

## Tontine Wines Group Ltd.

### Sweet wine drives revenue

#### to summarize...

- Revenue came in at RMB352.6m, a +21.1% yoy increase from RMB288.9m in 1H12/10A, while net profit came in at RMB70.4m, a -21.7% yoy decrease from RMB89.9m in 1H12/10A.
- The decline in profitability was mainly attributable to the share option expenses and exchange loss due to RMB exchange rate fluctuation, both of which are onetime accounting expense.
- Sweet wines contributed 68.8% of total sales in 1H FY12/11A, same from a year ago, while dry wine contributed the remaining 31.2%. Revenue from sweet wine represented 22.0% yoy growth to RMB242.5m and dry wine sales grew 22.2% yoy growth to RMB110.0m.
- Blended gross profit margin decreased 1.71pcp to 57.1% from 58.8% in FY12/10A. This is mainly due to newly imposed city construction tax and education surcharged by the local government.
- We revised our target price to HK\$1.64, representing 14.1x FY12/11F P/E and 11.5x FY12/12F P/E.

**1H FY12/11A results:** Revenue came in at RMB352.6m, a +21.1% yoy increase from RMB288.9m in 1H12/10A, while net profit came in at RMB70.4m, a -21.7% yoy decrease from RMB89.9m in 1H12/10A. Gross margin for the period was 57.09%, down 1.71pcp from 58.8% in FY12/10A (58.4% in 1H12/10A). EPS decreased 32.7 percent to RMB0.035 (1H FY12/10A: RMB0.052). The decline in profitability was mainly attributable to the share option expenses and exchange loss due to RMB exchange rate fluctuation.

**Table 1. 1H FY12/11A results**

6 months to Dec	Turnover (RMBm)	Gross Profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)
1H FY11	352.6	201.3	57.1	110.5	36.3	70.3
1H FY10	288.9	168.7	58.4	128.4	29.9	89.9
HoH(%)	22.0	19.3		(13.9)		(21.7)

Source: Company data

**Onetime expenses:** Share option expense and RMB exchange lost are one time lost. The share option expense of was around RMB20.9m. And the foreign exchange lost was RMB14.4m. The cash on-hand is now in the denomination of RMB, therefore should not recur again. If add back the onetime lost, pre-tax profit should be around RMB145.8m which is a 13.6% yoy increase over RMB128.4m from 1H FY12/10A.

**Sweet wine continues to be the key driver:** Tontine continues to focus on sales of sweet wine products. Sweet wines contributed 68.8% of total sales in 1H FY12/11A, same from a year ago (FY12/10A: 70.8%), while dry wine contributed the remaining 31.2% (FY12/10A: 29.2%). Revenue from sweet wine represented 22.0% yoy growth to RMB242.5m (1H FY12/10A: RMB198.8) with ASP increasing to RMB42.5 per tonne (1H FY12/10A: RMB34.9 per tonne, FY12/10A RMB38.3 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 22.2% yoy growth to RMB110.0m from RMB90.1m in 1H FY12/10A, while ASP for this segment increased slightly to RMB28.7 per tonne (1H FY12/10A: RMB28.6 per tonne, FY12/10A RMB29.3 per tonne).

**Newly imposed city tax hits margin:** Blended gross profit margin decreased

Ticker	0389 HK
Rating	BUY
Price (HK\$)	0.82
Target Price (HK\$)	1.64
12m Price Range (HK\$)	0.81-2.40
Market cap. (US\$m)	212.1
Daily t/o (US\$m)	1.0
Free float (%)	59.96

