Honworld Group - The Undervalued, Well-Run Leading Chinese Cooking Wine Producer Building a Moat and a National Brand

Honworld Group
Ticker: 2226:HKG
6 Month Avg. Daily Vol. (USD): $1,325,015

Recommendation: Buy
Closing Price (6/5/2015): HK$6.33
Est. 5 Year Annualized Return: ~17%

June 7, 2015

FACTOR RATINGS

Factor	Rating	Comment
Financial Health	4	The company has net debt/equity = 0.16 and net debt/EBIT = 0.75.
Business Quality	4	The company is in the process of potentially building a very strong moat based on economies of scale, brand and customer captivity.
Management Quality	4	Management seems very passionate, are owner operators and has a strategic vision for the company
Operations	4	It generates normalized ROIC above 20% and is spending heavily on fixed costs to take advantage of its scale. Products garner premium pricing with high market share
Capital Allocation	4	Strong capital allocation with the exception of inventory but will be better judged when growth slows
Corporate Governance	5	No corporate governance issues, Chairman and founder donated over 11 million liters of base wine
Valuation	4	The company is trading above a no growth valuation but still well below intrinsic value particularly with the profitability, management, and growth prospects of the company
Growth Prospects	5	Market is growing at 20% per year, Honworld is outpacing the market's growth, and the company key regions that account for 90% of sales only account for 26% of the population

Scale 1 = worst 5 = best

Source: Reperio Capital Research

KEY STATISTICS

KEY STATISTICS	TTM	5Yr Avg
Current Price (HK$)	**6.33**	
Price Range	3.80-7.59	3.80-11.80
Ave Daily Vol (Shares mn)	1,951,001	
Shares Outstanding (mn) basic	519	
Shares Outstanding (mn) diluted	519	
Market Cap (HK$ mn) diluted	**3,284**	
Net Debt (HK$ mn)	249	
Other Claims (HK$ mn)	-	
Enterprise Value (HK$ mn)	**3,533**	
EV per Share	6.81	
Net Debt/Equity	0.16	
Net Debt/EBIT	0.75	
PER SHARE (HK$)	**TTM**	**5Yr Avg**
Net Current Asset Value per Share	1.74	0.04
Tangible Invested Capital per Share	3.54	0.89
Net Tangible Operating Assets per Share	3.51	0.87
Tangible Book Value	3.03	0.40
Net Financial Assets per Share	(0.48)	(0.47)
Sales per Share	1.61	0.81
EBIT per Share	0.64	0.32
NOPAT per Share	0.55	0.26
FCF per Share	(1.78)	(0.44)
Residual Income per Share	0.20	0.14
Insider Ownership	53.6%	
Fiscal Year End	December	

VALUATION METRICS	TTM	5Yr Avg
P/NCAV	3.6	142.9
EV/IC	1.9	7.7
EV/NOA	1.9	7.8
EV/EBIT	10.7	21.3
EV/NOPAT	12.4	26.0
EV/FCF	(3.8)	(15.5)
EBIT Yield	9.4%	4.7%
FCF Yield	-26.2%	-6.4%
Dividend Yield	1.6%	0.4%
PROFITABILITY	**TTM**	**5Yr Avg**
RoTIC	16%	22%
RoNOA	18%	28%
FCF RoTIC	-50%	-36%
Gross Margin	58%	51%
Operating Margin	40%	36%
NOPAT Margin	34%	29%
FCF Margin	-111%	-72%
IC Turnover	0.5	0.8
Net Operating Asset Turnover	0.5	0.8
GROWTH	**TTM**	**5Yr Avg**
Sales Growth	26%	107%
Operating Profit Growth	24%	121%
NOPAT Growth	27%	129%
FCF Growth	NA	-
Invested Capital Growth	194%	104%

Source: Company data, Reperio Capital Research estimates

INVESTMENT THESIS

Honworld is the largest Chinese cooking wine producer with a 13.8% market share in 2012. The company is the only top four cooking wine producer using a naturally brewed, traditional production process allowing the company to garner premium pricing. This premium pricing amplifies the company's size advantage over its top four competitors, as 95% of cost of goods sold is raw materials in the form of agricultural commodities. As illustrated below in 2012 (latest available data), Honworld's sales are 2.16 times and its gross profit is 2.86 times its largest competitor. Sales are 3.21 times and gross profit is 4.21 times its second largest competitor.

Top 5 Cooking Wine Producers in China	Sales Multiple	Gross Profit Multiple
Honworld Group		
Beijing Wang Zhi He Food Group Co., Ltd	2.16	2.86
Beijing Lao Cai Chen Food Co., Ltd	3.21	4.21
Hengshun Vinegar Industry Co., Ltd	6.00	8.89
Chengdu Julong Food Co., Ltd	10.62	16.00

Source: Euromonitor, Reperio Capital Research estimates

Honworld's size advantage is important as fixed expenses account for a large portion of sales. Over the past two years, the company has spent 13.1% of sales and 22.7% of gross profit on fixed expenses. Only the two largest peers can match Honworld's spending on fixed costs and remain profitable. The company is spending on fixed costs accounts for 64.7% of the largest competitor's gross profit and 95.4% of the second largest competitor's gross profit.

	% of Sales			% of Gross Profit		
Top 5 Cooking Wine Producers in China	Distribution Expense	R&D Expense	Total Fixed Costs	Distribution Expense	R&D Expense	Total Fixed Costs
Honworld Group	5.5%	7.6%	13.1%	9.5%	13.2%	22.7%
Beijing Wang Zhi He Food Group Co., Ltd	11.9%	16.5%	28.3%	27.1%	37.6%	64.7%
Beijing Lao Cai Chen Food Co., Ltd	17.7%	24.5%	42.2%	40.0%	55.4%	95.4%
Hengshun Vinegar Industry Co., Ltd	33.0%	45.8%	78.8%	84.4%	117.0%	201.4%
Chengdu Julong Food Co., Ltd	58.5%	81.0%	139.5%	152.0%	210.6%	362.6%

Source: Euromonitor, Reperio Capital Research estimates

The market's growth, the convergence of tastes within China and the nature of the product all make economies of scale particularly important. In a rapidly growing market, Honworld can outspend competitors on reaching more customers through its distribution channel and building a stronger brand through advertising and R&D. Consumer tastes are converging in China is shifting the market from many regional markets to a national market. Larger companies will be the biggest beneficiaries as fixed costs can be spread over one market rather than customizing fixed costs for each regional market. Regional markets fragments the industry as smaller companies can survive with market share only in the regional market. In a national market, the presence of fixed costs leads to a higher minimum efficient scale driving out smaller competition. Cooking wine is a low priced experience good and a strong brand lowers search costs creating customer captivity via habit. The strength of Honworld's brand is evidenced by premium pricing with a high market share and pricing power with gross margins remaining constant over the past few years.

The Chairman, founder, and CEO, Mr. Chen Weizhong is a passionate owner operator with integrity, a long-term vision, and the ability to execute the company's vision. Mr. Chen holds 53.62% of Honworld aligning his interests with minority shareholders. Mr. Chen's passion is illustrated by building a personal base wine inventory from early 1990s when he entered the condiment industry. This inventory build started before he founded his first condiment company in 1995, where base wine was not used in the production process, and well before he purchased the Lao Heng He cooking wine brand in 2005. Mr. Chen then donated the 11.3 million liters of base wine inventory valued at RMB7.0 million. He also transferred his secret recipes to the company for RMB1. Over the past five years, the five highest paid employees received 0.51% of operating income compared to an industry average of 1.57%, further illustrating the integrity and the view minority shareholders are partners. Mr. Chen takes a long-term view as illustrated by the short pain associated with building inventory to support growth and spending heavily on fixed costs. These cement the company's competitive position despite depressing current profitability. The management team is also relatively young with the average age of 40 years old meaning they have the energy and desire to build a national brand.

The company's economies of scale, premium pricing, and pricing power allow the company to generate returns on invested capital above the cost of capital. From 2010 to 2014, assuming one year of base wine inventory and associated capital requirements, the company averaged a ROIC of 25.4%.

The company's ability to generate ROIC greater than its cost of capital allows growth to add value. Between 2012 and 2017, the Chinese condiment market is expected to grow at 12.4% per year and the Chinese cooking wine industry is expected to grow at 20.3% per year. Honworld is expected to outpace the overall Chinese cooking wine industry growth as the company's naturally brewed products sold at a premium price cater to an increasing wealthy, health conscious Chinese consumer. The company's current key region account for roughly 90% of sales only accounts for 26% of the population, so the company has long runway for growth.

The company is building a multi-faceted competitive advantage, has a strong management team, is very profitability, and has a long runway for growth yet is only trading on an EV/EBIT of 10.7 times. The market is pricing in 5% growth over the next five years fading to a terminal growth rate of 0% and 40% operating margins, which seems conservative given the market is growing at 20% and the company is depressing current profitability due to high spending on fixed costs.

The expected return for the Honworld assuming a constant ROIC is 17.3%.

Expected Return	TTM
NOPAT yield	7.0%
-Dividend yield	1.8%
=Reinvested earnings yield	5.3%
xFranchise value	2.00
=Value of reinvested earnings	10.6%
+Dividend yield	1.8%
+Organic growth	5.0%
Expected return	**17.3%**

Source: Reperio Capital Research estimates

The base case earnings valuation assumes 10% forecast period growth and 0% terminal growth with current margins. This scenario offers 14% upside to 2015 intrinsic value and 116% to 2020 intrinsic value.

KEY METRICS TO WATCH

- **Economies of scale** = market share relative to peers, gross profit share relative to peers, and spending on fixed costs
- **Brand strength** = premium pricing while maintaining market share advantage over peers
- **Pricing power** = gross margin consistency or expansion
- **Competitive rivalry** = market growth and consolidation
- **Capital efficiency** = capital turnover ratios and the level of base wine inventory are key drivers of profitability

HISTORY

The Lao Heng He brand, Honworld's main brand, can be traced back to Lao Yuan Da Jiang Yuan, a brewing enterprise focused on the manufacturing and sale of condiment products, established during the reign of Chinese Emperor Xianfeng (1851 A.D.–1861 A.D.). Lao Yuan Da Jiang Yuan had a number of fermentation starter recipes used to produce soy sauce, fermented bean curd, pickled vegetables, and other fermented products.

Lao Heng He won the Gold Award at the Panama - Pacific International Exposition, a world fair hosted by San Francisco, California in 1915 for its sauces and pickled vegetables. It also won the Gold Award at the West Lake Exposition, a world fair hosted by Hangzhou City in 1929 for its rose fermented bean curd. In 1930, the company changed its name to Lao Heng He Brewing Enterprise.

In the early days of Lao Heng He, the current majority shareholder's (Mr. Chen Weizhong) ancestors, including Mr. Chen Guofu and Mr. Chen Lifu, were major shareholders. In 1951, two years after the founding of the PRC, Lao Heng He Brewing Enterprise was registered with the Huzhou City government as a private partnership and renamed into Lao Heng He Xing Ji Brewing Factory. In 1957, it became a joint state-private operative enterprise under the name of Joint State-Private Operative Hu Zhou Lao Heng He Brewing Factory. In 1966, the company was restructured into a state-owned enterprise named Huzhou Brewing Factory. In 1988, Huzhou Brewing Factory was renamed to Huzhou Lao Heng He Brewing Factory restoring Lao Heng He to the company name. In 2000, the Huzhou Government approved the restructuring of Huzhou Lao Heng He Brewing Factory into a joint-stock cooperative enterprise. After of the restructuring, the shareholders of Huzhou Lao Heng He Brewing Factory consisted of 110 employee-shareholders and Huzhou Commercial Group Corporation, a state-owned enterprise.

Controlling Shareholder

In 1995, Mr. Chen Weizhong established Huzhou Zhong Wei Brewing Factory, a manufacturer of pickled vegetables, soy sauce, and other fermented condiment products. In 2006, the company changed its name to Zhejiang Zhong Wei Brewing Co., Ltd (Zhong Wei). Zhong Wei and its products received a number of awards under Mr. Chen's management.

2010

- National Flagship Enterprise in Agricultural Industrialization
- China's Best Ten Condiment Producer

2011

- Famous Brand in Zhejiang Province

Purchase of Lao Heng He

On June 1, 2005, to expand Zhong Wei's condiment business and to return the Lao Heng He business to his family, Mr. Chen purchased Huzhou Lao Heng He Brewing Factory for just under RMB4.2 million.

Mr. Chen did not have sufficient capital to purchase Huzhou Lao Heng He Brewing Factory so Ms. Ho Ping Tanya, a longtime business acquaintance of Mr. Chen, extended a loan of RMB2.6 million for a 25.41% equity interest in Huzhou Lao Heng He Brewing Factory in June 2005. Mr. Chen paid the remaining amount. In 2012, Ms. Ho's percentage ownership was adjusted to 25.8214%, to take into account approximately RMB0.9 million of uncollected trade receivables.

