SMALL CAP CHARM

Thesis and Ideas for 1Q 13

SBI E2-Capital

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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

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Here comes 2013...

Since quarterly strategy report issued in Q1 2011, our general performance was worse-than-expected partly in line with wider market

Nevertheless, we stick to our original focus on HK-listed small-to-mid cap with bottom-up approach to actively pick quality stock

Small-to-mid cap
- Maintains our focus on HK-listed small & mid cap stocks with market capitalization range US$100m-1,000m

Quality stock pick
- Pursues a more active stock selection approach to generate quality picks instead of a universal coverage

Bottom-up approach
- Concentrates on corporate-level, emphasizing business insight and management access

Our research portfolio in 4Q

Company	Ticker						
Core coverage		Target (HK$)	Latest update	Initiation	Abs. price return (%)	MSCI return (%)	Abs. up-to-date price return (%)
Comtec Solar	0712 HK	1.48	12-Nov-12	8-Jun-10	19.6%	1.7%	-15.3%
China Fiber Optic	3777 HK	1.80	24-Sep-12	24-Sep-12	8.7%	1.7%	10.4%
Tongda Group	0698 HK	0.539	27-Dec-12	29-Feb-12	14.7%	1.7%	36.8%
Chu Kong Pipe	1938 HK	3.78	3-Sep-12	3-Sep-12	26.9%	1.7%	51.9%
Watch list							
Leoch International	0842 HK	-	-	-	10.0%	-	-
CW Group	1322 HK	-	-	-	2.2%	-	-
IRC	1029 HK	-	-	-	33.0%	-	-
Labixiaoxin Snacks	1262 HK	-	-	-	14.6%	-	-
Sino Oil and Gas	0702 HK	-	-	-	5.6%	-	-
Shengli	1080 HK	-	-	-	20.9%	-	-

*Note: * return calculated based on closing price on 26 Nov and 31 Dec, non-annualized*   *** MSCI Hong Kong Small Cap Index*

Updated portfolio in 1Q

Company	Ticker	Target (HK$)	Latest update	Initiation	Analyst
Core coverage					
Comtec Solar	0712 HK	1.48	12 Nov 2012	08 Jun 2010	Kevin Mak
China Fiber Optic	3777 HK	1.80	24 Sep 2012	24 Sep 2012	Kevin Mak
Tongda Group	0698 HK	0.539	27 Dec 2012	29 Feb 2012	Kevin Mak
Chu Kong Pipe	1938 HK	3.78	03 Sep 2012	03 Sep 2012	Isaac Lau
Watch list					
Leoch International	0842 HK	-	-	-	Kevin Mak
CW Group	1322 HK	-	-	-	Kevin Mak
GA Pack	468 HK	-	-	-	Isaac Lau
IRC	1029 HK	-	-	-	Isaac Lau
Sino Oil and Gas	0702 HK	-	-	-	Isaac Lau
Shengli	1080 HK	-	-	-	Isaac Lau
Labixiaoxin Snacks	1262 HK	-	-	-	Isaac Lau

Core Coverage

Comtec Solar (0712 HK) (click here…)

