

Fuji Catering



BUY (unchanged)

Nice top line though margin squeezing

China Consumer

Key points:

- Top line to be driven by geographical expansion.
- Extra momentum for FY03/09F from acquisition of Golden Hans.
- Operating margin under pressure.
- Earnings forecast penciled down but at 25.1% growth rate for the next three years.
- Lower target price to HK\$13.60 with more conservative valuation assumptions.

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Stock data

Price	HK\$10.12
Target price	HK\$13.60 (+34.4%)
12 mth range	HK\$9.82-26.00
Market cap.	US\$702.7m
Daily t/o, 3 mth	US\$2.1m
Free float %	47.3%
Ticker	1175.HK/1175 HK

FY03/08A results recap

Summary. Turnover surged 59.7% to RMB1,915.6m, driven by strong growth of each individual business segment (catering services: up 48.4% to RMB1,383.2m, Chinese restaurants: up 18.1% to RMB275.1m, convenient food: up 93.0% to RMB65.9m) and acquisition of Golden Hans theme restaurant chain in Nov 2007 (generated RMB191.4m turnover). Blended gross margin slightly improved 0.9pcp to 58.9%. However operating margin squeezed from 36.2% to 30.3% due to substantial increase in operating expenses. Consequently, net profit increased 18.1% to RMB411.0m.

Table 1: Results summary

Year to Mar (RMBm)	YoY change		Difference		
	07A	08A	(%)	08F	(%)
Turnover					
Catering	932.3	1,383.2	48.4	1,235.3	(10.7)
Chinese restaurants	232.9	275.0	18.1	258.8	(5.9)
Theme restaurants		191.4	n.a.	231.0	20.7
Convenient food and others	34.2	65.9	93.0	80.8	22.6
Total turnover	1,199.4	1,915.6	59.7	1,806.0	(5.7)
Gross profit	695.4	1,127.8	62.2	1,066.9	(5.4)
Operating profit	433.7	581.2	34.0	569.8	(1.9)
Net profit	348.1	411.0	18.1	411.1	0.0
	07A	08A	(pcp)	08F	(pcp)
Gross margin (%)	58.0	58.9	0.9	59.1	0.2
Operating margin (%)	36.2	30.3	(5.8)	31.6	1.2
Net margin (%)	29.0	21.5	(7.6)	22.8	1.3

Source: Company data, SBI E2-Capital

Forward Looking

Top line. We expect geographical expansion to remain as a major driver to top line.

- According to our understanding, China's catering market is still very fragmented, presenting ample growing room for professional catering service. Fuji, as one of leading catering services providers in the PRC, has expanded its coverage from two cities in FY12/05A to around seven in FY12/08A. Daily

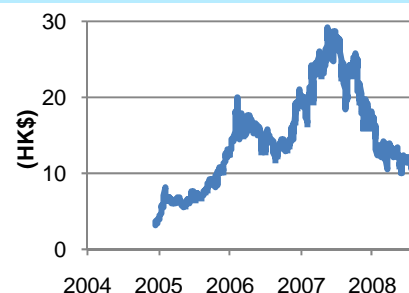
Financial summary

Year to Dec	06A	07A	08F	09F	10F
Turnover (RMBm)	1,199.4	1,915.6	2,870.8	3,613.6	4,382.9
Net Profit (RMBm)	348.1	411.0	546.9	677.4	805.2
EPS (RMB)	0.689	0.772	1.010	1.252	1.487
EPS Δ%	21.9	12.0	30.9	23.9	18.9
P/E (x)	14.2	12.7	9.7	7.8	6.6
P/B (x)	2.80	1.97	1.71	1.48	1.32
EV/EBITDA (x)	11.4	8.9	6.8	5.8	4.7
Yield (%)	1.9	2.2	2.7	3.5	4.2
ROE (%)	21.5	18.3	18.9	20.3	21.1
ROCE (%)	17.0	13.7	14.4	16.2	18.5
N. Gear. (%)	29.5	47.7	45.1	46.1	34.6

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-13.6	-10.6	-55.0
Actual price changes (%)	-14.8	-21.9	-54.8
	08F	09F	10F
Consensus EPS (RMB)	1.135	1.460	n.a.
Previous forecasts (RMBm)	631.9	838.1	n.a.
Previous EPS (RMB)	1.129	1.433	n.a.

