

Recipe still right

China F&B

Fuji Catering (1175 HK, HK\$13.60)

BUY (unchanged)

Target price: HK\$21.54 (+58%)

Turnover surged 63.4% to RMB540.9m in 3Q FY03/08A. Top line in good shape and momentum intact.

Catering services grew 42.5% in 3Q FY03/08A to RMB368.0m, slower than in 1H (51.7%) due to fewer new customers, but the company expects to catch up in 4Q and reach its daily output target of 750,000 meal sets by end-FY03/08F. The ASP rose 7-8% YoY in 3Q, due to soaring food prices in China.

The company opened three new Chinese restaurants (in Beijing, Shanghai and Suzhou) in Sep and Oct 2007, bringing the total to nine. It also completed the acquisition of 60.0% in Sky Charm in Nov 2007. In November and December, this new operation generated RMB77.0m in turnover, RMB16.6m in operating profit and RMB15.5m in net profit.

Fuji opened four convenience food stores (one in 2Q and three in 3Q) in Shanghai under the "123 Supermarket" brand. Turnover of this business increased 224.7% to RMB31.5m in 3Q FY03/08A (105.9% to RMB58.3m in 1-3Q).

Table 1: Segment summary

Year to Mar (RMBm)	3Q FY03/07A	% of total	3Q FY03/08A	% of total	Change (%)
Turnover					
Catering services	258.2	78.0	368.0	68.0	42.5
Chinese restaurants	63.0	19.0	64.4	12.0	2.2
Theme restaurants	-	-	77.0	14.2	-
Convenience food and others	9.7	3.0	31.5	5.8	224.7
Total	330.9		540.9		63.4
Operating margin (%)					
Catering services	41.1		36.1		(5.0)
Chinese restaurants	25.9		8.9		(17.0)
Theme restaurants	-		20.5		-
Convenience food and others	36.2		(5.4)		(41.6)
Total	38.2		31.6		(6.6)

Source: Company data

We expect the company's top line growth to be driven by its aggressive capacity expansion:

- Two new regional distribution and processing centres (RDPCs) to open in Apr and Jun 2008, respectively, boosting the company's daily catering capacity from 1.0m meals to 1.6m.

Table 2: Financial summary

Year to Mar	Net profit RMBm	EPS HK\$	EPS Δ %	P/E x	P/B x	EV/EBITDA X	Yield %	ROE %	ROCE %	N. Gearing %
05A	251.4	0.565	13.5	28.5	5.0	17.7	1.0	23.7	20.6	Cash
06A	348.1	0.689	22.1	23.4	4.5	13.5	1.3	21.5	18.4	Cash
07F	411.1	0.769	11.5	20.9	3.9	10.4	1.4	20.7	16.7	Cash
08F	631.9	1.129	46.9	14.3	3.4	7.3	2.1	25.7	20.2	Cash
09F	838.1	1.433	26.9	11.2	2.7	9.3	2.7	27.1	22.0	Cash

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- Plans to add around five Chinese restaurants and 18-20 theme restaurants in the next one or two years.
- Plans to open four to five 123 Supermarkets in FY03/09F to capture strong demand for convenience food.

Gross margin widened 1.3pcp YoY in 1-3Q FY03/08A despite rising raw materials prices.

The catering segment was able to pass more than 90.0% of incremental costs onto customers, according to the management. The restaurant operation managed costs mainly by optimizing its raw materials and product structure.

Fuji operates four sourcing and initial processing centers (SIPCs) in Shandong, Zhejiang and Anhui and will set up one in Guangxi to strengthen its upstream operation and reduce production costs.

The newly-acquired theme restaurant will be further integrated this year, creating synergies, particularly in procurement, and reducing costs.

We estimate the blended gross margin will narrow each year in our forecast period (FY03/08F - FY03/10F) due to sales mix changes (lower turnover contribution from the high-margin Chinese restaurant business).

Operating margin narrowed 5.0pcp YoY to 36.1% in 3Q FY03/08A on high operating expenses.

The aggressive expansion resulted in high pre-operating expenses. For example, the company usually needs six months to train staff for Chinese restaurants and three months for theme restaurants. We expect the pre-operating expense / sales ratio to decline gradually, as the company grows in size.

We believe inflation has also driven up its operating expenses. We expect the trend to persist in the next two years, due to the high crude oil price and China's tight food supply.

Overall, we expect further operating margin erosion but of a lesser magnitude than in FY03/08F.

Sales forecast maintained but net profit forecast cut by 9.3%. Target price reduced to HK\$21.54.

Although the catering service division failed to reach our estimate, the company's overall turnover in 3Q FY03/08A was in line, thanks to better-than-expected contributions from the new theme restaurant business. We maintain our sales forecast but expect a slight reduction in net profit (more profit sharing to minority shareholders as Fuji owns only 60.0% of Sky Charm). Accordingly, we set our new target price at HK\$21.54, based on 18.0x FY03/09F P/E.

Table 3: P&L

Year to Mar (RMBm)	2006A	2007A	2008F	2009F	2010F
Revenue	796.8	1,199.4	1,806.0	2,866.0	3,791.4
COGS	(344.1)	(504.1)	(739.1)	(1,187.3)	(1,589.5)
Gross profit	452.6	695.4	1,066.9	1,678.8	2,201.8
Other revenue	31.9	52.0	53.8	59.0	57.7
Staff costs	(56.2)	(97.8)	(189.6)	(315.3)	(417.1)
Operating lease rentals	(14.8)	(29.4)	(81.3)	(129.0)	(170.6)
Depreciation and amortization	(45.5)	(94.4)	(126.4)	(200.6)	(265.4)
Fuel and utility costs	(13.8)	(24.9)	(45.1)	(71.7)	(94.8)
Other operating expenses	(46.8)	(67.1)	(108.4)	(172.0)	(227.5)
Operating profit	308.2	433.7	569.8	849.3	1,084.3
Finance costs	(23.1)	(49.9)	(102.9)	(108.0)	(108.0)
Profit before tax	285.1	383.8	467.0	741.3	976.3
Tax	(33.7)	(35.7)	(37.4)	(59.3)	(78.1)
Minority interests	0.0	0.0	(18.5)	(50.1)	(60.1)
Net profit	251.4	348.1	411.1	631.9	838.1

Source: Company data, SBI E2-Capital