

Tontine Wines Group Ltd.

Installation of production capacity expansion completed

to summarize...

- Tontine has 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.
- They have continued to introduce premium products in their sweet wine category, where a higher selling price can be attained.
- By introducing premium products into their portfolio, there should be a margin improvement for 2H of 2010. We expect a margin improvement around +0.5pcp YoY to ~59.3%.
- Sweet wine continues to be the driver. For 2H of 2010, we expect the sales of sweet wine to be around RMB300m, which represents a 26% YoY growth with ASP increasing to ~RMB39 per tonne (2H FY12/09A: RMB37.3 per tonne).
- We maintain a buy rating with target price of HK\$2.28. Our target price represents 20.9x FY12/10F and 16.9x FY12/11F P/E. The HK listed peers are currently trading at average 24.1x FY12/10F and 19.5x FY12/11F P/E based on market consensus.

Expansion plan progress and developments: According to the management, they 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. The actual capacity in use will slowly ramp up and target to reach 24,000 tonnes by the end of 2011. 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 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. The construction of Wine Cellar said to be completed by the end of 2010 and target to be launched by 2011 is also delay to complete by the end of 2011 and launched by 2013.

Table 1. 1H FY12/10A results

6 months to Dec	Turnover (RMBm)	Gross Profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Tax rate (%)	Net profit (RMBm)
1H FY10	288.9	168.7	58.8	128.4	29.9	89.9
1H FY09	242.7	137.4	56.6	106.6	29.2	75.4
HoH(%)	19.0	22.7		20.0		19.2

Source: Company data

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.

Sweet wine as the key driver: Tontine will continue to focus on sales of their sweet wine products. Sweet wines contribute 68.8% of total sales in 1H FY12/10A, (up from 68.2% a year ago), with dry wine contributing the remaining 31.2%. Revenue from sweet wine represented 20.1% YoY growth to RMB198.8m with ASP increasing to RMB34.9 per tonne (1H FY12/09A: RMB29.3 per tonne). The significant increase

Ticker	0389 HK
Rating	BUY(Unchanged)
Price (HK\$)	1.62
Target Price (HK\$)	2.28(+41%)
12m Price Range (HK\$)	1.41-2.40
Market cap. (US\$m)	419.1
Daily t/o (US\$m)	1.9
Free float (%)	59.96

Financial summary

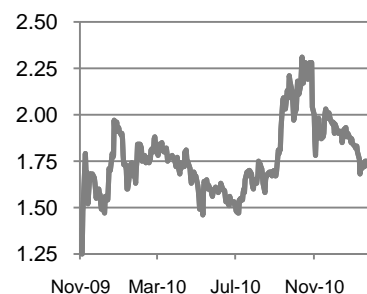
Year to Dec	08A	09A	10F	11F	12F
Turnover (RMBm)	486.7	584.3	704.0	866.7	998.0
Net Profit (RMBm)	136.8	174.1	214.8	273.0	323.9
EPS (RMB)	0.103	0.127	0.109	0.135	0.161
P/E (x)	13.3	10.8	12.6	10.1	8.5
P/B (x)	4.89	1.93	2.35	2.01	1.69
EV/EBITDA (x)	8.3	4.6	6.3	5.0	3.8
Yield (%)	-	2.0	1.7	2.1	2.5
ROE (%)	52.8	26.0	20.2	21.6	21.5
ROCE (%)	77.4	37.0	28.3	29.3	28.6
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI E2-Capital

	10F	11F	12F
Consensus EPS (RMB)	0.123	0.147	-
Previous earnings (RMBm)	214	273	-
Previous EPS (RMB)	0.123	0.147	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	-2.3	-15.0	-17.5
Actual price changes (%)	-3.6	-5.3	-6.9



Source: Bloomberg

SBI Research Team

(852) 2533 3700

sbie2research@sbie2capital.com

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 16% YoY growth to RMB90.1m. ASP for this segment increased RMB0.8 to RMB28.6 per tonne. For 2H of 2010, we expect the sales sweet wine to be ~RMB300m, represented 26% YoY growth with ASP increasing to ~RMB39 per tonne (2H FY12/09A: RMB37.3 per tonne). For dry wine we expect sales to grow ~11% YoY growth to ~RMB114m. ASP for this segment should increase ~RMB0.3 to RMB28.5 per tonne (2h FY 12/09A:RMB28.2 per tonne)

Margin improvement to continue: For 1H FY12/09A, margin was improved due to higher selling price and stabilizing of cost. The last blended gross profit margin improved 1.8pcp YoY to 58.4%, driven by a combination of increasing in sales of high margin product and stable cost. Total raw material cost drop slightly from 74.1% to 73.2% of COGS. For 2H of 2010, we expect margin improvement to continue due to increase in selling price. We expect blended gross profit margin should improve ~0.5pcp YoY to ~59.3%.

