

Tontine Wines Group

Gross profit margin improved

to summarize...

- Revenue came in at RMB379.2m, a +7.5% YoY from the previous year. Gross profit increased 8.1% to RMB217.7m and net profit increased 7.3% to RMB75.5m.
- Tontine continues to focus on sales of sweet wine products. Sweet wines contributed 68.4% of total sales in 1H FY12/12A, nearly unchanged while dry wine contributed the remaining 31.6%.
- Gross profit margin increased 0.3 pcp to 57.4% from 57.1% in FY12/11A. This was the result of shifting product mix towards higher margin products.
- Selling and distribution expense increased to RMB80.9m from RMB42m in the previous period due to increase in sales commission paid-out, increase in transportation cost and increase in advertising and promotional charges.
- Administrative expenses decreased to RMB27m from RMB51m in the previous period due to lack of share option expenses and exchange rate lost.
- We continue to expect the Chinese economy to remain weak throughout FY 2012 thus challenging to the consumption sector. We revised our target price to HK\$1.08, representing 9.9x FY12/12F P/E and 9.1x FY12/13F P/E.

1H FY12/12A results: Revenue came in at RMB379.2m, a +7.5% YoY from the previous year. Gross profit increased 8.1% to RMB217.7m. Net profit increased 7.3% to RMB75.5m. Gross margin for the period was 57.4%, increased 0.3pcp to 57.4% in 1H FY12/11A (57.7% in FY12/11A). EPS increased 5.7% to RMB0.037. The increase in profitability was mainly from increase in sales volume and improvement in the gross profit margin.

Table 1. 1H FY12/12A results

6 months to Dec	Turnover (RMBm)	Gross Profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)
1H FY12	379.2	217.7	57.4	113.4	33.5	75.5
1H FY11	352.6	201.3	57.1	110.5	36.3	70.3
HoH(%)	7.5	8.1		2.7		7.3

Source: Company data

Sweet wine vs. dry wine mix: Tontine continues to focus on sales of sweet wine products. Sweet wines contributed 68.4% of total sales in 1H FY12/12A, nearly unchanged (FY12/11A: 69.1%), while dry wine contributed the remaining 31.6% (FY12/11A: 30.9%). Revenue from sweet wine represented 7.0% YoY growth to RMB259.4m (1H FY12/11A: RMB242.5m) with ASP decreasing to RMB41.4 per tonne (1H FY12/11A: RMB42.5 per tonne, FY12/11A RMB38.7 per tonne). Meanwhile, dry wine sales grew 8.8% YoY growth to RMB119.7m from RMB110.0m in 1H FY12/11A, while ASP for this segment remain unchanged to RMB28.7 per tonne (FY12/11A RMB29.5 per tonne). The group introduced five new products, three in sweet wine products and two in dry wine products.

Margin: Blended gross profit margin increased 0.3 pcp to 57.4% from 57.1% in FY12/11A. This was the result of shifting product mix towards higher margin products. Total raw material cost drops increased from 68.3% in FY12/11A to 68.5% of COGS.

Expenses: Selling and distribution expense increased to RMB80.9m or 21.4% of the revenue, compare to 12% in the previous year. The increase was due to 1) the increase in sales commissions paid from higher sales volume. 2) increase in transportation cost and 3) increase in advertising and promotional charges for brand

Ticker	0389 HK
Rating	BUY
Price (HK\$)	0.68
Target Price (HK\$)	1.08
12m Price Range (HK\$)	0.60-1.18
Market cap. (US\$m)	175.5
Daily t/o (US\$m)	0.2
Free float (%)	59.9

