

# China Green



## Focus on geographical expansion

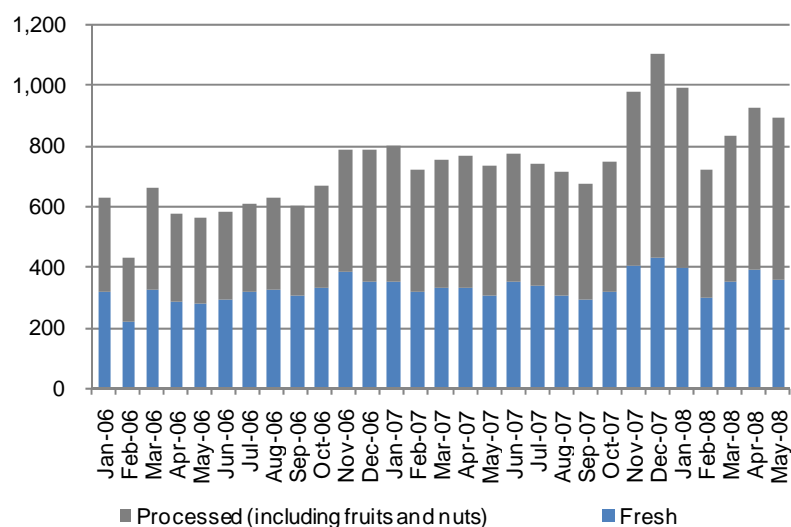
### Key points:

- Steady growth of China's vegetable exports
- Foray into new markets in Europe and the Middle East
- Booming green beverage & instant noodle business
- Increased budget for A&P and R&D.
- Target price lowered to HK\$8.17.

### Industry overview

**Healthy market.** In 2007, China's exports of fresh and processed vegetable products (including fruits and nuts) increased 8.9% (to US\$4,044.7m) and 43.9% (to US\$5,442.5m), respectively. In the first five months of 2008, despite unfavorable effects of February snowstorms and the Sichuan earthquake (May 2008), they increased 9.9% (to US\$1,784.4m) and 19.6% (to US\$2,560.9m) (17.8% and 23.2% for Apr/May). From May 2007 to Apr 2008 (CG's fiscal year), we estimate the country's exports of fresh and processed vegetable products grew 6.7% and 32.8%, respectively.

**Chart 1: China's export of vegetables (US\$m)**



Source: Ministry of Commerce of the PRC (Department of Foreign Trade), SBI E2-Capital

### Company discussion

**Fresh produce.** CG's segmental turnover increased 9.8% to RMB360.1m in FY04/08A. Due to transportation and storage constraints, domestic sales represented around 60.0%, exports to Japan around 30.0% and other Asian countries 10.0%. We expect steady high single-digit growth of this segment in the future. The newly launched (May 2008) logistic centre in Shanghai, serving mainly supermarkets, central kitchen and fast food restaurants chains, should help to achieve this because the end-user market yields better margins.

**Processed products.** Processed products (including pickles) are mainly (around 95.0%) sold overseas. In FY04/08A, sales surged 49.2% to RMB474.9m (the country's exports were up 32.8%).

**BUY (unchanged)**

### China Agriculture

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### Stock data

<b>Price</b>	<b>HK\$6.67</b>
<b>Target price</b>	HK\$8.17 (+22%)
<b>12 mth range</b>	HK\$6.20-11.30
<b>Market cap.</b>	US\$757.8m
<b>Daily t/o, 3 mth</b>	US\$1.9m
<b>Free float %</b>	48.7%
<b>Ticker</b>	904.HK/0904 HK

### Financial summary

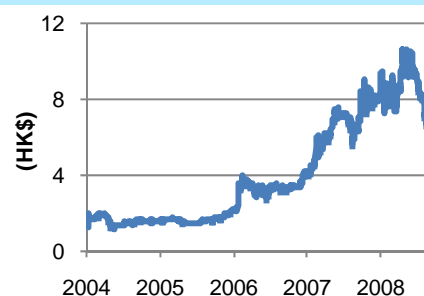
Year to Apr	06A	07A	08F	09F	10F
Turnover (RMBm)	954.11	267.11	664.22	095.82	552.4
Net Profit (RMBm)	346.0	471.0	515.2	582.1	700.8
EPS (RMB)	0.448	0.538	0.583	0.658	0.793
EPS Δ %	20.1	20.1	8.4	12.9	20.4
P/E (x)	13.5	11.3	10.4	9.2	7.6
P/B (x)	2.78	2.37	2.02	1.72	1.49
EV/EBITDA (x)	10.7	7.3	6.5	5.1	3.6
Yield (%)	1.6	2.2	2.7	3.3	3.9
ROE (%)	24.6	24.0	21.0	20.1	20.9
ROCE (%)	21.7	19.9	17.0	18.1	23.4
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

### Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-5.9	-21.5	23.3
Actual price changes (%)	-14.3	-35.9	2.5

	09F	10F	11F
Consensus EPS (RMB)	0.600	0.725	0.583
Previous forecasts (RMBm)	580.1	690.9	n.a.
Previous EPS (RMB)	0.655	0.780	n.a.