Stock statistics	Market cap: US$185.2m (closing price: HK$1.22); daily turnover: US$2.5m
Summary / review	• Comtec Solar is a pure-play monocrystalline solar ingot and wafer manufacturer based in China. In 1H 2012, 74.4% turnover was from n-type wafers sales to SunPower (SPWR US) fabrication facilities in Philippines. According to feedback from customer, highest efficiency achieved reached 24%. The company expects to raise n-type sales to another customer, Sanyo (6764 JP), possibly in 2013F. • The company recorded RMB456.2m revenue for 1H FY12/12A, with RMB218.5m in Q1 and RMB237.7m in Q2. While for Q3, revenue was high at RMB311.9m on stabilizing wafer ASP and increased shipment with its 600MW capacity with outperforming 10.2% gross margin and 4.8% core net margin.
Drivers / catalysts	• For end of Sep, Comtec indicated that its net-to-equity ratio was 6.0%. By end of the period, Comtec had RMB510.9m cash and other financial assets. On debt side, the company had RMB472.5m short-term bank loan, RMB19.5m long-term bank loan and RMB109.6m CB on the balance sheet. Comtec also announced to repurchase remaining RMB163.6m after Q3 results and to issue HK$57.5m new shares in Dec. Net-debt-to-equity would be low at mid-single digit. • Comtec had heavy reliance on SunPower in 1H due to n-type wader sales which presents moderate counterparty risk. Nevertheless, for the latest 6-month interim by non-GAAP standard, revenue was US$1,231m with US$26.0m operating income. By end of Jun, their net debt-to-equity ratio was still at satisfactory level of 39.5%. That said, as a major client of Comtec, we believe SunPower is to keep itself floating with certain profit and moderate financial health during this late stage of industry consolidation.
Our opinions	• Comtec was trading up to HK$1.21 from HK$0.67 since our last update in Sep after interim results announcement. We maintain our view that Comtec was bottoming-out in mid of the year and there is potential for improvement in volume in 2H. With 100-120MW wafer sales in 1H, we further review the number up to as much as 263MW with 87.5% utilization for 2H. • The counter is currently trading at 0.76x P/B based on RMB1,518m net equity FY12/12F. We revise our Target Price to HK$1.48 from HK$1.44, representing 16.0x and 8.3x P/E for FY12/12F and FY12/13F.

China Fiber Optic (3777 HK) (click here...)

Stock statistics	Market cap: US$215.4m (closing price: HK$1.38); daily turnover: US$2.1m
Summary / review	• China Fiber Optic Network System (CFONS) was listed in HK in Jun 2011 at HK$1.20 per share. Through processing soft optical cables and ceramic ferrules, the company offers 100+ models of fiber optic patch cords to communication industry since "Network Access License for Telecommunications Equipment" (电信设备进网许可证) was granted in 2001. Fiber optic patch cords are devices consist of soft optical cables with each of their ends connected to one or more connectors for light signal transmission purpose. • In terms of sales volume, CFONS market share in 2011 was 21.4% in China. By end of 2011 production capacity of fiber optic patch cords was 12m sets a year, which contributed to 12.9m units self-produced in addition to 5m outsourced units in 2011. As of 1H FY12/12A, revenue increased 14.4% YoY to RMB715m while net profit increased 11.5% YoY to RMB111.2m
Drivers / catalysts	• According to 12th Five-year-plan, infrastructure investment on IT is targeted at RMB2,000b for 2011A to 2015F. Average investment for the 2013F to 2015F is as much as RMB480b+ each year, up from ~RMB300m in 2012F. In particular, the draft emphasized speeding up construction of backbone network, regional network as well as FTTX applications. In Sep draft, MIIT aims to have more than 250m broadband users by 2015F up from 150m by end of 2011; and internet access speed is targeted at 20MB and 4MB for urban and rural area respectively by that time. We expect China to see strong demand for fiber optic patch cords in short-to-medium term with high penetration and speed target for FTTX applications.
Our opinions	• CFONS is working to expand its capacity from 9m sets a year in 2011 to 18m sets by end of 2012F partly with its IPO proceeds in 2H 2011. Under our conservative assumptions, CFONS will utilize 90% operating cash flow before working capital changes in one particular year for expansion of the following year, of which half goes to CAPEX and the other half serves as additional working capital. As such, we expect CFONS to maintain its net cash position while raising its capacity to 18m sets in 2012F and further to 22m sets in 2013F to capture attractive market opportunity. Based on our target price, implied P/E is 6.3x and 4.6x for FY12/12F and FY12/13F based on RMB287m and RMB395m net profit forecast respectively.

Tongda Group (0698 HK) (click here...)

