

Cashing in on strong appetite for green food

China F&B

China Green (904 HK, HK\$6.50)

BUY (unchanged)

Target price: HK\$10.32 (+58.8%)

Key takeaways from our meeting with the company's management yesterday:

Robust demand for food and beverage products. The beverage segment grew more than 63.0% in FY04/07 and contributed RMB114.6m of the company's total turnover. Beverage segment is expected to grow by 50.0% in FY04/08F on strong demand. The branded food and beverage segment including rice and rice flour products grew by 70.0% in FY04/07A and contributed 32.3% of the company's total turnover (RMB307.8m).

New products are well received. In January 2007, China Green (CG) launched non-fried noodles, which in the first four months of 2007 contributed RMB18.0m to total revenue. The company plans to add at least three production lines by March 2008 to its current two.

Strong growth in processed products. Accounting for 33.3% of its total turnover, the sales of processed products together with pickled products (refer to the following table 4) grew more than 53.0% in FY04/07A and should grow 30.0-45.0% in FY04/08F as global demand increases.

Surging exports to Europe. CG started to export to European countries in 2006, with turnover from the segment growing 134.8% in FY04/07A especially on strong demand for processed canned mushroom products. We estimate the growth rate at about 20.0% in FY04/08F for export segment.

Expanding distribution network. CG started its green food logistics and distribution operations in Xiamen, Fujian, in July 2007. It currently provides distribution services and operates a "China Green" counter in Minxing Supermarket, Xiamen and plans to open up to five such counters by the end of 2007 in Xiamen Fujian province. It supplies fresh produce to supermarkets such as Newhuada, Trust-Mart and Rainbow in Fuzhou, Xiamen and Quanzhou.

Brand building. The company appointed Chen Hua, China's top famous actress, its product promoter in April 2007. We expect her involvement and the company's advertising and marketing strategy to strengthen the brand considerably.

Earnings revision. We introduce net profit of RMB710.0m for FY04/10F to reflect the stronger than expected global demand for green food. We maintain our BUY call with the target price of HK\$10.32 unchanged. CG is becoming a green F&B at FY04/08F PE of only 12.9x compared with over 26.5x for peers. Our target price of HK\$10.32 represents 20.0x FY04/08F.

FY04/07A results recap. GG's net profit increased 27.5% to RMB346.0m (excluding RMB14.4m in interest on the liability component of CB), above our estimate of RMB340.9m and other market estimates. Turnover was up 39.0% at RMB954.2m. Gross profit was up 40.5% at RMB497.9m. A final dividend of HK\$0.063 was up

Table 1: Financial summary

Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gearing
Apr	RMBm	RMB	Δ %	x	x	x	%	%	%	%
06A	271.3	0.357	29.8	17.4	4.2	17.6	1.6	26.9	23.4	Cash
07A	346.0	0.400	12.0	16.3	3.2	13.0	1.9	25.3	21.3	Cash
08F	450.0	0.505	26.3	12.9	3.1	8.9	2.4	28.2	24.4	Cash
09F	570.7	0.640	26.7	10.2	2.2	6.9	3.1	29.2	25.4	Cash
10F	710.0	0.797	24.5	8.2	2.1	5.6	3.8	30.5	25.7	Cash

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

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

Analyst certification: the views expressed in this report accurately reflects 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: the information and opinions in this report were prepared by SBI E2-Capital Securities Limited. SBI E2-Capital Securities Limited does not undertake to advise you of changes in its opinion or information. SBI E2-Capital Securities Limited and others associated with it may have positions in and effect transactions in securities of companies mentioned and may also perform or seek to perform investment banking services for those companies. This memorandum is based on information available to the public. No representation is made that it is accurate or complete. This memorandum is not an offer to buy or sell the securities mentioned.

39.0% at RMB954.2m. Gross profit was up 40.5% at RMB497.0m. A final dividend of HK\$0.063 was proposed.

