

China Green: Promising new product

Recommendation: BUY (unchanged)

China F&B

Price	HK\$7.08	Year to Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.	
Target price	HK\$10.32(+45.8%)	Apr	RMBm	RMB	Δ %	X	X	X	%	%	%	%
12 mth range	HK\$2.70-7.65	05A	183.5	0.275	(8.3)	25.7	5.4	26.9	1.0	25.1	25.1	Cash
Market cap.	US\$768.84	06A	271.3	0.373	35.6	19.0	4.6	20.7	1.5	26.9	23.4	Cash
Daily t/o, 3 mth	US\$1.41	07F	340.9	0.403	7.9	17.6	3.8	15.1	1.5	25.3	21.3	Cash
Free float %	47.9%	08F	450.0	0.505	25.4	14.0	3.9	10.5	1.9	28.2	24.4	Cash
Ticker	0904.HK/904 HK	09F	570.7	0.640	26.8	11.1	2.8	8.1	2.4	29.2	25.4	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +14.7%, +22.4%, +60.4%

Actual price changes (1 mth, 3 mth, 12 mth): +14.6%, +26.4%, +105.2%

Consensus EPS (07F-08F): RMB0.404, RMB0.504

Key points:

- Newly launched non-deep fried noodles well received.
- China Green's food and beverage segments estimated to grow more than 50.0% a year in FY04/07F, FY04/08F and FY04/09F.
- Export market to grow about 30.0% a year in FY04/07F, FY04/08F and FY04/09F on strong demand for processed green food.
- Strong R&D supports new product launches and technological advancement.
- New distribution network to boost China sales.
- Branded products expected to account for over 45.0% of the company's total turnover in FY04/09F.
- Share price up 26.4% since our last report on 28 Feb 2007 - still trading at an attractive FY04/08F P/E of 14.0x (fully diluted EPS: RMB0.505 for FY04/08F).
- New target price revised up to HK\$10.32 based on 20.0x P/E FY04/08F and PEG of 0.8x.

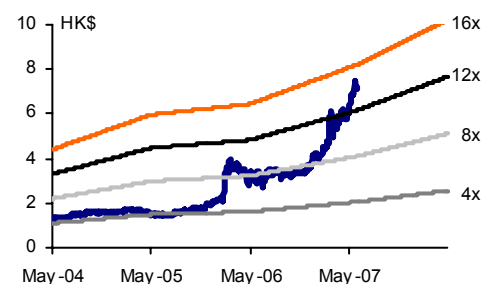
Strong demand for non-deep fried noodles. In the first four months of 2007, China Green (CG) received RMB18.0m worth of orders (10.0m packs) for its non-deep fried noodles at food trade fairs in Jiangxi and Fujian.

Huge growth potential in China. The Chinese Institute of Food Science and Technology (中國食品科學技術學會) estimates that non deep fried noodles represent less than 3.0% of the instant noodle market in China, 4.0% in Taiwan and 15.0% in Japan. In 2006, China's total instant noodle production reached 46.0 billion packs worth RMB298.4m.

Fast growing segment. According to www.foodqs.com (中國食品產業網), the technology to make non-deep fried noodles was introduced to China two years ago. The current market leader is Zhongwang International Investment Ltd (中旺國際投資), a private enterprise in Hubei province. Its major product, Five Grains Cereal Way Non-fried Instant Noodles (五谷道場), was launched in Nov 2005. According to China's "Contemporary Manager" (當代經理人) magazine, Zhongwang was the country's fastest growing company in terms of turnover (up 2,003.3% between 2003 and 2005 to RMB1.5b). Hualong (華龍) and Uni-president (統一), China's instant noodle market leaders, plan to launch non-deep fried noodles or set up joint ventures with non-deep fried noodle producers

Low production costs. CG's gross margin for non deep fried noodles is currently about 45% because of its low raw material costs (it uses own corn to make corn flour while other producers use palm oil and wheat flour, prices of which have been rising over the last three years). It was also able to adapt its existing production lines,

Chart 1: P/E band



Source: SBI E2-Capital

which resulted in lower investment spending (RMB16.0m compared with the industry average of RMB20.0m).

Increased production. Currently, CG has two production lines for non-deep fried noodles with an annual volume of 150m packs. It is in the process of increasing its output capacity and plans to set up new lines in northern China to meet strong market demand.

Robust beverage growth. We expect CG's beverage turnover to grow more than 50.0% annually from FY04/07F to FY04/09F. Its corn beverages are expected to generate more than 90% of turnover of the beverage segment. The segment's gross margin should exceed 58.0% in FY04/07F thanks to better economies of scale.

Rising demand for green food*. The annual per capita disposable income of urban households in China increased 10.4% YoY to RMB11,759.0 in 2006. It is estimated that turnover of the country's medium-sized enterprises wholesaling and retailing food, beverages, tobacco and liquor grew around 15.5% in 2006. Green food consumption grew around 46.0% in 2006.