Stock statistics	Market cap: US$238.2m (closing price: HK$0.390); daily turnover: US$0.23m
Summary / review	• TDG is the world largest manufacturer for in-mould lamination (IML) plastic casings with patented technology. Its products are applied in consumer electronics such as handset, notebook and electrical appliances. Major customers include fast-growing domestic brands such as ZTE (0763 HK), Huawei, Lenovo (0992 HK), Haier (1169 HK) and Midea (000527 CH). • Different from in-mould decoration (IMD) technology, which simply prints designs onto a certain surface, IML covers the patterns with a protective layer so that the finished product is much more scratch proof. Although IMD has currently larger market share and it is within 10% cheaper than IML-made products, IML is observed to be increasingly adopted.
Drivers / catalysts	• Tongda turnover was up 9.2% YoY to HK$1,398m for 1H FY12/12A. Of HK$118m increment, handset continued to be the major contributor which offset weakness in electrical appliances segment. At the same time, gross profit increased 29.6% YoY to HK$309m, representing an gross margin of 22.1%. Net profit was HK$113m for the period, up 11% YoY from a year ago partly due to HK$16.1m MI. • In Dec 2012, Templeton Strategic Emerging markets Funds acquired a block of 300m shares at HK$0.310 per share, which represented 6.3% shares. At the same time, Chairman Wang Yanan has an additional derivative interest of 300m shares with effective period from Dec 2015 to Jan 2016, which is a put option granted to Templeton. Management indicated Templeton has visited all their production plants and essentially met all of their key managements. While there is a put option, we still believe the fund gave Tongda and the industry a vote of confidence.
Our opinions	• In the past four years, Tongda recorded increase in top-line as well as profit margin despite global economic headwind. While we slightly adjusted net profit below HK$300m for 2012F, we still believe Tongda to achieve bottom-line double digit growth in short-term. • We value Tongda with discounted cash flow model at 17.5% discount rate and the target price is HK$0.539 per share, which represents 8.9x and 7.1x FY12/12F and FY12/13F P/E based on HK$288.4m and HK$360.7m net profit for the respective years.

Chu Kong Pipe (1938 HK) (click here...)

Stock statistics	Market cap: US$531.5m (closing price: HK$4.10); daily turnover: US$1.3m
Summary / review	• Chu Kong Pipe is one of the four approved LSAW suppliers for national pipeline projects with maximum production capacity of 1.3mtpa and is the sole domestic LSAW supplier has the capacity to produce deep sea LSAW steel pipes up to 1,500m depth. • Differentiated from the Chinese competitors, CK pipe's customers are globally diversified with over 600 customers in over 50 regions. Hence, CK pipe is less sensitive to the domestic national pipe CAPEX cycle. • Regardless of the oversea market, 2010 & 2011, i.e. 5th year of the 11 five year plan and 1st year of the 12 five year plan, are the typical national pipe industry 'down-cycle', hence company's domestic sales was adversely impacted; on the contrary, 2013 & 2014 i.e. 3rd & 4th year of 12 five year plan, we expect, the 'peak' season would be the key driver of Chu Kong pipe's earning.
Drivers / catalysts	• As approaching the peak period of the domestic national pipe CAPEX cycle, we expect national pipe tenders will gradually release. As usual practice, Chu Kong pipe will release major success of tenders, which in our view, can be the positive catalyst to CK pipe's short run price catalyst. • Strong overseas orders together with upcoming domestic 'up-cycle' are expected to drive up the operational utilization rate. • Chu Kong's LSAW capacity will further increase by 300ktpa to 2.2mtpa by the end of 13F, while two new SSAW steel pipe production lines with capacity of 660ktpa are coming online in the 3Q 12F and 1Q 13F.
Our opinions	• We are bullish on the Chu Kong 2013 and 2014 performance, however, the recent rally in share price (from 2H ~HK$2.5 to current ~HK$3.8) is reflecting its positive outlook. • Thus, we see two potential downside risks to the short-term share price; 1) lower than market expected 2H 2012 result due to high portion of regional orders being delivered during the period; 2) slower than expected tendering of the national pipe project, Chu Kong might not reward from national pipe order until 2Q 13 or further to 3Q 13. • We maintain BUY at TP HK$3.78 for now; while the TP will update upon announcement of new order-on-hand during the mid of Jan in 2013. Our estimated 12F net profit of RMB289m implied forward P/E of 11.5x at current price HK$4.10.

