

China Green: Unique Green F&B Play

Recommendation: BUY (initiating coverage)

China F&B

Price	HK\$5.60	Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.
Target price	HK\$7.58+(35.3%)	Apr	RMBm	RMB	Δ %	x	x	x	%	%	%	%
12 mth range	HK\$2.70-6.29	05A	183.5	0.275	(8.3)	20.4	4.24	20.7	1.2	25.1	25.1	Cash
Market cap.	US\$574.56m	06A	271.3	0.373	35.6	15.0	3.60	15.9	1.8	26.9	23.4	Cash
Daily t/o, 3 mth	US\$1.23m	07F	340.9	0.468	25.5	12.0	2.97	11.6	2.3	25.3	21.3	Cash
Free float %	49.9%	08F	450.0	0.618	32.1	9.1	2.83	8.0	3.0	28.2	24.4	Cash
Ticker	0904.HK/904 HK	09F	570.7	0.784	26.9	7.1	2.03	6.2	3.8	29.2	25.4	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +27.9%, +47.2%, +25.1%

Actual price changes (1 mth, 3 mth, 12 mth): +25.0%, +52.6%, +54.5%

Consensus EPS (07F-08F): RMB0.440, RMB0.560

Key points:

- Real vertical integrator with products ranging from fresh produce upstream to beverages such as corn milk and non-fried ramen noodles downstream.
- Good food safety and cost controls thanks to its control of upstream supply.
- Set to benefit from the rising demand for green food.
- Domestic contribution expected to rise from more than 54.2% of sales in 1H FY04/06A to 65.0 – 70.0% in the next few years reducing reliance on Japan export sales.
- Plans to provide cultivation services and logistic management to a leading Shanghai chain.
- Top line growth to exceed 30.0% in FY04/07F with the introduction of new products.
- Trading at an attractive FY04/07F P/E of around 14.0x and FY04/08F P/E of 11.1x (fully diluted EPS of RMB0.401 for FY04/07F and RMB0.505 for FY04/08F).
- Emerging unique green F&B play in Hong Kong, which deserves a premium rating - our target price of HK\$7.58 is based on FY04/08F 15.0x P/E.

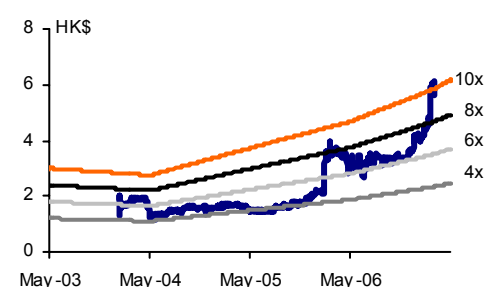
Fully vertical integrated supply chain. Established in 1998, China Green (CG) was listed in Hong Kong in January 2004. CG started with cultivating fresh vegetable products for its Japanese clients and established its first factory for processing fresh vegetables in 1999. It now has 10 advanced processing factories with a net production area of about 41,800 sq m and annual capacity of 397,000 tonnes located in Fujian, Zhejiang, Jiangxi, Hubei and Hebei. It also operates 33 cultivation bases with a total area of 52,100 mu and an annual capacity of about 236,000 tonnes.

Green Food demand to rise in China. In November 1992, the Ministry of Agriculture (MOA) established China Green Food Development Center (CGFD) to promote production and development of pollution-free, safe, high quality and nutritious food in China. CGFD is a member of the International Federation of Organic Agriculture Movements. As health awareness and disposable incomes increase in China, demand for green food is set to rise. According to a survey of 154 large supermarket chains conducted by CGFD, the average selling price of green food is 10 - 30% higher than that of ordinary products. The survey also found that 82.1% of the 329 surveyed green food enterprises recorded profit growth in 2006.

Recognized green food standards. To be able to export to Japan, where food safety standards are high, CG has obtained quality assurance certificates including the Safe Corp Certificate, China, (a standard regulating the growing and processing of agricultural products prescribed by China's Bureau of Quality and Technical Supervision, fulfillment of which confirms that the products are free from any hazardous substances and pesticide residues); Green Food Certificate, China; ISO9001; ISO9002 and Hazard Analysis and Critical Control

Please refer to important disclosures at the end of this report

Chart 1: P/E band



Source: SBI E2-Capital

Point (HACCP), a system developed by the US Department of Agriculture which monitors and controls sanitary measures in food processing plants. It has also received the State Agricultural Enterprise Leadership Award from Fujian province.