Financial summary

Year to Dec	09A	10A	11F	12F	13F
Turnover (RMBm)	584.3	703.5	830.1	922.2	1,035
Net Profit (RMBm)	174.1	208.2	188.8	180.0	209.3
EPS (RMB)	0.127	0.119	0.094	0.089	0.104
P/E (x)	4.3	4.7	5.9	6.2	5.3
P/B (x)	0.78	0.59	0.49	0.48	0.48
EV/EBITDA (x)	0.2	(0.7)	1.2	0.9	0.6
Yield (%)	4.7	3.7	3.8	3.3	3.8
ROE (%)	26.0	15.9	9.6	7.9	9.1
ROCE (%)	37.0	22.7	14.4	11.4	13.3
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	1.8	-13.2	-34.0
Actual price changes (%)	3.0	-9.3	-32.7



Source: Bloomberg

SBI Research Team

(852) 2533 3700

sbie2research@sbie2capital.com

building activities. The A&P expense amount to RMB58.3m compare to RMB21.3m in 2011. Administrative expenses amounted to RMB27m or 7.1% of revenue compare to RMB51.1m or 14.5% in the previous period. The decrease was due to lack of share option expense and exchange lost from Renminbi exchange rate in the previous years.

Table 2. Cost Structure

	1H 11A(RMBm)	%	1H 12A(RMBm)	%	YoY (%)
Raw material					
Grape and grape juice	66.1	43.7	65.3	40.5	(1.2)
Yeast & others	3.6	2.4	4.4	2.7	22.2
Packaging	33.3	22	40.6	25.1	21.9
Others	0.3	0.2	0.4	0.2	33.3
Subtotal	103.3	68.3	110.7	68.5	7.2
Others					
Prod'n o/heads	5.9	3.9	5.9	3.7	0
Tax	42.1	27.8	44.9	27.8	6.7
Subtotal	48.0	30.9	50.8	31.3	5.8
Total	151.3	100.0	161.5	100.0	6.7

Source: Company data

Capacity: Last year the company has completed the installation of the production capacity expansion, where the annual production capacity can increase up to ~39,000 tonnes from the previous ~19,000 tonnes. For FY2012, target capacity is estimated to be around 28,000 tonnes. The first half of year is usually a slower season, we estimate about 40% of total capacity is used in 1H and 60% of total capacity will be used the second half.

Wine Estate Development: The wines estate will 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 start of construction for Estate Wine was commence was in the middle of 2011 and expect to complete by 2H of 2012, the first batch of 200,000 bottles expect to sell in 2H 2013.

Wine Cellar Development: The completion of Wine Cellar is expected to be in the 2H of 2012. The 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 first batch of 200,000 bottles is expected to sell in 1H 2013.

Table 3. Sales volume, ASP and revenue breakdown

	1H 11A	1H 12A	YoY (%)	% of total
Sweet wine				
Vol (tonnes)	5,702	6,263	9.8	59.8
ASP(RMBk/t)	42.5	41.4	(2.6)	
Revenue (RMBm)	242.5	259.4	7	68.4
Dry wine				
Vol (tonnes)	3,840	4,179	8.8	40.2
ASP(RMBk/t)	28.7	28.7	0	
Revenue (RMBm)	110.0	119.7	8.8	31.6
Total				
Vol (tonnes)	9,542	10,442	9.4	100.0
ASP(RMBk/t)	37.0	36.4	1.6	
Revenue (RMBm)	352.6	379.2	7.5	100.0

Source: Company data

Retail shops Expansion: The group plans to establish 20 Tontine retails shops in selective cities across the PRC over the next three years. So far, there are total 8 shops in Beijing, Chengdu, Dengfeng, Jian, Shanghai, Shenyang, Wuhan and Xiangtan. The cost for each shop is estimated to be around 2 million RMB for three years of operation. For 2012, the group plan to open an additional 5 retail shops. The retail shops will serve as asles and marketing platforms.

Acquisition Target: The company announcement in November 2011 regards to the possible acquisition of equity interest in Yantai Baiyanghe Winery). In February 2012, the company enters into a 2nd supplemental agreement to modify and supplement the first MOU. The new modifications were: 1) the exclusivity period to negotiate will be extended to December 31st, 2012 and 2) They will pay to the target company an additional amount of RMB16m as earnest money. They initial paid earnest money of RMB20m. In the case of formal agreement is not concluded within the exclusivity period, the earnest money in full will refund without interest.

