

Robust growth ahead

China F&B

China Green (904 HK, HK\$7.90)

BUY (unchanged)

Target price: HK\$11.29 (+42.9%)

Earnings revision. We have revised up our net profit for China Green (CG) by 2.8% for FY04/09F and 2.0% in FY04/10F and slightly fine-tuned down FY04/08F net profit by 3.3% to H\$435.3m based on the newly estimated turnover of HK\$1.24b, HK\$1.65b and HK\$2.05b, which includes initial six month contributions in FY04/09F and full-year contributions in FY04/10F for the newly launched non-fried noodle expansion (6 – 8 production lines) in Shandong and processing canned food in Jiangxi province

Target price raised to HK\$11.29. Benefiting from strong demand for healthy green food and beverages, CG's turnover is expected to grow around 29.0% annually in the next three years. Given its fully vertically integrated business model, experienced management team and strong growth ahead, CG's current 13.0x P/E for FY04/09F is undemanding compared with other listed China F&B peers. We have lifted our target price to HK\$11.29 from HK\$10.32, based on 18.0x P/E FY04/09F and 0.6x PEG and the newly fully diluted EPS of RMB0.607, to reflect the latest market valuation.

Net proceeds of CB. CG has proposed to issue a three-year RMB1.0b zero coupon CB with an initial conversion price HK\$11.0, representing a premium of 35.0% to the last closing price of HK\$8.15 and about 9.7% of its enlarged issued share capital (the closing date is expected to be 29 October 2007).

Use of proceeds. Net proceeds of around RMB980.0m will be used for the company's new cultivation bases and expansion of non-fried noodles and processing canned food operations:

- RMB 220.0m - to purchase and install equipment including up to (6 – 8) non-fried noodle production lines in Shandong and processing canned food line in Jiangxi province
- RMB100.0m – to invest in the branded fresh produce supply chain business in Shanghai. The details will be announced by end-2007.
- RMB200.0m – to acquire land and processing plants in Jiangxi, Shandong and Shanghai.
- RMB200.0m – to construct and build those processing plants. in Jiangxi, Shandong and Shanghai
- RMB180.0m – to lease land and the infrastructure cost of its existing processing plants in Jiangxi, Shandong and Shanghai.

Financials. After the CB issue, net cash is expected to reach HK\$708.2m in FY12/08F and HK\$175.0m in FY04/09F. We expect its cash on hand at over RMB1.5b in FY04/09F and RMB1.2b in FY04/10F, sufficient for the company's near-term expansion.

Green food in demand. China's demand for green food is set to surge along with residents' rising incomes and

Table 1: Financial summary

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Apr	RMBm	RMB	Δ %	x	x	x	%	%	%	%
06A	271.3	0.373	35.6	21.2	5.1	21.0	1.3	26.9	17.0	Cash
07A	346.0	0.400	7.4	19.7	3.9	15.6	1.5	25.7	16.5	Cash
08F	435.3	0.473	18.3	16.7	4.5	11.4	1.9	27.3	17.5	Cash
09F	586.6	0.607	28.2	13.0	3.4	7.8	2.6	30.0	17.5	Cash
10F	723.9	0.749	23.4	10.6	3.2	5.7	3.2	31.1	21.3	Cash

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health awareness. Currently, green food in the country retails at prices 10.0 – 30.0% higher than ordinary food products. Japan and the EU recorded double-digit growth in imports of fruit and vegetable products from China over the past year. China's total vegetable exports grew at a CAGR of 13.0% over the past 15 years.

New awards. CG received the “Famous Trademark” title from the Xiamen Industry and Commerce Department in August 2007. The title is based on the evaluation of its products' brand awareness, goodwill and market share.

Brand building. The company appointed Chen Hua, China's famous actress, as its product promoter in April 2007. We expect her involvement and the company's advertising and marketing strategy to strengthen the brand considerably.

From distribution to direct sales. In July 2007, CG started using direct retail distribution chains in Xiamen, Fujian province. At present, it operates a “China Green” counter in Minxing Supermarket, Xiamen (fresh produce kiosk) and expects to open five similar counters by end-2007. CG also distributes fresh produce to Fujian-based supermarkets such as Newhuadu, Trust-Mart and Rainbow.

Growth momentum picks up in Japan. Turnover from Japan should increase 6.0 – 12.0% in FY04/08F based on the current order books. A Japanese vice president has been appointed to manage the direct sales business to Japan and branded fresh produce logistics chain in Shanghai.

Surging exports to Europe. CG started exporting to Europe in 2006. Its turnover from the segment grew 134.8% in FY04/07A on strong demand for processed canned mushroom products. Turnover from Europe is expected to grow 40.0 – 50.0% in FY04/08F. We expect the company's whole export segment to grow at least about 20.0% in FY04/08F.

New products are well received. In January 2007, CG launched non-fried noodles, which in the first four months of 2007 contributed RMB18.0m to total revenue. Using the CB proceeds, the company will add another 6 – 8 production lines in Shandong.