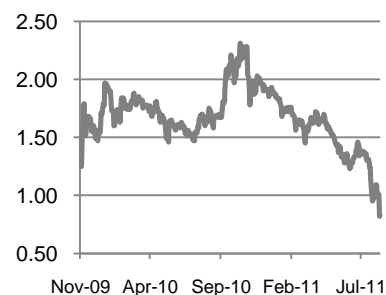
#### Financial summary

Year to Dec	08A	09A	10F	11F	12F
Turnover (RMBm)	486.7	584.3	703.5	790.8	871.1
Net Profit (RMBm)	136.8	174.1	208.2	190.8	235.4
EPS (RMB)	0.103	0.127	0.121	0.095	0.117
P/E (x)	6.5	5.3	5.5	7.1	5.8
P/B (x)	2.40	0.95	0.70	0.76	0.68
EV/EBITDA (x)	3.8	0.8	(0.1)	1.8	1.1
Yield (%)	-	3.9	3.2	2.9	3.6
ROE (%)	52.8	26.0	15.9	11.1	12.5
ROCE (%)	77.4	37.0	22.7	16.6	18.7
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	-30.5	-33.5	-49.1
Actual price changes (%)	-39.7	-43.1	-52.0



Source: Bloomberg

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1.71pcp to 57.1% from 58.8% in FY12/10A. This is mainly due to newly imposed city construction tax and education surcharged by the local government. The gross margin for sweet wine decreased 0.1pcp to 55.7% (1H FY12/10A: 55.6%, FY12/10A: 56.1%). Gross margin for dry wine decreased 4.3pcp to 60.1% (1H FY12/10A: 64.4%, FY12/10A: 65.6%). Total raw material cost drops from 73.2% in FY12/10A to 68.3% of COGS. Production overheads increased from 2.8% of COGS to 3.9% due to increase of depreciation for 20,000 tonnes production facilities expansion.

**Table 2. Cost Structure**

	1H 11A(RMBm)	%	1H 10A(RMBm)	%	YoY (%)
Raw material					
Grape and grape juice	66.1	43.7	55.7	46.3	18.7
Yeast & others	3.6	2.4	4.3	3.6	(16.3)
Packaging	33.3	22	27.7	23	20.2
Others	0.3	0.2	0.3	0.3	(0)
<b>Subtotal</b>	<b>103.3</b>	<b>68.3</b>	<b>88.0</b>	<b>73.2</b>	<b>17.4</b>
Others					
Prod'n o/heades	5.9	3.9	3.4	2.8	73.5
Tax	42.1	27	28.9	24	45.7
<b>Subtotal</b>	<b>48.0</b>	<b>30.9</b>	<b>32.3</b>	<b>26.8</b>	<b>48.6</b>
<b>Total</b>	<b>151.3</b>	<b>100.0</b>	<b>120.2</b>	<b>100.0</b>	<b>25.9</b>

Source: Company data

**New products planned for 2H FY2011:** So far, no new product was introduced in the 1H FY2011, but three new products is in plan for 2H FY2011, two sweet wines and one dry wine. The strong sales in the 1H FY2011 was reflected from the new products introduced in 2H of 2010. During 2010, Tontine introduced several premium products in the sweet wine category. The Tontine Premium Blueberry wine was introduced in the 1H of 2010. In 2H of 2010, seven new sweets wines and two dry wines were introduced. For sweet wines, Tontine premium Ice wine, Tontine Premium Rose wine and Tontine Dealcoholized Mountain Grape wine was introduce. In the dry wine category, Tontine Mountain grape Wine was introduced. By introducing products in the premium price range has allow them to attain a higher profit margin. A&P expenses total RMB21.3m for 1H FY 2011. For the full year A&P is targeted to be around seven to eight percent of the revenue.

**Table 3. Sales volume,ASP and revenue breakdown**

	1H 11A	1H 10A	YoY (%)	% of total
<b>Sweet wine</b>				
Vol (tonnes)	5,702	5,694	0.1	59.8
ASP(RMBk/t)	42.5	34.9	21.8	
Revenue (RMBm)	242.5	198.8	22.0	68.8
<b>Dry wine</b>				
Vol (tonnes)	3,840	3,154	21.8	40.2
ASP(RMBk/t)	28.7	28.6	0.3	
Revenue (RMBm)	110.0	90.1	22.2	31.2
<b>Total</b>				
Vol (tonnes)	9,542	8,848	7.8	100.0
ASP(RMBk/t)	37.0	32.7	13.5	
Revenue (RMBm)	352.6	288.9	22.1	100.0

Source: Company data

**Capacity expansion:** Tontine 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. The actual capacity in use will slowly ramp up and with target to reach 24,000 tonnes by the end of 2011. Since 1H 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 developments:** The wines estate will reduce 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 1H of 2011 and expect to complete by 2H of 2012, the first batch of 200,000 bottles expect to sell in 1H2013.