Mr. Chen kept Zhong Wei and Huzhou Lao Heng He Brewing Factory as separate entities, due to the distinct production processes and food safety risk profiles. Zhong Wei manufactured its products based on the pickled and preservation process, while Huzhou Lao Heng He Brewing Factory used a natural fermentation process to manufacture its products.

Since acquiring the Lao Heng He brand in 2005, Mr. Chen sought to rebuild the century-old brand and expand the cooking wine business by capitalizing on Zhong Wei's established condiment business, procurement capabilities, and distribution network. Given its dependence on Zhong Wei's procurement capabilities and distribution network, a large portion of Huzhou Lao Heng He Brewing Factory's raw material procurement and sales were from and to Zhong Wei. Zhong Wei represented 29.9%, 41.4%, 8.5%, and 3.8% of total raw material purchases in 2010, 2011, 2012, and for the eight months ended August 31, 2013, respectively. The percentage of sales to Zhong Wei by product is listed below.

% of Sales to Zhong Wei	2010	2011	2012
Cooking wine	88.2%	32.6%	0.8%
Soy sauce	100.0%	75.8%	7.9%
Vinegar	100.0%	50.9%	3.0%
Others	100.0%	21.1%	2.0%

Source: Company data

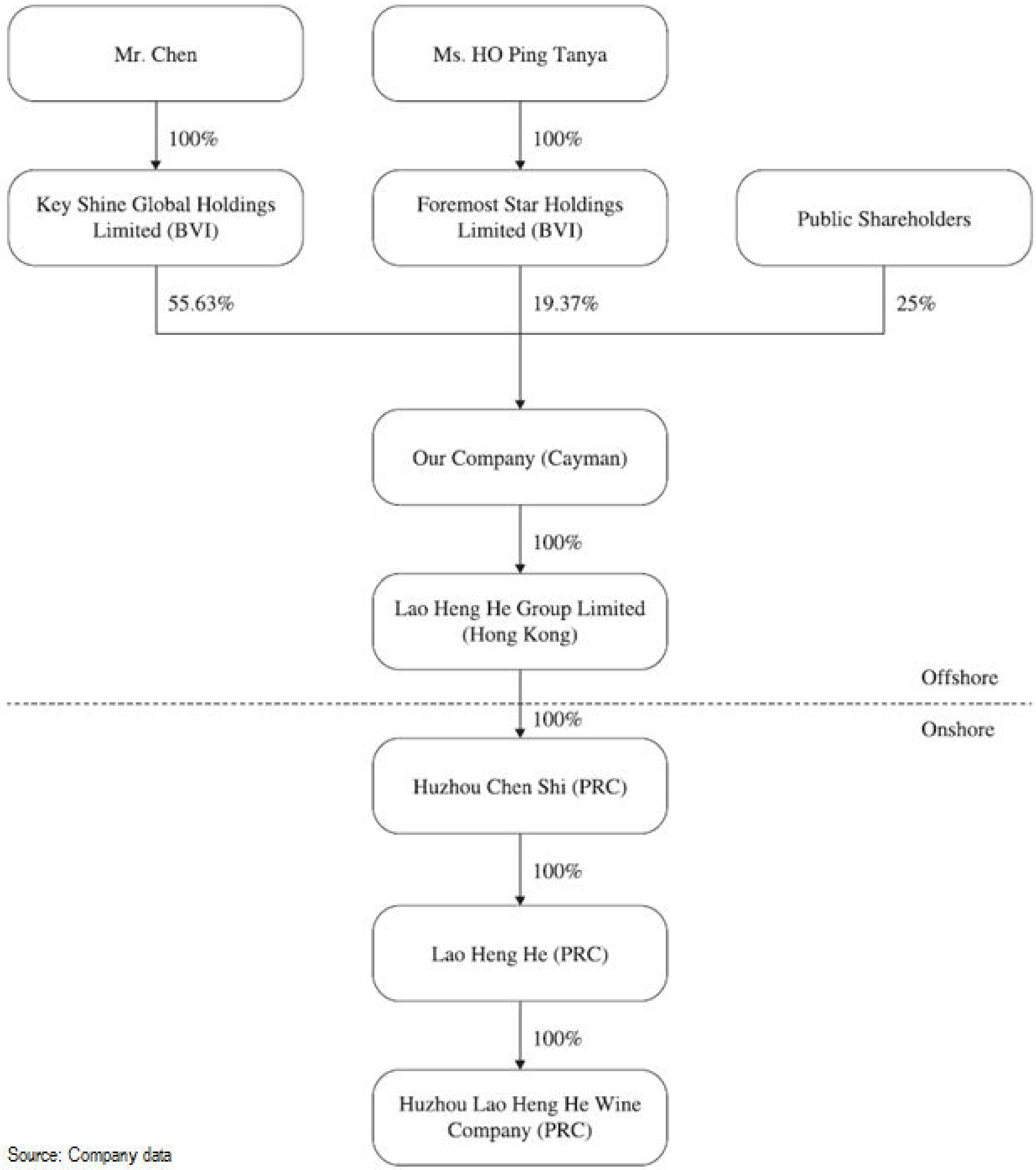
Zhong Wei resold the company's products to distributors leading to a lower margin on products sold to Zhong Wei relative to other distribution channels. As Huzhou Lao Heng He Brewing Factory built its own distribution and procurement capabilities, Zhong Wei significance diminished in importance and gross margin increased from 36.9% in 2010 to 57.2% in 2012. Along with the improvement in distribution channels, improving product mix and increased ASPs drove gross margin improvements.

In 2010, Mr. Chen contemplated listing Zhong Wei, including the Lao Heng He business, in China. At the time, there was a significant backlog of applications for listing on the A-share markets and the vetting and approval process for any listing of Zhong Wei was expected to be lengthy and uncertain.

In 2012, Mr. Chen decided to list the Lao Heng He business in Hong Kong and dispose of Zhong Wei. In June 2012, Zhong Wei transferred to Mr. Chen and Ms. Xing Liyu 95% and 5% of the equity interests in Lao Heng He, for a consideration of RMB9.5 million and RMB0.5 million, respectively. In addition, Zhong Wei granted Lao Heng He exclusive licenses to use the trademarks that were previously transferred by Lao Heng He, for nominal consideration.

On December 25, 2012, Mr. Chen and Ms. Xing transferred all of their ownership in Zhong Wei to an independent third party for just under RMB9.0 million and just over RMB1.0 million, respectively. The third party purchaser of Zhong Wei had been an investor in construction materials and condiment products distribution businesses.

In December 2012, Honworld was incorporated in the Cayman Islands and Lao Heng He Group Limited was incorporated in Hong Kong. Honworld went public on January 28, 2014 at HK$7.15 selling 25% of the company, in the form of new shares, to the public for HK$1,028 million. The post-IPO organizational structure is listed below.



Source: Company data

On September 2, 2014, Honworld issued warrants offering the right to purchase 100,000,000 new shares at HK$8.00 per share for gross proceeds of HK$10,000,000. The subscriber was Mr. Chan, the Chairman and director of CCH Group Co., Limited. CCH Group is engaged in organizing promotional events, movie production, operating a talent agency, and distribution of art works and commercial decorative products. The warrants are exercisable in the twelve months following September 2, 2014. The subscription price represented a 24.8% premium to the closing price on the last trading day before the announcement.

On May 14, 2015, Ms. Ho sold 14% (72.625 million shares) of the company to Hwabao Overseas Markets Investment No. 2 QDII Single Unit Trust Plan 32-8 for HK$405.25 million or $5.58 per share, a 17% discount to the May 14, 2015 closing price of $6.70. Hwabao Overseas Market Investment QDII No. 2 is an investment vehicle owned by Baosteel. Through Foremost Star Holdings, Ms. Ho continues to hold 4.67% of Honworld.

Today, Honworld is a producer of Chinese cooking wine, soy sauce, vinegar, and other condiment products. Cooking wine is the primary product accounting for 71% of revenues and an estimated 69% of gross profit in 2014.

% of Revenues	2011	2012	2013	2014
Cooking wine	55%	87%	74%	71%
Soy sauce	19%	4%	19%	16%
Vinegar	13%	3%	3%	10%
Others	14%	7%	4%	3%
% of Gross Profit	**2011**	**2012**	**2013***	**2014***
Cooking wine	61%	92%	73%	69%
Soy sauce	14%	2%	23%	19%
Vinegar	11%	3%	3%	10%
Others	13%	3%	2%	2%

Source: Company data

INDUSTRY

Chinese Condiment Industry

Condiment products are used in food preparation to add a particular flavor and aroma. Key condiment products include cooking wine, soy sauce, vinegar, and MSG.

According to a 2013 Euromonitor Report, the total value of the Chinese condiment market grew at a compound annual growth rate (CAGR) of 14.4% from 2008 to 2012. This growth is expected to continue with the condiment market expected to grow at a CAGR of 12.4% between 2012 and 2017.

The Chinese Cooking Wine Industry

Chinese cooking wine has been around for centuries and is an essential ingredient in food preparation to deliver richer flavors and dissolve meat and fish odors. It is also used as a dipping sauce for popular snacks.

According to the 2013 Euromonitor Report, from 2008 to 2012, the Chinese cooking wine retail sales grew at a CAGR of 23.4%. From 2012 to 2017, the Chinese cooking wine retail sales is expected to grow at a CAGR of 20.3% reaching RMB10.6 billion in 2017. From 2008 to 2012, retail volume in the Chinese cooking wine market grew at a CAGR of 15.6%. From 2012 to 2017, retail volume is expected to grow at a CAGR of 12.7%, reaching 1.5 million tonnes in 2017. From 2008 to 2012, retail prices increased by 6.7% per year. From 2012 to 2017, retail prices are expected to increase by 6.7%.

The key drivers of growth within the Chinese cooking wine industry is increasing urbanization and purchasing power, increasing health and safety awareness, and growing convergence of regional tastes.

Chinese cooking wine is primarily distributed through retail and catering service channels. In 2012, 50.5% of cooking wine sold through retail channels, 41.5% sold through catering service channels and 8.0% through other channels. Leading cooking wine brands tend to concentrate on retail sales channels as households generally demand higher value cooking wine products and are more brand sensitive.

Chinese Cooking Wine Production

Chinese cooking wine can be produced using one of three methods.

1. Naturally Brewed Rice Wine as a base
2. Alcohol as a base (chemically produced)
3. Mixture of the first two methods

Cooking wine using naturally brewed rice wine is higher quality and healthier as it contains many nutrients, such as vitamins and amino acids. Chemically produced cooking wine that uses alcohol as a base contains preservatives, plasticizer, glacial acetic acid, and other artificial flavors.

China's population is more and more health consciousness leading to naturally brewed cooking wine increasing in popularity and growing faster than the overall market. Honworld is the only top four cooking wine producer using the naturally brewed production method.

The Chinese cooking wine production process illustrated below takes between 30-35 days before the aging process.

Chinese Cooking Wine Production Process

Soaking	Primary Fermentation	Secondary Fermentation	Filtration and Sterilization
	3-5 days	25-30 days	
Soaking to Filtration and Sterilization takes 30-35 days			

Source: Company data

Fermentation usually takes place between October and May as the cold weather aides the process.

Chinese Cooking Wine Production Process

Aging	Blending and Seasoning	Packaging and Pasteurization	Quality Control

Source: Company data

Industry Activities

Profitability is tied to individual activities rather than the value chain as a whole; therefore, it is crucial to analyze each basic activity. The key activities in the Chinese Cooking Wine Value Chain are listed below.

Chinese Cooking Wine Value Chain

Raw Materials	Production	Aging	Seasoning/Blending	Fixed Costs	Distribution	Retail
Rice	Soaking			R&D	Retail	
Packaging materials	Fermentation			Distribution expenses	Catering	
Soy beans						
Wheat						
Others						

Source: Reperio Capital Research

Raw Materials

Raw materials averaged 95% of Honworld's cost of goods sold between 2010 to the IPO prospectus date. The key raw materials are listed below along with their percentage of total raw material costs.

Raw Materials	2010-IPO Prospectus date % of Raw Material Cost
Rice	57%
Packaging materials	26%
Soy beans	6%
Wheat	2%
Others	9%

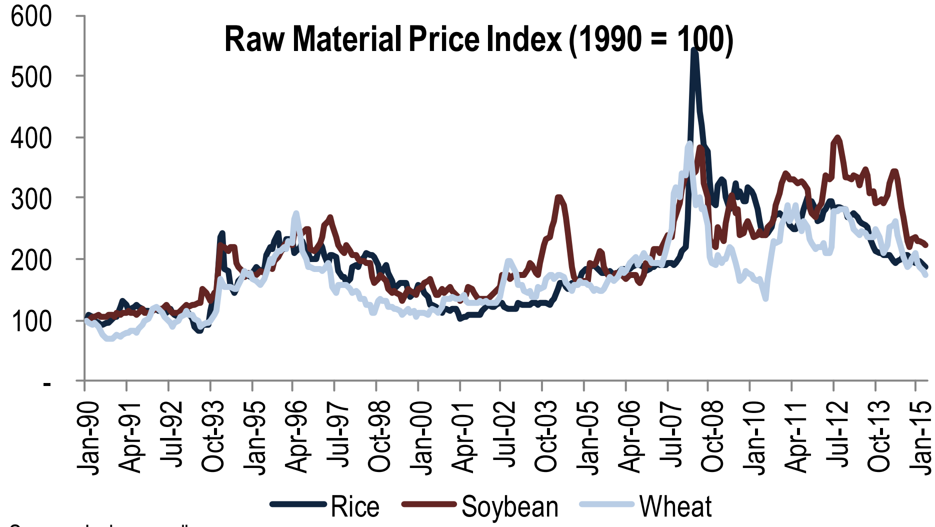
Source: Company data

The vast majority of raw materials are pure commodities with many sellers. Excess profitability from the production of pure commodities occurs from either short-term supply and demand mismatches or being a low cost producer.