Watch-list

Leoch Int'l (0842 HK)

Stock statistics	Market cap: US$207.2m (closing price: HK$1.21); daily turnover: US$0.56m
Summary / review	• Leoch is principally engaged in the manufacture and development of lead-acid batteries. It has a wide range of products including UPS (Uninterruptible power supply), telecom, consumable products, SLI batteries, renewable energy and motive batteries. Leoch developed moulds for wide range of 1,600+ customized products. • Customers of Leoch include Emerson Electric (EMR US), Eaton Corp (ETN US), BMW, Juguar, US batteries, Black & Decker (SWK US), to name a few. Leoch is one of the largest exporter in sales volume in China. • As we have discussed in the previous note, Zhaoqing facility was under suspension for self-examination and rectification, which was accounted for 20% of Leoch production capacity. As a matter of fact, production and sales for UPS clients, the core business, was negatively affected. While the management expects heavy allocation to Anhui facilities with UPS and SLI focus, Leoch needs to take time to repair relationship with major clients. Besides, the management needs to ramp-up another round of Anhui new equipments and involves as much as 7,000 staff in the base, which largely challenges management execution ability. Sales for 2H have to be revised. Sales in 1H were around 3.2m kVAh, while in base scenario full year estimates was revised down to 7.5m kVAh from previous 9.0m kVAh forecast. • For general lead acid battery providers, Leoch and its peers faced tightened regulation since 2H 2011, where a lot of facilities were suspended at least for 2012. In short-term, Leoch is still subject to the effect of increasing fixed costs due to expansion yet limited sales growth on partial capacity suspension. We would like to wait for higher visibility in respect to industry consolidation and company execution. For the time being, our rating on Leoch is HOLD with Target price at HK$1.15. Net profit estimates for FY12/12F and FY12/13F were RMB137m and RMB308m respectively. The counter is currently trading at 9.4x and 4.2x P/E according to our forecasts.

CW Group (1322 HK)

Stock statistics	Market cap: US$105.9m (closing price: HK$1.34); daily turnover: US$0.24m
Summary / review	• CW Group is a Singapore-headquartered precision engineering solution provider. As of 1H FY12/12A, around 50% of the group turnover was contributed by precision engineering turn-key solutions. Customers are of international scale from a wide range of industries including aerospace, oil and gas, energy and automotive, including Honeywell, Rolls-Royce, Hamilton Sundstrand and HP. Management indicates that CW Group is a well-positioned turn-key provider that sources equipment from both top-tier and lower-tier equipment suppliers to provide customized according to customers needs, maintaining a balance between total cost and production performance. • In addition to turn-key solutions, CW group also manufactures industrial equipment, components and parts with its production facilities in Shanghai and Tianjin in China, which made up around 40% of turnover in 1H FY12/12A. The segment includes cement production, CNC machining centres as well as components and parts. For CNC machining centres, CW Group formed a JV with Japan's Kiwa and manufacture products under its own brand name "菲斯特"; At the same time, CW Group is the OEM of Germany's DMPG. For cement production equipment, its production was based in Tianjin. • CW Group expects to enjoy organic growth through recurring sales from existing turn-key solutions clients. According to the management, those clients are ramping up sales and marketing efforts especially in emerging markets such as Indonesia and India to capture new orders. At the same time, CW Group is with a 3-year production expansion plan to raise its capacity from 200 units CNC machines centres and 140 units components & parts by end of 2012F to 400 units CNC machines centres and 400 units components & parts by 2014 with a total CAPEX of HK$380m in the 3 years. • CW Group has achieved HK$399m revenue in 1H FY12/12A and core net profit HK$26m in the period after adding back HK$25.8m listing expenses. The counter is currently trading at 12x historical P/E for FY12/11A.