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.

Last reported financials: Tontine last reported Interim results in September 2010. Their 1H FY12/10A results were in line with our expectations. Revenue was RMB288.9m, a 19% increase YoY and net profit came in at RMB89.9m, up 19% YoY. Gross margin for the period was 58.4%, up 1.8pcp. EPS decreased 8.8% to RMB0.052 (1H FY12/09A: RMB0.0057). The decrease in EPS was due to the increase in weighted average number of ordinary shares after the IPO in Nov 2009.

Table 2. Sales volume, ASP and revenue breakdown

Year to Dec.	1H 10A	1H 09A	YoY (%)	% of total
Sweet wine				
Vol (tonnes)	5,694	5,654	0.7	64.3
ASP(RMBk/t)	34.9	29.3	19.1	
Revenue (RMBm)	198.8	165.5	20.1	68.8
Dry wine				
Vol (tonnes)	3,154	2,774	13.7	35.6
ASP(RMBk/t)	28.6	27.8	2.9	
Revenue (RMBm)	90.1	77.2	16.7	31.1
Total				
Vol (tonnes)	8,848	8,428	4.9	100.0
ASP(RMBk/t)	32.7	28.8	13.5	
Revenue (RMBm)	288.9	242.7	19.0	100.0

Source: Company data

Table 3. Cost structure breakdown

Year to Dec.	1H 10A(RMBm)	%	1H 09A(RMBm)	%	YoY (%)
Raw material					
Grape and grape juice	55.7	46.3	47.9	45.5	16.3
Yeast & others	4.3	3.6	4.0	3.8	7.5
Packaging	27.7	23	25.8	24.5	7.4
Others	.3	0.3	0.3	.3	(0)
Subtotal	88.0	73.2	78.1	74.1	12.7
Others					
Prod'n o/heads	3.4	2.8	3	2.8	13.3
Tax	28.9	24	24.3	23	19.0
Subtotal	32.3	26.8	27.3	25.8	18.3
Total	120.2	100.0	105.3	100.0	14.2

Source: Company data

Valuation: We maintain our sales estimate of RMB704m for the full year of 2010 with assumption in 11.2% volume growth and 8.4% ASP growth. Given that the revenue for 1H2010 was RMB289m puts the 2H2010 revenue at RMB 415m, a split of ~40/60 is reasonable judging from the past sales trends. For 2011, we foresee a continuance growth in volume sales and price increase. We estimate a 17.8% in volume growth and 4.5% ASP growth which give an estimate of RMB866.7m for FY12/11F. From our sales estimate we derived net profit forecast of RMB214.8m for FY12/10F and RMB273m for FY12/11F. We maintain a buy rating with target price of HK\$2.28. Our target price represents 20.9x FY12/10F and 16.9x FY12/11F P/E. The HK listed peers are currently trading at average 24.1x FY12/10F and 19.5x 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 FOODS LTD	506 HK	1,575.2	4.40	27.5	24.9	19.2	2.2	10.7
DYNASTY FINE WIN	828 HK	524.9	3.28	23.6	23.4	19.9	2.1	8.8
Average				25.5	24.1	19.5		
China-listed								
YANTAI CHANGYU-A	000869 CH	5,513.9	88.77	36.3	33.4	26.8	14.2	40.4
CITIC GUOAN VI-A	600084 CH	886.8	8.54	90.9	42.7	-	6.2	6.8
GANSU MOGAO IN-A	600543 CH	499.4	12.13	102.4	110.3	43.3	3.8	3.7
TONGHUA GRAPE-A	600365 CH	202.8	11.30		205.5	94.2	11.9	-
Average				76.5	98.0	54.8		

Source: Bloomberg

Table 5. P & L forecast

Year to Dec. (RMBm)	08A	09A	10F	11F	12F
Revenue					
Sweet Wine	321.4	403.8	499.1	639.2	749.8
Dry Wine	165.3	180.5	204.9	227.5	248.2
Total	486.7	584.3	704.0	866.7	998.0
Cost of sales	(209.8)	(246.1)	(289.3)	(347.7)	(393.3)
Gross profit	276.9	338.2	414.7	519.0	604.6
Other income	0.2	1.7	6.0	8.7	12.0
Selling and distribution expenses	(53.5)	(67.9)	(96.2)	(128.6)	(151.0)
Administrative expenses	(9.8)	(13.3)	(17.6)	(19.9)	(22.0)
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	306.9	379.2	443.7
Income tax expense	(64.1)	(75.6)	(92.1)	(106.2)	(119.8)
Net profit	136.8	174.1	214.8	273.0	323.9

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.

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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

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