

Fuji Catering



BUY (unchanged)

Top line still strong

Key points:

- Sales up 84.2% in 1Q FY03/09A.
- Positive industry outlook.
- Margin squeeze to ease as China's CPI stabilizes.
- Cash chain might turn tight.
- Target price unchanged at HK\$13.30.

1Q FY03/09A results. Turnover increased 84.2% to RMB657.7m partly due to the acquisition of theme restaurants (Golden Hans) in Nov 2007. After stripping off contributions from this new business, revenue went up 49.6% to RMB534.2m, comprising RMB452.8m (up 57.7%) from catering services, RMB70.0m (up 10.5%) from Chinese restaurants and RMB11.4m (up 72.0%) from convenience food. The operating margin narrowed to 27.9% from 34.9% in the year-earlier period because of: 1) 2.9pcp decline in the gross margin to 57.2%; 2) 115.7% increase in total operating expenses; 3) dilution from theme restaurants (operating margin at 22.1% in 1Q FY03/09A). The company's effective tax rate increased 8.2pcp to 16.0%. Overall, its net profit rose 17.3% to RMB111.5m.

Table 1: 1Q FY03/09A results

Three months to Jun (RMBm)	08A	09A	YoY change (%)
Turnover	357.1	657.7	84.2
Catering	287.1	452.8	57.7
Chinese restaurants	63.3	69.9	10.5
Theme restaurants		123.5	n.a.
Convenient food and others	6.7	11.4	72.0
Gross profit	214.6	376.4	75.4
Operating profit	124.6	183.3	47.1
Net profit	95.1	111.5	17.3
			(pcp)
Gross margin (%)	60.1	57.2	(2.9)
Operating margin (%)	34.9	27.9	(7.0)
Net margin (%)	26.6	17.0	(9.7)

Source: Company data

Catering services

Output ramp up. Daily output increased from 750,500 meals per day at end-FY03/08A to 810,500 at end-1Q FY03/09A, which, according to our calculation, translates into 70.2m meals for the whole quarter, up 30.7% YoY. We maintain our view that the fragmented market presents plenty of consolidation opportunities for professional catering service providers and we expect Fuji's daily output to reach 933,500 by end-FY03/09F.

Profitability hurt by inflation. We reckon the ASP in 1Q FY03/08A increased 20.7% YoY, driven mainly by rising raw materials costs and operating expenses. The operating margin narrowed 9.4pcp to 27.8% (per meal operating profit dropped from RMB2.0 to RMB1.8), proving again that high inflation is hurting the company's profitability. Since China's consumer price index (CPI) has softened since Jan 2008, we expect the operating margin to stabilize at 27.9% in FY03/09F, versus 33.2% in FY03/08A (per meal

China Consumer

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Norman Zhang

(852) 2533 3715

normanzhang@sbi2capital.com

Stock data

Price	HK\$9.44
Target price	HK\$13.60 (+44%)
12 mth range	HK\$7.50-26.00
Market cap.	US\$655.5m
Daily t/o, 3 mth	US\$1.4m
Free float %	47.3%
Ticker	1175.HK/1175 HK

Financial summary

Year to Mar	07A	08F	09F	10F	11F
T/O (RMBm)	1,199.41	915.62	999.03	808.04	637.9
NP (RMBm)	348.1	411.0	533.4	656.2	772.8
EPS (RMB)	0.689	0.772	0.985	1.212	1.428
EPS Δ %	21.9	12.0	27.6	23.0	17.8
P/E (x)	12.5	11.1	8.7	7.1	6.0
P/B (x)	2.44	1.72	1.51	1.31	1.17
EV/EBITDA (x)	10.1	8.0	5.9	4.9	4.0
Yield (%)	2.2	2.6	3.1	4.0	4.8
ROE (%)	21.5	18.3	18.5	19.8	20.6
ROCE (%)	17.0	13.7	14.4	16.4	18.7
N. Gear. (%)	29.5	47.7	39.6	42.9	33.7

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+2.1	-5.2	-51.9
Actual price changes (%)	-6.7	-18.9	-59.9

	09F	10F	11F
Consensus EPS (RMB)	1.083	1.440	n.a.
Previous forecasts (RMBm)	546.9	677.4	805.2
Previous EPS (RMB)	1.010	1.252	1.487

Price Chart



operating profit will be reduced from RMB1.9 to RMB1.8).

