

Improving margins

China F&B

Fu Ji (1175 HK, HK\$15.98)

BUY (unchanged)

Target price: HK\$19.2 (+20.2%)

Catering services segment is the driver. Fu Ji reported 1H FY3/07 net profit of RMB172.2m, on the back of a 65.2% turnover growth to RMB534.8m. An interim dividend of HK\$10.2 cents was declared.

- Accounting for 74% of total sales, catering turnover surged 86.4% to RMB395.7m. Turnover from the Chinese restaurants (19% of total turnover) grew 8.6% to RMB102.4m. Sales generated from convenience food was up 9.0% in 1H FY3/07. As of Sept 06, average daily output reached 462,000 sets of meal - 1.3x higher than that in 1H FY3/06.
- Operating profit of catering services rose 52.7% to RMB154.0m, while that of Chinese restaurant and convenience food was up 10.7% to RMB24.8m and 16.1% respectively.

Table 1: 1H FY3/07 results

Year to Mar	Turnover (RMBm)	Gross profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)	Basic EPS (RMB)	Interim DPS (HK cents)
FY07	534.8	301.3	56.3	188.6	8.7	172.2	0.342	10.2
FY06	323.7	186.2	57.5	132.8	14.0	114.1	0.267	7.5
YoY (%)	65.2	61.9	-	42.0	-	50.8	28.1	36.0

Source: Company data

Table 2: Margin analysis

Year to Mar	Gross margin (%)	Operating margin (%)	Net margin (%)
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

Source: Company data

- Margin improvement was mainly due to: 1) Cost savings from existing SIPC's (sourcing and initial processing centre); 2) Increasing contribution from high-margin catering services to 74% of total turnover, from previous 66%; 3) Improving utilization current utilization increased to 54% as at Sept, with a target to reach full utilization within the next 24 months.
- ASP improved to RMB6 per meal as a result of increasing MNC client contribution (24% of its total customer mix). The current ASP for MNC clients is around RMB8 per meal.

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	70.4	35.6	8.0	22.3	0.2	38.9	40.7	Cash
06A	251.4	0.488	5.6	33.7	5.9	19.8	1.0	23.7	24.6	Cash
07F	377.0	0.732	49.8	22.5	4.7	13.4	1.3	23.1	25.8	Cash
08F	590.1	1.032	41.0	16.0	4.0	8.7	1.9	28.4	28.3	Cash
09F	902.9	1.435	39.1	11.5	3.0	8.5	2.6	33.0	24.9	Cash

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Table 4: Operating margin analysis

Year to Mar	Catering services (%)	Chinese restaurant (%)	Convenience food (%)
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

Growth drivers

- Fu Ji targets to achieve full utilization within the next 24 months.
- **Downstream expansion.** The Wuxi LDPC is expected to provide full scale catering service by Dec 2006. The Jiading RDPC is expected to commence operation by June 2007. The Beijing RDPC is expected to commence operation in 4Q CY07.
- **New client segment.** Fu Ji also discloses its blueprint to add clients from the exhibition and tourist attraction segments by 3Q CY07. By 2Q CY07/08, the company will capture more clients from railway, highway, shipping, primary and secondary schools.

Fine-tuning target price and earnings. We have slightly adjusted FY3/07F earnings forecast downward by 6% to RMB377m and 3.5% upward for net profit to RMB590m for FY3/08F to reflect the delay in commencement of its Wuxi, Hangzhou and Jiading centers. We have slightly fine-tuned our target price to HK\$19.2 based on 19x FY3/08F P/E.

Table 5: Peer comparisons

Company	Ticker	Year end	Currency	Mkt cap. (US\$m)	Hist. P/E (x)	Fwd yr 1 P/E (x)	Fwd yr 2 P/E (x)	ROE (%)	Operating margin (%)	PEG (x)
Compass	CPG LN	Sep	GBP	11,116.5	72.4	21.0	17.3	0.04	3.5	3.1
Sodexo	SW FP	Aug	EUR	9,123.8	27.4	19.8	17.2	7.7	4.0	2.3
Café de Coral	341 HK	Mar	HK\$	960.1	23.1	19.3	16.8	18.1	11.2	1.4
Fairwood	52 HK	Mar	HK\$	151.1	15.5	14.7	11.5	16.8	3.4	Na
Singapore Food	SFI SP	Dec	SGD	315.7	14.6	14.6	12.8	27.0	8.9	Na
Fu Ji	1175 HK	Mar	HK\$	1,034.5	33.7	22.5	16.0	28.9	44.3	0.4
AVG					31.1	18.7	15.3	16.4	13.0	1.8

Source: Bloomberg & SBI E2-Capital