

# Chinese Food and Beverage Group (8272 HK)

25 Apr 2013



## Expansion in Chinese Fine Dining

### Transforming into premium Chinese restaurant chain

Chinese Food and beverage Group Limited (“CFBG”) has announced on 30 Jan 2013 the subscription for convertible bond (“CB”) with principal amount of HK\$ 200 million convertible bond issued by the holding company of Fook Lam Moon (“FLM”) restaurants. Upon full conversion of CB, the Company would be entitled to effective interests of 44.63% and 43% in FLM HK restaurant and FLM Kowloon restaurant, respectively. On 27 Mar 2013, CFBG announced conditional CB placement to raise up to HK\$ 240 million to fund the transaction. On 24 Apr 2013, CFBG announced framework agreement for potential acquisition of the remaining stake in FLM HK and FLM Kowloon.

### Solid brand equity

FLM has been a reputable Chinese fine dining brand with over 60 years of history. Average spending per check amounts to approximately HK\$ 500 for lunch and over HK\$ 1,500 for dinner, well above market. Average daily revenue per seat is above HK\$1,000 level, compared with market average of HK\$ 600-700.

### Long term growth intact

There has been strategic alliance between Shangri-La and FLM in PRC. With previous successful experience in Beijing, Shanghai and Shenzhen, we believe FLM is well capable of replicating the in-hotel dining model, which help to bring stable customer flow and raise brand recognition. Long term growth potential lies with accelerated urbanization, followed by increasing demand for luxurious dining and wedding boom in PRC.

### Valuation undemanding

The restaurant and branded food peers have been trading at around 20.2x FY2015E P/E. Based on the estimated net profit forecast of HK\$ 146 million for FY2015 and HK\$ 184 million for FY2016, the current share price reflects forward 2015E P/E of 2.5x and 2016E P/E of 2.0x, respectively, reflecting 88-90% discount to peers. The forward P/E of 5.9x and 4.7x implied by the conversion price of HK\$ 0.80 represent approximately 70% discount to peers.

China/Hong Kong

Rating	Not Rated
Price (24 Apr 13)	HK\$ 0.34
Market Cap	HK\$158M US\$20M

Sector Staples

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Please refer to the important disclosure and analyst certification information at the end of this report.

Forecast Summary (HKD '000, 31 Mar)	2014e	2015e	2016e
Revenue	375,183	641,973	811,743
Net profit	84,025	155,886	195,646
Attributable profit	51,707	145,835	183,655
Fully diluted EPS (HK cents)	6.4	13.5	17.0
P/E ratio for current share price (HK\$0.34/share)	5.3	2.5	2.0
P/E ratio for CB conversion price (HK\$ 0.80/share)	12.5	5.9	4.7

Source: FT Securities estimates

**Chinese Food & Beverage Group Limited**

Chinese Food & Beverage Group Limited is principally engaged in local catering business, brand management and acting as sourcing agent for reputable buyers in a variety of products. The Group was listed on the GEM Board of The Stock Exchange of Hong Kong Limited since June 2003 with Stock Code: 8272.

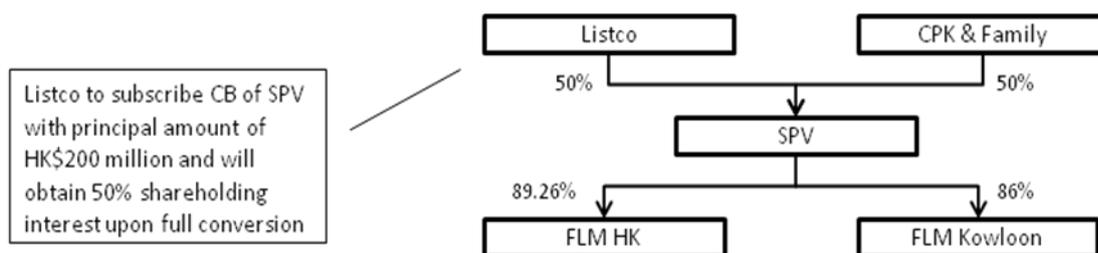
The Group started its catering business by opening its first Chinese fine dining restaurant in 2011 at Empire Hotel, Wanchai, Hong Kong. The restaurant is now operated under the brand Guo Fu Lou, headed by two of Hong Kong’s most respected restaurant professionals – Restaurant manager Chan Nin and Executive Chef Chan Yau Leung. Both Chan Nin and Chan Yau Leung have previously served in Fook Lam Moon for over 25 years.

