

EcoGreen: Target price raised to HK\$2.5

Recommendation: BUY (unchanged)

China Chemicals

Price	HK\$1.88	Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.
Target price	HK\$2.50 (+33.0%)	Dec	RMBm	RMB	Δ %	x	x	x	%	%	%	%
12 mth range	HK\$1.08-1.96	04A	61.4	0.156	na	12.3	2.6	8.3	1.0	30.2	20.8	Cash
Market cap.	US\$111.11m	05A	71.1	0.167	7.4	11.5	1.9	7.1	1.2	18.6	16.7	Cash
Daily t/o, 3 mth	US\$0.32m	06F	90.9	0.197	17.7	9.7	1.4	5.5	1.8	17.6	16.6	Cash
Free float %	50.7%	07F	115.1	0.250	26.9	7.7	1.2	4.2	2.3	17.7	17.5	Cash
Ticker	2341.HK/2341 HK	08F	154.7	0.336	34.4	5.7	1.0	3.0	3.1	19.9	20.4	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +16.9%, +35.2%, +5.8%

Actual price changes (1 mth, 3 mth, 12 mth): +22.9% +49.2%, +38.2%

Consensus EPS (06F-07F): RMB0.194, RMB0.240

Key points:

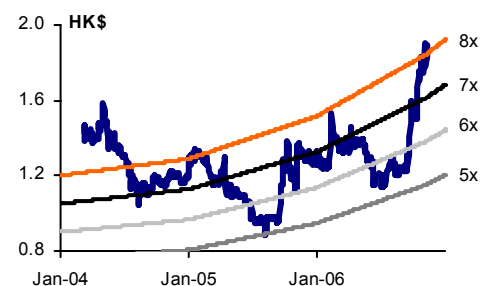
- Proximity to the abundant reserves of gum turpentine oil in China.
- Gum turpentine oil price expected to have peaked out, which bodes well for its gross margins
- Unique fixed-bed catalytic technology to enhance non-stop production of aroma chemicals and was recognized as a Green Chemistry* Demonstration Factory in 2003.
- Part 1 of the Phase III production plant (a multifunctional workshop) is expected to be completed by 2H FY12/07 and speed up the launch of new high-margin products.
- Continue to benefit from the global outsourcing trend and expected to expand market share of key product (Dihydromyrcenol) up to 40% in the next few years.
- The company has started to receive orders for FY12/07 since 2H FY12/06 while production has ramped up faster than expected due to strong demand from the downstream producers.
- Dedicated management team and energetic professional R&D team with strong governmental support.
- Target price has been upgraded from HK\$2.0 to HK\$2.5, equivalent to 10x FY12/07F EPS to reflect the strong global demand for fast moving consumer goods.

Established network to tap resources. Annual production capacity of gum turpentine oil in the world is around 140,000 MT and currently China accounts for around 77% of its total output. Major areas that produce gum turpentine oil are southern China provinces such as Guangxi (41%, lion of China production), Guangdong (21%), Yunnan (15%), Fujian (10%), Jianxi (7%) and Hunan (3%).

Proximity to raw material suppliers. The production plant of EcoGreen is close to these major raw material suppliers. EcoGreen has strong bargaining powers with these suppliers (mainly farmers or processing plants near the pine tree plantation) as EcoGreen currently consumes around 10% of China's total output of gum turpentine oil.

Unique technology sets higher entry barriers. With over ten years of extensive research and development, the company has developed the fixed-bed catalytic technology to produce terpene aroma chemicals. In China, there are no direct comparable competitors in the product segments where EcoGreen is producing. In fact, the flexibility and scale of EcoGreen's production lines enable the company to re-shuffle product mix to achieve better gross margins. Moreover, EcoGreen's Xiamen plant has also demonstrated why it was recognized as Green

Chart 1: P/E bands



Source: SBI E2-Capital

Chemistry* Demonstration Factory and accredited ISO 14001 certificate in 2003.