GA Pack (468 HK)

Stock statistics	Market cap: US$716.4m (closing price: HK$4.19); daily turnover: US$1.5m
Summary / review	• Formed in 2003, GA Pack is engaged in aseptic pack sales and manufacturing business in China. The current production bases are located near the downstream customers, in Inner Mongolia and Shandong province along with the newly constructed production facility in Germen, together add up total annual capacity of 17.4b packs. • Capacity is expanding. GA Pack targeted to add 4b packs of annual production capacity in 2013 and 8b packs in 2014 to total 29.4b packs by the end of 2014. • The aseptic packaging market is highly concentrated and is dominated by a Swiss-based producer, Tetra Pak, who accounted for ~80% of the global market share and ~70% of the domestic market share. Other sizable producers are SIG Combibloc and Elopak, who together shared ~10 to 15% of the global aseptic packs share • Tetra Pak and GA Pack are the roll-fed type aseptic pack producer, while SIG Combibloc and Elopak are the key blank-fed type aseptic pack producer. Hence, GA Pack is the only sizable alternative supplier of the roll-form aseptic pack. • GA Pack's aseptic pack sales currently accounted for ~14% of the domestic market supply. Key customers of GA Pack include Yili and Mengniu (2319 HK), of which roughly ~17% their aseptic packs used were purchased from GA Pack in 2011A. • We like GA Pack as the packaging supplier of a fast growing staple market (dairy beverage). Company enjoys organic industry growth, meanwhile it is less subject to brand / product risks. • GA Pack is also the only sizable domestic supplier, despite majority of equity interest is hold by foreign PE funds, we believe the company background might be an advantage when developing in the domestic market. • We see GA Pack is a good foundational driven investment opportunity for the mid to long term investment basket.

IRC (1029 HK)

Stock statistics	Market cap: US$524.1m (closing price: HK$1.17); daily turnover: US$1.0m
Summary / review	• IRC (1029 HK) is an Russian iron ore mining company. Its key assets are located in Far East of Russia at regions namely Amur and EAO. The mine assets are situated relatively close to the North-eastern of the Chinese border. • Three key iron ore mine assets are namely, Kuranakh, K&S and Garinskoye, they are all open-pit mines with access to national railway networks. There are three prospective mining projects namely Garinskoye Flanks, Kostenginskoye and Bolshoi Seym to sustain longer term development with total mine life over 50 years. • Up to date, the total measured, indicated and inferred resources are 1,514m tons, of which 1,051m tons are measured and indicated resources. • On 19 Dec 2012, IRC released mining operation update that iron ore concentrate output had reached the year target and expect to exceed by 15% which in our view, will contribute to company's 1Q 13 result. • In terms of the iron ore spot price, since the early 4Q 12, the spot price has shown a strong rebound from the recent low ~US$87/t to currently ~US$140/t. • Coming toward 2013, IRC is one step closer to the commencement production of the K&S project. Any key construction milestone/ earlier-than-planned construction progress can be positive catalysts to IRC share price. • As the K&S project is yet to contribute coupled with increasing borrowing expense as a result of bank financing for the project CAPEX, we expect IRC's 2013 earning will continue to be marginal and might result in net loss during the 2013. • We maintained HOLD rating at target price HK$1.12.

Sino Oil and Gas (0702 HK)

