

## EcoGreen Fine Chemicals

### Growth smelled for 2011

to summarize...

- The company is a leading supplier of natural turpentine aroma chemicals, occupying ~25% global market share of dihydromyrcenol.
- Competitive strength relies on its innovated technology. A new generation technology has been developed and implemented, which will further improve production efficiency and bring down production cost.
- A 600 mt production line for turpentine chemicals will trial soon in Apr. Meanwhile, new Changtai plant will be put into operation in May.
- New quarterly pricing mechanism allows better transfer of incremental cost, minimizing impact of gum turpentine price fluctuation.
- Based on the capacity release and gum turpentine price movement, FY12/11F earnings are anticipated to rise 26% to RMB164m,
- The counter is trading at 8.1x P/E historically, versus 22% CAGR at top line, 13% at bottom line and 10% for EPS since being listed in 2004.

**Leading supplier of turpentine aroma chemicals.** Headquartered in Xiamen, Ecogreen is a leading fine chemical company in China, producing aroma chemicals, natural extracts and intermediates, which all are raw materials widely applied in industries such as healthcare & personal care, food & beverage and pharmaceutical. Core products are natural turpentine aroma chemicals, making up ~40% of the company's total sales in FY12/10A. Core single product is dihydromyrcenol (27% of the total revenue), for which Ecogreen has ~25% share around the world.

**Technology-driven expansion.** 72% of gum turpentine oil in the world comes from China, which gives local producers a natural edge to dominate the turpentine and related market. Ecogreen outran its peers for its innovated technology. A good example is its synthesis technology, heterogeneous Catalytic Reaction via Fixed Bed Process, which allows high production efficiency at relatively low cost. According to the management, an upgraded synthesis technology has been developed. It, after adoption, can accelerate reaction process, resulting in output increase (50-100%), while further reduce solvent and utilities consumption, enhancing gross margin by 3-4 pcps. Although re-engineering (1-2 months time lead) of existing facilities (3,500 mt) will wait until year end or even the next Chinese New Year due to already stretched production schedule, a brand new line (600 mt) is under construction and will launch trial in Apr.

**Other products in progress.** For other aroma products (30% of total revenue), natural extracts (14% of total revenue) and intermediates (7% of total revenue), production is sub-contracted or conducted within Xiamen plant phase III. Design capacity of the phase III plant is RMB300-350m. Current utilization rate is ~50%, which, however, may improve to ~80% in 2011 with more orders secured. The new Changtai plant, designed for intermediates (all outsourced presently) and material chemicals (capacity: RMB300m), completed construction and will start testing in Apr and trial in May. By shifting production back from external manufacturers, intermediate products may entitle some margin improvement (external manufacturers' gross margin: ~10%), although the actual figure is still subject to utilization rate as well as product mix.

**New pricing model to minimize margin risk.** Ecogreen used to expose to turpentine price fluctuation as most contracts are negotiated and fixed at year beginning. This explains the margin decline from 2007 to 2009, when price of gum turpentine oil hiked continuously. Last year, the company managed to revise its pricing mechanism and, now, contracts are reviewed on a quarterly basis, which, together with ~3 month inventory in hand, may largely stabilize its gross margin.

Ticker	2341 HK
Rating	Not Rated
Price (HK\$)	2.60
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1.71-3.40
Market cap. (US\$m)	160.5
Daily t/o (US\$m)	0.2
Free float (%)	23.9

#### Financial summary

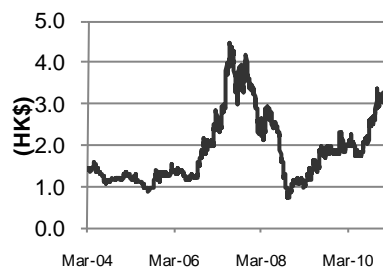
Year to Dec	08A	09A	10A
Turnover (RMBm)	740	728	908
Net Profit (RMBm)	114	107	130
EPS (RMB)	0.244	0.231	0.280
P/E (x)	9.3	9.8	8.1
P/B (x)	1.41	1.25	1.14
EV/EBITDA (x)	5.2	5.1	4.2
Yield (%)	1.6	1.5	1.8
ROE (%)	16.2	13.6	14.5
ROCE (%)	12.6	10.6	11.0
N. Gear. (%)	3.3	cash	cash

Source: SBI E2-Capital

	11F	12F	13F
Consensus EPS (RMB)	0.47	0.53	-
Previous earnings (RMBm)	-	-	-
Previous EPS (RMB)	-	-	-

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(3.6)	(18.1)	+13.8
Actual price changes (%)	(3.0)	(16.9)	+26.8



Source: Bloomberg

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**Earnings to up 26% to FY12/11F.** Based on the expected output increase backed by capacity expansion together with the selling price improvement driven by rising gum turpentine oil price, we preliminary forecast the company's top line will pick up 24% in FY12/11F to RMB1,130m. Blended gross margin will stay at 25% level. Thus, net profit will increase 26% to RMB164m.