Macro environment. We notice the present macro developments (government policies, Renminbi appreciation, US economic slowdown) are likely to affect manufacturing firms, Fuji's major clients, and may change the company's business landscape, possibly forcing it to move from coastal to inland regions and set up more mid-size distribution centres. However, we expect the impact to be mild and gradual.

Table 2: Catering service segment

Year to Mar	07A	08A	09F	10F	11F
Daily output at year-end (meal)	567,500	750,500	933,500	1,116,500	1,299,500
Est. output during the year (meals m)	168.2	240.7	311.4	374.3	441.1
ASP (RMB per meal)	5.5	5.7	6.5	6.8	7.1
Per meal operating profit (RMB)	1.942	1.907	1.793	1.825	1.902
Turnover (RMBm)	932.3	1,383.2	2,011.7	2,534.6	3,119.1
Operating profit (RMBm)	326.6	459.1	558.4	682.9	839.0
Operating margin (%)	35.0	33.2	27.8	26.9	26.9

Source: Company data, SBI E2-Capital

Theme restaurants

New business. In Nov 2007, the company acquired 60.0% in Sky Charm, which owns Golden Hans, a Brazil barbecue theme restaurants chain. Five new stores (bringing the total to 40) have been opened since then and Fuji plans to add 10 – 12 each year, which, in our view, is feasible, given the duplicable store model.

Performance. Turnover in 1Q FY03/09A was RMB123.5m with an operating profit of RMB27.3m. Considering the stabilizing raw material prices (mainly for agricultural products) this year, we expect the company's full-year operating margin at 21.4%, almost flat from 22.1% in 1Q.

Table 3: Theme restaurants segment

Year to Mar	07A	08A	09F	10F	11F
Number of stores		39	51	61	71
Number of customers (m)		5.9	16.4	20.4	24.1
Turnover (RMBm)		191.4	558.5	695.0	819.1
Operating profit (RMBm)		40.9	119.3	134.6	158.6
Operating margin (%)		21.4	21.4	19.4	19.4

Source: Company data, SBI E2-Capital

Other businesses

Chinese restaurants. Turnover edged up 10.4% to RMB69.9m, affected by renovations at four of its nine restaurants. The four will re-open in September and November. The operating margin narrowed from 31.2% in 1Q FY03/08A to 16.9%, and, in our view, could decline further, as it remains at the high-end of the industry average.

Convenience food. Thanks to expansion efforts, sales surged 72.0% to RMB11.4m in 1Q FY03/09A. The company however incurred an operating loss of RMB5.7m from an RMB0.1m profit in 1Q FY03/08A, mainly due to depreciation expenses. The management expects this division to break even by 4Q FY03/09F.

Estimates and recommendation.

Financial status. At end-1Q FY03/09F, Fuji had RMB2,280.3m in debt, comprising RMB438.1m convertible bonds expiring in Nov 2009 (conversion price HK\$17.18), RMB1,395.3m convertible bonds expiring in Oct 2010 (conversion price HK\$32.825) and bank loans. With its recent share price retreat, convertible bond holders may not exercise their rights. Together with its potential capital expenditure (our estimates: RMB2,387.4m for FY03/09F – FY03/11F), the company will need RMB4,667.7m in cash, which will be financed from existing cash reserves (RMB945.4m at end-1Q FY03/09A), operating cash inflow (RMB3,380.1m for the three year period) and new bank loans, in our view. We think the company's cash chain will be a bit tight but still healthy.

