

## Stepping into new lands

**BUY (unchanged)**

### Financial summary

Year to Apr	08A	09A	10F	11F	12F
Turnover (RMBm)	1,267.11	547.71	877.62	227.32	700.0
Net Profit (RMBm)	471.0	454.9	515.9	608.9	732.2
EPS (RMB)	0.538	0.515	0.584	0.689	0.828
EPS Δ%	20.1	(4.3)	13.3	18.0	20.2
P/E (x)	10.4	10.8	9.6	8.1	6.7
P/B (x)	2.18	1.92	1.65	1.46	1.24
EV/EBITDA (x)	6.7	6.9	5.3	4.5	4.3
Yield (%)	2.6	2.3	2.7	3.2	3.9
ROE (%)	24.0	18.9	18.5	19.1	19.9
ROCE (%)	19.9	16.1	18.1	21.8	26.3
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI E2-Capital

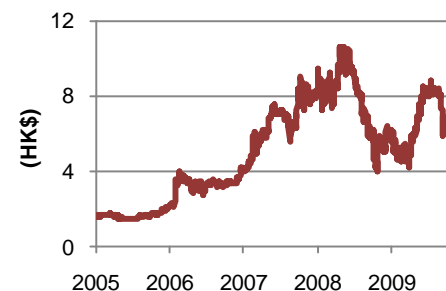
### Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-21.5	-32.2	-8.7
Actual price changes (%)	-21.1	-24.0	+5.5

	10F	11F	12F
Consensus EPS (RMB)	0.605	0.702	0.863
Previous forecasts (RMBm)	569.8	676.4	n.a.
Previous EPS (RMB)	0.644	0.765	n.a.

### Price Chart



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Ticker:	0904.HK	12 mth range:	HK\$3.85-8.92
Price:	HK\$6.35	Market cap:	US\$719.7m
Target:	HK\$7.61 (+20%)	Daily t/o, 3 mth:	US\$2.3m
		Free float %:	54.1%

### Key points:

- ★ Satisfactory geographic expansion as expected.
- ★ Beverage growth to re-accelerate.
- ★ Instant noodle business slowed.
- ★ Uncertainty on leasing model brought by new land policy.
- ★ Earnings projection lowered 9.4% and 10.1% for FY04/10F and FY04/11F.
- ★ New target at HK\$7.61, down from HK\$7.94.

**Geographic expansion as the main driver.** Sales to Japan contracted slightly by 5.3% in FY04/09A to RMB410.6m, partly due to the poisoned dumpling incident and weak economy after the financial crisis, according to the management. Nevertheless, other overseas markets did well with aggregate turnover surging 62.5% to RMB401.7m during the period. The management re-iterated its developing strategy to increase occupancy within existing markets while explore new markets by leveraging up its "Green" concept and quality control ability. In view of the high maturity of Japanese market, we believe geographic expansion is necessary. The company's progress in this area, so far, is satisfactory. Under such a trend, meanwhile, we expect more processed products in the sales mix going forward due to distant transportation, which will also favor blended gross margin (Gross margin of processed products division actually squeezed 2.9pcp in FY04/09A to 55.0% due to more sales of canned food whose margin is ~5pcp lower than frozen ones. However, this change is somewhat random and, therefore, should not be regarded as sustainable). A notable fact is that the company used to receive formulas and assistants from Japanese clients. This model might not be applicable in other countries and CG has to develop its own formulas and new products to attract purchases. As a result, R&D expenses increased 64.0% in FY04/09A to RMB52.3m (3.4% of revenue).

**Elapsing impact of melamine issue on Beverage.** Corn milk, CG's core beverage product, has been recovering quickly. The whole segment registered 17.5% growth in FY04/09A to RMB234.9m. Sales coverage has been extended from Fujian, Jiangxi and Guangdong further to Hubei and Zhejiang. The company is looking for a 40% sales increase this year with growth from both existing products and launch of new ones.