In the case of short-term supply and demand mismatches allows for short-term excess profits or losses for producers. Supply and demand mismatches are unpredictable and the ability to bring on new supply will determine the length of excess profits or losses. Given farmers can shift the crops they plant on an annual basis, supply and demand mismatches should not persist for more than a year or two and will affect the price for the consumer of raw materials. Excess profitability from being a low cost producer may exist for a prolonged period but does not affect the prices to the next step in the value chain.

Raw material sellers have very little bargaining power, as their product is a commodity in the truest sense; products are standardized making pricing the only thing that matters. There a large amount of sellers so these commodities can be purchased from many different sellers. No cooking wine producer participates in the production of raw materials.

Raw material production is very political in China as food security is crucial. Rice prices on the domestic market are much higher than the import market due to Beijing's price support for domestically produced rice to incentivize domestic production. Many Chinese mills import lower cost international rice. Raw material production and regulation must be watched due to the political nature and potential for regulatory changes in China. The chart below illustrates international raw material prices indexed to 100 at the beginning of 1990.



Source: Indexmundi

Cooking Wine Production

At the end of 2012, there were over 1,000 Chinese cooking wine producers. The large number of players points to low barriers to entry, regional tastes, or a combination of both. Producing cooking wine takes little capital, little equipment, and little time (30-35 days) so it is probably a combination of both.

In 2012, the top five producers in the cooking wine industry account for 28.1% market share in terms of value and 14.0% in terms of volume.

Top 5 Cooking Wine Producers in China	2012 Retail Sales Value Market Share	2012 Retail Sales Volume Market Share	Production Method
Honworld Group	13.8%	5.8%	Naturally Brewed
Beijing Wang Zhi He Food Group Co., Ltd	6.4%	3.6%	Chemically Produced
Beijing Lao Cai Chen Food Co., Ltd	4.3%	2.4%	Chemically Produced
Hengshun Vinegar Industry Co., Ltd	2.3%	1.4%	Chemically Produced
Chengdu Julong Food Co., Ltd	1.3%	0.8%	Naturally Brewed
Total Top 5 Producers	**28.1%**	**14.0%**	

Source: Euromonitor, Company data

Although barriers to entry in production may be minimal, the ability to differentiate during the production process (naturally brewed vs. alcohol based vs. mixture) is growing in importance as customers grow increasingly health conscious allowing naturally brewed cooking wine to continue to take share and command a premium price.

With various contamination and food safety scandals in recent years, customers are becoming more concerned with the quality of the product shifting competition away from pure price, favoring larger well-known brands. There is also increased regulatory scrutiny, which brings increased fixed costs associated with compliance of regulations also favoring larger brands.

Ageing

There are various categories of cooking wine classified by the percentage of base wine per liter of cooking wine, the percentage of vintage base wine per liter of cooking wine (aged based wine), the alcohol by volume (ABV), and the average age of the vintage base wine.

Category	Products	% Base wine in 1 liter (2013)	% Vintage base wine in 1 liter (2013)	% Mixer base wine in 1 liter (2013)	Alcohol by Volume (ABV)	Average Age of Vintage Wine (years)
Premium	Well-aged Cooking Wine Chef's Huadiao	93.0%	6.0%	87.0%	15%	10
High-end	15% ABV Cooking Wine Steamed Fish Cooking Wine	87.0%	6.0%	81.0%	15%	8
Medium-range	Spiced Cooking Wine Scallion & Ginger Cooking Wine Lao Heng He Cooking Wine	85.0%	4.0%	81.0%	10%	5-6
Mass-market		68.0%	4.0%	64.0%	10%	5-6
Total		**86.5%**	**4.9%**	**81.6%**	**12%**	**7.0**

Source: Company data

The longer base wine is aged the greater the scarcity and the more difficult it is for peers to replicate the product, as it requires patience, discipline, and capital. The capital probably is the most abundant, patience and discipline in a short-term oriented world is very scarce.

Honworld's gross margins illustrate either scarcity of aged vintage wine or lack of competition. For the periods reported in the IPO prospectus, premium cooking wine generated gross margins of 70-80%, high-end cooking wine generates gross margin of 65-70%, medium-range cooking wine generates gross margin between 45-50%, and mass-market cooking wine generates gross margin of 50-55%.

Smaller to medium size competitors selling commodity, alcohol based products will have a difficult time competing on age of inventory with larger companies that have greater profitability from selling premium products and access capital market.

Seasoning and Blending

Seasoning and blending is the mixing of the base wine and the flavoring of the cooking wine. The amount of base wine used, the amount vintage of the base wine, and the age of vintage base wine determine the product quality. Honworld adds vintage base wine with regular base wine and spices. Given cooking wine is a key flavor in Chinese cooking and is ingested, the ability to create a product meeting customer tastes is crucial and could potentially lead to customer captivity as customer get used to a specific flavor of cooking wine.

Fixed Costs

Fixed costs consist of distribution expense and research and development. Distribution expense consists of advertising expenses, marketing expenses, promotion expenses, travelling expenses, and remuneration of sales employees. Fixed costs not associated with selling products favors larger companies as larger companies can spend more reaching more customers through higher advertising expenses and larger distribution networks. This is particularly advantageous as the market shifts from many regional markets to a national market as advertising can reach all customers within the national market rather than being fragmented by local tastes and languages. The shift from regional markets to one national market aides the bigger players as relative size in the local market is what matters. If the local market becomes a national market, the largest companies are the biggest beneficiaries as the minimum efficient scale increases.

The large distribution network and a consistent brand means the same product can be found in any part of the national market with similar consistency easing a customer's purchasing decision lowering search costs leading to habit and customer captivity. If a customer travels from one part of the country to another part of the country, a national brand gives the customer comfort as cooking wine is an experience good whose quality is only determined through use. The brand represents a known product and as long the customer experienced consistency with the brand the customer will be more likely to choose the brand over an untested regional brand. With a low priced, experience good that forms such an important part of a dish, purchasing an untested brand is a risk.

Research and development includes spending on new products, existing products and improving the production process. As long as research and development is efficient it benefits larger companies as larger companies can spend more than smaller companies to improve the existing business and introduce new products. As Chinese economy grows and people migrate, regional tastes converge leading to homogeneous national tastes. Larger cooking wine producers have the ability to spend more research to find the national taste through the distribution of new products.

Honworld's scale advantage is illustrated by Honworld market share. In 2012, Honworld was the largest producer of cooking wine with 13.8% market share of total value. Honworld's market share is 2.16 times its largest competitor, 3.21 times its second largest competitor, 6.00 times its third largest competitor, and 10.62 times its fourth largest competitor. In 2013 and 2014, Honworld spent and 5.5% of sales on selling and distribution expenses and 7.6% of sales on research and development leading to a total of 13.1% of sales spent on fixed costs. Assuming the top five companies had similar growth, for competitors to spend an equivalent amount on fixed cost the largest competitor would spend 28.3% of sales, the second largest competitor would spend 42.2% of sales, the third largest competitor would spend 78.8% of sales, and the fourth largest competitor would spend 139.5% of sales.

Top 5 Cooking Wine Producers in China	Sales Multiple	% of Sales: Distribution Expense	R&D Expense	Total Fixed Costs
Honworld Group		5.5%	7.6%	13.1%
Beijing Wang Zhi He Food Group Co., Ltd	2.16	11.9%	16.5%	28.3%
Beijing Lao Cai Chen Food Co., Ltd	3.21	17.7%	24.5%	42.2%
Hengshun Vinegar Industry Co., Ltd	6.00	33.0%	45.8%	78.8%
Chengdu Julong Food Co., Ltd	10.62	58.5%	81.0%	139.5%

Source: Euromonitor, Reperio Capital Research estimates

Honworld's value market share to volume market share ratio illustrates higher profitability than peers creating even greater scale advantage. In 2012, Honworld's value market share to volume market share ratio is 2.38 times a 39% premium to its peer group average value market share to volume market share ratio of 1.71 times, meaning Honworld ASP is 39% higher than its peer group. Given 95% of cost of goods sold is raw materials where no player has a purchasing edge, the cost of goods sold per unit should be roughly equivalent amplifying Honworld's top line edge.

Top 5 Cooking Wine Producers in China	Gross Profit Multiple	% of Gross Profit: Distribution Expense	R&D Expense	Total Fixed Costs
Honworld Group		9.5%	13.2%	22.7%
Beijing Wang Zhi He Food Group Co., Ltd	2.86	27.1%	37.6%	64.7%
Beijing Lao Cai Chen Food Co., Ltd	4.21	40.0%	55.4%	95.4%
Hengshun Vinegar Industry Co., Ltd	8.89	84.4%	117.0%	201.4%
Chengdu Julong Food Co., Ltd	16.00	152.0%	210.6%	362.6%

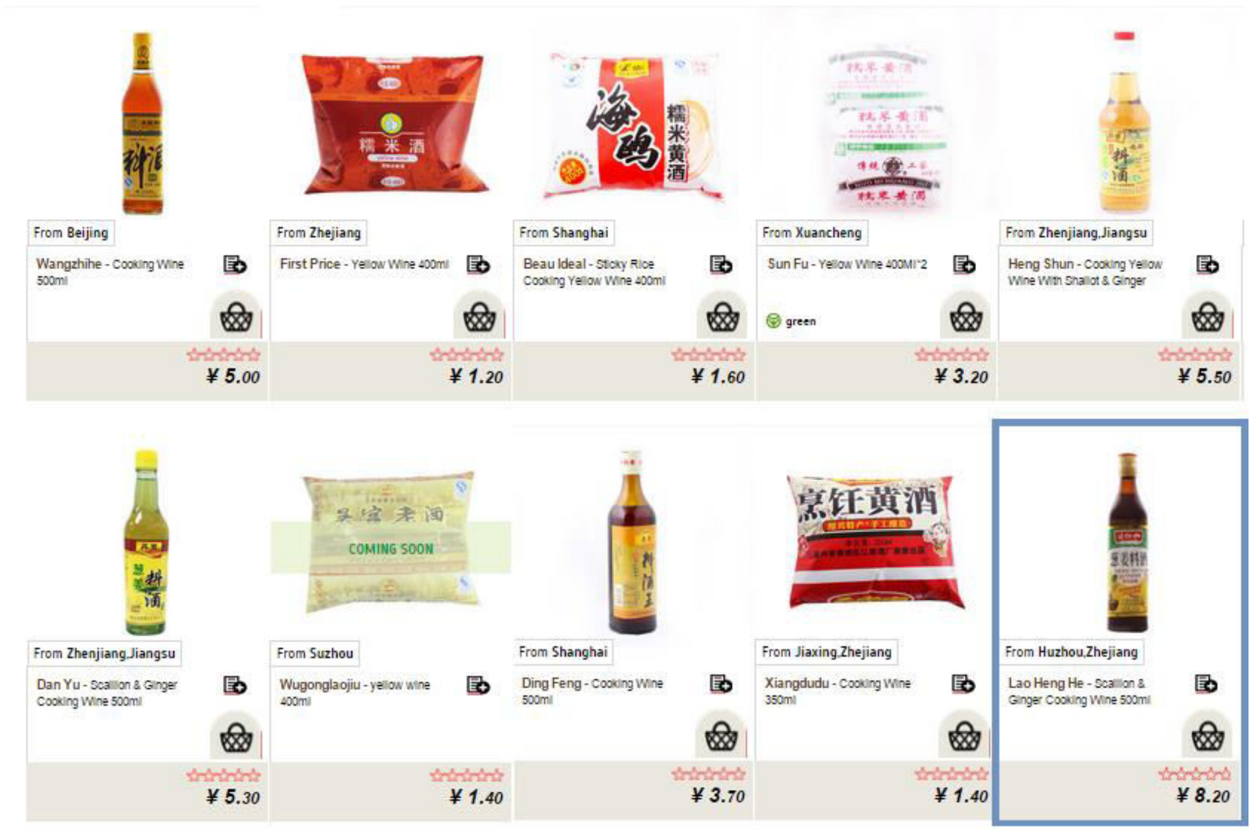
Source: Euromonitor, Reperio Capital Research estimates

In 2012, Honworld's gross profit was 2.86 times its largest competitor, 4.21 times its second largest competitor, 8.89 times its third largest competitor, and 16.00 times its fourth largest competitor. In 2013 and 2014, Honworld spent 9.2% of gross profit on selling and distribution expenses and 13.2% of sales on research and development leading to a total 22.7% of gross profit spent on fixed costs. Assuming the top five companies had similar growth, for competitors to spend an equivalent amount on fixed cost the largest competitor would spend 64.7% of sales, the second largest competitor would spend 95.4% of sales, the third largest competitor would spend 201.4% of sales, and the fourth largest competitor would spend 362.6% of sales.