* Green food refers to products free from any hazardous substances and pesticide residue.

Table 1: Key statistics for China's green food industry

	2000	2005	2006	Growth % (06 over 05)
Number of enterprises involved in green food production	964	3,695	5,759	56.0
Total annual sales of green food products (RMBb)	40.0	103.0	150.0	46.0
Total exports of green good products (US\$m)	200.0	1,620.0	2,000.0	23.0
Total annual production volume of green food products (m tones)	15.0	63.0	72.0	14.0
Number of products using green food label	1,831	9,728	12,868	32.0

Source: www.Greenfood.org.cn

Booming export markets. China's exports of agricultural products have grown rapidly in the past five years. With agricultural exports to Japan at US\$821.24m in 2006, China is the country's largest source of agricultural products. CG exported 40.5% of its turnover (RMB278.1m) to Japan in 2006. Its exports to Europe are expected to grow 40.0 – 50.0% annually in the next three years from the current 37.6%.

Table 2: China's agricultural exports (2002 – 2006)

US\$b	2002	2003	2004	2005	2006
Total	18.0	21.2	23.1	27.2	31.0
Growth (% YoY)	12.8	17.9	8.7	17.7	14.1

Source: Ministry of Agriculture, PRC

Table 3: China's exports of vegetables and related products (2002 – 2006)

US\$b	2002	2003	2004	2005	2006
Exports of vegetables, processed vegetables, fruit and nuts	3.6	4.3	5.1	6.1	7.5
Vegetable export growth (% YoY)	7.5	15.8	16.4	20.3	21.7
Processed vegetable, fruit and nuts export growth (% YoY)	17.5	23.2	19.0	20.0	22.2

Source: Ministry of Agriculture, PRC

Table 4: China's agricultural produce exports

Countries/ Regions	2006 (US\$m)	2005 (US\$m)	Growth (% YoY)
Japan	821.24	792.69	3.6
USA	3,776.06	2,838.68	33.0
Russia	884.58	729.47	21.3
Germany	1,101.39	931.16	18.3
ASEAN	3,053.79	2,422.46	26.1

Source: Ministry of Agriculture, PRC

Table 5: Top ten importers of China's agricultural products in 2006

Ranking	Countries and regions	% of the total
1	Japan	26.20
2	USA	12.25
3	Korea	9.24
4	Hong Kong	8.88
5	Germany	3.54
6	Russia	2.83
7	Malaysia	2.69
8	Holland	2.46
9	Indonesia	1.97
10	UK	1.64

Source: Ministry of Agriculture, PRC

Increasing cultivation bases. As of 30 April 2007, the company operated 36 cultivation bases with a total area of about 4,406.7 hectares, which we expect to expand at 20% per annum in the next three years. Their annual capacity was estimated of around 285,600 tones on 30 April 2007. The company has 10 processing factories with a net production area of about 55,000 sqm. Their annual production processing capacity is about 442,400 tones.

Table 6: Cultivation bases as of 30 April 2007

Subsidiaries	Area (hectares)	Cultivation capacity (tons)	Production capacity (tons)
Fujian (Huian) (including Zhejiang)	2,000.0	150,000.0	148,000.0
Fujian (Quanzhou)	na	na	28,800.0
Fujian (Zhangpu)	666.7	50,000.0	99,000.0
Hubei (Changyang)	200.0	13,000.0	15,000.0
Hebei	533.3	25,600.0	30,600.0
Jiangxi			
-Rice	200.0	1,200.0	49,500.0
-Rice flour	na	na	48,000.0
-Processed products	140.0	9,800.0	10,000.0
-Noodles	na	na	13,500.0
Hubei (Tianmeng)	666.7	36,000.0	na
Total	4,406.7	285,600.0	442,400.0

Source: Company data

Strong R&D. The company launches five to six new products each year. It has about 40 R&D specialists developing technological solutions for mass cultivation and advanced processing of vegetables and fruits and improving cultivation techniques related to harvest and seed planting methods, and new crops.

New distribution network. The company plans to set up networks in Zhejiang, Hunan, and Hubei to further expand its reach and brand. Currently around 30.0% of its products are sold under its own brands and the ratio is expected to rise to 50.0% by FY04/09F. Its Shanghai joint venture is under negotiation and we expect CG to benefit from its potential partners' strong distributions network.

Financials. FY04/07F capex is estimated at around RMB444.0m. It will be spent mainly on the construction of processing centers in Jiangxi and Fujian. Together with net proceeds of its CB, cash on hand is estimated at around RMB900.0m, sufficient for the company's near-term expansion.