**Table 1. Preliminary forecasts**

Year to Dec (RMBm)	10A	11F Notes
<b>Revenue</b>	908.3	1,130.5
Aroma chemicals	641.0	833.5
Turpentine	363.3	465.8
Non-turpentine	277.7	367.7
Natural extracts	127.0	139.7
Intermediates	60.3	69.3
Trading	79.9	87.9
<b>YoY growth</b>	24.7%	24.5%
Aroma chemicals	31.7%	30.0%
Turpentine		28.2% • Assume 400 mt output from the new 600 mt line; • 23% increase in gum turpentine oil price so far this year
Non-turpentine		32.4% • Utilization of phase III plant is anticipated to raise from 50% to 80% with orders in hand
Natural extracts	12.3%	10.0% • Organic growth
Intermediates	7.2%	15.0% • Organic growth • Contribution from Changtai plant
Trading	10.2%	10.0% • Organic growth
<b>Gross profit</b>	224.8	278.8
Aroma chemicals	155.8	204.2
Natural extracts	30.2	33.5
Intermediates	29.5	31.2
Trading	9.0	9.9
<b>Gross margin</b>	24.7%	24.7%
Aroma chemicals	24.3%	24.5% • Minor improvement as the new line can operate even lower cost
Natural extracts	23.8%	24.0% • Minor improvement due to larger scale
Intermediates	48.9%	45.0% • Moderate decline due to launch of new Changtai plant
Trading	11.3%	11.3% • Steady gross margin
<b>Operating profit</b>	164.1	203.9
<b>Net profit</b>	130.1	164.1

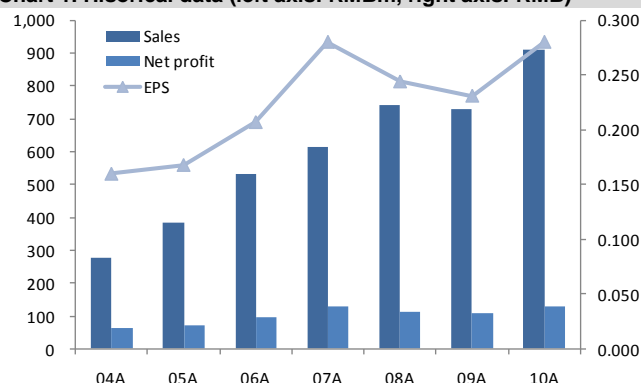
Source: SBI E2-Capital

**Long-term opportunity from industry transition.** Global flavors & fragrances market grew at 6% CAGR in 2005-09, which is slightly lower than 7% nominal GDP growth rate during the same period. The market is highly concentrated. Top 10 vendors, all from developed countries, controlled 72.5% market share in 2009 (2008:70.7%). These leading players are gradually moving towards downstream and drifting away from cost-conscious upstream operation, which leaves business opportunity to emerging names which can commit quality supply. We expect Ecogreen to be one of such names given the company's technical advantage.

**Undemanding valuation.** The company's top line has been growing at 22% CAGR since its listing in 2004 while net profit 13% CAGR and EPS 10% CAGR. The slower bottom line growth can be largely attributed to the gum turpentine oil price hike. The counter now is trading at 8.1x FY12/10A earnings, which may further decline to 6.5x based on our FY12/11F estimates. Considering its track record and growth prospect, we think current valuation is undemanding.

**Risks.** Any major change in gum turpentine oil supply might impact both the company's output (i.e. revenue) and profit margin.

**Chart 1. Historical data (left axis: RMBm, right axis: RMB)**



Source: Company data

**Table 2. Key financials**

Year to Dec (Rmbm)	08A	09A	10A
Revenue	740.0	728.5	908.3
Gross profit	210.5	187.1	224.8
Operating profit	140.7	137.0	164.1
Net profit	114.2	107.5	130.1
EBITDA	167.2	172.0	206.7
Fixed assets	8.6	9.9	9.5
Inventories	76.1	72.2	115.5
Receivables	273.5	248.7	389.9
Payables	101.6	101.2	179.9
Cash	424.0	541.9	582.4
Short-term debt	224.5	100.1	184.8
Long-term debt	224.5	100.1	184.8
Shareholders' fund	745.7	840.5	957.5
Total equity	749.0	844.0	961.0
Net cash from operating activities	67.4	179.3	n.a.
Net cash used in investing activities	(88.1)	(43.5)	n.a.
Net cash from financing activities	132.0	(7.7)	n.a.
Net change in cash and cash equivalents	111.3	128.1	n.a.

Source: Company data

**Table 3. P&L**

Year to Dec (Rmbm)	08A	09A	10A
Revenue	740.0	728.5	908.3
Cost of goods sold	(529.5)	(541.4)	(683.5)
Gross profit	210.5	187.1	224.8
Other gains and losses	(0.3)	0.3	(0.4)
Selling and marketing costs	(28.4)	(20.0)	(23.7)
Administrative expenses	(41.1)	(30.3)	(36.6)
Profit from operations	140.7	137.0	164.1
Finance costs	(6.8)	(16.0)	(11.9)
Profit before taxation	134.0	121.0	152.2
Income tax expenses	(19.5)	(13.3)	(22.1)
Profit for the period	114.5	107.7	130.1
Attributable to:			
Owners of the Company	114.2	107.5	130.1
Minority interest	0.2	0.2	(0.0)
EPS - Basic (Rmb)	0.244	0.231	0.280
EPS - Diluted (Rmb)	0.239	0.229	0.273
Proposed DPS (HK\$)	0.041	0.038	0.047
Proposed dividend	16.8	15.6	19.0

Source: Company data

**Table 4. Shareholding structure**

Shareholders	Interest
Yang Yirong	40.7%
Keywise	14.8%
Fedility	8.7%
UBS	6.0%
Platinum Investment Management	5.9%
Others	23.9%
Total	100.0%

Source: HKEx

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**BUY** : absolute upside of >10% over the next six months

**HOLD** : absolute return of -10% to +10% over the next six months

**SELL** : absolute downside of >10% over the next six months

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