Honworld has the potential to build a national brand. It is currently the only top four producers using the healthier naturally brewed base wine. As illustrated, the company can outspend peers on advertising to build its brand, educating consumer on the benefits of naturally brewed cooking wine, growing its distribution channel to reach new customers, spending on creating new products to meet customers' needs.

Cooking wine is also a low priced, experience good meaning the quality of the product can be determined through use. With cooking wine being an important part of many dishes including being used as a marinade, buying a lower quality cooking wine could ruin a dish. Given the marinating process takes significant amount of time, it would be a huge source of frustration if a dish is ruined and spending slightly more for a good cooking wine that is a known entity makes a lot of sense.

Honworld brand strength is illustrated through its premium pricing and pricing power. Honworld's market share in value is 2.38 times its market share in volume compared to peers average market share in value to market share in volume ratio of 1.71 times illustrating Honworld's ability to generate higher ASP than peers. As illustrated by the market share in value to market share in volume ratio, Honworld prices its products at a 39% premium to its largest competitors while maintain a significant market share advantage over peers. In 2012, the overall industry average price per liter is RMB4.4 compared to Honworld's RMB5.4 per liter. Regarding pricing power, in 2014, Honworld increased prices on its mid-range products by 25%. The average price of the cooking wine is very low at RMB4.4 per liter but it is vital component in many Chinese dishes giving it significant potential for price increases. The graphic below shows the cost of various Chinese cooking wines. Lao Heng He Scallion and Ginger is one of Honworld's medium-range products and are priced at a premium to peer group products. Products packaged in a pouch can be assumed to be mass-market products while bottled products can be assumed to be medium-range products similar to Honworld's product.



Source: AuchanDrive.cn http://cy.auchandrive.cn/product/c/C46

The table below illustrates the price of Honworld's product relative to other grocery products.

Cost of Various Products	(RMB)
Honworld cooking wine average price (1 liter, IPO Prospectus)	8.02
Honworld premium cooking wine average price (1 liter, IPO Prospectus)	16.70
Honworld high-end cooking wine average price (1 liter, IPO Prospectus)	11.00
Honworld medium-range cooking wine average price (1 liter, IPO Prospectus)	6.20
Honworld mass-market cooking wine average price (1 liter, IPO Prospectus)	4.30
Industry average cooking wine price (1 liter, 2013 est)	4.67
Milk (regular), (1 liter)	13.17
Loaf of fresh white bread (500g)	9.71
Rice (white), (1kg)	6.38
Eggs (12)	11.76
Local cheese (1kg)	96.49
Chicken breasts (boneless, skinless), (1kg)	25.44
Apples (1kg)	11.51
Oranges (1kg)	10.30
Tomato (1kg)	7.29
Potato (1kg)	5.53
Lettuce (1 head)	4.11
Water (1.5 liter bottle)	3.69
Bottle of wine (mid-range)	80.00
Domestic beer (0.5 liter bottle)	4.55
Imported beer (0.33 liter bottle)	13.51

Source: Company data, Numbeo.com

As illustrated above a liter of Honworld's mass-market cooking wine is less than half the price of a loaf of white bread, while a liter of Honworld's premium product is slightly more expensive than a liter of milk.

The table below shows a few recipes that use Chinese cooking wine also known as Shaoxing wine. The cost of the cooking wine is compared to only the cost of the meat in the dish. Using Honworld's premium cooking wine price, cooking wine accounts for 6.8%, 25.9%, and 15.5% of the cost of the meat in General Tso's Chicken, Chinese Hoisin Chicken, and Shaoxing Drunken Chicken, respectively. A 5% increase would be barely noticeable to the consumer particularly when food inflation is about 2.7% in China.

General Tso's Chicken		Chinese Hoisin Chicken		Shaoxing Drunken Chicken	
Ingredient	Cost (RMB)	Ingredient	Cost (RMB)	Ingredient	Cost (RMB)
10 ozs chicken meat	7.21	150 grams chicken breasts	3.82	2 chicken	50.88
1/2 tbsp Shaoxing wine	0.49	1 tbsp Shaoxing wine	0.99	2 cups Shaoxing wine	7.90
1 pinch salt		1/2 cup broccoli florets		2 ginger	
1/3 cup corn starch		1/2 carrots		1 scallions	
oil (for deep frying)		1 clove garlic		1 ginseng (small)	
11/2 tbsps oil		1 cm ginger		10 grams medlars	
3 slices ginger		1/2 tsp corn starch		1 tsp salt	
1 clove garlic		1 tbsp hoisin sauce			
5 red chili peppers		1 tbsp light soy sauce			
2 stalks scallions		1 tsp sesame oil			
3 tbsps Chinese rice vinegar		1 tsp sugar			
21/2 tbsps soy sauce		1/8 cup water			
1/2 tbsp dark soy sauce					
1 tsp hoisin sauce					

Source: Yummly.com, Numbeo.com

Honworld's premium prices inform customers of the quality of the product, as individuals perceive higher price products to be better quality. The naturally brewed products inform customers of the healthiness and quality of the product.

Fixed costs separate from volume allows for economies of scale and higher profitability for larger players. The economies of scale will grow in importance as the market consolidates from many regional markets to one national market and the national fixed costs can be spread over a large amount of volume. Any player wanting to maintain profitability advantages from economies of scale needs to maintain its size advantage over competitors.

Distribution

Within the Chinese cooking wine industry, distribution is outsourced to regional distributors with well-established local distribution networks primarily involved in the distribution of food and condiment products. If something is outsourced, every competitor can gain access to it and therefore there are no opportunities to gain excess profits. Although, distributors have limited resources and smaller producers may find it difficult to gain access to the same distribution channels as larger players further adding to the size advantage in the industry. Among the larger players, there will be probably little difference in the ability to access distribution networks.

Well-established distribution networks take time to replicate. Furthermore, as an owner of a product you want to partner with the largest distribution networks to get your product in the most outlets at the lowest possible cost giving large distributors bargaining power over their suppliers.

Cooking wine distribution will most likely continue to be outsourced as the time and cost of replicating the distribution network internally is prohibitive. Distributors will likely consolidate as the food and condiment industry shifts from regional markets to a national market. The increased bargaining power that comes with consolidation will be dependent on the speed of consolidation of distributors relative to the consolidation of cooking wine producers.

Although there are over 1,000 cooking wine manufacturers, there are potential barriers to entry within activities in the Chinese cooking wine industry. These activities with the greatest potential for barriers to entry are ageing of base wine, blending and seasoning, fixed costs (distribution expense and R&D), and distribution.

As regional markets become a national market with more homogenous tastes, the industry should consolidate as the minimum efficient scale increases making economies of scale become more important.

Other Competitive Forces

The competitive rivalry among participants is low as the market is growing at 15-20% annually. In addition, some players have been able to differentiate their product by naturally brewing the base wine, increased percentage of base wine, increased percentage of vintage base wine, and age of vintage base wine leading to competition on product characteristics rather than price. The price of the product is low priced potentially allowing for price increases decreasing competitive rivalry. There are no exit barriers.

The risk of substitution is low. High quality Sherry wine can be used as a substitute but is foreign and a person cooking a Chinese dish in China is more likely to have Chinese cooking wine on hand than Sherry. If that person goes to the store to purchase Chinese cooking wine, it is likely to be more available than Sherry. Chinese cooking wine has been used for the recipe for generations and is much more likely to be on the front of the mind than Sherry. The customer probably does not even think of Sherry as a substitute.

COMPANY DESCRIPTION

Honworld is a producer of Chinese cooking wine, soy sauce, vinegar, and other condiments. Cooking wine is the primary source of both revenues and gross profit accounting for 71% of revenues and an estimated 69% of gross profit in 2014.

% of Revenues	2011	2012	2013	2014
Cooking wine	55%	87%	74%	71%
Soy sauce	19%	4%	19%	16%
Vinegar	13%	3%	3%	10%
Others	14%	7%	4%	3%
% of Gross Profit	**2011**	**2012**	**2013***	**2014***
Cooking wine	61%	92%	73%	69%
Soy sauce	14%	2%	23%	19%
Vinegar	11%	3%	3%	10%
Others	13%	3%	2%	2%

Source: Company data

Value Proposition

Honworld provides healthy, high quality condiment products. It uses a naturally brewed, traditional production process for its cooking wine and other condiments. It is the only top four cooking wine producer using a naturally brewed production process. The company's goal is to be one of the largest Chinese condiment producers.

Given its focus on naturally brewed products manufactured with traditional production methods, it aims to serve the premium, high-end and medium-range end of the market. Honworld sells very little in the mass-market segment. The company is trying to build a premium brand image to maintain consistency the company primarily selling medium-range products and above.

The company sells its products at a premium to the market and its main competitors, yet, maintains a large market share lead illustrating the strength of the company's brand. Honworld's premium prices inform the customer of the quality of the product, as individuals perceive higher price products to be better quality. The naturally brewed production process informs the customer of the product's health attributes.

Cooking Wine

Source: Company data

Cooking wine accounts for 71% of sales and an estimated 69% of gross profit in 2014. Honworld's cooking wine is naturally brewed. Its three largest cooking wine competitors use alcohol as a base, also known as chemically produced, in their cooking wine. Naturally brewed cooking wine is healthier, due to higher level of nutrients. With the increasing health consciousness in China, the company's growth is outpacing the market. Honworld's naturally brewed production is one of the reasons it is the largest cooking wine producers in China with a 13.8% value market share and a 5.8% volume market share in 2012.

Top 5 Cooking Wine Producers in China	2012 Retail Sales Value Market Share	2012 Retail Sales Volume Market Share	Production Method
Honworld Group	13.8%	5.8%	Naturally Brewed
Beijing Wang Zhi He Food Group Co., Ltd	6.4%	3.6%	Chemically Produced
Beijing Lao Cai Chen Food Co., Ltd	4.3%	2.4%	Chemically Produced
Hengshun Vinegar Industry Co., Ltd	2.3%	1.4%	Chemically Produced
Chengdu Julong Food Co., Ltd	1.3%	0.8%	Naturally Brewed
Total Top 5 Producers	**28.1%**	**14.0%**	

Source: Euromonitor, Company data

Honworld's naturally brewed cooking wine allows it to position itself as a premium producer and receive a higher ASP for its products. As illustrated by the value market share to volume market share ratio, in 2012, Honworld was able to receive a 39% higher ASP relative to the top five players in the market and a 16.6 percentage point gross margin advantage over its peers. The average ASP in 2013 across all cooking wine producers was estimated at RMB4.67 per liter while Honworld's ASP was an estimated RMB8.02 per liter.

Honworld produces four categories of cooking wine premium, high-end, medium-range and mass-market. Each category is classified by the amount of base wine used, the amount of vintage age base wine, the age of the vintage age base wine, and the amount of alcohol by volume.

Category	Products	% Base wine in 1 liter (2013)	% Vintage base wine in 1 liter (2013)	% Mixer base wine in 1 liter (2013)	Alcohol by Volume (ABV)	Average Age of Vintage Wine (years)
Premium	Well-aged Cooking Wine Chef's Huadiao	93.0%	6.0%	87.0%	15%	10
High-end	15% ABV Cooking Wine Steamed Fish Cooking Wine	87.0%	6.0%	81.0%	15%	8
Medium-range	Spiced Cooking Wine Scallion & Ginger Cooking Wine Lao Heng He Cooking Wine	85.0%	4.0%	81.0%	10%	5-6
Mass-market		68.0%	4.0%	64.0%	10%	5-6
Total		**86.5%**	**4.9%**	**81.6%**	**12%**	**7.0**

Source: Company data

The suggested retail prices, average selling prices, 2014 revenues, 2013 estimated gross margins, and packaging material used for each product category are illustrated below.

