

Strategic consultant and planned acquisition

China F&B

Fu Ji (1175 HK, HK\$24.00)

BUY (unchanged)

Target price: HK\$30.1 (+25.0%)

Key takeaways from our telephone conference with management:

Strategic consultant Fu Ji Catering's parent has signed a strategic consulting agreement with financial group Giltmir (www.giltmirbank.com), which offers banking and financial services to seafood/food, sustainable energy and offshore service vessel industries. The bank listed on the Icelandic Stock Exchange in 1993. Under the agreement, Giltmir will act as a financial and strategic consultant for Fu Ji in China.

Positive move. Giltmir's history goes back to the establishment of Islandsbanki in 1904 in Iceland, where Giltmir has its headquarters. The company focuses on the seafood industry. In 2006, its net profit reached EUR435.0m and total assets EUR23,743.0m. It is rated by three major independent credit rating agencies. (A-/Stable/A-2 from Standard & Poor's on 25 April 2007; Aa3/C/P-1 from Moody's on 2 May 2007 and Long-term Issuer Default (IDR) 'A', Short-term IDR 'F1'. Individual 'B/C', Support Rating Floor of 'BBB' from Fitch on 23 Aug 2007). With Giltmir's help, Fu Ji is expected to quicken the pace of its M&A and joint venture projects.

Planned acquisition recap. On 2 Oct 2007, Fu Ji announced its plans to acquire a restaurant chain. It is expected to pay 8.0x – 8.5x forward one-year P/E (after the completion of the deal) to acquire 60.0% of the entire issued share capital of Sky Charm, which holds 35 Chinese companies. The companies operating the Golden Hans restaurant chain, which includes 33 restaurants in 24 cities in China, including Beijing, Shanghai, Tianjin, Changchun, Harbin, Hefei and Dalian. The Chain offers western-style barbecued food and self-brewed beer.

Consideration. Fu Ji will have the right of first refusal to acquire the remaining stake in Golden Hans, which is wholly owned by Miss Zhou Li. The total consideration is the aggregate purchase price, which is lower than (a) HK\$800.0m or (b) the sum of Purchase Price I and Purchase Price II. Purchase Price I is calculated on the basis of 30.0% of 8.0x P/E (or 8.5x P/E if Golden Hans' net profit exceeds HK\$99.0m one year after the deal's completion). Purchase Price II is calculated on the basis of 30.0% of 8.0x P/E (or 8.5x if Golden Hans' net profit exceeds HK\$148.5m two years after the deal's completion). Golden Hans' net profit was RMB48.6m in FY12/06A and RMB26.0m in FY12/05A.

Synergies. The acquisition will allow Fu Ji to procure and process food ingredients and raw materials for Golden Hans through its centralized system of sourcing, processing and distribution to achieve higher profit margins through economies of scale and sharing of resources. Over the past three years, Golden Hans added up to eight stores a year and expects the pace to pick up if the Fu Ji deal is completed. Golden Hans' net profit surged to 86.9% in FY12/06A to RMB48.6m on the back of 76.7% turnover growth to RMB265.0m. Its net margin was

Table 1: Financial summary

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Mar	RMBm	RMB	Δ %	X	X	X	%	%	%	%
06A	251.4	0.555	20.0	35.7	6.2	31.1	0.8	23.7	20.6	Cash
07A	348.1	0.693	24.8	28.6	5.5	23.8	1.0	21.5	18.4	Cash
08F	525.5	1.020	47.2	19.4	4.7	16.3	1.5	26.6	21.4	26.9
09F	828.6	1.608	57.7	12.3	3.8	11.4	2.4	34.3	26.8	17.4
10F	1,238.3	2.404	49.4	8.2	3.0	9.8	3.6	36.8	32.3	14.1

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17.3% in FY12/05A and 18.3% in FY12/06A. It is expected to remain at this level in FY12/07F. We expect the acquisition to further strengthen Fu Ji's earnings growth.

Conditions. The deal depends on: 1) Fu Ji's shareholders approval; 2) all government approvals; 3) completion of the restructuring of the 35 companies, which are beneficially owned by Sky Charm and 4) completion of Fu Ji's US\$100.0m financing exercise, which in part will be used to fund the acquisition. Fu Ji said it is looking into other forms of financing. We estimate its current net gearing at less than 20.0%.

Table 2: Jan – Aug 2007 Catering Retail Sales Growth (%)

Month	2007 (RMBm)	2006 (RMBm)	Growth rate YoY (%)
Jan	1,083.9	934.2	16.0
Feb	975.2	825.7	18.1
Mar	924.5	781.5	18.3
Apr	896.5	757.2	18.4
May	983.6	835.0	17.8
June	950.0	801.7	18.5
July	923.0	782.2	18.0
Aug	985.3	827.0	19.1
Jan-Aug	7,722.0	6,544.5	18.0

Source: Ministry of Commerce, PRC & SBI E2-Capital

Strong sector growth. As mentioned in our note dated 20 Sep 2007, China's catering sales grew 19.1% YoY in August to RMB985.0m (Table 2). The Ministry of Commerce said on 30 Sep 2007 that the retail index of China's core catering enterprises rose 17.9% YoY in August, up 0.4pcp from July, and 17.3% YoY in the Jan-August period.

Valuation. If the deal is completed by end-2007, the first significant contribution will come in FY03/09F. We retain our earnings model unchanged and will make necessary revisions as the deal progresses. Even without the contribution of the acquisition, the counter is trading at an undemanding 19.4x for FY03/08F, 12.3x for FY03/09F. We reiterate our BUY recommendation with a target price of HK\$30.01, representing 18.0x FY03/09F.

Table 3: Peer comparison

Company	Ticker	Year end	Mkt cap. (US\$m)	His. P/E (x)	Fwd yr 1 P/E (x)	Fwd yr207F P/E (x)	ROE (FY05) (%)	Operating margin (%)	Fwd yr 1 PEG (x)
Compass	CPG LN	Sep	12,010.3	19.6	17.6	15.6	11.8	4.7	2.0
Sodexo	SW FP	Aug	11,362.9	21.7	22.4	19.2	15.4	4.7	1.8
Café de Coral	341 HK	Mar	1,025.6	21.3	18.0	15.8	19.1	10.8	1.0
Fairwood	52 HK	Mar	162.0	14.6	11.7	9.8	27.2	7.6	0.5
Singapore Food	SFI SP	Dec	283.9	14.1	12.0	11.0	21.1	7.4	na
AVG				18.3	16.3	14.3	18.9	7.0	1.3

Source: Bloomberg & SBI E2-Capital