Price Chart



output (at the end of each fiscal year) rose from 100,000 sets of meal to 750,500 accordingly. The company is considering tapping into new markets such as Wuhan, Fujian and Jiangxi. We expect its daily output to grow by 18,000 – 20,000 sets each year for the coming three years.

- ❑ Operation of Chinese restaurant started early in 2000. By the end of FY03/08A, the company had nine Chinese restaurants. Considering the keen competition and high reliance on professionals (e.g. chefs), we reckon it is difficult to expand this business rapidly and expect the company to open 1 – 2 new stores each year.
- ❑ In Nov 2007, Fuji acquired 60.0% interest in Sky Charm, which owns Golden Hans theme restaurant chain. Since then six new stores had been opened and total number reached 39 in FY03/08A. We think this theme restaurant chain, by serving standardized Brazilian barbecue food, carries better growth potential than Chinese restaurants. The company plans to add 18 – 20 new stores in the next one or two years.
- ❑ Convenience food division is still small, though segmental revenue near doubled in FY03/08A to RMB65.9m. The company observes strong demand for convenience food and intends to open 4 – 5 “123” supermarkets in FY03/09F to boost this business.

Gross margin. Blended gross margin improved mildly by 0.9pcp in FY03/08A to 58.9%. Possible reasons include: 1) the company’s ability in passing on incremental raw materials costs, which has been multiply mentioned by the management; 2) optimization of cost structure; 3) change of sales mix. We expect gross margin to maintain relatively steady in the future, declining only mildly because of more contribution from lower-margin convenience food segment.

Operating margin. Operating margin dropped substantially from 36.2% to 30.3%. All operating expenses items recorded dramatic increases, accompanied by the high inflation in China. We see inflation a continuous but moderated issue this year and reckon that operating margin will squeeze further. On a segmental basis,

- ❑ Catering services division – operating margin shrank 1.8pcp to 33.2% in FY03/08A. We expect it to decline another 1.2pcp in FY03/09F.
- ❑ Chinese restaurant division – operating margin narrowed from 28.9% one year before to 18.3%, which, however, is still higher than peer companies. We assume operating margin will drop to low-teen level this year.
- ❑ Theme restaurant division – operating margin was 21.4% in FY03/08A. The integration of theme restaurant with Fuji’s existing businesses will largely enhance its bargaining power against suppliers. Nevertheless, we expect its operating margin to decline backed by the similar consideration applied to Chinese restaurant division.
- ❑ Convenience food division – it booked RMB15.8m operating loss in FY03/08A, versus RMB17.8m profit in FY03/07A. In view of the expanding top line, we expect this segment to approach break-even in FY03/09F.

Table 2: Key assumptions

Year to Mar	07A	08F	09F	10F	11F
Catering services division					
Daily output at period end (sets)	567,500	750,500	933,500	1,116,500	1,299,500
Total output (sets m)	168.2	240.7	307.5	374.3	441.1
ASP (RMB)	5.5	5.7	6.0	6.3	6.6
Segmental turnover (RMBm)	932.3	1,383.2	1,847.0	2,350.1	2,896.0
Chinese restaurants					
Number of stores	6	9	11	13	14
Segmental turnover (RMBm)	232.9	275.0	366.7	440.1	495.1
Theme restaurants					
Number of stores	33.0	39.0	49.0	59.0	69.0
Segmental turnover (RMBm)	191.4	558.2	685.0	811.9	
Convenient food and others					
Segmental turnover (RMBm)	34.2	65.9	98.9	138.4	180.0
Operating margin (%)*					
Catering services	36.2	30.3	27.1	26.1	25.3
Chinese restaurants	35.0	33.2	32.0	31.2	30.9
Theme restaurants	28.9	18.3	12.8	10.3	10.3
Convenient food and others	n.a.	21.4	16.4	13.4	13.4
	52.0	(23.9)	(2.9)	8.5	10.5

Source: Company data, SBI E2-Capital

Note: * the overall operating profit includes unallocated income and expenses.

Forecast and valuation

Earnings Forecast. Despite the in-line earnings in FY03/08A, we wrote down our FY03/09F and FY03/10F forecast by 13.4% and 19.2%, respectively, mainly because of lower-than-expected operating margin in FY03/08A and higher tax expenses. We estimate the company's turnover will grow at a CAGR of 31.8% from FY03/08A to FY03/11F while net profit at 25.1%. With narrowing operating margin, any slow-down in top-line growth will be amplified and reflected in bottom line.