Category	Suggested Retail Price (RMB @ IPO)	ASP (RMB per liter @ IPO)	% 2014 Revenue	Est 2013 Gross Margin	Packaging	% of 2014 Cooking Wine Revenue
Premium	19.8-38.0	16.7	14.8%	75.0%	Bottle	20.9%
High-end	16.8-19.8	11.0	16.6%	65.0%	Bottle	23.4%
Medium-range	7.9-16.0	6.2	36.8%	46.0%	Bottle	52.0%
Mass-market	2.5-6.0	4.3	2.7%	60.5%	Pouch & Bottle	3.8%
Total						

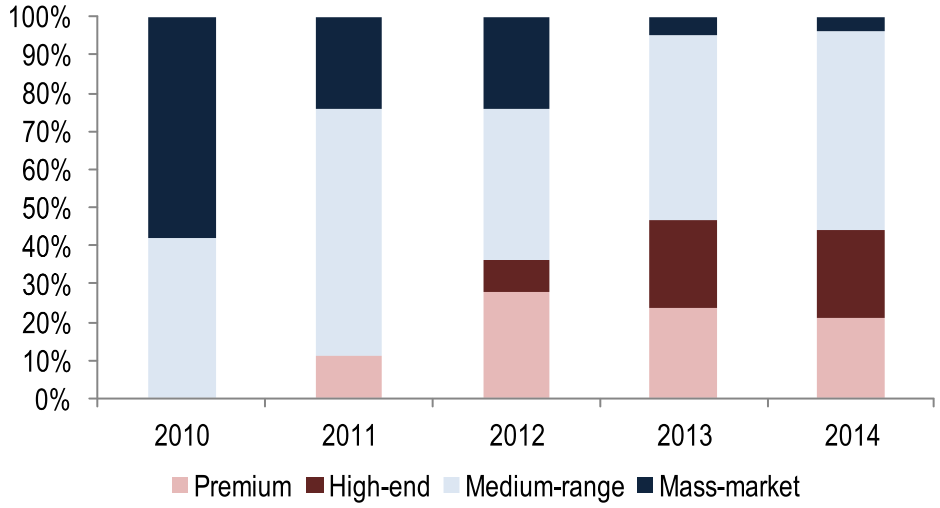
Source: Company data

In 2014, premium cooking wine accounted for 14.8% of total sales, 20.9% of cooking wine sales, and an estimated 18.8% of total gross profit. High-end cooking wine accounted for 16.6% of total sales, 23.4% of cooking wine sales, and an estimated 18.6% of total gross profit. Medium-range cooking wine accounted for 36.8% of total sales, 52.0% of cooking wine sales, and an estimated 28.6% of total gross profit. Mass-market cooking wine accounted for 2.7% of total sales, 3.8% of total sales, and an estimated 3.8% of total gross profit. The overall cooking wine segment grew by 136.5% per year from 2010 to 2014, with all cooking wine segments recording strong growth.

Revenue Breakdown (RMB mn)	2010	2011	2012	2013	2014	CAGR
Cooking Wine	**15.1**	**60.2**	**292.3**	**393.4**	**472.9**	**136.5%**
Premium	-	6.6	81.5	92.6	98.7	146.4%
High-end	-	-	24.8	90.4	110.7	111.4%
Medium-range	6.3	39.0	115.4	191.2	245.7	149.5%
Mass-market	8.8	14.6	70.6	19.2	17.8	19.3%
Soy sauce	9.7	20.5	12.8	101.9	106.4	81.8%
Vinegar	3.8	13.9	9.3	14.2	68.6	106.6%
Others	3.9	14.9	22.8	20.9	20.5	51.3%
Total Revenues	**32.5**	**109.5**	**337.1**	**530.4**	**668.4**	**112.9%**

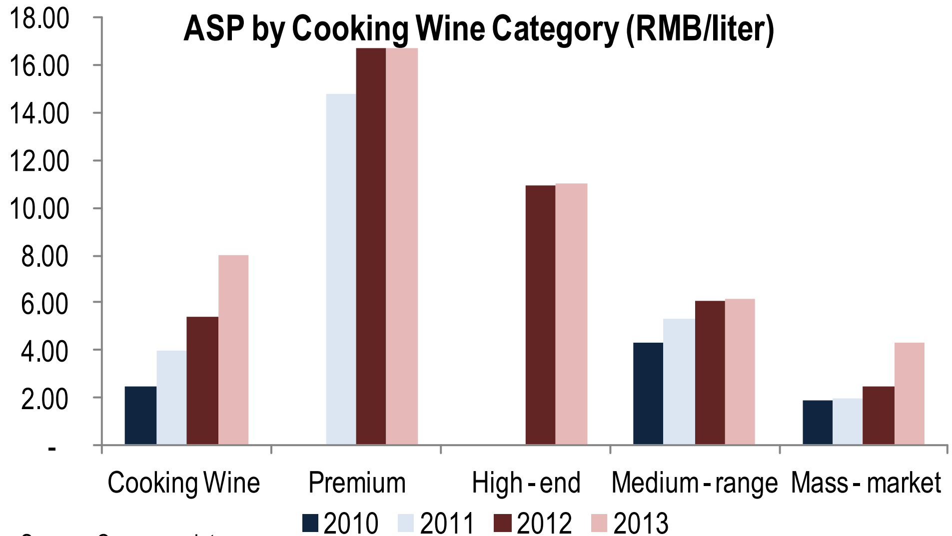
Source: Company data

As shown above, in 2010 Honworld primarily produced mass-market and medium-range cooking wine. In December 2011, the company started producing naturally brewed cooking wine. The shift to naturally brewed products allowed the company to differentiate its products and position them as a higher quality, healthier option increasing the customer's willingness to pay. As illustrated below, post-2011, there was a big shift from mass-market products to higher-end and premium products.



Source: Company data

The shift to higher quality cooking wine and increased ASP within each category has lead to an increase in the cooking wine blended ASP.



Source: Company data

Overall, Honworld's blended cooking wine ASP has increased from RMB2.48 per liter in 2010 to RMB8.02 per liter at the time of the IPO prospectus. The growth in ASP is a combination of both product mix and rising ASPs within each category, with the change in product mix accounting for the majority of the growth as mass-market went from 58% of sales in 2010 to 4% of sales in 2014.

ASP Change	2011	2012	2013
Cooking Wine	**60.6%**	**35.1%**	**49.0%**
Premium		12.8%	0.0%
High - end			0.9%
Medium - range	23.3%	15.1%	1.6%
Mass - market	5.3%	25.0%	72.0%

Source: Company data,* denotes estimates

Above the mass-market segment, annual cooking wine ASP changes saw barely any increase. The company mentioned it was able to raise prices by 25% on some medium-range products in the second half of 2014.

From 2010 to 2014, mass-market cooking wine volume declined slightly, while medium-range volume accounted for 71% of total volume growth, high-end accounted for 19% of total volume growth, and premium volume accounted for 11% of total volume growth.

Volume (mn liter)	2010	2011	2012	2013*	2014*	CAGR
Cooking Wine	6.10	15.10	54.31	49.07	59.74	76.9%
Premium		0.45	4.88	5.54	5.91	136.7%
High - end			2.27	8.22	10.06	110.4%
Medium - range	1.47	7.35	18.92	30.83	39.64	127.7%
Mass - market	4.62	7.30	28.24	4.47	4.13	-2.8%

Source: Company data,* denotes estimates

The table below shows gross margin each cooking wine category. 2013 and 2014 gross margins are estimated, as the company have not reported gross margin post-IPO prospectus.

Gross Margin	2010	2011	2012	2013*	2014*	Ave GM Δ
Cooking Wine	**41.3%**	**46.8%**	**60.8%**	**57.9%**	**56.2%**	**3.7%**
Premium		84.6%	75.6%	75.0%	73.8%	-3.6%
High - end			68.9%	65.0%	64.8%	-2.0%
Medium - range	23.5%	39.3%	51.9%	46.0%	45.0%	5.4%
Mass - market	54.0%	50.0%	55.5%	60.5%	60.5%	1.6%

Source: Company data,* denotes estimates

Gross margin for the premium and high-end segment are extremely high as it takes significant amount of patience, discipline, and capital, due to inventory requirements, to create a premium and high-end products leading to lower competition in these segments. Medium-range products face more competition. Prices are RMB1.90 per liter above mass-market but the cost of production is RMB1.85 per liter is higher due to the requirements to differentiate from mass-market products. In 2013, medium-range products had 21% more base wine per liter than mass-market products and required bottle packaging vs. pouches for mass-market. These two characteristics drove the cost of goods sold per liter up from RMB1.70 on mass-market products to RMB3.35 on medium-range products.

ASP (RMB per liter)	2010	2011	2012	2013*	2014*	CAGR
Cooking Wine	**2.48**	**3.98**	**5.38**	**8.02**	**8.02**	**34.1%**
Premium		14.80	16.70	16.70	16.70	4.1%
High - end			10.90	11.00	11.00	0.5%
Medium - range	4.30	5.30	6.10	6.20	6.20	9.6%
Mass - market	1.90	2.00	2.50	4.30	4.30	22.7%
COGS (RMB per liter)	**2010**	**2011**	**2012**	**2013***	**2014***	**CAGR**
Cooking Wine	**1.46**	**2.12**	**2.11**	**3.38**	**3.46**	**24.2%**
Premium		2.28	4.08	4.18	4.38	24.3%
High-end			3.39	3.85	3.87	6.8%
Medium	3.29	3.22	2.93	3.35	3.41	0.9%
Mass market	0.87	1.00	1.11	1.70	1.70	18.1%
Gross Profit (RMB per liter)	**2010**	**2011**	**2012**	**2013***	**2014***	**CAGR**
Cooking Wine	**1.02**	**1.87**	**3.27**	**4.64**	**4.45**	**44.4%**
Premium		12.52	12.62	12.53	12.32	-0.5%
High - end			7.51	7.15	7.13	-2.5%
Medium - range	1.01	2.08	3.17	2.85	2.79	28.9%
Mass - market	1.03	1.00	1.39	2.60	2.60	26.2%

Source: Company data,* denotes estimates

In 2014, estimated gross profit per liter was RMB12.32 per liter for the premium segment, RMB7.13 per liter for the high-end segment, RMB2.79 per liter for the medium-range segment, and RMB2.60 per liter for the mass-market segment. While premium and high-end gross profit per liter remained relatively stable, medium-range and mass-market gross profit have respectively grown 28.9% and 26.2% per year from 2010 to 2014.

Soy Sauce

Honworld's soy sauce products mainly consist of Fish Soy Sauce and Premium Flavored Soy Sauce. Fish Soy Sauce is produced using fish and soy beans in the fermentation process, a production technique that is patented by Honworld in China. Fish Soy Sauce is primarily used as a dipping sauce. At the time of the IPO, it came in 200 ml bottles with a suggested retail price of RMB28.0. Premium Flavored Soy Sauce products come in 150 ml to 1.28 liter bottles with suggested retail prices ranging from RMB4.9 to RMB26.8, can be used both as a dipping sauce and as flavoring agent in cooking and food preparation. The company is also increasingly focused on the production of higher end soy sauce leading to higher ASPs.

Soy Sauce	2010	2011	2012	2013*	2014*	CAGR
Sales (RMB mn)	9.74	20.54	12.78	101.90	106.35	81.8%
Gross profit (RMB mn)	0.88	6.64	4.73	70.82	73.92	202.4%
% of sales	29.9%	18.8%	3.8%	19.2%	15.9%	
% of gross profit	9.2%	14.4%	2.5%	22.6%	19.1%	
ASP (RMB per liter)	3.30	3.50	4.30	10.50	10.50	33.6%
COGS (RMB per liter)	3.00	2.37	2.71	3.20	3.20	1.6%
Gross profit (RMB per liter)	0.30	1.13	1.59	7.30	7.30	122.1%
Gross margin	9.1%	32.3%	37.0%	69.5%	69.5%	15.1%

Source: Company data,* denotes estimates

In 2014, soy sauce accounted for 16% of revenues and 19% of gross profit. ASP has steadily increased in 2011 and 2012 then saw a dramatic increase in 2013. The dramatic increase in revenues, ASP, and profitability was due to a new distribution agreement with a leading soy sauce distributor. The company is able to generate very strong profitability in the soy sauce business.

In January 2015, the company launched two new soy sauce products, Stewed Mushroom Dark Soy Sauce and Zero-additive Premium Flavored Soy Sauce. Both are healthy products using traditional brewing methods consistent with the premium, natural, healthy brand Honworld is trying to project.

The company is a much smaller player in the soy sauce and may struggle against larger players due to similar competitive advantages the company is trying to build in the cooking wine market. Despite the potential competitive struggles, it makes sense for the company to create healthy products using traditional brewing methods consistent with its brand image that the company can push through existing distribution channels with very little additional investment required.

Vinegar

Honworld's vinegar is rice vinegar. The company's key vinegar products are Rose Rice Vinegar, Premium Zhejiang Vinegar, and Crab Vinegar. All of Honworld's vinegar is naturally brewed and can be used either as a flavor agent or a dipping sauce. At the time of the IPO, vinegar products came in 200 ml to 750 ml bottles or 400 ml bags, with suggested retail prices ranging from RMB4.3 to RMB38.0.

Vinegar	2010	2011	2012	2013*	2014*	CAGR
Sales (RMB mn)	3.77	13.87	9.29	14.24	68.63	106.6%
Gross profit (RMB mn)	1.23	5.24	5.15	8.36	40.29	139.4%
% of sales	11.6%	12.7%	2.8%	2.7%	10.3%	
% of gross profit	12.7%	11.3%	2.7%	2.7%	10.4%	
ASP (RMB per liter)	2.70	4.10	3.60	5.20	5.20	17.8%
COGS (RMB per liter)	1.82	2.55	1.60	2.15	2.15	4.2%
Gross profit (RMB per liter)	0.88	1.55	2.00	3.05	3.05	36.5%
Gross margin	32.5%	37.8%	55.5%	58.7%	58.7%	6.5%

Source: Company data,* denotes estimates

Vinegar has been a very strong product category for Honworld. It has consistently grown at a rapid pace and the company's Premium Zhejiang Vinegar is well known in China. The naturally brewed production process fits well with the company's brand and positioning. The company has consistently increased ASPs, volumes, and gross margins in the vinegar business.