Strong growth in processed products. Accounting for 33.3% of its total turnover, the sales of processed and pickled products grew more than 53.0% in FY04/07A and should increase 30.0-45.0% in FY04/08F as global demand increases.

New organic food plan. CG plans to lease 20,000 mu (1,333.3 hectares) in Tianmen, Hubei province, and use it as an organic cultivation base, producing mainly for Japanese and domestic clients. It will implement its first organic seasonal complementary cultivation model and use contemporary ecological principles and advanced technologies to ensure that products meet organic standards. CG's first organic crops are expected in three years.

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

FY04/07A results recap. CG net profit increased 27.5% to RMB346.0m (excluding RMB14.4m in interest on the liability component of CB), above our estimate of RMB340.9m and other market estimates. Turnover was up 39.0% at RMB954.2m and gross profit 40.5% at RMB497.9m. A final dividend of HK\$0.063 was proposed.

China sales up. CG derived about 46.7% of its turnover from exports, including about 67.4% from Japan. China, its largest contributor, generated 53.3% of total turnover, up from 52.1% in FY04/06A, thanks to robust demand for beverage and rice flour products in Fujian and Jiangxi. Sales to other Asian countries grew 28.0% and to Europe by 135.0%.

Table 2: Turnover breakdown by countries

Year to Apr (RMBm)	FY04/06A	% of total	FY04/07A	% of total	YoY (%)
Japan	278.0	40.5	300.5	31.5	8.1
China	328.7	47.9	508.4	53.3	54.7
Other Asian countries	37.8	5.5	48.4	5.1	28.3
Europe	38.8	5.7	91.1	9.5	134.8
Australia	3.3	0.5	4.5	0.5	36.6
Africa	Na	Na	1.1	0.1	Na
Total	686.6	100.0	954.1	100.0	39.0

Source: Company data

Beverage sales surge. Beverage sales grew 63.5% to RMB114.6m, with corn milk accounting for RMB92.3m. Branded food and beverage products (beverages, instant noodles, rice and rice flour products) accounted for

32.3% of total turnover, from 26.4% a year ago. Turnover of non-fried instant noodles reached RMB18.5m in the first four months of 2007. Its gross margin reached 40% in FY04/07A.

Margins. The gross margin widened to 52.2% (our estimate: 51.6%) reversing its two-year downtrend on increasing contributions from the branded high-margin food and beverage segment (gross margin: 47.0% in FY04/07A) and shrinking sales of lower margin rice products (9.0% of total turnover from 12.0%). The operating margin narrowed to 37.8% from 39.0% mainly due higher general and administrative expenses. As a result of increased share option costs, the net margin narrowed to 36.2% from 39.5%.

Table 3: Turnover by product

Year to Apr (RMBm)	FY04/06A	% of total	FY04/07A	% of total	YoY (%)
Fresh produce	297.6	43.3	328.0	34.4	10.2
Processed products	124.8	18.2	183.0	19.18	46.7
Pickled products	83.1	12.1	135.3	14.18	162.8
Rice products	81.0	11.8	86.3	9.05	6.6
Rice flour products	30.0	4.4	88.4	9.26	194.3
Beverage products	70.0	10.2	114.6	12.01	63.6
Non-fried Instant noodles	Na	na	18.5	1.94	na
Total	686.6	100.0	954.1	100.0	100.0

Source: Company data

Table 4: Gross profit by product

Year to Apr (RMBm)	FY04/06A	% of total	FY04/07A	% of total	YoY (%)
Japan	164.3	46.4	173.2	34.8	5.4
China	145.2	41.0	242.7	48.7	67.1
Other Asian countries	20.9	5.9	27.5	5.5	31.5
Europe	22.0	6.2	51.1	10.3	131.9
Australia	1.90	0.5	2.8	0.6	47.2
Africa	Na	na	0.6	0.1	na
Total	262.5	100	497.9	100.0	40.5

Source: Company data

Table 5: Gross profit margin by country

Year to Apr (RMBm)	FY04/06A	FY04/07A	YoY (%)
Japan	59.1	57.6	-1.5
China	44.2	47.7	3.5
Other Asian countries	55.5	56.9	1.4
Europe	56.7	56.0	-0.7
Australia	57.0	61.4	4.4
Africa	na	57.5	na
Total	51.6	52.2	0.6

Source: Company data

Table 6: China's exports of agricultural products

Countries (US\$m)	2005	2006	Change (%)	1H 2006	1H 2007	Change (%)
Japan	7,926.9	8,212.4	3.6	3,909.5	4,151.9	6.2
USA	2,838.7	3,776.1	33.0	1,637.7	2,106.8	28.6
Russia	729.5	884.6	21.3	400.2	594.7	48.6
Germany	931.2	1,101.4	18.3	533.6	648.9	21.6
ASEAN	2,422.5	3,053.8	26.1	1,346.7	1,761.1	30.8

Source: Ministry of Agriculture of the PRC