Forecast. Overall, we think Fuji's top line growth momentum remains intact. Its operating margin in FY03/09F will be under pressure due to inflation. However with China's CPI curve turning relatively flat this year, we expect the company's operating margin squeeze to ease, with a 3.5pcp decline in FY03/09F to 26.9%,

compared with a 7.0pcp drop in 1Q to 27.9%. EPS will grow at 22.7% CAGR from RMB0.772 in FY03/08A to RMB1.428 in FY03/11F. We maintain our target price at HK\$13.60 and our BUY recommendation.

Table 4: Forecast adjustments for FY03/09F

Year to Mar (RMBm)	Old	New	Adjustment Note (%)
Turnover	2,870.8	2,999.0	4.5
Catering	1,847	2,012	8.9 costs increase was higher than we expected in 1Q, which pushed up ASP
Chinese restaurants	366.7	330.0	(10.0) renovation of four restaurants
Theme restaurants	558.2	558.5	0.1 fine-tune
Convenient food and others	98.9	98.9	0.0 maintain
Segmental results			
Catering	591	558	(5.6) costs increase was higher than we expected in 1Q
Chinese restaurants	47.0	50.6	7.5 better-than expected operating margin in 1Q
Theme restaurants	91.3	119.3	30.6 better-than expected operating margin in 1Q
Convenient food and others	(2.9)	(12.8)	344.5 revised up depreciation expenses due to expansion
Operating profit	778.6	807.3	3.7
Finance costs	(117.7)	(121.5)	3.2 raised debt estimates for potential tightening of cash chain
Profit before taxation	660.9	685.7	3.8
Income tax	(81.9)	(112.4)	37.3 higher-than-expected effective tax rate in 1Q
Minority interest	(32.0)	(39.9)	24.7 more contribution from theme restaurants business, in which Fuji owns 60.0% interest
Net profit	546.9	533.4	(2.5)

Source: SBI E2-Capital

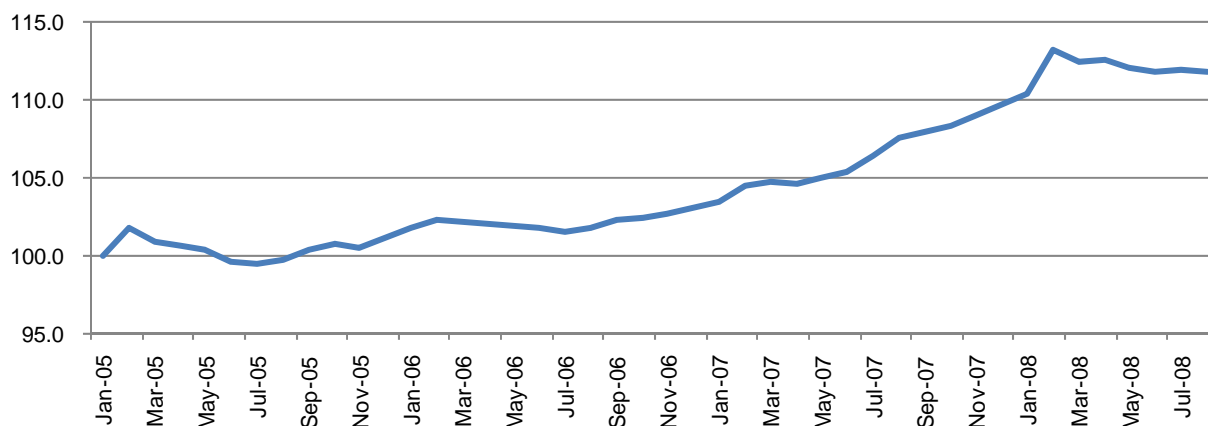
Table 5: Peers comparison

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	655.5	11.5	8.7	7.1	18.3
Xi'an Catering	000721 CH	12/2007	108.0	93.4	24.9	17.1	3.4
Do & Co	DOC AV	03/2008	199.6	21.4	14.0	13.7	9.6
CIS	CTRG FP	12/2007	215.9	18.3	13.6	11.4	31.2

Source: Bloomberg, SBI E2-Capital

Note: estimated by SBI E2-Capital

Risk. We regard inflation as a major threat to the company's earnings.

