

Tontine Wines Group Ltd.

Development on the way

to summarize...

- Results is in line with our estimate with revenue increased 21.7% YoY and net profit increased 28.7% YoY for 2H FY12/09.
- Sweet wine was the main growth driver with 3.5% YoY volume growth and 26.1% ASP growth.
- Scale effect improved the margin level with 19.2% YoY and 21.5% YoY growth in cost of grape and grape juice and tax respectively while the overhead only up 0.9% YoY.
- Launch of new sweet wine product in 2010 is expected to encourage the growth of sweet wine.
- With net cash of RMB713.3m on hand, Tontine is following its original schedule in expansion.
- We revised our target price to HK\$2.38, Maintain BUY.

2H FY12/09A results. Tontine's results for 2H FY12/09A are in line with our estimate. Revenue increased 21.7% YoY to RMB341.6m while the net profit increased 28.7% YoY to RMB98.8m. The gross margin widened 1.7 pcp YoY to 58.8% while the net margin increased 1.6 pcp YoY to 28.9%. The dividend payout ratio was 25.0%.

Table 1. 2H FY12/09A results

6 months to Dec	Turnover (RMBm)	Gross Profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)
2H FY09	341.6	200.8	58.8	143.1	31.0	98.8
1H FY09	242.7	137.4	56.6	106.6	29.3	75.4
HoH(%)	40.7	46.2		34.3		31.0
2H FY08	280.7	160.3	57.1	113.5	32.4	76.7
YoY (%)	21.7	25.2		26.0		28.7

Source: Company data

Sweet wine was the main growth driver. For 2H FY12/09A, the sales sweet wine increased 30.5% YoY to RMB238.3m, accounting for 69.8% of total sales, with 3.5% YoY growth in volume and 26.1% YoY growth in ASP. The ASP growth was mainly drive by increased sales in higher ASP products, such as Wild Rose Grape Wine and Ice Wine. The sales of dry wine was only 5.4% YoY to RMB103.3m with 3.3% YoY growth in volume and 2.0% growth in ASP because Tontine was more focus on sweet wine. In 2010, Tontine will launch of 4 new products: Tontine special selection ice Red, Tontine premium ice wine, Tontine premium blueberry wine, and Tontine premium rose wine, which we think would further drive up the growth of its sweet wine.

Scale effect improved the margin. After analysis the cost structure of the company, we observed that the total cost increased 16.9% YoY to RMB140.8m, which was mainly because of the increase of 19.2% YoY in grape and grape juice and 21.5% YoY in tax while the production overhead only increased 0.9% YoY. The total cost growth was lower than the top line growth of 21.7% YoY, which drove up the overall margin level.

Development on the way. Tontine raised RMB491.6m cash by IPO in November 2009. By the end of 2009, the company had net cash of HK\$713.3m cash on hand. Its expansion is now on the way. 1) 105% capacity expansion will be completed in Q4 2010 with total investment of around RMB180.0m and production will be start by the end of the year. 2) Wine estate construction will start in 2010 and finish in 2014 with total investment of around RMB150.0m. The Tontine estate wine will be officially launched in 2012. 3) Wine cellar construction with total investment of around

Ticker	389 HK
Rating	BUY(Unchanged)
Price (HK\$)	1.77
Target Price (HK\$)	2.38(+34%)
12m Price Range (HK\$)	1.25-2.05
Market cap. (US\$m)	389.8
Daily t/o (US\$m)	1.8
Free float (%)	53.0

Financial summary

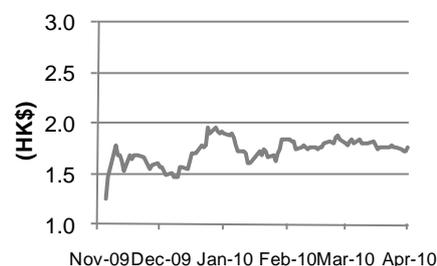
Year to Dec	08A	09A	10F	11F	12F
Turnover (RMBm)	486.7	584.3	709.5	874.5	1,007.5
Net Profit (RMBm)	136.8	174.1	212.2	272.0	322.9
EPS (RMB)	0.103	0.101	0.124	0.158	0.188
P/E (x)	15.1	15.4	12.6	9.8	8.3
P/B (x)	5.6	2.8	2.3	2.0	1.6
EV/EBITDA (x)	9.5	8.1	6.6	5.0	3.9
Yield (%)	-	1.6	2.0	2.5	3.0
ROE (%)	52.8	26.0	20.0	21.5	21.5
ROCE (%)	77.4	37.0	27.9	29.2	28.6
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

	10F	11F	12F
Consensus EPS (RMB)	0.127	0.148	-
Previous earnings (RMBm)	211.8	270.9	-
Previous EPS (RMB)	0.123	0.158	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	-7.0	-9.4	-
Actual price changes (%)	-2.2	-7.3	-



Source: Bloomberg

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RMB60.0m will be completed by the end of 2010 and cellar wines targets to be launched in 2011. 4) Tontine will establish 5 retail outlet in 2010 in Beijing, Chengdu, Shanghai, Shenyang, and Wuhan. It will further add 20 more retail outlet in China in 4 years. 5) Tontian will build its brand "Tongtian 通天" and "Tongtian Hong 通天红" by intensifying marketing and promotional activities, organizing wine tasting meeting, engaging brand ambassador. 6) The company will also actively exploring the expansion opportunity by acquisition and building strategic alliances with domestic and international entities.