### Price Chart



Attempts to expand in Europe and the Middle East generated positive results. We believe CG's geographical expansion will be its major sales driver, with the sales of processed products expected to increase 33.9% in FY12/09F to RMB635.9m.

**Beverages.** CG's corn milk and other healthy beverage products have been well received, according to the management, and are expanding beyond its traditional markets of Fujian and Jiangxi provinces. With its existing 28,000tonne capacity fully utilized, CG will add 23,000tonnes (both in Fujian) in FY04/09F. Sales in FY04/08A increased 61.2% to RMB184.8m.

**Instant noodles.** The company sold instant noodle only in Fujian and Jiangxi in FY04/08A, with turnover soaring 245.2% to RMB63.8m. It intends to expand to other regions in FY04/09F. Four new production lines will commence operation in Oct 2008, boosting its total capacity from 8,000tonnes to 24,000tonnes (all in Jiangxi).

**Organic farming.** The company allocated 10,000 mu (666.7 hectares) in Hubei for organic farming. The operation will be launched in 2011 because three years are needed to get the land qualified for growing organic plants.

**Gross margins.** Renminbi appreciation (47.0% turnover came from overseas in FY04/08A and is mainly US\$-denominated) and new beverage & instant noodle capacities are two major negative factors. Nevertheless, we expect the blended gross margin to be stable in FY04/09F and improve gradually thereafter, backed by sales mix changes.

**Operating expenses.** The company budgets RMB92.0m for A&P and RMB40.0m for R&D in FY04/09F. We expect total operating expenses to rise substantially in FY04/09F, depressing CG's operating margin. The operating margin should recover in FY04/11F, as the company's operating leverage improves.

**Earnings forecasts.** Turnover rose 32.8% YoY to RMB1,267.1m in FY04/08. The gross margin widened 1.2pcp to 53.4% mainly due to sales mix changes. Net profit increased 36.1% to RMB471.0m. For FY04/09F, we project 31.3% top line growth to RMB1,644.2m and 9.4% bottom line growth to RMB515.2m. Our new earnings forecast is 11.2% lower than the previous one because: 1) we revised up operating expense estimates for FY04/09F after the company released its budget; 2) the company issued a RMB1.0bn zero-coupon convertible bond in Oct 2007, which carries an effective interest rate of 5.8% per annum.

Table 1: Forecast adjustments

Year to Apr (RMBm)	08A	08F	Difference (%)	09F (old)	09F (new)	Adjustment (%)	Main reason for adjustments
Turnover	1,267.1	1,236.1	(2.4)	1,559.3	1,664.2	6.7	
Fresh produce	360.1	366.2	1.7	410.4	391.1	(4.7)	lower-than-expected sales in FY04/08A
Processed and pickled products	474.9	443.1	(6.7)	601.3	635.9	5.7	better-than-expected sales in FY04/08A
Rice products	183.5	183.5	(0.0)	196.3	189.0	(3.7)	more conservative long-term growth assumption (from previous 5.0% to 3.0%)
Beverage products	184.8	174.6	(5.5)	257.0	299.9	16.7	growth figure in FY04/08A, existing capacity has been fully utilized
Instant noodles	63.8	68.7	7.7	94.2	148.3	57.4	growth figure in FY04/08A, existing capacity has been fully utilized
Gross profit	676.6	648.5	(4.2)	822.5	889.5	8.2	better growth of higher-margin processed products and beverage products
Other revenue	58.3	25.0	(57.2)	37.4	58.9	57.3	assume additional RMB18.9m gain from investment in Renminbi exchange rate related derivatives
Gain arising from changes in fair value less estimated point-of-sale costs of biological assets	19.9	68.1	241.5	82.0	23.7	(71.2)	to better reflect FY04/08A results
Operating expenses	(244.5)	(225.1)	(7.9)	(271.4)	(365.9)	34.9	total RMB132.0m budget on A&P and R&D in FY04/09F
Operating profit	510.3	516.4	1.2	670.6	606.2	(9.6)	
Finance cost	(26.6)	(1.4)	(94.7)	0.0	(58.0)	n.a.	RMB1.0bn zero-coupon convertible bond issued in Oct 2007 with effective interest rate of 5.8%
Profit before taxation	483.7	515.0	6.5	670.6	548.1	(18.3)	
Income tax	(12.8)	(41.2)	222.0	(90.5)	(32.9)	(63.7)	the company guides effective tax rate at 2.0-8.0% for FY04/09F
Net profit	471.0	473.8	0.6	580.1	515.2	(11.2)	
			(pcp)			(pcp)	
Gross margin	53.4	52.5	(0.9)	52.7	53.5	0.7	
Operating margin	40.3	41.8	1.5	43.0	36.4	(6.6)	
Net margin	37.2	38.3	1.2	37.2	31.0	(6.2)	