**Proposed Transaction (“Transaction”)**

On 18 Dec 2012, CFBG entered into CB subscription agreement to subscribe for CB of HK\$ 200 million, convertible into 50% of the issued capital of the SPV which in turn has 89.26% and 86% interest in FLM HK and FLM Kowloon, respectively, constituting a Very Substantial Acquisition (“VSA”) under the GEM Listing Rules. Upon full conversion of the CB, the Listco will be entitled to an effective interest of 44.63% and 43% in FLM HK and FLM Kowloon, respectively.

At completion, CFBG shall grant to the SPV the loan of not less than HK\$ 80 million but capped at not more than HK\$ 135 million. Both proceeds from the subscription price of the CB and the loan shall first be applied solely and exclusively for the settlement of the restructure of FLM.

**Figure 1: Shareholding Structure of FLM HK and KLN upon full conversion of CB**



Source: Company announcements

On 27 Mar 2013, CFBG announced conditional placement of CB under specific mandate with principal amount of up to HK\$ 240 million, convertible into 300 million shares with conversion price (after share consolidation) of HK\$ 0.80 per share. The placement of the CB is conditional on shareholder's approval to the VSA and placing of CB. The proceeds from the CB placement shall be used to fund the Transaction.

On 24 Apr 2013, CFBG announced framework agreement for potential acquisition of the remaining stake in FLM HK and FLM Kowloon. The completion of the acquisition is subject to entering into further formal agreement.

### **Fook Lam Moon Restaurants**

Fook Lam Moon is a reputable Chinese fine dining restaurant established in 1948 by Mr. Chui Fook Chuen, former head chef of Ho Tung family. Fook Lam Moon specializes in exquisite food such as shark's fin, abalone, bird's nest fresh etc. Sourcing only the best premium ingredients and upholding the finest tradition in Cantonese cooking, Fook Lam Moon is famous for its superior quality, cooking and service.

There have been 5 restaurants operated under the Fook Lam Moon brand in the Greater China region. Total gross floor area amounts to approximately 71,000 sq.ft with approximately 870 seats. The Hong Kong SAR based restaurants are located in Wanchai, Hong Kong and Tsim Sha Tsui, Kowloon. The PRC restaurants are operated in Shangri-La hotels in Beijing, Shanghai and Shenzhen.

### **New Restaurant Openings**

FLM will remain focused on expanding new restaurant outlets at world-class luxurious hotel groups in the following 2-3 years. Based on the proven successful cooperation with Shangri-La, we are positive on FLM's management experience to replicate the in-hotel restaurant model. We believe that in-hotel restaurant model demonstrates less market risk and execution risk. Moreover, strategic partnership helps raise brand awareness and facilitate future market penetrations.

### Key Performance Indicators (“KPI”)

Positioning at the top end of the market, Fook Lam Moon enjoys superior pricing power and high operating margins. Average check per cover is approximately HK\$500 and HK\$1,500 for lunch and dinner respectively.