Stock statistics	Market cap: US$307.3m (closing price: HK$0.19); daily turnover: US$2.3m
Summary / review	• Sino Oil and Gas (SOG) is a resource investment company focused on upstream business of oil and gas as well as CBM exploration and development. The key asset is Sanjiao CBM project, which is located in Shaanxi province with total area of 382km2(previously 462km2), and has the net 2P and 3P gas reserves of 7.7b cubic meters and 15.9b cubic meters respectively. • The Sanjiao project is operated via 70% PSC with PetroChina (857 HK) and targeted to achieve daily CBM sales of note less than 100,000 cubic meters by the end of 2012. • On 16 Aug 2012, company has received an approval letter from national energy administration (NEA) in relation to consent on the work in relation to the Sanjiao project , hence, the project officially moved to development phase. • With the approval from the NEA, the CBM project is officially moved to the next stage of development. As a result, PetroChina will bear 30% of project CAPEX as compared to previously 100% paid by SOG at exploration stage. • Yet, the approval from the NEA also enables, pursuant to the credit terms, to utilize the remaining loan facility of RMB800m from China Development Bank. The amount is sufficient for the coming two years CAPEX for the CBM project. • Despite the CBM project is still preliminary and can take over 3 to 5 years to reach production stage, it is already the pioneer of the domestic CBM development as the first foreign PSC partner reaching the development stage of the CBM project. • For 2013, we expect only small contribution from the existing CBM wells, however, yet to form substantial upside to company's financial result.

Shengli (1080 HK)

Stock statistics	Market cap: US$257.6m (closing price: HK$0.81); daily turnover: US$0.61m
Summary / review	• Shengli is the leading SSAW pipe producer in China with current production capacity of 1,150k tonnes, denoted ~33% of current China market share. • Shengli is also one of the four authorized SSAW pipe manufacturer for the nation pipe projects, which the SSAW steel pipe is the main component of the national pipeline, accounting for 70% of the national pipeline structure. • Pursuant to the 12th five-year plan, it is set to increase the total length of PRC national pipeline by 95% to 150,000km. By end of 2011, the total national length was 82,500km representing a short of 67,500km. Assuming 1km of steel pipeline will require 350/t of steel of which 70% is formed by SSAW steel pipe, national pipeline market might demand up to 16.5m tonnes of SSAW pipe by the end of 2015. • On 17 Sep, Shengli formed a JV that will engaged in processing, manufacturing and distribution of dome integration house. Company will contribute RMB100m for 40% interest in the JV. • Similar to Chu Kong pipe (1938 HK), Shengli is also a cyclical player, but more domestic market focused, and therefore earning is highly associated with the CAPEX cycle of the national pipeline projects. • As the commencement of the national pipe CAPEX perk cycle, we expect to see a strong rebound in 2013 earning result, and hence will be the positive catalyst to Shengli's share price. • We concern the JV business in dome integration house business, which might imply the risk of management continuity and business orientation.

Labixiaoxin Snacks (1262 HK)

Stock statistics	Market cap: US$441.6m (closing price: HK$3.06); daily turnover: US$2.1m
Summary / review	• Labixiaoxin Snacks (LBXX) is the second largest jelly snacks and beverage producer in China accounting for 10% of market share in terms of retails sales value in Jelly products. • LBXX's jelly products are mainly self-produced, has annual capacity of 225,000 tons. LBXX's production bases are located in Fujian, Tianjin and Chengdu regions along with a new construction production factory in Chuzhou, Anhui. • LBXX is also engaged in sales of other snack and confectionary products, of which production process is mainly via OEM agreement or outsource to third parties. • Listed on Dec 2011, LBXX valued at market value of HK$2,982.8m at offer price of HK$2.65. COFCO, that state-owned food processing companies, is the second largest shareholder and the pre-IPO investor of the company with holding position of 6.4%. • LBXX targeted to double its capacity to annual production capacity of 400,000 tons from current 220,000 tons in five years. The total estimated investment for the new factory is around RMB450m. We expect CAPEX of RMB150m in 2H 12F and further RMB100m~RMB150m in 1H 13F on top of RMB450m. • In our view, LBXX is a fast growing jelly snack producer with established brand 'LBXX'. With the existing distribution network and the renowned brand name, we believe LBXX has a better position in expanding into other snack products market. • We also like LBXX as the one of the few sizable domestic snack food producers, comparing to other peers who are mostly TW based conglomerate.

Thank You!

SBI Research Team
(852) 2533 3700
sbie2research@sbie2capital.com