**Instant noodle slowing down.** Following the postponed construction of instant noodle plant in Shandong, the company has further decided to hold the expansion this year and concentrate on well-performed operations such as processed products and beverage. We reckon difficulties the company is facing in developing instant noodle business might include: 1) moderated growth industry wise (the entire industry's growth rate has decreased to high-single digit); 2) privilege prevailing consumption attention on brand and taste instead of CG's "non-fried" and "Green" concepts; 3) insufficient distribution network (sales is still confined in Fujian and Jiangxi)

**Uncertainty from buck leasing prepayment.** CG paid RMB793.3m in lump sum in FY04/09 to renew ~55% of existing cultivation land leasing contracts with farmers (mainly in Fujian). The payment, covering 25-year term, is out of our expectation as the company used to pay leasing fees in each five years. According to the management, the change is backed by the central government's announcement to promote land transferring in rural area in Oct 2008.

Please refer to important disclosures at the end of this report

Hong Kong

After discussing and negotiating with local government, the company paid the 25-year leasing fee in advance in exchange for secured land using right. Nevertheless, the management sees the old model (i.e. payment is made in each five years) still prevailing in most other regions. As this issue will materially impact the company's future cash flow, especially in short & middle-term, we have constructed two scenarios to accommodate different assumption on this particular regard.

**Target price down to HK\$7.61.** FY04/09A results are broadly in line with our expectation. However, considering the slowdown in fresh produces (mainly to Japan) and instant noodle and increase in R&D expenses, we have penciled down our earnings forecasts for FY04/10F and FY04/11F 9.4% and 10.0%, respectively, to RMB515.9m and RMB608.2m. Growth in FY04/012F, however, is expected to accelerate after launching organic products in 2011. DCFE fair value of the counter in the two scenarios (5-year payment and 25-year payment) is HK\$8.96 and HK\$6.75, respectively. We slightly revised down our target price from HK\$7.94 to HK\$7.61, which represents 15% discount to the HK\$8.96 DCFE fair value in the five-year payment scenario.

**Table 1: FY04/09A results highlight**

Year to Apr (RMBm)	08A	09A	YoY (%)	09F	Estimate difference (%)
Turnover	1,267.1	1,547.7	22.1	1,581.3	2.2
Cost of sales	(590.5)	(747.5)	26.6	(743.4)	(0.6)
Gross profit	676.6	800.1	18.2	837.9	4.7
Other revenue	58.3	23.2	(60.1)	24.1	3.6
Gain arising from changes in fair value less estimated point-of-sale costs of biological assets	19.9	19.5	(2.3)	23.7	21.4
Selling and distribution expenses	(125.2)	(152.3)	21.7	(160.8)	5.6
General and administrative expenses	(119.4)	(141.5)	18.5	(125.2)	(11.5)
Operating profit	510.3	549.1	7.6	599.6	9.2
Finance cost	(26.6)	(53.7)	102.0	(58.0)	8.0
Profit before taxation	483.7	495.3	2.4	541.6	9.3
Income tax	(12.8)	(40.4)	215.9	(81.2)	101.0
Net profit	471.0	454.9	(3.4)	460.3	1.2

Source: Company data, SBI E2-Capital

**Table 2: P & L**

Year to Apr (RMBm)	08A	09A	10F	11F	12F
Turnover	1,267.1	1,547.7	1,877.6	2,227.3	2,700.0
Cost of sales	(590.5)	(747.5)	(876.3)	(1,031.9)	(1,241.4)
Gross profit	676.6	800.1	1,001.3	1,195.4	1,458.5
Other revenue	58.3	23.2	25.0	22.0	19.0
Gain arising from changes in fair value less estimated point-of-sale costs of biological assets	19.9	19.5	21.2	23.1	25.0
Selling and distribution expenses	(125.2)	(152.3)	(188.6)	(227.1)	(279.4)
General and administrative expenses	(119.4)	(141.5)	(171.7)	(203.6)	(246.9)
Operating profit	510.3	549.1	687.2	809.7	976.3
Finance cost	(26.6)	(53.7)	(58.0)	(29.0)	0.0
Profit before taxation	483.7	495.3	629.2	780.7	976.3
Income tax	(12.8)	(40.4)	(113.3)	(171.8)	(244.1)
Net profit	471.0	454.9	515.9	608.9	732.2
EPS - basic (RMB)	0.538	0.515	0.584	0.689	0.828
EPS - diluted (RMB)	0.506	0.513	0.581	0.686	0.825
Proposed DPS (RMB)	0.144	0.128	0.150	0.180	0.220
Proposed dividend	125.1	113.7	132.6	159.1	194.5

Source: Company data, SBI E2-Capital

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