

3Q FY03/06 results review

China F&B

Fu Ji (1175 HK, HK\$21.20)

BUY (unchanged)

Target price: HK\$24.8 (+16.8%)

Net profit up 50.4%. Fu Ji reported a 50.4% YoY increase in net profit to RMB274.6m in 3Q FY03/07 on the back of a 57.4% turnover growth to RMB865.7m.

Major drivers. Accounting for 74% of total sales, catering turnover surged 70.5% to RMB641.5m with operating profit up 51.6% to RMB865.7m. Turnover from Chinese restaurants (19.0% of total turnover) grew 9.3% to RMB165.4m. As of September 2006, the average daily output reached 520,000 meal sets, 87.5% higher than at the end of December 2005.

Margins. The gross margin improved to 57.2% from 57.0% a year ago. The operating margin widened to 37.6% from 37.2% in 2Q FY03/07 but shrunk from 40.6% a year ago. The net margin narrowed to 31.7% from 33.2% a year ago.

Table 1: 3Q FY3/07 results

Year to Mar	Turnover (RMBm)	Gross profit (RMBm)	Operating profit (RMBm)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)	Basic EPS (RMB)
FY07	865.7	370.2	325.2	299.0	8.2	274.6	0.546
FY06	549.9	236.9	223.2	208.7	12.5	182.6	0.422
YoY (%)	57.4	56.3	45.7	43.3		50.4	29.4

Source: Company data

Table 2: Margin analysis

Year to Mar	Gross margin (%)	Operating margin (%)	Net margin (%)
3Q FY3/07	57.2	37.6	31.7
2Q FY3/07	56.3	37.2	32.2
1Q FY3/07	54.9	36.4	31.9
4Q FY3/06	56.6	34.4	27.9
3Q FY3/06	57.1	40.6	33.2

Source: Company data

Margin expansion is a result of cost saving initiatives by the sourcing and initial processing centre (SPIC) and an increasing contribution from high-margin catering services to 74.1% of total turnover (from 68.4%). Sourcing and initial processing businesses contributed RMB71.1m in 3Q FY03/07 to turnover despite of their negative operating profit contribution.

Table 3: Financial summary

Year to Mar	Net profit RMBm	EPS RMB	EPS Δ %	P/E X	P/B X	EV/EBITDA X	Yield %	ROE %	ROCE %	N. Gearing %
05A	165.4	0.462	67.9	45.8	10.4	30.0	0.2	38.9	33.4	Cash
06A	251.4	0.488	5.5	43.4	8.4	28.1	0.7	23.7	20.6	Cash
07F	377.0	0.741	51.8	28.6	5.8	20.5	1.0	24.0	19.4	26.9
08F	590.1	1.032	39.3	20.5	5.2	13.7	1.5	29.3	23.5	17.4
09F	902.9	1.435	39.0	14.8	5.3	9.5	2.5	33.4	27.7	14.1

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Table 4: Operating margin breakdown by segment

Year to Mar	Catering services (%)	Chinese restaurant (%)	Convenience food (%)
3Q FY3/07	40.4	24.9	45.2
2Q FY3/07	40.3	24.4	44.4
1Q FY3/07	37.2	24.0	56.8
4Q FY3/06	41.1	17.3	na

Source: Company data

Near-term catalysts

- A regional distribution and processing centre (RDPC) in Jiading, Shanghai, is scheduled to begin production by 30 June 2007 and will boost Fu Ji's capacity by 300,000 meals per day. Another new RDPC will be built in Beijing.
- Beijing Olympics. Fu Ji plans to sign catering service contracts for the 2008 Beijing Olympics to become an official food caterer of the event.

Valuation. The counter is currently trading at FY03/07F P/E of 28.6x and FY03/08F P/E of 20.5x. Compared with other listed peers, it has the lowest PEG. To reflect its better-than-expected booming industry outlook, we increase our target price to HK\$24.8, which is based on 24.0x FY03/08F P/E (fully diluted EPS: RMB1.032).

Table 5: Peer comparison

Company	Ticker	Year end	Mkt cap. (US\$m)	His. P/E (x)	Fwd 1 Yr P/E (x)	Fwd 2 Yr P/E (x)	ROE (FY05) (%)	Operating margin (%)	PEG (x)
Compass	CPG LN	Sep	12,182.1	22.4	21.6	19.3	12.5	4.7	1.3
Sodexo	SW FP	Aug	11,689.2	26.8	30.0	25.0	15.4	4.7	1.3
Café de Coral	341 HK	Mar	947.0	19.8	22.9	19.1	18.1	11.2	1.3
Fairwood	52 HK	Mar	192.8	19.8	17.1	13.3	28.3	5.9	na
Singapore Food	SFI SP	Dec	473.1	15.6	13.3	12.6	21.1	7.4	na
Fu Ji	1175 HK	Mar	1,379.0	43.4	28.6	20.5	23.7	37.8	1.1
AVG				24.6	22.3	18.3	19.9	12.0	1.3
Median				21.1	22.3	19.2	19.6	6.7	1.3

Source: Bloomberg & SBI E2-Capital