Chart 1: China's CPI curve*

Source: National Bureau of Statistics

Note: * Jan 2005 = 100

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	2,999.0	3,808.0	4,637.9	EBIT	410.5	553.4	747.3	920.1	1,119.0
% chg	50.5	59.7	56.6	27.0	21.8	Depre./amort.	94.4	154.5	232.2	294.2	358.8
Gross profit	695.4	1,127.8	1,706.6	2,164.2	2,624.7	Net int. paid	2.6	(0.3)	39.5	16.0	(84.8)
EBITDA	504.9	707.8	979.4	1,214.2	1,477.9	Tax paid	(34.4)	(35.2)	(63.2)	(122.4)	(169.5)
Depre./amort.	(94.4)	(154.5)	(232.2)	(294.2)	(358.8)	Dividends received					
EBIT	410.5	553.4	747.3	920.1	1,119.0	Gross cashflow	473.1	672.3	955.7	1,107.8	1,223.6
Net int. income/(exp.)	(26.8)	(77.6)	(61.5)	(62.1)	(84.8)	Chgs. in working cap.	(1.6)	(134.6)	32.8	13.3	17.5
Exceptionals						Operating cashflow	471.5	537.8	988.5	1,121.1	1,241.1
Associates						Capex	(1,015.9)	(1,658.0)	(845.6)	(1,142.9)	(740.8)
Jointly-controlled entit.						Free cashflow	(544.5)	(1,120.2)	142.9	(21.8)	500.3
Pre-tax profit	383.8	475.8	685.7	858.0	1,034.2	Dividends paid	(90.1)	(111.9)	(141.8)	(186.1)	(220.8)
Tax	(35.7)	(49.5)	(112.4)	(157.8)	(210.9)	Net distribution to MI					
Minority interests	0.0	(15.4)	(39.9)	(43.9)	(50.5)	Investments					
Net profit	348.1	411.0	533.4	656.2	772.8	Disposals					
% chg	38.5	18.1	29.8	23.0	17.8	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	366.1	449.6	536.6	Net cashflow	(572.5)	(617.5)	(100.0)	(297.5)	154.2
EPS (RMB) - Basic	0.689	0.772	0.985	1.212	1.428	Net (debt)/cash - Beg.	94.9	(477.7)	(1,095.1)	(1,195.1)	(1,492.6)
EPS (RMB) - F.D.	0.689	0.772	0.985	1.212	1.428	Net (debt)/cash - End.	(477.7)	(1,095.1)	(1,195.1)	(1,492.6)	(1,338.5)
DPS (HK\$)	0.206	0.241	0.288	0.378	0.449	Interim Results (RMBm)	06A	07A	08A		
No. sh.s o/s (m) - W.A.	504.9	532.6	541.3	541.3	541.3	Six months to Sep					
No. sh.s o/s (m) - Y.E.	510.3	541.3	541.3	541.3	541.3	Turnover	323.7	534.8	780.2		
No. sh.s o/s (m) - F.D.	505.1	532.6	541.3	541.3	541.3	% chg		65.2	45.9		
Margins (%)						Profit from operations	137.2	198.7	249.8		
Gross	58.0	58.9	56.9	56.8	56.6	Interest expenses	(4.5)	(10.1)	(35.7)		
EBITDA	42.1	37.0	32.7	31.9	31.9	Associates					
EBIT	34.2	28.9	24.9	24.2	24.1	Jointly-controlled entit.					
Pre-tax	32.0	24.8	22.9	22.5	22.3	Pre-tax profit	132.8	188.6	214.1		
Net	29.0	21.5	17.8	17.2	16.7	Tax	(18.6)	(16.4)	(17.3)		
						Minority interests					
						Net profit	114.1	172.2	196.8		
						% chg		50.8	14.3		
						EPS (RMB) - Basic	0.267	0.342	0.376		
