

Tontine Wines Group Ltd.

Margin improvement from higher ASP

to summarize...

- Tontine's FY12/10A results were in line with our expectations. Revenue came in at RMB703.5m, a 20.4% increase YoY while net profit came in at RMB208.1m, up 19.5% YoY. Gross margin for the period was 58.8%, up 0.9pcp due to increases in sales of high margin product and stable cost.
- Tontine continues to focus on sales of sweet wine products. Sweet wines contributed 70.8% of total revenue, increase from 69.1% in FY12/09A.
- Tontine plans to launch four new products in the sweet wine segment in this year to further strengthen their sweet wine portfolio.
- Tontine have completed the installation of the production capacity expansion, where the annual production capacity can be increased up to ~39,000 tonnes from the previous ~19,000 tonnes.
- We maintain our target price to HK\$2.28, Maintain BUY. Our target price represents 9.3x FY12/11F and 8.2x FY12/12F P/E.

FY12/10A results: Tontine's FY12/10A results were in line with our expectations. Revenue was RMB703.5m, a 20.4% increase YoY while net profit came in at RMB208.1m, up 19.5% YoY. Gross margin for the period was 58.8%, up 0.9pcp. EPS decreased 6.2% to RMB11.9 cents from RMB12.7 due to increased in weighted average number of ordinary shares after share placement in November 9th 2010.

Table 1. FY12/10A

6 months to Dec	Turnover (RMBm)	Gross Profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)
FY10A	703.5	413.9	58.8	300.6	30.8	208.1
FY09A	584.3	338.2	57.9	250.0	30.3	174.1
YoY(%)	20.4	22.4		20.2		19.5

Source: Company data

Sweet wine continues to be the key driver: Tontine continues to focus on sales of sweet wine products. Sweet wines contribute 70.8% of total sales in FY12/10A, (up from 69.1% a year ago), with dry wine contributing the remaining 29.2%. Revenue from sweet wine represented 23.4% YoY growth to RMB498.2m with ASP increasing to RMB38.3 per tonne (FY12/09A: RMB33.5 per tonne). The significant increase in the average selling price of sweet wine products was the result of changing product mix to higher price product. Meanwhile, dry wine sales grew 13.8% YoY growth to RMB205.4m. ASP for this segment increased from RMB28.1 to RMB29.3 per tonne.

Margin improvement from higher selling price and stable cost: Blended gross profit margin improved 0.9pcp YoY to 58.8%, driven by a combination of increasing in sales of high margin product and stable cost. Total raw material cost drop slightly from 73.7% to 72.5% of COGS.

New premium products introduced: During 2010, Tontine has introduced several premium products in the sweet wine category. The Tontine Premium Blueberry wine was introduced in the 1H of 2010. In the 2H of 2010, Tontine premium Ice wine, Tontine Premium Rose wine and Tontine Dealcoholized Mountain Grape wine was introduced. In the dry wine category, Tontine Mountain grape Wine was introduced in the 2H of 2010. The selling prices of the premium product are in the range of over RMB100. By introducing products in the premium price range will allow them to attain a higher profit margin.

Capacity expansion: Tontine have completed the installation of the production capacity expansion, where the annual production capacity can be increased up to

Ticker	0389 HK
Rating	BUY
Price (HK\$)	1.59
Target Price (HK\$)	2.28(+43%)
12m Price Range (HK\$)	1.41-2.40
Market cap. (US\$m)	411.3
Daily t/o (US\$m)	1.5
Free float (%)	59.9

Financial summary

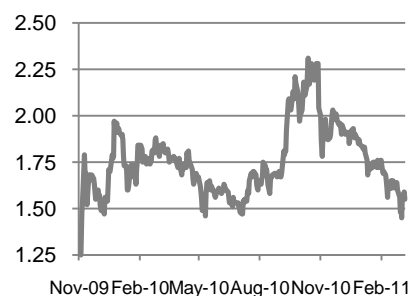
Year to Dec	08A	09A	10A	11F	12F
Turnover (RMBm)	486.7	584.3	703.5	851.3	955.1
Net Profit (RMBm)	136.8	174.1	208.2	252.4	288.5
EPS (RMB)	0.103	0.127	0.119	0.144	0.164
P/E (x)	13.0	10.6	11.3	9.3	8.2
P/B (x)	4.80	1.90	1.43	1.28	1.13
EV/EBITDA (x)	8.1	4.4	3.9	4.1	3.1
Yield (%)	-	2.0	1.6	2.3	2.6
ROE (%)	52.8	26.0	15.9	14.4	14.7
ROCE (%)	77.4	37.0	22.7	20.6	21.0
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI

	11F	12F
Consensus EPS (RMB)	0.150	0.177
Previous EPS (RMB)	0.147	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	-2.0	-15.6	-
Actual price changes (%)	-5.4	-16.8	-



Source: Bloomberg

SBI Research Team

(852) 2533 3700

sbie2research@sbie2capital.com

~39,000 tonnes from the previous ~19,000 tonnes. The actual capacity in use will slowly ramp up and target to reach 24,000 tonnes by the end of 2011.

Wine estate developments: The group also plans to develop a wines estate to produce premium range of estate bottle wine labeled under "Estate Bottled" from higher quality of grapes. The grapes use will be from their self-operated vineyard where the size will be up to approximately 2,000 mu (667 square metres). The annual yield expected to be around 500 tonnes which is approximate 600,000 bottles of 750ml size. The construction of Estate Wine previously said to commence in second half of 2010 and complete by 2014 is delay the start in 2011 and complete by 2015.