Like soy sauce, the company is a smaller player but the company's products are consistent with the overall brand image and with an expanding distribution network, there is very little cost of pushing additional products through the distribution channels. The product seems to be catching on with consumers as illustrated by the 382% growth in 2014.

Others

Other products include Zhong Wei branded paste and pickled vegetables procured from Zhong Wei, such as Gold Chili Paste. The company also produces Lao Heng He branded bean curd products, such as Rose Fermented Bean Curd, which was granted the gold award at the 1929 Westlake Exposition. Other products sales have not grown since 2012. Honworld's focus is on higher margin, faster growing products. Other products only accounted for 3.1% of sales and an estimated 1.6% of gross profit in 2014. Other products also have much weaker gross margin as these products are a combination of own brand and Zhong Wei branded products.

Others	2010	2011	2012	2013*	2014*	CAGR
Sales (RMB mn)	3.91	14.94	22.78	20.91	20.52	51.3%
Gross profit (RMB mn)	1.28	6.19	5.26	6.25	6.14	48.0%
% of sales	12.0%	13.6%	6.8%	3.9%	3.1%	
% of gross profit	13.3%	13.4%	2.7%	2.0%	1.6%	
Gross margin	32.7%	41.4%	23.1%	29.9%	29.9%	-0.7%

Source: Company data,* denotes estimates

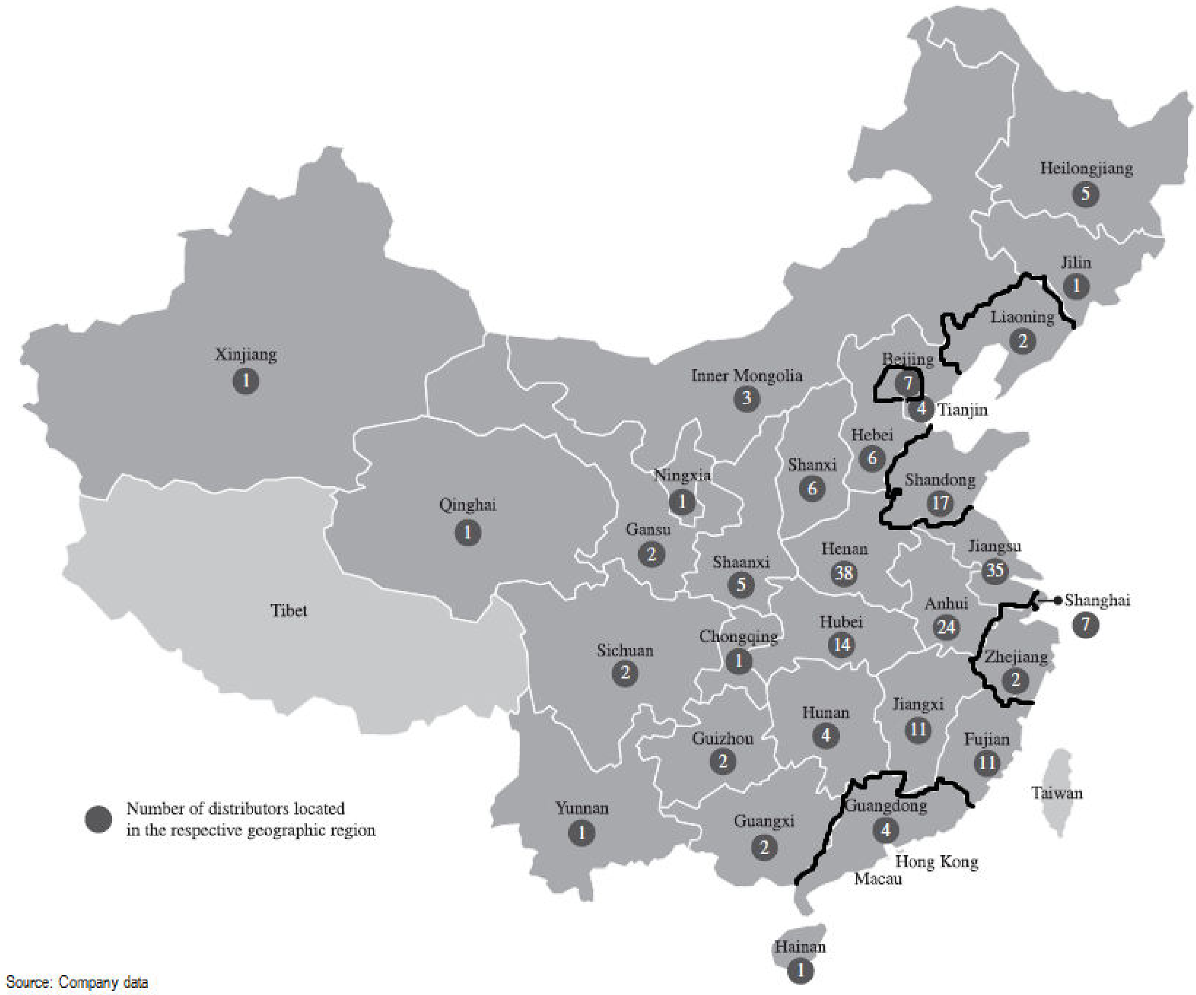
Distribution

Currently, Honworld's sales are primarily in the regional markets of Zhejiang Province, Shanghai, Guangdong Province, Liaoning Province, Shandong Province, and Beijing. Sales to these regions accounted for 73%, 62%, 85%, and 88% of sales in 2010, 2011, 2012, and in the eight months ending August 2013, respectively.

Sales by Region (RMB mn)	2012	8 mths Aug 2013	8 mths Aug 2013 % of Total	Population (mn)	GDP per capita (RMB)	GDP (RMB mn)
Zhejiang Province	98	79	24%	55	73,152	4,015,313
Shanghai	17	55	17%	24	97,555	2,366,372
Guangdong Province	52	47	15%	106	63,452	6,753,831
Liaoning Province	45	39	12%	44	65,210	2,862,719
Shandong Province	41	34	11%	97	61,055	5,942,721
Beijing	31	40	12%	22	99,214	2,134,688
Rest of China	52	29	9%	1,009	43,516	43,910,015
Total sales	**337**	**323**				
China				1,357	50,086	67,985,660
Honworld's key regions				348	74,243	24,075,645
Honworld's sales % China				**26%**		**35%**

Source: Company data, National Bureau of Statistics, Provincial Statistics Bureaus

Honworld's key regions account for 26% of China's population and 35% of its GDP meaning there is a large runway for growth if the company is able to move from a regional player to a national player.



Source: Company data

The graphic above shows Honworld's distribution network at the time of its IPO with its key regions outlined.

Since the IPO, Honworld has added a number of new distribution partners in new and existing markets. Since December 2014, the company has announced distribution agreements via the Hong Kong Stock Exchange.

On December 14, 2014, Honworld announced Lao Heng He brand Cooking wine would be sold in Hong Kong's major supermarkets, including but not limited to Wellcome and PARKnSHOP, by January 2015 at the earliest. On February 11, 2015, the company announced 750ml Chef's Huadiao and 500ml Chinese Cooking Wine (were available in 138 Wellcome stores and 5 Megasuper Market stores and will be available in 200 PARKnSHOP stores and 89 China Resources Vanguard stores within the next two to three months. This is the company's first entrance into the Hong Kong market.

On January 12, 2015, the company announced its premium, high-end, and medium-range cooking wine products were for sale on the Heike Flagship Store, and the company's other range of products will be launched for sale shortly after. Shenzhen Shunfeng Heike is the online shopping service community store under that services the O2O (online to offline) market. This is a new market.

On January 20, 2015, Honworld announced it expanded its direct sales efforts in the Eastern China market by signing a cooperation agreement with Zhejiang Zhongyi Trading Company Limited (Zhongyi). Zhongyi owns 45 supermarkets in Zhejiang Province and has access to other distribution channels, including 120 highway service stations in Eastern China. 11 of Honworld's products, including cooking wines, vinegar, soy sauce and other products will be sold through these channels. This is Honworld's strongest market and illustrates there is still growth potential within its strongest markets.

On January 26, 2015, Honworld launched a flagship store on JD.com. All of the company's products will be available on this e-commerce platform. This is a new market.

On February 24, 2015, the company announced a distribution agreement with Taiyuan Honghan Food Co. Ltd, one of the major cooking oil distributors in Taiyuan. A number of Honworld's cooking wines are available for sale in hypermarkets and wholesale markets in the Taiyuan region. Taiyuan is the capital and largest city of North China's Shanxi province. This is one of Honworld's least penetrated regions.

On March 12, 2015, the company announced a distribution agreement in the Guangzhou region with Guangzhou Guangshenglin, a major cooking oil distributor in the region. Honworld's products will be available in 396 supermarkets in the region. Guangzhou is the capital and largest city of Guangdong province. This is one of Honworld's strongest regions. The agreement illustrates even in its strongest regions, it still can increase its presence.

On March 31, 2015, Honworld announced distribution agreements with Yanchen Funing Dinghao Trading Co Ltd and Yancheng Binhai Dontuo Food Trading Company for the Jiangsu region. Both are well known condiment distributors and Honworld's products will be available in community stores, agricultural trade markets, and wholesale markets in the Jiangsu region. At the time of the IPO, Jiangsu Province has the second most distributors at 35.

On April 9, 2015, the company announced it opened a flagship store on Yihaodian, a Chinese online grocery business, with 20 of the company's products available. This is a new market.

On April 21, 2015, the company entered into a distribution agreement with Anhui Linquan Jiawangshangmao Co., Ltd. The company's products will be in supermarket, community stores, agricultural trade markets, and wholesale markets in Linquan County areas distributed by Jiawangshangmao. Jiawangshangmao is the county-level chief distributor of famous cooking oil and pickle brand in Linquan County with extensive distribution channels in the county. Linquan County is a county of Anhui Province, China. With 24 distributors at the time of the IPO, Anhui Province is one of the most penetrated provinces.

On April 24, 2015, Honworld entered into cooperation agreements with Jiangsu Jianhu Xiangtianjie Trading Co., Ltd. and Jintan City Chengxi Binhui Seasoning Operation Department. Xiangtianjie Trading and Chengxi Binhui are a county-level master distributor and a distributor of condiment brands in their county, respectively. The company's products will be sold through the sales channels of Xiangtianjie Trading and Chengxi Binhui and are now widely available in local community stores, small-scale supermarkets, agricultural trade markets, and wholesale markets. . At the time of the IPO, Jiangsu Province has the second most distributors at 35

In 2013 and 2014, Honworld spent an average of 7.3% of sales on distribution expense. Due to its scale advantage, the company should continue to spend heavily on distribution expenses.

Research and Development

In 2013 and 2014, the company spent a combined RMB91.5 million or 7.6% of sales on research and development. Honworld's research and development effort goes to improving the production process, improving existing products, and creating new products. Given the company's market share lead in cooking wine, additional fixed cost creates a competitive advantage over peers.

In the first half of 2014, Honworld introduced two new products including lees cooking wine and Shrimp Paste Soy Sauce.

In February 2015, the company announced new soy sauce products, Stewed Mushroom Dark Soy Sauce and Zero-additive Premium Flavored Soy Sauce. These products use traditional brewing methods while still being product innovations. Stewed Mushroom Dark

Soy Sauce does not use caramel additives and Zero-additive Premium Flavored Soy Sauce also has no additives. Naturally brewed products using traditionally production methods, or healthy products all position the company as a high quality, premium producer reinforcing its existing brand.

Operating Margin

% of Sales	2010	2011	2012	2013	2014	2011-2014 Avg
Gross margin	36.9%	42.2%	57.2%	59.0%	57.8%	50.6%
Distribution expense	3.7%	14.9%	7.1%	4.8%	6.0%	7.3%
Administrative expense	2.7%	0.9%	6.8%	14.0%	12.2%	7.3%
Operating margin	30.5%	26.5%	43.3%	40.2%	39.6%	36.0%
Taxes	25.4%	27.0%	27.3%	15.9%	14.1%	21.9%
NOPAT	22.8%	19.3%	31.5%	33.8%	34.0%	28.3%
Working capital investment	31.2%	-17.1%	-25.3%	-40.1%	-99.1%	-30.1%
Fixed capital investment	-14.5%	-29.5%	-6.0%	-11.1%	-50.1%	-22.2%

Source: Company data, Reperio Capital Research estimates

Honworld's gross margin increased from 36.9% to 57.8% from 2010 to 2014. An improving product mix and decreased reliance on Zhong Wei's distribution lead to the increase in gross margin. Honworld's reliance on Zhong Wei's distribution is now insignificant so margin expansion due to higher margin distribution will be not drive margin expansion in the future. Gross margin improvements will have to come from continued product mix improvement and pricing power.