						DPS (HK\$)					
Balance Sheet (RMBm)	07A	08A	09F	10F	11F	Shareholding Structure					
Year to Mar							Shares o/s (m)	%			
Fixed assets	2,042.6	3,190.9	3,787.2	4,220.7	4,521.3	Wei Dong & Yao Juan	285.0	52.7			
Intangible assets	197.5	795.8	930.0	1,026.4	1,123.5	Bank of America Corporation	33.4	6.2			
Other LT assets	80.7	301.1	184.0	161.0	145.3	Janus Capital	32.9	6.1			
Cash	819.2	1,093.9	931.3	643.5	572.3	UBS	32.4	6.0			
Accounts receivable	31.1	53.8	84.2	106.9	130.2	JP Morgan Chase	28.5	5.3			
Other receivables	46.0	193.1	302.4	384.0	467.6	Others	129.1	23.9			
Inventories	27.8	88.7	138.9	176.3	214.8	Total	541.3	100.0			
Due from related co.s						Background					
Other current assets						Headquartered in Shanghai, Fu Ji Food and Catering Services mainly provides catering service to industrial clients in China. It is one of the largest professional catering service company with daily capacity exceeding 1m sets of meal in 2008. The company is also engaged in operation of Chinese restaurants, theme restaurants and sales of convenient food.					
Total assets	3,244.9	5,717.3	6,358.0	6,718.9	7,175.0	Key Ratios	07A	08A	09F	10F	11F
Accounts payable	(21.5)	(126.2)	(207.0)	(263.3)	(322.5)	Net gearing (%)	29.5	47.7	39.6	42.9	33.7
Other payable	(110.8)	(221.3)	(363.1)	(461.8)	(565.6)	Net ROE (%)	21.5	18.3	18.5	19.8	20.6
Tax payable	(23.4)	(38.6)	(87.8)	(123.3)	(164.7)	EBIT ROCE (%)	17.0	13.7	14.4	16.4	18.7
Due to related co.s						Dividend payout (%)	30.0	29.3	31.4	31.5	30.6
ST debts	(319.5)	(269.0)	(105.4)	(205.4)	(505.4)	Effective tax rate (%)	9.3	10.4	16.4	18.4	20.4
Other current liab.	0.0	0.0	(341.9)	0.0	0.0	Net interest coverage (x)	15.3	7.1	12.1	14.8	13.2
LT debts	(977.3)	(1,920.0)	(2,021.0)	(1,930.8)	(1,405.4)	A/R turnover (days)	8.5	8.1	8.4	9.2	9.3
Other LT liabilities	0.0	(341.9)	0.0	0.0	0.0	A/P turnover (days)	4.7	14.1	20.3	22.5	23.1
Total liabilities	(1,452.5)	(2,917.0)	(3,126.3)	(2,984.6)	(2,963.7)	Stock turnover (days)	15.6	27.0	32.1	35.0	35.5
Share capital	5.4	5.7	5.7	5.7	5.7						
Reserves	1,787.0	2,688.9	3,080.5	3,539.1	3,965.6						
Shareholders' funds	1,792.4	2,694.6	3,086.1	3,544.7	3,971.3						
Minority interest	-	105.7	145.6	189.5	240.0						
Total	1,792.4	2,800.3	3,231.7	3,734.3	4,211.3						
Capital employed	3,089.2	4,989.3	5,358.2	5,870.5	6,122.1						
Net (debt)/cash	(477.7)	(1,095.1)	(1,195.1)	(1,492.6)	(1,338.5)						

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