Table 3: Forecast adjustments

Year to Mar (RMBm)	09F			10F		
	New forecast	Old forecast	Adjustment (%)	New forecast	Old forecast	Adjustment (%)
Turnover	2,870.8	2,866.0	0.2	3,613.6	3,791.4	(4.7)
Gross profit	1,682.9	1,678.6	0.3	2,110.5	2,201.8	(4.1)
Operating profit	778.6	849.3	(8.3)	828.0	1,084.3	(23.6)
Net profit	546.9	631.9	(13.4)	677.4	838.1	(19.2)

Source: SBI E2-Capital

Target price cut but maintain BUY. Considering the change of overall market environment, we also adopt a more conservative 13.5% discount rate (4.7% risk-free interest rate plus 8.8% market risk premium) to derive our new target price, which is HK\$13.60 (old target price: HK\$21.54). We maintain our BUY recommendation mainly for Fuji's already set-up market position, which grounds the company to benefit from the industry consolidation.

Table 4: Peers comparison

Company name	Ticker	Fiscal Year end	Mkt Cap (US\$m)	His P/E(x)	Curr-Yr Fwd P/E(x)	Nxt-Yr Fwd P/E(x)	ROE (%)
Fuji Catering	1175 HK	03/2008	702.7	11.5	-	-	18.3
Xi'an Catering	000721 CH	12/2007	159.2	93.4	24.9	17.1	3.4
Do & Co	DOC AV	03/2008	206.2	21.4	14.0	13.7	9.6
CIS	CTRG FP	12/2007	199.8	18.3	13.6	11.4	31.2