**Wine Cellar developments:** The completion of Wine Cellar is expected to be in the 2H of 2011. 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 1H2012.

**Retail shops:** The group has plan to establish 20 Tontine retails shops in selective cities across the PRC over the next three years. So far, there're shops in Beijing, Chengdu, Shanghai, Shenyang and Wuhan. For the second half there are three new retail shops in plan. The cost for each shop is estimated to be around two million RMB for three years of operation.

**Valuation:** We revised our sales estimate to RMB790.8m for FY12/11F with 5.1% volume growth and 6.9% ASP growth for the full year. We estimate RMB871.1m for FY12/12F with 8.0% volume growth and 2.0% ASP growth. We estimate that the net profit would be RMB190.8m for FY12/11F and RMB235.4m for FY12/12F. Our new DCF-derived target price is HK\$1.64 based on 2% terminal growth and 16% discount rate. The new target price represents 14.1x FY12/11F and 11.5x FY12/12F P/E. The HK listed peers are currently trading at average 14.2x FY12/11F 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 Food	506 HK	2,105.4	5.88	38.4	26.0	20.1	2.8	7.5
Silverbase	828 HK	1,096.9	7.19	14.6	10.4	8.2	5.2	37.9
Dynasty Fine Wine	828 HK	296.0	1.85	14.5	15.4	12.5	1.2	8.3
Tontine	389 HK	212.1	0.82	5.6	4.9	4.2	0.8	15.9
JLF	472 HK	124.1	0.58	24.3	-	-	1.6	7.8
<i>Average</i>				19.5	14.2	11.2		
China-Listed								
Changyu	000869 CH	6,758.7	112.86	34.4	32.3	25.2	15.0	41.7
Citic Guoan	600084 CH	888.8	8.56	41.3	-	-	6.3	6.8
Gansu Mogao	600543 CH	457.0	11.10	74.2	-	-	3.3	4.1
Tonghua	600365 CH	176.8	9.85	-	-	82.1	10.5	-
<i>Average</i>				50				

Source: Bloomberg

**Table 5. P & L forecast**

Year to Dec (RMBm)	08A	09A	10A	11F	12F
<b>Revenue</b>					
Sweet Wine	321.4	403.8	499.1	561.6	618.7
Dry Wine	165.3	180.5	204.9	229.1	252.4
	<b>486.7</b>	<b>584.3</b>	<b>703.5</b>	<b>790.8</b>	<b>871.1</b>
Cost of sales	(209.8)	(246.1)	(289.6)	(340.1)	(374.8)
<b>Gross profit</b>	<b>276.9</b>	<b>338.2</b>	<b>413.9</b>	<b>450.6</b>	<b>496.3</b>
Other income	0.2	1.7	3.3	5.5	6.0
Selling and distribution expenses	(53.5)	(67.9)	(84.3)	(94.5)	(104.1)
Administrative expenses	(9.8)	(13.3)	(32.3)	(71.3)	(40.1)
Other expenses	(13.0)	(9.0)	0.0	0.0	0.0
Finance costs	0.0	0.0	0.0	0.0	0.0
<b>Profit before tax</b>	<b>200.9</b>	<b>249.7</b>	<b>300.6</b>	<b>290.3</b>	<b>358.2</b>
Income tax expense	(64.1)	(75.6)	(92.5)	(99.5)	(122.7)
<b>Net profit</b>	<b>136.8</b>	<b>174.1</b>	<b>208.1</b>	<b>190.8</b>	<b>235.4</b>

Source: Company data, SBI E2-Capital

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

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