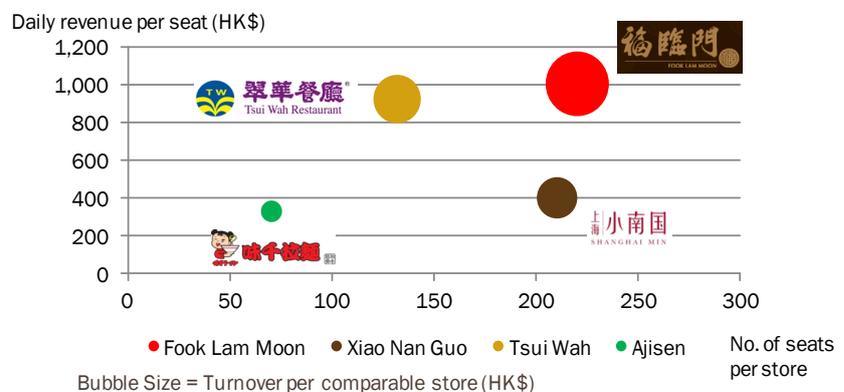
**Figure 2: KPI Comparisons**

KPI Comparison	Fook Lam Moon	Market Average
Daily revenue per table	HK\$ 4,300-4,400	HK\$ 2,700-2,800
Daily revenue per cover/seat	HK\$ 1,000-1,100	HK\$ 600-700
Daily revenue per staff	HK\$ 3,600-3,700	HK\$1,900-2,000

Source: Company data, FT Securities

Fook Lam Moon restaurants excel in fine dining industry, showing much stronger efficiency in terms of KPIs such as revenue per table, per cover/seat, and per staff.

**Figure 3: Restaurant Comparisons**



Source: Company data, FT Securities

Due to strong cash revenue per unit of restaurant or per new seat added, FLM demonstrates higher cash generating power than peer restaurant operators. The long existing brand loyalty as well as lower execution risk for the in-hotel expansion model helps provide FLM with more stable cash income.

## **Branded Food Operation**

The management target to launch Fook Lam Moon Fine Foods Brand in 2013 to further leverage on the existing brand equity subject to the completion of the Transaction. The Fook Lam Moon Fine Foods include mooncake, bakery, pastry and other traditional Chinese food products. The products are to be manufactured in Hong Kong with no outsourcing.

The management is targeting 80,000 boxes of mooncake sales in 2013. Based on the estimated market size of approximately 6 million boxes of annual sales volume of mooncake in Hong Kong, we believe this target is achievable given the strong brand quality and less than 1.5% of market share gain.

Compared with current market competitors, Fook Lam Moon branded food enjoys advantages in terms of point of sales, length of history, use of premium ingredients and label of Hong Kong production. Among many other mooncake brands in the market, Fook Lam Moon is the only traditional Chinese restaurant brand with Michelin Stars and awards.

## **Robust Earnings Growth**

### *Restaurant operations*

The Group is expanding FLM restaurants in PRC and Macau with a pace of 2 new outlets per year. Typically, each new expansion is estimated to contribute close to HK\$ 42-48 million annual revenue and HK\$ 4.6-5.3 million attributable profit after 6-9 month ramp-up period. By FY2016, number of new outlets under the Group will reach 6, contributing total of HK\$ 238 million revenue and HK\$ 26-27 million attributable profit to the Group's restaurant operations.

Combined with the 3 existing outlets in Hong Kong, the total of 9 HK, PRC and Macau restaurants will generate total revenue of HK\$ 296 million, HK\$ 404 million and HK\$ 515 million for FY2014-16, respectively. Attributable net profit is estimated to reach HK\$ 31 million, HK\$ 69 million and HK\$ 84 million for the same period.

### Branded food

Subsequent to the completion of the VSA, the Group will diversify its business into fine food products to broaden the revenue stream by launching the first premium moon cake product in Q2 FY2014.

From FY2014 to FY2016, the sales volume of premium moon cake is estimated to be 80k, 250k and 300k boxes with average selling price of HK\$ 750 per box, increasing 5% yoy. Revenue from premium moon cake sales is estimated to reach HK\$ 60 million, HK\$197 million and HK\$248 million, representing 76%, 83% and 84% of total branded food revenue in FY2014, FY2015 and FY2016, respectively. The rest of the branded food products include Chinese pudding for the Chinese Lunar New Year and rice dumplings for the Dragon Boat Festival in May/Jun, and other traditional pastries.

