

## Company visit

## China Consumer

### China Flavors and Fragrances (3318 HK, HK\$3.39)

### Not Rated

**1H 06 results out in August** China F & F is expected to release its interim results in August. Its 1Q 06 top line growth rate reached 25% - 30%. Management expects the growth momentum should be sustainable for FY12/06. The company intends to pay out 40% of net profit in the future.

**Placement** After the recent share placement of 73.1m shares (HK\$3.15 per share), EPS would be diluted around 8%. Top line growth rate is expected to over 60% for the fine chemical segment, over 35% for F & B and over 15% for the tobacco segment. The market is looking for a 25% top line growth for the next 3 years.

**Capacity expansion** P&G in China is one of its potential clients. P&G would like to purchase at least 10,000 tonnes of products from China F & F per year. The company hopes to fulfil 10% to 20% of P&G's requirements after increasing its capacity to 5,200 tonnes by mid-08 from the current 2,600 tonnes.

**Margins** Gross margin reached 64% in FY12/05, which was mainly due to a 5% increase of its overall ASP, the roll out of new formulations and strong organic growth. The company has rolled out around 30 - 40 new formulations so far in 2006. According to management, the gross margin for tobacco enhancers is around 72% - 74%, 42% - 47% for the F & B enhancers and 35% for the fine chemical segment.

**CAPEX plan.** HK\$67m of the placement proceed is for the plant expansion and HK\$44m for general working capital. Capex totals RMB30m for FY12/06 and RMB100m for FY12/07, of which RMB70m will be used in the construction of new plant. At least another RMB30m will be prepared for FY12/08 if there is no other new expansion plan. Management considers to increase its capacity to 10,000 - 15,000 tonnes per year in the medium to long term.

**Valuation.** It is currently trading at c.18.9x FY06F and 15.7x FY07F consensus P/E, compared with its international peers' 17.2x and 16x. Note that the recent proposed acquisition of flavors and fragrances assets by Huabao (336 HK, HK\$2.81, NR) is priced at 13.2x trailing (FY3/06 P/E).

**Table 1: peer comparisons**

Company	Ticker	Currency	Price	Mkt Cap. (US\$m)	FY05 P/E (x)	FY06F P/E (x)	FY07F P/E (x)	ROE (%)	PEG (x)
International Flavors & Fragrances	IFF US	USD	34.53	3,136.6	17.3	17.1	16.3	21.2	1.54
T Hasegawa	4958.JP	JPY	1,615	571.1	17.9	18.5	17.6	7.2	na
Givaudan	GIVN.VX	CHF	968	5,786.3	17.2	na	na	16.9	2.61
Takasago	4914.JP	JPY	517	446.4	18.2	17.9	16.3	5.4	na
Sensient Technologies	SXT US	USD	23.40	942.7	15.9	15.5	14.9	6.9	3.77
Danisao A/S	DCODC	DKK	427.0	3,598.6	37.0	16.8	na	4.6	2.43
Robertet SA	RBT FP	EUR	122.0	335.6	19.0	15.9	15.2	na	na
China Flavors & Fragrances	3318 HK	HK\$	3.39	177.3	17.4	18.9	15.7	37.5	1.79
<b>Average</b>					<b>20.0</b>	<b>17.2</b>	<b>16.0</b>	<b>14.2</b>	<b>2.4</b>

Source: Bloomberg and SBI E2 Capital

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. If you would like to access our research reports and know more about our services, please contact Raymond Jook, Head of Research, on (852) 2533 3715 or [raymondjook@softbank.com.hk](mailto:raymondjook@softbank.com.hk). Find our research on: [sbie2capital.com](http://sbie2capital.com), [thomsononeanalytics.com](http://thomsononeanalytics.com) and [multex.com](http://multex.com)

Investors should assume that SBI E2-Capital is seeking or will seek investment banking or other primary businesses with the companies in this report.

**Analyst certification:** the views expressed in this report accurately reflects the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

**Disclaimer:** the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

**Table 2: business comparisons**

Company	China Flavors & Fragrances	Huabao International
Ticker	3318 HK	336 HK
Price (HK\$)	3.39	2.81
Market Cap. (US\$m)	177.27	89.09
12 mth range (HK\$)	1.17-3.90	1.00-2.975
Recommendation	NR	NR
Year of commencement operations	1991	1996
Business model	Research and development, and manufactures and sales of flavours and fragrances for tobacco, food and daily consumer goods	Research and development, production and sales of flavours and fragrances, for use in tobacco, food and daily consumer goods.
Major clients from tobacco industry	Zhangjiagou Cigarette Factory (10% of its tobacco turnover in FY12/05), Hongta Group and Ningbo Cigarette Factory	Hongta Tobacco Group (26.3% of its tobacco turnover in FY3/06)
Distribution network in China	Sales network in 15 provinces and cities. 10 liaison offices for client services.	Sales network in 21 provinces and cities
Overseas experts, experienced perfumers and application engineers	38 flavorists, 5 perfumers and more than 90 R & D experts	Over 100 people

Source: company data & SBI E2-Capital \* The acquisition target company

**Table 3: financial comparisons**

Company	China Flavors & Fragrances	Huabao International
Financials		
Fiscal year	Dec 2003	Mar 2004
Turnover breakdown	Tobacco flavors: 73% Food flavors: 26.7% Fine chemical flavors: 0.3%	Tobacco flavors: 100%*
Net profit (RMBm)	34.8	104.17*
Financials		
Fiscal year	Dec 2004	Mar 2005
Turnover breakdown	Tobacco flavors: 72.7% Food flavors: 25.4% Fine chemical flavors: 1.9%	Tobacco flavors: 91.5%* Food flavors: 8.5%*
Net profit (RMBm)	42.5	109.52*
Financials		
Fiscal year	Dec 2005	Mar 2006
Turnover (RMBm)	221.7	779.018**
Turnover breakdown	Tobacco flavors: 65.7% Food flavors: 26.2% Fine chemical flavors: 8.1%	Tobacco flavors: 89.9%* Food flavors: 10.1%*
Net profit (RMBm)	59.8	303.483*, 283.089**
Gross margin (%)	63.7	48.0*, 47.3**
Operating margin (%)	34.3	40.4*, 39.4**
Net margin (%)	27.0	38.2*, 36.3**

\* The acquisition target company

\*\* Unaudited pro forma income statement of the Enlarged Group

Source: company data & SBI E2-Capital

**Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the Sub-Placing Agent for China Flavors and Fragrances (2.8m shares at HK\$1.18) on 7 Dec 2005**