Source: Bloomberg

P & L (RMBm)	07A	08A	09F	10F	11F	Cash Flow (RMBm)	07A	08A	09F	10F	11F
Year to Mar						Year to Mar					
Turnover	1,199.4	1,915.6	2,870.8	3,613.6	4,382.9	EBIT	410.5	553.4	738.6	888.4	1,075.3
% chg	50.5	59.7	49.9	25.9	21.3	Depre./amort.	94.4	154.5	220.5	278.0	338.2
Gross profit	695.4	1,127.8	1,682.9	2,110.5	2,550.9	Net int. paid	2.6	(0.3)	23.3	17.7	(68.8)
EBITDA	504.9	707.8	959.1	1,166.4	1,413.5	Tax paid	(34.4)	(35.2)	(56.6)	(90.1)	(129.2)
Depre./amort.	(94.4)	(154.5)	(220.5)	(278.0)	(338.2)	Dividends received					
EBIT	410.5	553.4	738.6	888.4	1,075.3	Gross cashflow	473.1	672.3	925.8	1,094.0	1,215.4
Net int. income/(exp.)	(26.8)	(77.6)	(77.7)	(60.4)	(68.8)	Chgs. in working cap.	(1.6)	(134.6)	9.1	8.9	10.3
Exceptionals						Operating cashflow	471.5	537.8	934.9	1,102.9	1,225.7
Associates						Capex	(1,015.9)	(1,658.0)	(958.2)	(1,077.8)	(651.7)
Jointly-controlled entit.						Free cashflow	(544.5)	(1,120.2)	(23.2)	25.0	574.0
Pre-tax profit	383.8	475.8	660.9	828.0	1,006.5	Dividends paid	(90.1)	(111.9)	(141.8)	(186.1)	(220.8)
Tax	(35.7)	(49.5)	(81.9)	(119.2)	(165.0)	Net distribution to MI					
Minority interests	0.0	(15.4)	(32.0)	(31.3)	(36.3)	Investments					
Net profit	348.1	411.0	546.9	677.4	805.2	Disposals					
% chg	38.5	18.1	33.1	23.9	18.9	New shares	0.0	4.5	0.0	0.0	0.0
Dividends	(104.6)	(120.3)	(167.3)	(206.7)	(236.2)	Others	62.1	610.2	(101.0)	(89.6)	(125.4)
Retained earnings	243.5	290.7	379.6	470.8	569.0	Net cashflow	(572.5)	(617.5)	(266.1)	(250.6)	227.8
EPS (RMB) - Basic	0.689	0.772	1.010	1.252	1.487	Net (debt)/cash - Beg.	94.9	(477.7)	(1,095.1)	(1,361.3)	(1,611.9)
EPS (RMB) - F.D.	0.689	0.772	1.010	1.252	1.487	Net (debt)/cash - End.	(477.7)	(1,095.1)	(1,361.3)	(1,611.9)	(1,384.1)
DPS (HK\$)	0.206	0.241	0.288	0.378	0.449						
No. sh.s o/s (m) - W.A.	504.9	532.6	541.3	541.3	541.3	Interim Results (RMBm)	06A	07A	08A		
No. sh.s o/s (m) - Y.E.	510.3	541.3	541.3	541.3	541.3	Six months to Jun					
No. sh.s o/s (m) - F.D.	505.1	532.6	541.3	541.3	541.3	Turnover	323.7	534.8	780.2		
						% chg		65.2	4588.0%		
Margins (%)						Profit from operations	137.2	198.7	249.8		
Gross	58.0	58.9	58.6	58.4	58.2	Interest expenses	(4.5)	(10.1)	(35.7)		
EBITDA	42.1	37.0	33.4	32.3	32.3	Associates					
EBIT	34.2	28.9	25.7	24.6	24.5	Jointly-controlled entit.					
Pre-tax	32.0	24.6	23.0	22.9	23.0	Pre-tax profit	132.8	188.6	214.1		
Net	29.0	21.5	19.1	18.7	18.4	Tax	(18.6)	(16.4)	(17.3)		
						Minority interests					
						Net profit	114.1	172.2	196.8		
						% chg		50.8	1429.9%		
						EPS (RMB) - Basic	0.267	0.342	0.376		
						DPS (HK\$)					
Balance Sheet (RMBm)	07A	08A	09F	10F	11F						
Year to Mar						Shareholding Structure					
Fixed assets	2,042.6	3,190.9	3,904.2	4,326.6	4,576.0						
Intangible assets	197.5	795.8	913.6	1,001.8	1,091.6						
Other LT assets	80.7	301.1	207.7	155.0	129.3						
Cash	819.2	1,093.9	659.8	318.9	321.3						
Accounts receivable	31.1	53.8	80.6	101.5	123.1						
Other receivables	46.0	193.1	289.5	364.4	441.9						
Inventories	27.8	88.7	132.9	167.3	203.0						
Due from related co.s											
Other current assets											
Total assets	3,244.9	5,717.3	6,188.3	6,435.5	6,886.2						
Accounts payable	(21.5)	(126.2)	(190.3)	(240.8)	(293.5)						
Other payable	(110.8)	(221.3)	(333.7)	(422.3)	(514.7)						
Tax payable	(23.4)	(38.6)	(64.0)	(93.1)	(128.9)						
Due to related co.s											
ST debts	(319.5)	(269.0)	(105.4)	(405.4)	(705.4)						
Other current liab.	0.0	0.0	(341.9)	0.0	0.0						
LT debts	(977.3)	(1,920.0)	(1,915.6)	(1,525.4)	(1,000.0)						
Other LT liabilities	0.0	(341.9)	0.0	0.0	0.0						
Total liabilities	(1,452.5)	(2,917.0)	(2,950.9)	(2,686.9)	(2,642.4)						
Share capital	5.4	5.7	5.7	5.7	5.7						
Reserves	1,787.0	2,688.9	3,094.0	3,573.8	4,032.8						
Shareholders' funds	1,792.4	2,694.6	3,099.7	3,579.5	4,038.5						
Minority interest	-	105.7	137.7	169.1	205.3						
Total	1,792.4	2,800.3	3,237.4	3,748.5	4,243.8						
Capital employed	3,089.2	4,989.3	5,258.4	5,679.3	5,949.2						
Net (debt)/cash	(477.7)	(1,095.1)	(1,361.3)	(1,611.9)	(1,384.1)						
						Key Ratios	07A	08A	09F	10F	11F
						Net gearing (%)	29.5	47.7	45.1	46.1	34.6
						Net ROE (%)	21.5	18.3	18.9	20.3	21.1
						EBIT ROCE (%)	17.0	13.7	14.4	16.2	18.5
						Dividend payout (%)	30.0	29.3	30.6	30.5	29.3
						Effective tax rate (%)	9.3	10.4	12.4	14.4	16.4
						Net interest coverage (x)	15.3	7.1	9.5	14.7	15.6
						A/R turnover (days)	8.5	8.1	8.5	9.2	9.3
						A/P turnover (days)	4.7	14.1	20.1	21.8	22.2
						Stock turnover (days)	15.6	27.0	34.1	36.5	36.9

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