Table 7: Capex in FY04/07F

	RMBm
Leasing of cultivation bases	69.0
Infrastructure and leasehold improvement in cultivation bases	50.0
Building of processing plants and frozen warehouses	145.0
Installation of production lines, transportation equipment, etc.	180.0
Total	444.0

Source: Company data

Table 8: F&B Peer comparison

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 (%)	FY07 PEG (x)
China Mengniu	2319 HK	HKD	25.5	4,480.4	47.1	29.2	22.8	27.3	1.3
Yili	600887 CH	RMB	34.65	2,340.3	49.5	42.3	36.7	14.1	7.1
Tingyi	322 HK	HKD	9.16	6,560.7	44.1	32.6	36.7	16.7	1.9
Groupe Danone	BN FP	EUR	115.3	40,502.5	23.4	18.4	16.4	24.4	1.8
Uni-President	1216 TT	TWD	31.90	3,234.9	32.4	19.6	17.0	8.0	na
Nissin Food	2897 JP	JPY	4,350	4,556.0	28.8	25.9	25.4	7.0	na
Kirin Brewery	2503 JP	JPY	1,867	1,510.3	32.7	32.0	29.3	5.4	na
Average					37.7	31.3	27.4	14.7	3.2

Source: Bloomberg & SBI E2-Capital

Valuation. Branded sales represented more than 30.0% of the company's turnover in 1H FY04/07A, with beverages accounting for 44.0% of all branded products. To reflect its huge potential in non-deep fried noodles, strong growth in corn beverages and second highest ROE of 26.9% among peers (after China Mengniu's 27.3%), we have lifted our target price to HK\$10.32 from HK\$7.58, which represents 20.0x P/E FY04/08F and a PEG of 0.8x, compared with China's F&B industry average of around 1.7x (excluding Yili).

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

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	0.403	0.505	0.640	Net (debt)/cash - Beg.	353.6	531.8	551.1	595.2	274.4
EPS (RMB) - F.D.	0.275	0.357	0.382	0.505	0.640	Net (debt)/cash - End.	531.8	551.1	595.2	274.4	505.8
DPS (RMB)	0.069	0.103	0.109	0.136	0.173	Interim Results (RMBm)	04A	05A	06A		
No. sh.s o/s (m) - W.A.	667.7	728.1	847.0	891.3	891.3	Six months to Oct					
No. sh.s o/s (m) - Y.E.	667.7	728.1	847.0	891.3	891.3	Turnover	177.9	262.5	387.2		
No. sh.s o/s (m) - F.D.	667.7	760.8	891.3	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				Shares o/s (m)	%
Year to Apr						Mr. Sun Shao Feng				405.3	47.9
Fixed assets	196.7	400.9	850.9	1,250.9	1,650.9	Value Partners				66.9	8.0
Intangible assets	(6.3)	-	-	-	-	Jayhawk China Fund				47.7	5.6
Other LT assets	82.3	131.5	110.1	128.0	143.7	Arisaig Greater China Fund				40.7	4.8
Cash	531.8	852.9	799.0	566.2	797.6	Public				286.4	33.7
Accounts receivable	9.2	22.6	30.7	41.3	55.7	Total				847.0	100.0
Other receivables	107.7	37.8	38.2	43.2	58.2	Background					
Inventories	5.2	7.7	15.2	20.7	27.9	China Green started with cultivating fresh 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 55,000 sq m and annual capacity of 442,400 tonnes. It operates 33 cultivation bases with a total area of 66,100 mu and an annual capacity of about 285,600 tonnes and 10 production plants in Fujian, Zhejiang, Jiangxi, Hubei and Hebei provinces					
Due from related co.s	-	-	-	-	-	Key Ratios	05A	06A	07F	08F	09F
Other current assets	56.6	65.0	74.0	84.2	97.1	Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Total assets	983.3	1,518.4	1,918.0	2,134.5	2,831.1	Net ROE (%)	25.1	26.9	25.3	28.2	29.2
Accounts payable	(23.0)	(16.2)	(30.1)	(41.1)	(55.5)	EBIT ROCE (%)	28.8	22.7	21.5	25.5	29.0
Other payable	-	-	-	-	-	Dividend payout (%)	27.3	27.7	27.0	27.0	27.0
Tax payable	(73.1)	(67.3)	(121.9)	(164.7)	(204.5)	Effective tax rate (%)	11.7	(3.4)	-	3.7	12.0
Due to related co.s	-	-	-	-	-	Net interest coverage (x)	100.7	403.2	104.7	147.7	195.1
ST debts	-	-	-	-	-	A/R turnover (days)	7.1	12.0	11.9	12.3	13.2
Other current liab.	(0.9)	-	(0.6)	(0.7)	(0.8)	A/P turnover (days)	17.8	8.6	11.7	12.2	13.1
LT debts	-	(301.8)	(203.9)	(291.8)	(291.8)	Stock turnover (days)	4.1	4.1	5.9	6.2	6.6
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						

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