Wine cellar developments: There's also plan to develop wine cellaring capabilities where they can store wines with properly controlled environment to undergo an ageing process. The storage capacity of the cellar is expected to accommodate up to 600,000 bottles of 750ml in size. The construction of Wine Cellar said to be completed by the end of 2010 and target to be launched by 2011 is also delay, they expect to complete by the end of 2011 and launched the products by 2013.

Movements in Issued Share capital: Tontine did a top-up share placement of 300 million shares at HK\$2.08 per share in November 9th 2010. At the time, the placing price was a discount of approximately 8.8% to its previous closing price of HK\$2.28. The placing share represented approximately 17.5% of the existing issued share capital and approximately 14.9% of the issued share capital after the placing and subscription. Tontine granted 70 millions (~3.5% of issued share capital) share options to their eligible employee on November 23rd, 2010 at an exercise price of HK\$1.98.

Table 2. Sales volume, ASP and revenue breakdown

	FY 10A	FY 09A	YoY (%)	% of total
Sweet wine				
Vol (tonnes)	12,997	12,046	7.9	64.9
ASP(RMBk/t)	38.3	33.5	14.3	
Revenue (RMBm)	498.2	403.8	23.4	70.8
Dry wine				
Vol (tonnes)	7,017	6,432	9.1	35.1
ASP(RMBk/t)	29.3	28.1	4.3	
Revenue (RMBm)	205.4	180.5	13.8	29.2
Total				
Vol (tonnes)	20,014	18,478	8.3	100.0
ASP(RMBk/t)	35.2	31.6	11.4	
Revenue (RMBm)	703.5	584.3	20.4	100.0

Source: Company data

Table 3. Cost structure breakdown

	FY 10A (RMBm)	%	FY 09A (RMBm)	%	YoY (%)
Raw material					
Grape and grape juice	132.8	45.8	112.6	45.8	17.9
Yeast & others	8.6	3.0	8.6	3.5	0.9
Packaging	67.9	23.5	59.5	24.2	14.1
Others	0.7	0.2	0.6	0.2	0.9
Subtotal	210.0	72.5	181.3	73.7	15.9
Others					
Prod'n o/heads	7.6	2.6	6.4	2.6	18.8
Tax	71.9	24.9	58.4	23.7	23.1
Subtotal	79.5	27.5	64.8	26.3	22.7
Total	289.6	100.0	246.1	100.0	17.7

Source: Company data

Valuation: We revised our sales estimate to RMB851.3m for FY12/11F (from RMB866.7m) with 10.0% volume growth and 10.0% ASP growth for the full year. We estimate RMB955.1m for FY12/12F (from RMB998.0m) with 10.0% volume growth and 2.0% ASP growth. We estimate that the net profit would be RMB252.4m for FY12/11F (from RMB273.0m) and RMB288.5m for FY12/12F (from RMB323.9m). We maintain a buy rating with target price of HK\$2.28. Our target price represents 9.3x FY12/11F and 8.2x FY12/12F P/E. The HK listed peers are currently trading at average 21.2x FY12/11F and 21.0x FY12/12F P/E based on market consensus.

Table 4. 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 Foods	506 HK	1,779.3	4.97	31.1	30.1	21.8	2.5	10.7
Dynasty Wine	828 HK	492.9	3.08	22.2	22.0	18.7	2.0	8.8
Tontine	389 HK	411.3	1.59	10.5	10.9	8.9	2.4	26
Average				21.2	21.0	16.5		
China-Listed								
Changyu	000869 CH	5,674.2	91.48	37.5	34.6	27.6	14.6	40.4
Citic Guoan	600084 CH	914.8	8.81	93.8	44.1	-	6.4	6.8
Gansu Mogao	600543 CH	532.3	12.93	109.1	117.5	46.2	4.0	3.7
Tonghua	600365 CH	233.9	13.03	-	236.9	108.6	13.7	-
Average				80.1	108.3	60.8		
Average*				65.6	39.3	27.6		

*excluding Gansu Mogao and Tonghua

Source: Bloomberg

Table 5. P & L forecast

Year to Dec (RMBm)	08A	09A	10A	11F	12F
Revenue					
Sweet Wine	321.4	403.8	499.1	602.7	676.2
Dry Wine	165.3	180.5	204.9	248.6	279.0
	486.7	584.3	703.5	851.3	955.1
Cost of sales	(209.8)	(246.1)	(289.6)	(349.7)	(384.8)
Gross profit	276.9	338.2	413.9	501.6	570.4
Other income	0.2	1.7	3.3	4.0	4.5
Selling and distribution expenses	(53.5)	(67.9)	(84.3)	(102.1)	(114.5)
Administrative expenses	(9.8)	(13.3)	(32.3)	(39.0)	(43.8)
Other expenses	(13.0)	(9.0)	0.0	0.0	0.0
Finance costs	0.0	0.0	0.0	0.0	0.0
Profit before tax	200.9	249.7	300.6	364.6	416.7
Income tax expense	(64.1)	(75.6)	(92.5)	(112.1)	(128.1)
Net profit	136.8	174.1	208.1	252.4	288.5

Source: Company data, SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities Limited was acted as the sub-placing agent for the China Tontine Wines Group Limited (stock code: 389) in November 2010.

SBI E2-Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: sbie2capital.com, thomsononeanalytics.com, factset.com and multex.com

SBI E2-Capital stock ratings:

STRONG BUY : absolute upside of >50% over the next three months

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

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

Analyst certification: The views expressed in this report accurately reflect 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: This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI E2-Capital Securities Limited ('SBI E2-Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI E2-Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI E2-Capital as of the date of this report only and are subject to change without notice. Neither SBI E2-Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI E2-Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI E2-Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI E2-Capital located in such recipient's home jurisdiction.

Copyright © SBI E2-Capital Securities Limited 2008. All rights reserved.
