

Better visibility ahead

China Chemicals

EcoGreen (2341 HK, HK\$1.91)

BUY (unchanged)

Target price: HK\$2.50 (+31.0%)

Increase in ASP for major products. ASP for Dihydromyrecenol (DIHMOL) has increased by 2–3% so far in 2H of the year. In addition to its strong organic growth, EcoGreen also received some new orders, which were originally placed to its India competitors by customers. As its Indian competitors failed to fulfill the customers' requirement by delivering the goods on time, the customers switch the new orders to EcoGreen. This demonstrates the importance of locating the production plants near the raw material bases.

Gum turpentine oil prices. Current turpentine oil prices dropped further to around RMB7,000 level from RMB7,600 in November. Thus gross profit margin in FY12/07F is expected to further improve. Management expects price should stabilize at the current level with a little downward pressure going forward.

Phase III expansion on track. The Phase III expansion plant is on track to commence operation by the end of FY12/07. Two new products for F&B aroma chemicals have been launched in the 2H FY12/06. Part I of the Phase III production plant (a multifunctional workshop) is expected to be completed by 2H FY12/07F, thus it will speed up the production volume of new-high margin products.

IFF showed strong 3Q06 results. IFF (IFF US, US\$47.97, NR) announced a strong set of 3Q06 results in November. Fragrance sales increased 24%, which were mainly driven by new products. The fine fragrance sales from Asia Pacific region surged 58% during the period. Share price of IFF recorded a 52-week new high of US\$48.87 after the impressive 3Q06 results.

Booming industry. On 22 November, 2006, **Givaudan (GIVN VX, CHF1085, NR)**, the market leader announced to acquire the fragrance and flavor business from Quest International for a total consideration of GBP1.2b. The deal will enable Givaudan to further secure its number one position in the industry. Note that Symrise (number four player) also plans for an IPO to raise EUR650m in Frankfurt in 2006.

Valuation. The counter is trading at 9.8x FY12/06F P/E and 7.7x FY12/07F P/E while its international peers are trading at around 20.8x and 17.1x respectively. With its leading market position in the upstream market, EcoGreen will benefit from strong global demand for FMCG. We retain our BUY call with a target price of HK\$2.50.

Table 1: Financial summary

| Year to | Net profit | EPS | EPS | P/E | P/B | EV/EBITDA | Yield | ROE | ROCE | N. Gearing |
|---------|------------|-------|--------|------|-----|-----------|-------|------|------|------------|
| Dec | RMBm | RMB | Δ % | X | X | X | % | % | % | % |
| 04A | 61.4 | 0.156 | (14.5) | 12.4 | 2.7 | 8.3 | 1.0 | 30.2 | 20.8 | Cash |
| 05A | 71.1 | 0.167 | 7.4 | 11.5 | 1.9 | 7.2 | 1.2 | 18.6 | 16.7 | Cash |
| 06F | 90.9 | 0.197 | 17.7 | 9.8 | 1.4 | 5.6 | 1.8 | 17.6 | 16.6 | Cash |
| 07F | 115.1 | 0.250 | 26.9 | 7.7 | 1.2 | 4.3 | 2.3 | 17.7 | 17.5 | Cash |
| 08F | 154.7 | 0.336 | 34.4 | 5.7 | 1.0 | 3.1 | 3.1 | 19.9 | 20.4 | Cash |

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Table 2 : 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 | 2341 HK | HKD | 1.91 | 11.5 | 9.8 | 7.7 | 18.6 |
| Produits Chimiques Auxiliair | a | PCA FP | EUR | 4.85 | na | 20.2 | 14.7 | (5.8) |
| Rhodia SA | a | RHA FP | EUR | 2.50 | na | 30.9 | 14.5 | NA |
| Dynaction SA | a | DYT FP | EUR | 12.2 | na | 28.4 | 12.5 | (15.2) |
| Lyondell Chemicals | a | LYO US | USD | 25.66 | 7.9 | 7.7 | 7.2 | 18.2 |
| International Flavours & Fragrances | b | IFF US | USD | 47.97 | 21.0 | 19.7 | 17.9 | 21.2 |
| Givaudan | b | GIVN VX | CHF | 1085 | 19.2 | 16.9 | 16.9 | 16.9 |
| T Hasegawa | b | 4958 JP | JPY | 1770 | 19.7 | 18.8 | 17.7 | 6.4 |
| Takasgo | b | 4914 JP | JPY | 578 | 17.4 | 20.0 | 18.2 | 5.4 |
| Huabao | b | 336 HK | HKD | 4.41 | na | 2.74 | 20.9 | Na |
| China F&F | b | 3318 HK | HKD | 3.19 | 16.1 | 17.4 | 14.7 | 37.5 |
| P&G | c | PG US | USD | 63.80 | 23.7 | 21.1 | 18.5 | 21.8 |
| Tingyi | c | 322 HK | HKD | 6.59 | 38.2 | 31.0 | 24.8 | 14.8 |
| China Mengniu | c | 2319 HK | HKD | 17.0 | 47.0 | 36.9 | 28.1 | 21.3 |
| Hengan | c | 1044 HK | HKD | 18.3 | 43.9 | 30.9 | 22.6 | 20.4 |
| Average | | | | | 24.6 | 20.8 | 17.1 | 14.0 |

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

Source: SBI E2-Capital & Bloomberg