Table 2. Sales volume, ASP and revenue breakdown

	2H 09A	2H 08A	YoY (%)	% of total
Sweet wine				
Vol (tonnes)	6,392	6,178	3.5	63.6
ASP(RMBk/t)	37.3	29.6	26.1	
Revenue (RMBm)	238.3	182.7	30.5	69.8
Dry wine				
Vol (tonnes)	3,658	3,541	3.3	36.4
ASP(RMBk/t)	28.2	27.7	2.0	
Revenue (RMBm)	103.3	98.0	5.4	30.2
Total				
Vol (tonnes)	10,050	9,719	3.4	100.0
ASP(RMBk/t)	34.0	28.9	17.7	
Revenue (RMBm)	341.6	280.7	21.7	100.0

Source: Company data

Table 3. Cost structure breakdown

	2H 09A(RMBm)	%	2H 08A(RMBm)	%	YoY (%)
Raw material					
Grape and grape juice	64.6	45.9	54.2	45.0	19.2
Yeast & others	4.6	3.2	4.1	3.4	11.0
Packaging	33.7	23.9	30	24.9	12.2
Others	0.3	0.2	0.5	0.4	(34.6)
Subtotal	103.2	73.3	88.9	73.8	16.1
Others					
Prod'n o/heads	3.4	2.4	3.4	2.8	0.9
Tax	34.1	24.3	28.1	23.3	21.5
Subtotal	37.6	26.7	31.5	26.2	19.3
Total	140.8	100.0	120.4	100.0	16.9

Source: Company data

Valuation. We revised up our sales estimate to RMB709.5m for FY12/10F (from RMB670.0m) with 16.5% volume growth and 4.2% ASP growth and RMB874.5m for FY12/11F (from RMB827.2m) with 18.1% volume growth and 4.4% ASP growth. We estimate that the net profit would be RMB212.2m for FY12/10F (from RMB211.8m) and RMB272.0m for FY12/11F (from RMB270.9m). We introduced our net profit estimate for FY12/12F to be RMB322.9m. Our new DCF-derived target price is HK\$2.38 based on 2% terminal growth and 12% discount rate. Keep BUY. The new target price represents 17.0x FY12/10F and 13.2x FY12/11F P/E. The HK listed peers are currently trading at average 21.0 FY12/10F and 17.4x FY12/11F P/E based on market consensus.

Table 4. DCF valuation reference table

Discount Rate	Terminal Growth				
	0.5%	1.0%	1.5%	2.0%	2.5%
11.0%	2.48	2.56	2.64	2.73	2.83
12.0%	2.21	2.26	2.32	2.38	2.45
13.0%	1.99	2.03	2.08	2.12	2.18
14.0%	1.81	1.84	1.88	1.92	1.97

Source: SBI E2-Capital

Table 5. Valuation comparison

Company name	Ticker	Mkt cap (US\$m)	Last Price (Local)	His P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	Est ROE (%)
HK-listed								
China Food	506 HK	2319.9	6.48	31.8	23.6	18.8	3.4	10.0
Dynasty	828 HK	434.2	2.72	21.6	18.4	16.0	1.9	8.7
Average				26.7	21.0	17.4		
China-Listed								
Tongpu	600365 CH	240.2	11.71	-	78.1	58.6	10.5	-
CITIC Guoan Vine	600084 CH	1182.9	9.97	-	-	-	7.6	-
Mogao	600543 CH	577.7	12.28	141.4	55.8	41.2	4.0	6.7
Changyu	000869 CH	5178.8	71.6	36.4	34.6	28.3	14.3	37.5
Average				88.9	56.2	42.7		
Average*				88.9	45.2	34.7		

*exclude the Tongpu and CITIC Guoan Vine

Source: Bloomberg

Table 6. P & L forecast

Year to Dec (RMBm)	08A	09A	10F	11F	12F
Revenue					
Sweet Wine	321.4	403.8	509.0	652.0	764.8
Dry Wine	165.3	180.5	200.5	222.5	242.7
	486.7	584.3	709.5	874.5	1,007.5
Cost of sales	(209.8)	(246.1)	(295.4)	(355.8)	(402.8)
Gross profit	276.9	338.2	414.0	518.7	604.7
Other income	0.2	1.7	7.1	8.7	12.1
Selling and distribution expenses	(53.5)	(67.9)	(103.7)	(129.6)	(152.4)
Administrative expenses	(9.8)	(13.3)	(14.2)	(20.1)	(22.2)
Other expenses	(13.0)	(9.0)	-	-	-
Finance costs	-	-	-	-	-
Profit before tax	200.9	249.7	303.2	377.7	442.3
Income tax expense	(64.1)	(75.6)	(91.0)	(105.8)	(119.4)
Net profit	136.8	174.1	212.2	272.0	322.9

Source: Company data, SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities Limited was acted as the sole bookrunner and lead manager for the China Tontine Wines Group Limited (stock code: 389) in November 2009.

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