Dominant China sales. In 1H FY04/06A, around 45.8% of CG's turnover was derived from exports, including about 71.0% from Japan. China, the largest contributor, represented 54.2% of total turnover, up from 43.5% in 1H FY04/06A, thanks mainly to robust demand for beverage and rice flour products in Fujian and Jiangxi. Sales to other Asian countries grew 64.1% and Europe, the new export market, also performed well. The dependence on Japan was reduced to 32.7% from 41.2% in 1H FY04/05A. More significantly, the share of domestic sales is expected to increase to 65.0% in the next few years.

Table 1: Turnover growth rate by region

Year to Apr (RMBm)	1H05	1H06	% Change
China	146.3	209.8	43.5
Japan	108.1	126.6	17.1
Other Asian countries	7.8	12.8	64.1
Europe	na	37.6	na
Australia	0.4	0.4	0.4
Total	262.5	387.2	47.5

Source: Company data

Table 2: Turnover breakdown by region

Year to Apr (RMBm)	1H05	% of total	1H06	% of total
China	146.3	55.7	209.8	54.2
Japan	108.1	41.2	126.6	32.7
Other Asian countries	7.8	3.0	12.8	3.3
Europe	na	na	37.6	9.7
Australia	0.4	0.2	0.4	0.1
Total	262.5	100.0	387.2	100.0

Source: Company data

Table 3: Exports of Chinese agricultural products in 2005

Countries/Region	Quantity	Growth (%)	Amount (US\$m)	Growth (%)
Japan	399.8	15.24	421.17	23.86
USA	486.1	5.17	358.54	9.21
Russia	354.8	21.88	153.13	39.32
Germany	170.9	66.07	112.35	75.45
ASEAN	1,049.1	15.75	392.00	24.16

Source: Company data

Changing business model – move downstream. The company aims to establish the most comprehensive green food supply chain in China, from cultivation and purchasing to freshness preservation and processing. It also wants to set up its own logistics system to deliver and distribute green food products to end consumer under its own brands. In July 2005, CG launched its corn milk beverage, the first of its kind in China (Chart 2).

Increasing beverage contribution. In 1H FY04/06A, its beverage segment contributed 13.9% in terms of sales and we expect it to account for over 20.0% in FY04/07F and 25.0% in FY04/08F thanks to the company's efforts to promote own brand names and its first mover advantage after the launch of its branded corn milk in China. CG plans to spend around RMB40.0m on advertising and promotional activities, especially on its brand name building in Jiangxi and Fujian, and expansion in Greater Shanghai. It plans to introduce two to three new product series (five to six products) each year.

Table 4: Turnover growth rate by product

Year to Apr (RMBm)	1H05	1H06	% Change
Fresh produce	102.2	111.9	9.5
Processed products	63.4	98.9	56.1
Pickled products	23.1	54.2	134.6
Beverage	24.0	53.6	123.3
Rice and rice flour products	49.7	68.5	37.8
Total	262.5	387.2	47.5

Source: Company data

Table 5: Turnover breakdown by product

Year to Apr (RMBm)	1H05	% of total	1H06	% of total
Fresh produce	102.2	39.0	111.9	28.9
Processed products	63.4	24.2	98.9	25.6
Pickled products	23.1	8.8	54.2	14.0
Beverage	24.0	9.1	53.6	13.9
Rice and rice flour products	49.7	18.9	68.5	17.6
Total	262.5	100.0	387.2	100.0

Source: Company data

Margin boost. With its vertically integrated processing platform, CG creates high value green vegetable and fruit products, which command higher selling prices and profit margins. The company's control of its upstream supply ensures stringent cost and quality supervision and reduces reliance on suppliers. Its overall gross margin widened from 44.6% in 1H FY04/05A to 51.0% in 1H FY04/06A because of better food processing techniques. The increase in the gross margins of fresh produce, processed products and beverages will boost the overall gross margin.