Source: Company data, SBI E2-Capital

**Valuation.** We lower target price for the counter to HK\$8.17 based on the fair value derived from our DCF model (discounted at 4.3% risk-free rate plus 8.8% risk premium). BUY unchanged.

P & L (RMBm)	07A	08A	09F	10F	11F
<b>Year to Apr</b>					
<b>Turnover</b>	<b>954.1</b>	<b>1,267.1</b>	<b>1,664.2</b>	<b>2,095.8</b>	<b>2,552.4</b>
% chg	39.0	32.8	31.3	25.9	21.8
Gross profit	497.9	676.6	889.5	1,144.1	1,405.0
EBITDA	415.8	575.6	721.0	909.4	1,140.8
Depre./amort.	(70.5)	(94.2)	(154.8)	(217.3)	(244.3)
EBIT	345.3	481.4	566.2	692.1	896.5
Net int. income/(exp.)	0.4	2.4	(18.0)	(23.0)	2.0
Exceptionals					
Associates					
Jointly-controlled entit.					
<b>Pre-tax profit</b>	<b>345.8</b>	<b>483.7</b>	<b>548.1</b>	<b>669.1</b>	<b>898.5</b>
Tax	0.2	(12.8)	(32.9)	(87.0)	(197.7)
Minority interests					
<b>Net profit</b>	<b>346.0</b>	<b>471.0</b>	<b>515.2</b>	<b>582.1</b>	<b>700.8</b>
% chg	27.5	36.1	9.4	13.0	20.4
Dividends	(91.3)	(125.1)	(159.1)	(194.5)	(229.8)
Retained earnings	254.7	345.8	356.1	387.6	471.0
EPS (RMB) - Basic	0.448	0.538	0.583	0.658	0.793
EPS (RMB) - F.D.	0.417	0.506	0.580	0.645	0.785
DPS (RMB)	0.109	0.144	0.180	0.220	0.260
No. sh.s o/s (m) - W.A.	847.0	847.0	884.0	884.0	884.0
No. sh.s o/s (m) - Y.E.	772.5	875.5	883.3	884.0	884.0
No. sh.s o/s (m) - F.D.	864.8	983.1	989.0	992.0	892.8
<b>Margins (%)</b>					
Gross	52.2	53.4	53.5	54.6	55.0
EBITDA	43.6	45.4	43.3	43.4	44.7
EBIT	7.0	38.0	34.0	33.0	35.1
Pre-tax	36.2	38.2	32.9	31.9	35.2
Net	36.3	37.2	31.0	27.8	27.5
<b>Balance Sheet (RMBm)</b>	<b>07A</b>	<b>08A</b>	<b>09F</b>	<b>10F</b>	<b>11F</b>
<b>Year to Apr</b>					
Fixed assets	475.5	523.4	1,039.6	1,385.4	1,219.4
Intangible assets	176.8	265.4	600.7	876.7	899.4
Other LT assets					
Cash	1,050.5	2,098.0	1,642.7	1,711.7	1,434.1
Accounts receivable	50.6	34.7	45.6	57.4	70.0
Other receivables					
Inventories	14.3	26.2	49.8	62.7	76.3
Due from related co.s					
Other current assets	73.3	220.1	251.8	119.9	140.5
<b>Total assets</b>	<b>1,841.0</b>	<b>3,167.8</b>	<b>3,630.3</b>	<b>4,213.8</b>	<b>3,839.7</b>
Accounts payable	(22.4)	(24.1)	(31.6)	(38.8)	(46.7)
Other payable					
Tax payable	(67.6)	(54.9)	(32.9)	(87.0)	(197.7)
Due to related co.s					
ST debts					
Other current liab.	(0.8)	(6.0)	(6.6)	(7.5)	(9.0)
LT debts	(64.6)	(843.2)	(901.2)	(959.2)	0.0
Other LT liabilities	0.0	0.0	0.0	0.0	0.0
<b>Total liabilities</b>	<b>(155.4)</b>	<b>(928.2)</b>	<b>(972.3)</b>	<b>(1,092.5)</b>	<b>(253.4)</b>
Share capital	88.9	92.1	92.3	92.3	92.3
Reserves	1,596.6	2,147.5	2,565.7	3,029.1	3,494.0
<b>Shareholders' funds</b>	<b>1,685.5</b>	<b>2,239.6</b>	<b>2,658.0</b>	<b>3,121.4</b>	<b>3,586.2</b>
Minority interest					
<b>Total</b>	<b>1,685.5</b>	<b>2,239.6</b>	<b>2,658.0</b>	<b>3,121.4</b>	<b>3,586.2</b>
Capital employed	1,750.1	3,082.8	3,559.2	4,080.6	3,586.2