High-margin new products. When Part 1 of Phase III (a multifunctional workshop) completes construction by 2007, large-scale of high-margin new products will be launched. Currently, 100% of EcoGreen's aroma products are used for personal care products while the company will start its F&B related aroma chemical production (e.g. milky and fruity flavour).

Benefit from outsourcing. Currently IFF (IFF US) accounts for around 30% of total output of its key products (Dihydromyrenol) while Green captures around 20% of the market share. It is expected that IFF will gradually outsource its output to EcoGreen in order to enjoy the 30% cost savings.

M&A. In addition to strong organic growth, EcoGreen will further strengthen its market position to acquire potential upstream companies.

Management commitments. Mr. Yang Yirong, Chairman of EcoGreen, has more than 10 years of experience in natural organic chemistry research before he started the company. He has established strong connections with forestry industry in China, which is a critical factor for EcoGreen to secure raw materials supply. Moreover, Mr. Yang has indicated that he does not have any side-business. As the company belongs to the category of high-tech enterprises, EcoGreen receives R&D grant for basic research, government subsidy for university and industry R&D. The company can commercialize the R&D results and employs only 3% of its turnover as R&D costs (versus 5% - 10% for foreign competitors).

Strong financial position. The group has net cash position of around RMB195m, which is sufficient for its future CAPEX.

Valuation. Due to the strong global demand for fast moving consumer goods (personal care products, food and beverage products and pharmaceutical products), the valuation of the listed stocks of the whole industry chain is undergoing a major re-rating. Being a unique upstream company, we expect EcoGreen will benefit from the booming global demand.

Table 1 : Peers along the food chain

Company	Industry position [#]	Ticker	Currency	Price	Hist. P/E (x)	Fwd Yr 1 P/E (x)	Fwd Yr 2 P/E (x)	Hist. ROE (%)
EcoGreen	a	2341HK	HKD	1.88	11.5	9.8	7.7	18.6
Produits Chimiques Auxiliair	a	PCA FP	EUR	5.20	NA	22.0	17.3	NA
Rhodia SA	a	RHA FP	EUR	2.15	NA	32.6	13.3	NA
Dynaction SA	a	DYT FP	EUR	13.26	NA	30.8	13.5	NA
Lyondell Chemicals	a	LYO US	USD	25.52	7.8	7.6	7.0	18.2
International Flavours & Fragrances	b	IFF US	USD	45.50	19.9	18.7	17.0	21.2
Givaudan	b	GIVN VX	CHF	1034	16.0	16.2	15.5	16.9
T Hasegawa	b	4958 JP	JPY	1693	18.7	19.4	18.2	7.2
Takasgo	b	4914 JP	JPY	557	16.7	19.3	17.6	5.4
Huabao	b	336 HK	HKD	3.38	na	23.3	17.2	Na
China F&F	b	3318 HK	HKD	3.06	15.5	16.9	14.0	37.5
P&G	c	PG US	USD	64.11	23.8	21.2	18.6	21.8
Tingyi	c	322 HK	HKD	6.79	39.4	31.9	25.5	14.8
China Mengniu	c	2319 HK	HKD	15.50	43.3	33.9	25.8	21.3
Hengan	c	1044 HK	HKD	18.78	45.1	31.7	23.2	20.4
Average					23.4	22.3	16.8	18.5

[#] a: upstream producers; b: midstream producers (Flavours & Fragrances companies); c: downstream producers (Consumer goods manufacturers)

Source: SBI E2-Capital & Bloomberg

* According to U.S. Environmental Protection Agency, there are 9 principles of Green Chemistry

- Prevent waste
- Design less hazardous chemical syntheses
- Use catalysts, not stoichiometric reagents
- Maximize atom economy
- Use safer solvents and reaction conditions
- Increase energy efficiency
- Design chemicals and products to degrade after use
- Analyze in real time to prevent pollution
- Minimize the potential for accidents