As the Chinese consumer grows richer, the company's product mix should continue improve as sales shift from medium-range products (GM~45%) to high-end (GM~65%) and premium products (GM~75%). As mentioned under the industry section, pricing power will come from the low price of the product and the brand the company is creating by spending more on fixed costs (distribution expense and R&D) given the company's market share advantage over its cooking wine competitors. In 2012, Honworld had 2.16 times the market share of its largest competitor, 3.21 times the market share of its second competitor, 6.00 times the market share of its third largest competitor, and 10.62 times the market share of its fourth largest competitor. When looking at gross profit advantage, Honworld's premium price amplifies the scale advantage. In 2012, Honworld's gross profit was 2.86 times its largest competitor, 4.21 times its second largest competitor, 8.89 times its third largest competitor, and 16.00 times its fourth largest competitor.

Distribution expenses have increased as Honworld aggressively builds its distribution network and advertises. It is a fixed cost that will eventually decrease as a percentage of sales, but over the next five to ten years as the distribution network shifts from regional to national it will remain elevated. The company should spend as much as possible to increase its distribution network as the presence of fixed costs lead to economies of scale. The presence of economies of scale means market share and gross profit market share are the key factors in profitability within the industry.

Research and development expenses are the majority of administrative expenses averaging 57% of administrative expenses over the past three years. The other administrative expenses are not disclosed but the company has done a good job of keeping the number of management and administrative employees to a minimum at 11 and the expense of the five highest paid employees has not increased dramatically.

Employees	2010	2011	2012	2013	2014
Employees	79	97	241	202	329
Production				145	254
Management and administration				11	11
Sales and marketing				17	19
Quality Control, R&D, and others				29	45
Personnel expense (RMB mn)	1	3	10	11	16
Personnel expense per employee (RMB)	10,354	32,144	41,747	53,842	47,745
Personnel expense % Operating Income	7.4%	10.8%	6.9%	5.1%	5.9%
Five highest paid employees (RMB mn)	0.13	0.15	0.39	0.32	1.16
Five highest paid employees % Operating Income	1.19%	0.52%	0.26%	0.15%	0.44%

Source: Company data

The company is also building inventory and production facilities for future growth so there may be a case that the additional administrative expenses are infrastructure for future growth. At the time of the company's IPO, Honworld only utilized 41.3% of bottling capacity in the first eight months of 2013 and 59.9% in 2012.

To get an idea of the potential for distribution expenses and administrative expenses, other Chinese condiment companies are listed below.

Peer Group	Honworld	Foshan Haitian Flavouring and Food	Zhejiang Guyuelongshan Shaoxing Wine	Chongqing Fuling Zhacai Group	Jiangsu Hengshun Vinegar	Jiajia Foodstuff	Changshouhua Food	Fufeng
Gross margin	54.1%	38.2%	37.7%	40.2%	36.0%	26.8%	19.7%	17.6%
Distribution % sales	-8.2%	-12.8%	-23.3%	-23.0%	-34.1%	-15.2%	-8.5%	-5.7%
Administrative % sales	-8.5%						-2.3%	-4.3%
Operating margin	37.4%	25.4%	14.4%	17.2%	1.9%	11.6%	8.9%	7.7%
Effective tax rate	21.1%	18.1%	22.6%	15.1%	28.5%	25.7%	20.1%	17.0%
NOPAT	30.1%	20.8%	11.1%	14.6%	1.3%	8.6%	7.0%	6.3%
Cash flow from operations margin	37.1%	16.7%	-18.1%	18.4%	-0.5%	6.8%	6.3%	7.7%
Working capital investment	-83.5%	-8.5%	-22.8%	0.0%	-17.7%	-2.9%	-3.0%	-0.6%
Fixed capital investment	-45.6%	-9.2%	-13.8%	-12.9%	-10.5%	-14.3%	-5.5%	-19.0%
Free cash flow margin	-92.0%	16.0%	-9.1%	5.5%	6.7%	-4.5%	-2.2%	-11.9%
IC turnover	0.8	4.8	0.6	1.6	0.7	2.4	2.3	1.4
ROIC	23.9%	100.4%	6.2%	22.9%	0.9%	21.0%	16.0%	8.9%
Sales growth	82.8%	17.2%	2.4%	8.7%	5.9%	0.0%	10.5%	10.4%
Operating profit growth	109.1%	27.0%	10.6%	12.2%	- to +	-2.0%	15.0%	12.9%
EV/EBIT	11.9	32.9	36.2	36.9	29.2	36.7	6.3	13.3
EV/IC	1.9	33.3	2.7	7.9	4.7	3.8	1.5	1.6

Source: Company data

Over the past four years, the average gross margin of Chinese condiment producers is 30.9% compared to Honworld's 54.1%. Honworld's higher gross margin is evidence that its message of naturally brewed products using traditional production processes are getting through to customers and their products are increasing the customers willingness to pay. This premium pricing is further illustrated by the company's higher ASP than top five cooking wine peers with significant market share lead.

For Chinese condiment producers listed in China, we were unable to get a breakdown of SG&A between distribution expenses and administrative expenses. Overall, from 2011 to 2014 Chinese condiment producers average SG&A was 18.5% of sales compared to Honworld's 16.7% of sales. For those condiment producers listed in Hong Kong, the average distribution expense was 7.5% of sales so Honworld's distribution expenses at 8.2% of sales was roughly the same. The average administrative expense of Hong Kong listed Chinese condiment producers was 3.3% while Honworld's was 8.5%. In 2013 and 2014, Honworld's average administrative expense was 13.0% of sales. The differential in administrative expense is Honworld's research and development expense, which averaged 7.6% of sales in 2013 and 2014. Given the company's market share advantage in the cooking wine segment, creating additional fixed costs required to compete increases the minimum efficient scale within the industry consolidating the market. Other than research and development, Honworld seems to be building its infrastructure for future growth in the form of production, storage, and bottling capacity.

Management and administrative employees are kept low at 11 and personnel expenses are not ballooning so the additional administrative expenses do not seem to be due to inefficiencies.

Peer Group	Honworld	Want Want	Tingyi	Uni-President China	China Foods	Tenfu	Huiyuan Juice
Gross margin	54.1%	39.0%	29.3%	32.4%	22.2%	62.3%	30.2%
Distribution % sales	-8.2%	-11.9%	-19.8%	-27.7%	-18.6%	-28.7%	-26.8%
Administrative % sales	-8.5%	-8.3%	-2.9%	-3.6%	-3.1%	-11.4%	-9.0%
Operating margin	37.4%	18.8%	6.6%	1.1%	0.5%	22.1%	0.7%
Effective tax rate	21.1%	25.0%	28.5%	22.7%	35.5%	28.0%	9.7%
NOPAT	30.1%	14.0%	4.7%	0.8%	0.2%	15.9%	0.5%
Cash flow from operations margin	37.1%	12.6%	10.8%	10.9%	0.7%	11.0%	10.0%
Working capital investment	-83.5%	-5.1%	1.8%	3.0%	-0.5%	-8.7%	3.1%
Fixed capital investment	-45.6%	-7.8%	-10.8%	-18.5%	-2.7%	-12.6%	-12.4%
Free cash flow margin	-92.0%	-0.3%	1.8%	-4.6%	-2.5%	-10.4%	0.7%
IC turnover	0.8	3.0	2.4	2.1	3.2	1.4	0.4
ROIC	23.9%	41.9%	11.1%	1.8%	0.8%	22.1%	0.2%
Sales growth	82.8%	8.6%	9.2%	9.9%	-1.5%	-1.2%	6.3%
Operating profit growth	109.1%	14.2%	2.9%	12.5%	-31.0%	-5.4%	+ to -
EV/EBIT	11.9	18.2	19.0	107.4	55.5	8.8	-41.9
EV/IC	1.9	7.5	2.6	2.8	2.0	2.0	0.6

Source: Company data

Hong Kong listed Chinese food and beverage companies' distribution and administrative expenses are in the table above to get an idea of what companies with the largest distribution networks pay to maintain and grow their networks. There is a wide disparity in spending on distribution expense between different players with Want Want spending 11.9% of sales on the low end and Tenfu spending 28.7% with an average distribution expense at 22.2% of sales. On the administrative side, there is also a wide disparity with Tingyi on the low end at 2.9% of sales and Tenfu on the high end at 11.4% of sales with an average administrative expense at 6.4% of sales.

Given Honworld's market share advantage and the potential for fixed costs in the form of distribution expenses, including advertising, and research and development, spending as much as possible on these fixed costs in an efficient manner will improve the company, increase its reach, educate more customers, and consolidate the market by increasing the minimum efficient scale to compete. These economies of scale are magnified by potential customer captivity in the form of a brand as cooking wine is a low priced, experience good and consistency of brand will lower search costs for consumers and potentially lead to habit forming behavior creating customer captivity.

Taxes

On March 7, 2014 Honworld received approval of new and advanced technology enterprise status allowing the company to pay a 15% tax rate for three years ending 2015 including the retroactive tax rate for 2013. From 2016 onwards, the company's tax rate will revert to the 25% statutory tax rate.

Investment Requirements

Investment Requirements	2010	2011	2012	2013	2014
WC investment % sales	34.8%	-17.1%	-25.3%	-40.1%	-99.1%
FC investment % sales	-16.1%	-29.5%	-6.0%	-11.1%	-50.1%
Change in NOA % sales	NA	-45.5%	-64.3%	-26.0%	-144.5%

Source: Company data

The table above shows investment requirements as a percentage of total sales. Working capital is Honworld's largest investment requirement. Within working capital, inventory is the largest investment requirement.

Working Capital Investment	2010	2011	2012	2013	2014
Days sales outstanding	409.4	193.4	84.9	61.2	102.6
Raw materials days	103.3	12.3	6.9	4.9	7.6
WIP days	**121.2**	**190.9**	**110.3**	**214.0**	**427.4**
Finished goods days	15.2	10.1	6.9	5.8	18.5
Total inventories days	239.7	213.3	124.1	224.8	453.5
Other current asset days	345.2	237.1	138.1	44.4	91.3
Days payable outstanding	227.5	219.6	52.1	72.9	95.9
Other NIBCLs days	46.1	136.6	77.0	54.6	41.1
Cash conversion cycle	**720.7**	**287.6**	**218.0**	**202.9**	**510.4**

Source: Company data

It is a bit concerning that days sales outstanding, other current assets days (100% prepaid expenses), payables days, and other non-interest bearing current liabilities days increased in 2014, potentially pointing to inventory being pushed through the channel, increasing bad debt from distributors, or growth of assets tied to the company's inventory build.

Inventory	2010	2011	2012	2013	2014	2015
Value of raw materials inventory (RMB mn)	9	4	6	7	14	
Value of WIP inventory (RMB mn)	11	57	102	311	783	1,238
Value of finished goods inventory (RMB mn)	1	3	6	8	34	
Base wine inventory (mn liters)	12	21	29	55	158	225
Cost per liter of base wine (RMB)	1.8	3.0	3.9	5.9	5.2	5.5

Source: Company data

Honworld is building its inventory to support future growth, to create sufficient supply of base wine to create a buffer against raw material costs, and to allow for ageing of vintage base wine. The higher the concentration of vintage wine and the older the vintage wine, the higher the premium that can be charged so in this case the building of inventory either supports growth or leads to the ability to charge a premium due to more and older vintage base wine. In the near term, cash flow is hurt, but like with R&D and distribution expenses, short term pain leads to long-term gain. There is a risk that the company is just decreasing capital efficiency and compensation in the form of higher prices will not come to fruition and profitability will suffering.

In 2015, the company's target is to build its base wine inventory to 225 million liters. Over the past two years, the cost of each liter of base wine, as measured by base wine inventory divided by total inventory, has equaled roughly RMB5.5. At this rate, it will cost RMB366 million to build inventory to the 2015 target.

In addition, to go from 55 million liters of base wine to 158 million liters of base wine additional capex of RMB133 million was needed for production and storage facilities or an additional RMB1.29 million in capex was needed for each additional million liters of base wine inventory. Using the RMB1.29 million in capex, to increase the base wine inventory from the current 158 million liters to 225 million liters, an additional RMB86 million in capex for new production facilities will be needed bringing the total investment required for both inventory and production facilities to RMB452.2 million or RMB6.79 per liter.

Honworld's capital expenditures are growth oriented. From 2010 to 2014, the company spent on average 22.6% of sales or 62.4 times depreciation expense over the same period. The company should continue to spend a significant amount of sales on capex as the company moves from a regional condiment producer to a national condiment producer.