Total revenue of branded food operation in FY2014, FY2015 and FY2016 is estimated to be HK\$ 79 million, HK\$ 238 million and HK\$ 297 million, respectively. The attributable net profit over the same period is estimated to be HK\$ 21 million, HK\$ 76 million and HK\$ 99 million, respectively.

### Sum-of-the-parts

The combined revenue of restaurant and branded food operations is estimated to be HK\$ 375 million, HK\$ 642 million and HK\$ 811 million for FY2014-16, implying a 3-year CAGR of 47%, and the combined attributable net profit is estimated to be HK\$ 52 million, HK\$ 146 million and HK\$ 184 million during the period of FY2014 and FY2016, implying a 3-year CAGR of 87%.

### **Valuation undemanding**

The restaurant and branded food peers have been trading at around 20.2x FY2015E P/E. Based on the estimated net profit forecast of HK\$ 146 million for FY2015 and HK\$ 184 million for FY2016, the current share price reflects forward 2015E P/E of 2.5x and 2016E P/E of 2.0x, respectively, reflecting 88-90% discount to peers. The forward P/E of 5.9x and 4.7x implied by the conversion price of HK\$ 0.80 represent approximately 70% discount to peers.

**Figure 4: China Restaurant and Branded Food Players**

Company	Stock Code	Mkt Cap (HK\$m)	PER	PER	PER	Rev.	Rev.	EBITDA	EBITDA	Net Profit	Net Profit	Dvd Yld	Dvd Yld
			(x)	(x)	(x)	(HK\$m)	(HK\$m)	Margin (%)	Margin (%)	Margin (%)	Margin (%)	(%)	(%)
			FY13E	FY14E	FY15E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY12	FY13E
<b>Chain Restaurant and Branded Food Players</b>													
AJISEN CHINA HOLDINGS LTD	538 HK	5,952	27.2	21.3	15.4	3,429	3,910	13.1	14.2	6.3	7.1	0.7%	2.1%
CAFE DE CORAL HOLDINGS LTD	341 HK	14,093	25.7	23.4	20.4	6,496	7,269	14.3	14.4	8.3	8.3	2.5%	3.0%
FAIRWOOD HOLDINGS LTD	52 HK	2,076	15.2	14.4	14.0	1,987	2,170	8.1	7.5	6.6	6.4	3.6%	4.5%
TAO HEUNG	573 HK	4,883	15.4	13.7	n/a	4,519	5,131	n/a	n/a	7.0	7.0	2.7%	n/a
TINGYI (CAYMAN ISLN) HLDG CO	322 HK	112,157	28.4	23.3	20.2	10,880	12,443	12.0	12.4	4.7	5.0	1.2%	1.7%
TSUI WAH HOLDINGS LTD	1314 HK	6,045	40.1	29.1	22.4	1,130	1,569	17.4	17.9	13.5	13.4	0.0%	2.3%
UNI-PRESIDENT CHINA HOLDINGS	220 HK	29,767	21.3	19.0	15.8	26,145	31,347	8.4	8.6	4.2	3.9	0.7%	1.1%
WANT WANT CHINA HOLDINGS LT	151 HK	156,616	30.0	25.0	21.2	4,101	4,879	23.7	23.6	16.6	16.5	1.9%	2.1%
<b>Simple Avg</b>			<b>25.4</b>	<b>21.2</b>	<b>18.5</b>			<b>13.9</b>	<b>14.1</b>	<b>8.4</b>	<b>8.5</b>		
<b>Mkt Cap Weighted Avg</b>			<b>28.3</b>	<b>23.6</b>	<b>20.2</b>			<b>17.5</b>	<b>17.6</b>	<b>10.7</b>	<b>10.7</b>		

Source: Bloomberg, 24 April, 2013

**Key Drivers**

- Potential restaurant expansion in PRC and Macau;
- Robust growth of fine dining industry in PRC;
- Branded food operation to increase revenue stream and diversify business risk.

**Risks**

- Possible slowdown in economic growth;
- Increased competition.

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