Pic 1: Production facilities



Pic 2: Rectification tower



Pic 3: R&D professional



Pic 4: Product samples



Pic 5: Lab



Pic 6: Phase III expansion



Pic 7: Management team & SBI E2-Capital staff



Pic 8: Finished products ready for distribution



Source: SBI E2-Capital

Source: SBI E2-Capital

P & L (RMBm)	04A	05A	06F	07F	08F
Year to Dec					
Turnover	276.5	384.4	510.7	654.2	896.6
% chg	23.9	39.0	32.8	28.1	37.1
Gross profit	114.4	133.4	163.9	212.6	298.6
Yield	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
EBITDA	79.9	93.5	121.5	156.8	213.2
Depre./amort.	(7.2)	(8.6)	(13.8)	(19.0)	(24.0)
EBIT	72.7	84.9	107.7	137.8	189.2
Net int. income/(exp.)	(6.0)	(6.9)	(8.3)	(11.4)	(15.8)
Exceptionals	-	-	-	-	-
Associates	-	-	-	-	-
Jointly-controlled entit.	-	-	-	-	-
Pre-tax profit	66.6	78.0	99.4	126.4	173.4
Tax	(5.2)	(6.9)	(8.5)	(11.4)	(18.7)
Minority interests	-	-	-	-	-
Net profit	61.4	71.1	90.9	115.1	154.7
% chg	12.2	15.8	28.0	26.6	34.4
Dividends	(7.7)	(9.6)	(15.9)	(20.1)	(26.7)
Retained earnings	53.7	61.4	75.0	94.9	128.0
EPS (RMB) - Basic	0.156	0.167	0.197	0.250	0.336
EPS (RMB) - F.D.	0.148	0.154	0.197	0.250	0.336
DPS (RMB)	0.019	0.023	0.034	0.044	0.058
No. sh.s o/s (m) - W.A.	393.6	424.3	461.0	461.0	461.0
No. sh.s o/s (m) - Y.E.	415.0	461.0	461.0	461.0	461.0
No. sh.s o/s (m) - F.D.	415.0	461.0	461.0	461.0	461.0
Margins (%)					
Gross	41.4	34.7	32.1	32.5	33.3
EBITDA	28.9	24.3	23.8	24.0	23.6
EBIT	26.3	22.1	21.1	21.1	21.1
Pre-tax	24.1	20.3	19.5	19.3	19.3
Net	22.2	18.5	17.8	17.6	17.3
Balance Sheet (RMBm)	04A	05A	06F	07F	08F
Year to Dec					
Fixed assets	119.4	184.1	270.3	351.3	427.3
Intangible assets	22.0	27.7	27.8	32.6	35.8
Other LT assets	0.4	0.4	0.4	0.4	0.4
Cash	208.7	260.8	322.8	334.8	354.8
Accounts receivable	67.2	101.8	130.0	160.0	220.0
Other receivables	16.8	40.6	32.0	43.0	47.6
Inventories	19.5	33.3	54.0	70.0	95.0
Due from related co.s	-	-	-	-	-
Other current assets	31.8	0.3	3.1	3.1	3.1
Total assets	485.8	648.9	840.4	995.2	1,184.1
Accounts payable	(15.2)	(48.1)	(57.7)	(69.2)	(83.0)
Other payable	(19.0)	(30.6)	(55.5)	(73.9)	(88.7)
Tax payable	(1.2)	(2.4)	(3.0)	(4.0)	(6.5)
Due to related co.s	-	-	-	-	-
ST debts	(122.6)	(117.8)	(118.0)	(120.0)	(122.0)
Other current liab.	(1.9)	(0.3)	(0.6)	(0.6)	(0.6)
LT debts	(5.0)	(5.0)	(14.8)	(19.8)	(34.8)
Other LT liabilities	(0.1)	(0.0)	(0.2)	(0.2)	(0.2)
Total liabilities	(165.1)	(204.2)	(249.8)	(287.7)	(335.9)
Share capital	44.0	48.8	48.8	48.8	48.8