Table 6: Interim results

Six months to Oct	Turnover (RMBm)	Gross profit (RMBm)	Gross margin (%)	Operating profit (RMBm)	Net profit (RMBm)	EPS Basic (RMB)	DPS (RMB)
FY04/06	387.2	197.5	51.0	151.8	141.5	0.190	0.048
FY04/05	262.5	117.7	44.6	106.4	106.4	0.150	0.040
YoY (%)	47.5	67.8	-	42.7	33.0	26.7	20.0

Source: Company data

Table 7: Gross profit by product

Year to Apr (RMBm)	1H05	1H06	% Change
Fresh produce	47.0	52.9	12.6
Processed products	34.4	56.7	64.8
Pickled products	10.7	29.8	178.5
Beverage	12.1	31.9	163.6
Rice products	13.6	10.3	(24.3)
Rice flour products	na	15.8	na
Total	117.7	197.5	67.8

Source: Company data

Table 8: Gross margin breakdown by product

Year to Apr (RMBm)	1H05	1H06	pcp
Fresh produce	46.0	47.3	1.3
Processed products	54.3	57.3	3.1
Pickled products	46.3	55.0	8.7
Beverage	50.4	59.5	9.1
Rice products	27.4	27.0	0.0
Rice flour products	na	7.8	na
Total	51.0	44.8	6.2

Source: Company data

Healthy non-fried corn ramen instant noodles. CG started to make non-fried corn ramen (Chart 3) in 2006. With their lower fat content, non-fried corn noodles are perceived as a healthier alternative to the fried variety. The noodles were well received by the market, with 100,000 cases booked during one day at a recent trade fair in Fujian province. Ordinary instant noodles are fried as a part of their manufacturing process, resulting in high levels of saturated fat. According to Hong Kong-based Chewy International Foods Ltd, the fat content of the non-fried variety is 20.0% lower than that of ordinary instant noodles.

Chart 2: Non-fried corn ramen noodles



Source: SBI E2-Capital & company

Chart 3: Corn beverages



Source: SBI E2-Capital & company

Near-term catalysts. The company teamed up with strong partners to enter the Shanghai market. In 1992, CG ventured into Jiangxi and Fujian with its rice and beverage products. It is also close to setting up a JV with Shanghai’s leading supermarket chain, which in 2005 had more than 1,572 stores nationwide and the sales volume of RMB17.5b, according to the Ministry of Commerce. Under the JV, the supermarket chain may outsource its cultivation of vegetables and related logistics management to CG and reduce promotional and listing fees to distribute CG’s food and beverage products in its chain stores.

From green to organic. To further standardize its green food supply chain, CG leased 20,000 mu in Hubei to convert it into China’s largest organic cultivation base. It plans to adopt the combination of contemporary ecological principles and advanced cultivation technologies to implement comprehensive green controls in order to ensure food safety.

Financials. Capex is estimated at RMB580.0m for FY04/07F mainly for the construction of processing centers in Shanghai, Jiangxi and Fujian. Together with the net proceeds of CB and net cash of RMB600.0m, the company has sufficient funds.

Table 9: Capex expenditure in FY04/07F

Year to Apr	RMBm
Leasing of cultivation bases	69.0
Infrastructure and leasehold improvement on cultivation bases	50.0
Building of processing plants and frozen warehouses	145.0
Installation of production lines, transportation equipment, etc.	180.0
Working capital for logistics center located in Shanghai	80.0
Advertising and promotion expenses	40.0
R&D expenses	16.0
Total	580.0

Source: Company data

Valuation. Over 50.0% of CG’s turnover was generated from China domestic sales in 1H FY04/06A and 13.9% from beverage. It is estimated that turnover contributions from beverage to reach over 25.0% in FY04/08F. CG is moving towards a Green F&B play and we therefore rate CG with other listed China domestic F&B peers for comparison. China Green is now trading only at FY04/08F of P/E of 11.1x. Our target price of HK\$7.58 represents 15.0x FY04/08F while other listed China F&B peers are relatively expensive at around 30.0x FY08F P/E.

Table 10. F&B Peer comparisons

Company	Ticker	Currency	Price	Mkt Cap. (US\$m)	Hist. P/E (x)	Fwd Yr. 1 P/E (x)	Fwd Yr. 2 P/E (x)	ROE (%)	FY06 PEG (x)
China Mengniu	2319 HK	HK\$	21.45	3,763.2	58.8	47.7	36.8	21.3	2.7
Yili	600887 CH	RMB	26.88	1,793.8	40.8	37.7	33.1	13.5	1.9
Tingyi	322 HK	US\$	8.45	6,054.4	49.2	40.1	32.3	14.8	0.7
Groupe Danone	BN FP	EUR	120.61	41,496.5	16.7	24.7	21.8	30.7	2.3
Uni-President	1216 TT	TWD	32.20	3,271.8	51.9	32.2	24.8	4.9	5.0
Nissin Food	2897 JP	JPY	4,230.	4,547.4	28.1	27.0	28.2	6.6	na
Kirin Brewery	2503 JP	JPY	1831.0	1,520.7	32.0	33.7	31.5	6.3	na
Average					39.6	34.7	29.8	14.0	2.5

Source: Bloomberg & SBI E2-Capital

Corporate governance.

