of formal agreement is not concluded within the exclusivity period, the earnest money in full will refund without interest.

Yantai Baiyanghe: Yantai Baiyanghe was found in 1958 in Qixia City along the Baiyang River in Shandong Province. It is located at approximately the same latitude as the world-renowned Bordeaux wine-producing region in France and is the only international vine and wine city in Asia. They produces approximately 80 types of wines, including grape wines, brandies and rice wines and also offers premium imported wines from countries overseas, like France, Australia and Chile. They have a nation-wide sales network covers all provinces and cities in the PRC, with its main markets in Guangxi, Shandong, Fujian, Zhejiang and Jiangsu.

Possible benefit: The proposed acquisition would expand its wine products portfolio particularly in the premium high-end grape wine and imported wine products; upgrade the Group's wine making technology and reducing production costs through economies of scale using the combined production facilities; and bolster its sales and distribution network in the PRC and improve its profitability in the long run. It would also generate synergies through complementary strengths, as well as through sharing of resources.

Table 4. Valuation comparison

Company name	Ticker	Mkt cap (US\$m)	Last Price (Local)	His P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	Est ROE (%)
HK-listed								
China Foods	506 HK	2,696.2	7.53	37.3	31.2	23.8	3.3	7.5
Silverbase	886 HK	822.3	5.39	8.3	7.0	5.7	3.7	37.9
Dynasty Wine	389 HK	280.0	1.75	22.5	35.0	21.9	1.1	8.3
Average					24.4	17.7		
China-Listed								
Changyu	000869	6,159.5	102.00	29.7	28.8	22.2	12.4	41.7
Citic Guoan	600084	700.9	6.75	-	-	-	5.9	-
Gansu Mogao	600543	417.5	10.14	65.8	-	-	3.0	4.1
Tonghua	600365	142.2	7.92	284.3	-	-	8.1	2.9
Average					28.8	22.2		

Source: Bloomberg

Valuation: We revised our sales estimate to RMB914.4m for FY12/12F with 8.0% volume growth and 2.0% ASP growth for the full year. We estimate RMB1,026m for FY12/13F with 10.0% volume growth and 2.0% ASP growth. We estimate that the net profit would be RMB211.7m for FY12/12F and RMB226.3m for FY12/13F. We maintain a buy rating with target price of HK\$1.54. Our target price represents 11.9x FY12/12F and 11.1x FY12/13F P/E. The HK listed peers are currently trading at average 28.8x FY12/12F and 22.2x FY12/13F P/E based on market consensus.

Table 5. P & L forecast

Year to Dec (RMBm)	09A	10A	11A	12F	13F
Revenue					
Sweet Wine	403.8	499.1	573.7	632	709
Dry Wine	180.5	204.9	256.4	282.4	316.9
	584.3	703.5	830.1	914.4	1,026
Cost of sales	(246.1)	(289.6)	(351.0)	(394.5)	(452.9)
Gross profit	338.2	413.9	479.1	519.9	573
Other income	1.7	3.3	6.2	6.8	7.7
Selling and distribution expenses	(67.9)	(84.3)	(119.9)	(132.0)	(151.2)
Administrative expenses	(13.3)	(32.3)	(75.7)	(83.4)	(96.7)
Other expenses	(9.0)	0.0	0.0	0.0	0.0
Finance costs	0.0	0.0	0.0	0.0	0.0
Profit before tax	249.7	300.6	289.7	311.3	332.9
Income tax expense	(75.6)	(92.5)	(100.9)	(99.6)	(106.5)
Net profit	174.1	208.1	188.8	211.7	226.3

Source: Company data, SBI E2-Capital

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