Yantai Baiyanghe: Yantai Baiyanghe was found in 1958 in Qixia City along the Baiyang River in Shandong Province. It is located at approximately the same latitude as the world-renowned Bordeaux wine-producing region in France and is the only international vine and wine city in Asia. They produces approximately 80 types of wines, including grape wines, brandies and rice wines and also offers premium imported wines from countries overseas, like France, Australia and Chile. They have a nation-wide sales network covers all provinces and

cities in the PRC, with its main markets in Guangxi, Shandong, Fujian, Zhejiang and Jiangsu.

Possible benefit: The proposed acquisition would expand its wine products portfolio particularly in the premium high-end grape wine and imported wine products; upgrade the Group's wine making technology and reducing production costs through economies of scale using the combined production facilities; and bolster its sales and distribution network in the PRC and improve its profitability in the long run. It would also generate synergies through complementary strengths, as well as through sharing of resources.

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 Food	506 HK	2,479.5	6.92	29.9	22.0	17.1	2.9	10.2
Silver Base	886 HK	525.4	3.36	5.9	5.0	4.0	2.0	37.9
Dynasty Wine	828 HK	203.2	1.27	373.5	31.8	23.1	0.8	0.2
JLF	472 HK	85.6	0.40	14.3	-	-	1.0	7.4
Average				16.7	19.6	14.7		
China-Listed								
Changyu	000869 CH	4,394.6	55.48	19.5	17.5	14.3	7.4	43.1
CITIC GUOAN	600084 CH	584.6	5.63	-	-	-	5.1	-
Gansu Mogao	600543 CH	484.2	11.76	71.9	49.0	35.1	3.4	4.5
Tonghua	600365 CH	195.6	10.90	121.4	-	-	10.6	2.9
Average				70.9	33.3	24.7		

Source: Bloomberg

Valuation and our view: We continue to expect the Chinese economy to remain weak throughout FY 2012 thus challenging to the consumption sector. We revised our sales estimate to RMB922.2m for FY12/12F with 10% volume growth and 1.0% ASP growth for the full year. We estimate RMB1,034.7m for FY12/13F with 10.0% volume growth and 2.0% ASP growth. We estimate that the net profit would be RMB180.0m for FY12/12F and RMB209.3m for FY12/13F. We maintain a buy rating with target price of HK\$1.08. Our target price represents 9.9x FY12/12F and 9.1x FY12/13F P/E. The HK listed peers are currently trading at average 19.6x FY12/12F and 14.7x FY12/13F P/E based on market consensus.

Table 5. P & L forecast

Year to Dec (RMBm)	09A	10A	11A	12F	13F
Revenue					
Sweet Wine	403.8	499.1	573.7	637.4	715.2
Dry Wine	180.5	204.9	256.4	284.8	319.6
	584.3	703.5	830.1	922.2	1,034.7
Cost of sales	(246.1)	(289.6)	(351.0)	(397.9)	(456.8)
Gross profit	338.2	413.9	479.1	524.3	577.9
Other income	1.7	3.3	6.2	6.9	7.7
Selling and distribution expenses	(67.9)	(84.3)	(119.9)	(196.9)	(196.6)
Administrative expenses	(13.3)	(32.3)	(75.7)	(65.6)	(76.7)
Other expenses	(9.0)	0.0	0.0	0.0	0.0
Finance costs	0.0	0.0	0.0	0.0	0.0
Profit before tax	249.7	300.6	289.7	268.7	312.4
Income tax expense	(75.6)	(92.5)	(100.9)	(88.7)	(103.1)
Net profit	174.1	208.1	188.8	180.0	209.3

Source: Company data, SBI E2-Capital

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 Financial Services 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 Financial Services Limited. All rights reserved.