Net (debt)/cash	985.9	1,254.8	741.5	752.5	1,434.1
<b>Cash Flow (RMBm)</b>	<b>07A</b>	<b>08A</b>	<b>09F</b>	<b>10F</b>	<b>11F</b>
<b>Year to Apr</b>					
EBIT	345.3	481.4	566.2	692.1	896.5
Depre./amort.	70.5	94.2	154.8	217.3	244.3
Net int. paid	0.4	2.4	(18.0)	(23.0)	2.0
Tax paid	0.0	(25.5)	(54.9)	(32.9)	(87.0)
Dividends received					
<b>Gross cashflow</b>	<b>416.2</b>	<b>552.5</b>	<b>648.0</b>	<b>853.5</b>	<b>1,055.8</b>
Chgs. in working cap.	21.5	34.5	(34.5)	(27.2)	(28.1)
<b>Operating cashflow</b>	<b>437.7</b>	<b>587.0</b>	<b>613.6</b>	<b>826.3</b>	<b>1,027.8</b>
Capex	(190.9)	(235.0)	(1,016.1)	(849.3)	(110.2)
<b>Free cashflow</b>	<b>246.9</b>	<b>352.0</b>	<b>(402.5)</b>	<b>(23.1)</b>	<b>917.6</b>
Dividends paid	(83.7)	(103.1)	(141.0)	(174.3)	(209.6)
Net distribution to MI					
Investments	0.0	(139.5)	0.0	152.8	0.0
Disposals	0.3	0.0	0.0	0.0	0.0
New shares	43.7	34.6	0.0	0.0	0.0
Others	227.7	124.8	30.2	55.6	(26.4)
<b>Net cashflow</b>	<b>434.8</b>	<b>268.9</b>	<b>(513.3)</b>	<b>11.0</b>	<b>681.6</b>
Net (debt)/cash - Beg.	551.1	985.9	1,254.8	741.5	752.5
Net (debt)/cash - End.	985.9	1,254.8	741.5	752.5	1,434.1
<b>Interim Results (RMBm)</b>	<b>06A</b>	<b>07A</b>	<b>08A</b>		
<b>Six months to Jun</b>					
<b>Turnover</b>	<b>262.5</b>	<b>387.2</b>	<b>533.7</b>		
% chg		47.5	37.8		
Profit from operations	106.4	148.0	218.5		
Interest expenses		(6.4)	(1.1)		
Associates					
Jointly-controlled entit.					
<b>Pre-tax profit</b>	<b>106.4</b>	<b>141.5</b>	<b>217.3</b>		
Tax			(9.5)		
Minority interests					
<b>Net profit</b>	<b>106.4</b>	<b>141.5</b>	<b>207.8</b>		
% chg		33.0	46.8		
EPS (RMB) - Basic	0.150	0.190	0.240		
DPS (RMB)	0.040	0.048	0.063		
<b>Shareholding Structure</b>					
				<b>Shares o/s (m)</b>	<b>%</b>
Sun Shaofeng				413.7	46.8
Kwok Kin Kwok				45.0	5.1
Investco				44.8	5.1
McCarthy Kent				10.0	1.1
Others				370.5	41.9
<b>Total</b>				<b>884.0</b>	<b>100.0</b>
<b>Background</b>					
Established in 1998, China Green is a vertically-integrated food producer with headquarter in Fujian province. The company has three buesiness segments: fresh produce, processed products and branded beverage and instrant noodle products. The company listed in Hong Kong exchange in 2004.					
<b>Key Ratios</b>	<b>07A</b>	<b>08A</b>	<b>09F</b>	<b>10F</b>	<b>11F</b>
Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Net ROE (%)	24.6	24.0	21.0	20.1	20.9
EBIT ROCE (%)	21.7	19.9	17.0	18.1	23.4
Dividend payout (%)	26.4	26.6	30.9	33.4	32.8
Effective tax rate (%)	(0.1)	2.6	6.0	13.0	22.0
Net interest coverage (x)	na	na	31.4	30.1	na
A/R turnover (days)	21.2	12.3	8.8	9.0	9.1
A/P turnover (days)	7.4	6.7	6.1	6.1	6.1
Stock turnover (days)	8.8	12.5	17.9	21.6	22.1

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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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