Management. Mr. Sun Shaofeng, Chairman, Managing Director and Founder of China Green. He has over 10 years of management experience in the agricultural industry and is responsible for the overall management, business development, strategic planning and marketing of CG. Mr. Nie Xing, Vice Chief Operating Officer is responsible for the financial planning, operation and corporate financing.

Dividend Policy. The company aims to maintain a stable dividend payout policy of around 25.0%. Its actual payout was around 27.0% since the IPO.

Auditor history. CCIF CPA has been CG's auditor since 2004.

Capital history. In 2004, CG placed 150m new shares to institutional investors at HK\$1.46 each. In January 2006, it issued a five-year HK\$325.0m convertible bond with an annual interest rate of 2.125% and a conversion price of HK\$2.655.

Major risks. 1) RMB appreciation; 2) Execution of capacity and downstream expansion; 3) New product execution and 4) Natural disasters.

Corporate milestones

1998: Established in Huian, Fujian. The first base in Huian county

1999: First processing factory for fresh vegetables

2000: Second processing factory for processed vegetables

2001: Accredited with ISO9002

2002: Received Safe Corp Certification

2004: Listed on the Main Board of the Stock Exchange in January by offering 150m shares at HK\$1.28 each.

2004: Accredited ISO9001 and the HACCP certificate. Identified as the State-Level Leading Industrialized Agricultural Enterprise by Fujian province. Placed 150m new shares to institutional investors.