Table 2: FY12/07A results

Year to Apr	Turnover (RMBm)	Gross profit (RMBm)	Gross margin (%)	Pre-tax profit (RMBm)	Net profit (RMBm)	EPS (RMB)	*DPS (HK\$)
FY07	954.1	497.9	52.2	345.8	346.0	0.448	0.063
FY06	686.6	354.4	51.6	262.3	271.3	0.373	0.062
YoY (%)	39.0	40.5		31.8	27.5	20.1	

Source: Company data *Final DPS

China sales up. CG derived about 46.7% of its turnover from exports, including about 67.4% from Japan. China, its largest contributor, generated 53.3% of total turnover, up from 47.9% in FY04/06A, thanks to robust demand for beverage and rice flour products in Fujian and Jiangxi. Sales to other Asian countries grew 28.3% and to Europe by 134.8%.

Table 3: Turnover breakdown by country

Year to Apr (RMBm)	FY04/06A	% of total	FY04/07A	% of total	YoY (%)
Japan	278.0	40.5	300.5	31.5	8.1
China	328.7	47.9	508.4	53.3	54.7
Other Asian countries	37.8	5.5	48.4	5.1	28.3
Europe	38.8	5.7	91.1	9.5	134.8
Australia	3.3	0.5	4.5	0.5	36.6
Africa	na	na	1.1	0.1	na
Total	686.6	100.0	954.1	100.0	39.0

Source: company data

Beverage sales surge. Beverage sales grew 63.6% to RMB114.6m, with corn milk accounting for RMB92.0m. Branded food and beverage products (beverages, instant noodles, rice and rice flour products) accounted for 32.3% of total turnover, from 26.4% a year ago. Turnover of non-fried instant noodles reached RMB18.48m in the first four months of 2007. Its gross margin reached 40.0% in FY04/07A.

Margins. The gross margin widened to 52.2% (our estimate: 51.6%) reversing its two-year downtrend on increasing contributions from the branded high-margin food and beverage segment (gross margin: 47.0% in FY04/07A) and shrinking sales of lower margin rice products (9.1% of total turnover from 11.8%). The operating margin narrowed to 37.8% from 39.0% mainly due higher general and administrative expenses. As a result of increased share option costs, the net margin narrowed to 36.2% from 39.5%.

Table 4: Turnover breakdown by product

Year to Apr (RMBm)	FY04/06A	% of total	FY04/07A	% of total	YoY (%)
Fresh produce	297.6	43.3	328.0	34.4	10.2
Processed products	124.8	18.2	183.0	19.2	46.7
Pickled products	83.1	12.1	135.3	14.2	162.8
Rice products	81.0	11.8	86.3	9.1	6.6
Rice flour products	30.0	4.4	88.4	9.3	194.3
Beverage products	70.0	10.2	114.6	12.0	63.6
Non-fried Instant noodles	Na	na	18.5	1.9	Na
Total	686.6	100.0	954.2	100.0	100.0

Source: company data

Table 5: Gross profit breakdown by product

Year to Apr (RMBm)	FY04/06A	% of total	FY04/07A	% of total	YoY (%)
Japan	164.3	46.4	173.2	34.8	5.4
Mainland China	145.2	41.0	242.7	48.7	67.1
Other Asian countries	20.9	5.9	27.5	5.5	31.5
Europe	22.0	6.2	51.1	10.3	131.9
Australia	1.90	0.5	2.8	0.6	47.2
Africa	Na	Na	0.6	0.1	na
Total	262.5	100.0	497.9	100.0	40.5

Source: company data

Table 6: F&B Peer comparison

Company	Ticker	Currency	Price	Mkt Cap. (US\$m)	Hist. P/E (x)	Fwd Yr. 1 P/E (x)	Fwd Yr. 2 P/E (x)	ROE (%)	FY07 PEG (x)
China Mengniu	2319 HK	HKD	29.65	5,348.6	53.2	41.7	32.7	27.3	1.4
Yili	600887 CH	RMB	34.19	2,341.2	47.7	44.1	35.8	14.1	7.4
Tingyi	322 HK	HKD	10.34	7,420.7	41.7	40.2	33.2	16.7	2.1
Groupe Danone	BN FP	EUR	55.20	38,683.8	22.5	20.2	18.2	24.4	1.7
Uni-President	1216 TT	TWD	36.3	1107.1	39.0	19.7	19.7	8.0	4.2
Nissin Food	2897 JP	JPY	3,680	4,029.6	24.4	24.8	21.6	7.3	na
Kirin Brewery	2503 JP	JPY	1,450	12263.8	27.6	25.0	23.2	6.3	na
Average					36.6	30.8	26.3	14.9	3.4

Source: Bloomberg & SBI E2-Capital