Reserves	276.5	396.0	541.7	658.5	799.2
Shareholders' funds	320.5	444.8	590.4	707.3	848.0
Minority interest	0.3	0.2	0.2	0.2	0.2
Total	320.8	445.0	590.7	707.5	848.2
Capital employed	448.4	567.8	723.5	847.3	1,005.0
Net (debt)/cash	81.1	138.0	190.0	195.0	198.0
Cash Flow (RMBm)	04A	05A	06F	07F	08F
Year to Dec					
EBIT	72.7	84.9	107.7	137.8	189.2
Depre./amort.	7.2	8.6	13.8	19.0	24.0
Net int. paid	(6.0)	(6.9)	(8.3)	(11.4)	(15.8)
Tax paid	(4.0)	(5.8)	(6.9)	(8.5)	(11.4)
Others	3.5	2.0	18.6	16.4	35.1
Gross cashflow	73.4	82.9	124.9	153.3	221.0
Chgs. in working cap.	(0.1)	(27.6)	(5.8)	(27.1)	(61.0)
Operating cashflow	73.3	55.3	119.1	126.2	160.1
Capex	(34.8)	(70.6)	(70.0)	(133.5)	(142.1)
Free cashflow	38.5	(15.3)	49.1	(7.3)	18.0
Dividends paid	-	(11.5)	(12.0)	(13.5)	(19.0)
Net distribution to MI	0.3	-	-	-	-
Investments	-	(0.3)	-	-	-
Disposals	-	-	-	-	-
New shares	168.2	61.8	-	-	-
Others	(58.7)	22.2	14.9	25.8	4.0
Net cashflow	148.3	56.8	52.0	5.0	3.0
Net (debt)/cash - Beg.	(67.1)	81.1	138.0	190.0	195.0
Net (debt)/cash - End.	81.1	138.0	190.0	195.0	198.0
Interim Results (RMBm)	04A	05A	06A		
Six months to Jun					
Turnover	127.8	171.0	253.5		
% chg	37.1	33.9	48.2		
Profit from operations	38.7	42.5	54.1		
Interest expenses	(4.1)	(3.4)	(3.3)		
Associates	-	-	-		
Jointly-controlled entit.	-	-	-		
Pre-tax profit	34.6	39.1	50.8		
Tax	(2.5)	(3.4)	(4.3)		
Minority interests	-	(0.0)	0.0		
Net profit	32.0	35.7	46.5		
% chg	62.7	11.4	30.3		
EPS (RMB) - Basic	0.086	0.094	0.100		
DPS (RMB)	-	0.008	0.008		
Shareholding Structure					
			Shares o/s (m)	%	
Mr. Yang Yirong			193.3	41.9	
Neon Liberty			50.7	11.0	
Value Partners			39.6	8.6	
Senior management			34.1	7.4	
Public			143.4	31.1	
Total			461.0	100.0	
Background					
EcoGreen is engaged in the production, research and distribution fine chemical products of functional ingredients and intermediates for application in pharmaceutical industry, healthcare industry and personal care and personal care industry.					
Key Ratios	04A	05A	06F	07F	08F
Net gearing (%)	Cash	Cash	Cash	Cash	Cash
Net ROE (%)	30.2	18.6	17.6	17.7	19.9
EBIT ROCE (%)	20.8	16.7	16.6	17.5	20.4
Dividend payout (%)	12.5	13.6	17.5	17.5	17.3
Effective tax rate (%)	7.9	8.9	8.6	9.0	10.8
Net interest coverage (x)	12.1	12.3	13.0	12.1	11.9
A/R turnover (days)	88.8	96.6	92.9	89.3	89.6
A/P turnover (days)	34.2	69.9	60.7	57.2	50.7
Stock turnover (days)	43.9	48.4	56.8	57.9	58.0

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