2005: Launched new processing factories in Hebei, Jiangxi and Fujian

2006: Issued HK\$325.0m convertible bonds to Goldman Sachs

P & L (RMBm)	05A	06A	07F	08F	09F	Cash Flow (RMBm)	05A	06A	07F	08F	09F
Year to Apr						Year to Apr					
Turnover	470.5	686.6	941.2	1,223.6	1,540.5	EBIT	209.9	262.9	344.2	470.7	651.9
% chg	25.3	45.9	37.1	30.0	25.9	Depre./amort.	32.6	53.9	93.7	124.9	148.1
Gross profit	254.5	354.4	485.7	642.4	825.7	Net int. paid	(2.1)	(0.7)	(3.3)	(3.2)	(3.3)
EBITDA	242.5	316.8	437.9	595.7	800.0	Tax paid	(3.6)	-	(9.4)	(12.6)	(16.9)
Depre./amort.	(32.6)	(53.9)	(93.7)	(124.9)	(148.1)	Others	(19.6)	(15.4)	(39.1)	(24.9)	(16.9)
EBIT	209.9	262.9	344.2	470.7	651.9	Gross cashflow	221.0	307.8	386.1	555.0	762.9
Net int. income/(exp.)	(2.1)	(0.7)	(3.3)	(3.2)	(3.3)	Chgs. in working cap.	16.9	1.1	11.0	0.9	13.9
Exceptionals	-	-	-	-	-	Operating cashflow	237.9	308.8	397.0	555.9	776.8
Associates	-	-	-	-	-	Capex	(67.4)	(229.5)	(450.0)	(400.0)	(400.0)
Jointly-controlled entit.	-	-	-	-	-	Free cashflow	170.5	79.3	(53.0)	155.9	376.8
Pre-tax profit	207.9	262.3	340.9	467.5	648.5	Dividends paid	(34.8)	(57.5)	(62.8)	(74.8)	(85.9)
Tax	(24.4)	9.0	-	(17.5)	(77.8)	Net distribution to MI	-	-	-	-	-
Minority interests	-	-	-	-	-	Investments	-	-	-	-	-
Net profit	183.5	271.3	340.9	450.0	570.7	Disposals	-	0.1	0.2	0.3	0.4
% chg	21.9	47.8	25.7	32.0	26.8	New shares	162.5	-	-	-	-
Dividends	(50.1)	(75.2)	(92.0)	(121.5)	(154.1)	Others	(120.0)	(2.6)	159.6	(402.1)	(60.0)
Retained earnings	133.4	196.1	248.9	328.5	416.6	Net cashflow	178.2	19.3	44.0	(320.7)	231.4
EPS (RMB) - Basic	0.275	0.373	0.468	0.618	0.784	Net (debt)/cash - Beg.	353.6	531.8	551.1	595.2	274.4
EPS (RMB) - F.D.	0.275	0.357	0.401	0.505	0.640	Net (debt)/cash - End.	531.8	551.1	595.2	274.4	505.8
DPS (RMB)	0.069	0.103	0.126	0.167	0.212	Interim Results (RMBm)	04A	05A	06A		
No. sh.s o/s (m) - W.A.	667.7	728.1	825.7	825.7	825.7	Six months to Oct					
No. sh.s o/s (m) - Y.E.	667.7	728.1	825.7	825.7	825.7	Turnover	177.9	262.5	387.2		
No. sh.s o/s (m) - F.D.	667.7	760.8	849.9	891.3	891.3	% chg	90.9	47.5	47.5		
Margins (%)						Profit from operations	82.6	106.4	151.8		
Gross	54.1	51.6	51.6	52.5	53.6	Interest expenses	-	-	(10.3)		
EBITDA	51.5	46.1	46.5	48.7	51.9	Associates	-	-	-		
EBIT	44.6	38.3	36.6	38.5	42.3	Jointly-controlled entit.	-	-	-		
Pre-tax	44.2	38.2	36.2	38.2	42.1	Pre-tax profit	82.6	106.4	141.5		
Net	39.0	39.5	36.2	36.8	37.0	Tax	(20.5)	-	-		
						Minority interests	-	-	-		
						Net profit	62.1	106.4	141.5		
						% chg	215.3	71.4	33.0		
						EPS (RMB) - Basic	0.100	0.150	0.190		
						DPS (RMB)	0.030	0.038	0.048		
Balance Sheet (RMBm)	05A	06A	07F	08F	09F	Shareholding Structure					
Year to Apr											
Fixed assets	196.7	400.9	850.9	1,250.9	1,650.9						
Intangible assets	(6.3)	-	-	-	-						
Other LT assets	82.3	131.5	110.1	128.0	143.7						
Cash	531.8	852.9	799.0	566.2	797.6						
Accounts receivable	9.2	22.6	30.7	41.3	55.7						
Other receivables	107.7	37.8	38.2	43.2	58.2						
Inventories	5.2	7.7	15.2	20.7	27.9						
Due from related co.s	-	-	-	-	-						
Other current assets	56.6	65.0	74.0	84.2	97.1						
Total assets	983.3	1,518.4	1,918.0	2,134.5	2,831.1						
Accounts payable	(23.0)	(16.2)	(30.1)	(41.1)	(55.5)						
Other payable	-	-	-	-	-						
Tax payable	(73.1)	(67.3)	(121.9)	(164.7)	(204.5)						
Due to related co.s	-	-	-	-	-						
ST debts	-	-	-	-	-						
Other current liab.	(0.9)	-	(0.6)	(0.7)	(0.8)						
LT debts	-	(301.8)	(203.9)	(291.8)	(291.8)						
Other LT liabilities	(3.8)	(0.5)	(2.2)	(3.7)	(4.1)						
Total liabilities	(100.7)	(385.8)	(358.6)	(501.9)	(556.8)						
Share capital	77.1	77.5	81.3	81.3	81.3						
Reserves	805.5	1,055.1	1,478.1	1,551.3	2,193.1						
Shareholders' funds	882.6	1,132.6	1,559.4	1,632.6	2,274.3						
Minority interest	-	-	-	-	-						
Total	882.6	1,132.6	1,559.4	1,632.6	2,274.3						
Capital employed	882.6	1,434.4	1,763.2	1,924.4	2,566.1						
Net (debt)/cash	531.8	551.1	595.2	274.4	505.8						
						Key Ratios	05A	06A	07F	08F	09F
						Net gearing (%)	Cash	Cash	Cash	Cash	Cash
						Net ROE (%)	25.1	26.9	25.3	28.2	29.2
						EBIT ROCE (%)	28.8	22.7	21.5	25.5	29.0
						Dividend payout (%)	27.3	27.7	27.0	27.0	27.0
						Effective tax rate (%)	11.7	(3.4)	-	3.7	12.0
						Net interest coverage (x)	100.7	403.2	104.7	147.7	195.1
						A/R turnover (days)	7.1	12.0	11.9	12.3	13.2
						A/P turnover (days)	17.8	8.6	11.7	12.2	13.1
						Stock turnover (days)	4.1	4.1	5.9	6.2	6.6

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BUY : absolute upside of >10% over the next six months

HOLD : absolute return of -10% to +10% over the next six months

SELL : absolute downside of >10% over the next six months

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