ROIC

Profitability	2010	2011	2012	2013	2014	2011- 2014 Avg
Return on assets	5.0%	6.9%	20.6%	23.9%	10.9%	13.5%
Return on tangible equity	40.6%	56.7%	74.2%	58.9%	16.9%	49.4%
Return on tangible invested capital	9.7%	17.4%	29.7%	35.9%	15.5%	21.7%
Return on net tangible operating assets	13.7%	22.2%	42.1%	43.9%	18.2%	28.0%
FCF return on tangible invested capital	-90.3%	-12.2%	-36.3%	7.4%	-50.4%	-36.4%
FCF return on net tangible operating assets	-89.7%	-22.0%	-31.9%	8.4%	-50.9%	-37.2%
Gross profit to total assets	10.6%	15.7%	40.3%	43.0%	20.0%	25.9%

Source: Company data, Reperio Capital Research estimates

Honworld has performed very well over the past few years with ROIC well above the company's cost of capital averaging 20.7% from 2010 to 2014. In 2014, there was a decline in ROIC due to the influx of capital from the IPO, investments in inventory, investment in productive assets that have not been fully utilized, investment in distribution network and investment in research and development. In the short to medium term, profitability will probably in the form of ROIC will remain depressed but longer term, Honworld profitability will be determined on the ability to capture value through economies of scale and customer captivity.

Since shifting to a naturally brewed production process, Honworld has been able to differentiate its products to command a premium price and grow its operations rapidly. The company has started to build a brand in its key regions where the vast majority of its sales come from. Over the longer term, there is potential for the company to build a national brand and customer captivity allowing it to take advantage of its size and the opportunity to outspend competitors.

Business Economics

The table below illustrates the business economics on a per liter of sales volume basis. The total volume is the sum of volume disclosed by the company or estimated (2013 & 2014) and includes all cooking wine volume, soy sauce volume, and vinegar volume. In 2013 & 2014, ASP and gross margin were estimated for each product. ASP remained flat from the last reported figure in the eight months ending August 2014.

Per Liter of Sales Volume	2010	2011	2012	2013*	2014*
Sales volume (mn liters)	**10.44**	**24.35**	**59.86**	**61.51**	**83.07**
ASP	**3.48**	**4.50**	**5.63**	**8.62**	**8.05**
COGS	2.19	2.60	2.41	3.53	3.39
Gross profit	**1.28**	**1.90**	**3.22**	**5.09**	**4.65**
Distritbution expense	0.13	0.67	0.40	0.42	0.49
Administrative expense	0.09	0.04	0.38	1.20	0.98
Operating profit	**1.06**	**1.19**	**2.44**	**3.47**	**3.19**
Tax rate	25.4%	27.0%	27.3%	15.9%	14.1%
NOPAT	**0.79**	**0.87**	**1.77**	**2.92**	**2.74**
Inventory	2.05	2.63	1.91	5.31	10.00
Other working capital	4.42	0.32	1.45	(0.52)	1.25
Fixed capital	1.70	2.03	2.60	3.32	6.38
Total invested capital	**8.17**	**4.98**	**5.96**	**8.11**	**17.63**
Return on investment	9.7%	17.4%	29.7%	35.9%	15.5%

Source: Company data, * denotes estimate

Total volume continues to grow quickly. ASP looks to have declined in 2014 due to the estimated volume growth of Vinegar, which is a lower ASP product (estimated RMB5.50 per liter). Vinegar's gains are more likely to be a combination of volume and ASP as volume would have grown by 382% to account for the growth in Vinegar revenues. The lower ASP of vinegar drives everything on the income statement lower on a per liter basis.

The balance sheet accounts continue to grow on a sales volume basis as the company builds inventory for future growth. Other working capital (with exception of accounts receivables) and fixed capital are a function of inventory build. The growth in invested capital per liter sold drives down capital efficiency and the return on invested capital of the business.

The table below illustrates inventory, other working capital, and fixed capital per liter of base wine inventory. On a per liter basis, balance sheet accounts are more appropriately analyzed on the base wine inventory volume rather than sales volume.

Per Liter of Base Wine Inventory	2010	2011	2012	2013	2014	CAGR
Base wine inventory (mn liters)	11.8	21.3	29.4	55.4	158.4	91.6%
Investment in inventory	1.82	3.01	3.90	5.90	5.24	30.3%
Net investment in other working capital	4.07	1.05	2.95	(0.57)	0.66	-36.6%
Fixed capital investment	1.51	2.33	5.28	3.68	3.35	22.0%
Total investment requirement	**7.40**	**6.38**	**12.13**	**9.01**	**9.25**	**5.7%**
COGS per liter sold/Cost of inventory per liter of base wine inv.	121%	88%	70%	77.2%*	80.1%*	
						Average
NOPAT per liter of volume sold	0.79	0.87	1.77	2.60	2.39	1.68
Total investment requirement per liter of volume sold	8.93	5.62	8.52	6.95	7.41	7.48
IC turnover	0.39	0.80	0.66	1.24	1.09	0.84
ROIC	**8.9%**	**15.5%**	**20.8%**	**37.4%**	**32.3%**	**23.0%**

Source: Company data, * denotes estimate

Over the past two years, the investment in inventory averaged RMB5.57 per liter of base wine in inventory. Net investment in other working capital is volatile and less significant averaging RMB1.02 per liter of base wine. Over the past four years, fixed capital investment has averaged RMB3.23 per liter of base wine.

COGS per liter sold to the cost of inventory per liter of base wine inventory has fluctuated over the past four years with an averaged 78.88%. A liter of base wine inventory produces greater than a liter of cooking wine as it is mixed with water. The percentage of base wine used in the production of a liter of cooking wine is one of the key determinants of the grade of cooking wine. For example in 2013, the company's premium products contained only 93% base wine per liter of cooking wine, high-end products contained 87% base wine, medium-range contained 85% base wine, and mass-market contained 68% base wine per liter of cooking wine. This allows us to connect the level of investment required to the income statement.

Given the growth of the company and the capital requirements to support the growth, it is best to eliminate capital expenditures on growth to identify the true profitability of the business. Using volume sold as a denominator in the per liter calculation gives an accurate representation of the income statement but not the balance sheet as investments are made to support base wine inventory, which is growing much faster than sales volume. To get an accurate representation of investment requirements, it is best to use base wine inventory volume as the denominator in the per liter calculation and then link the investments on a per liter of base wine to the income statement through the cost of goods sold to cost of inventory ratio. The tax rate is normalized to the statutory rate for 2013 and 2014. This methodology leads to a ROIC of 36.1% in 2013 and 32.3% in 2014 and a 2010 to 2014 average ROIC of 22.7%.

Another way of illustrating the same calculation is to assume one year of base wine inventory is sufficient to run the business in a steady state. Assets above this level are investments for growth and assets below this level assumes underinvestment on the part of the company. This method of determining profitability allows for scenario analysis, in case, capital efficiency continues to deteriorate.

Inventory levels are the key driver of the level of Honworld's assets as fixed capital in the form of production and storage facilities are determined by the level of base wine inventory. Non-interest bearing liabilities and pre-paid expenses are primarily to purchase raw materials or other assets related to base wine inventory. Accounts receivables are probably the only working capital item not directly tied to base wine inventory. Given the relationship of operating assets and liabilities to base wine inventory, it is the key driver of capital requirements. The tax level is also normalized to the statutory tax rate of 25% rather than the current temporary rate of 15%.

Two base wine inventory scenarios are used to determine the underlying profitability of the company. One scenario is close to the historical average of capital efficiency for the company and another scenario is near trough capital efficiency for the company.

Maintenance Capital Requirements- 1 year base wine	2010	2011	2012	2013	2014	Average
Maintenance investment in inventory	23	64	164	280	349	
Maintenance investment in other working capital	51	22	124	(27)	44	
Maintenance fixed capital investment	19	50	222	175	223	
Maintenance invested capital	**93**	**137**	**510**	**428**	**615**	
Growth investment in inventory	(2)	(0)	(49)	47	482	
Growth investment in other working capital	(5)	(15)	(37)	(5)	60	
Growth fixed capital investment	(1)	(0)	(67)	29	307	
Growth invested capital	**(8)**	**(15)**	**(153)**	**71**	**849**	
Total investment in inventory	21	64	115	327	830	
Total investment in other working capital	46	8	87	(32)	104	
Total fixed capital investment	18	50	155	204	530	
Total invested capital	**85**	**121**	**357**	**499**	**1,465**	
NOPAT margin	22.8%	19.3%	31.5%	30.2%	29.7%	30.4%
Maintenance IC turnover- 1 year base wine inventory	0.39	0.80	0.66	1.24	1.09	0.84
Return on maintenance capital- 1 year base wine inventory	**8.9%**	**15.5%**	**20.8%**	**37.4%**	**32.3%**	**25.4%**
Maintenance IC turnover- 2 year base wine inventory	0.19	0.40	0.33	0.62	0.54	0.42
Return on maintenance capital- 2 year base wine inventory	**4.4%**	**7.7%**	**10.4%**	**18.7%**	**16.1%**	**12.7%**

Source: Company data, Reperio Capital Research estimates

In 2011 and 2012, the company held too little inventory, other working capital, and fixed capital therefore growth investment was negative and maintenance capital requirements were above total invested capital leading to an artificially elevated ROIC.

In 2013, the company invested capital was close to the capital required for one year of base wine inventory but the tax rate was at the temporary 15% rate. After adjusting the tax rate to the statutory tax rate of 25%, the company's ROIC was 37.4%.

In 2014, assuming one year of base wine inventory, the company's true ROIC was 32.3%. Assuming two years of base wine inventory the true ROIC was 16.1%. Using the NOPAT margin of the last three years and five year turnover measures, the average ROIC for one year of base wine inventory is 25.4% and 12.7% for two years of base wine inventory.

If the company is efficient enough to maintain base wine inventory of one year while maintaining premium pricing, pricing power, and the heavy spend on fixed costs, it can generate a ROIC twice its cost of capital. If the company continues to build base wine inventory and is unable to turn the inventory build into a higher portion of high-end and premium products, which use higher levels of vintage base wine and garner higher prices and gross profits per liter, the company's profitability will revert to its cost of capital.

At two years of base wine inventory, the lower capital efficiency associated with the higher asset level requires operating margin to increase from the current 40% to 75% to compensate for the lower turnover levels, which will be very difficult to do given only the gross margins on premium products are anywhere near that level.

In the short to medium term, profitability will probably in the form of ROIC will remain depressed due to the inventory and related asset build to support future growth and high levels of fixed costs to build out the distribution network and create new products. Over the longer term, assuming the company does not over build inventory, Honworld should reap the rewards of current investments given the ability to capture value through economies of scale and customer captivity.

Growth Outlook

Given ROIC is consistently greater than the company's cost of capital and there is a potential competitive advantage, growth adds value and is worthy of review.

The cooking wine market is expected to grow at roughly 20% per year between 2012 and 2017. Honworld should outperform the market as its healthier, naturally brewed product using traditional production methods resonates with a more health conscious and increasingly wealthier consumer. The company can also outspend peers on distribution to reach consumers, advertising to educate consumers, and research and development to improving existing products and processes and to create new products.

Honworld's key markets only accounts for 26% of the total population of China and 36% of China's GDP so the company has a long run way for growth, if it is successful at transitioning from a regional player to a national player.

Sales by Region (RMB mn)	2012	8 mths Aug 2013	8 mths Aug 2013 % of Total	Population (mn)	GDP per capita (RMB)	GDP (RMB mn)
Zhejiang Province	98	79	24%	55	73,152	4,015,313
Shanghai	17	55	17%	24	97,555	2,366,372
Guangdong Province	52	47	15%	106	63,452	6,753,831
Liaoning Province	45	39	12%	44	65,210	2,862,719
Shandong Province	41	34	11%	97	61,055	5,942,721
Beijing	31	40	12%	22	99,214	2,134,688
Rest of China	52	29	9%	1,009	43,516	43,910,015
Total sales	**337**	**323**				
China				1,357	50,086	67,985,660
Honworld's key regions				348	74,243	24,075,645
Honworld's sales % China				**26%**		**35%**

Source: Company data, National Bureau of Statistics, Provincial Statistics Bureaus

Financing growth

Financing Requirements	2010	2011	2012	2013	2014	2011-2014 Avg
Sales	36	109	337	530	668	411
Incremental sales		73	228	193	138	158
Operating profit	**11**	**29**	**146**	**213**	**265**	**163**
Operating margin	*30.5%*	*26.5%*	*43.3%*	*40.2%*	*39.6%*	*37.4%*
Working capital investment	11	(19)	(85)	(213)	(662)	(245)
Fixed capital investment	(5)	(32)	(20)	(59)	(335)	(112)
External financing requirements	**17**	**(22)**	**40**	**(58)**	**(732)**	**(193)**
Working capital	69	86	201	295	935	379
Fixed capital	5	37	132	181	503	213
Invested capital	**75**	**124**	**333**	**476**	**1,437**	**592**
Working capital turnover	0.52	1.27	1.67	1.80	0.72	1.08
Fixed capital turnover	6.80	2.93	2.56	2.93	1.33	1.93
Invested capital turnover	0.49	0.89	1.01	1.12	0.47	0.69

Source: Company data, Reperio Capital Research estimates

The ability to use capital efficiently driven by capital turnover will Honworld's ability to finance growth internally. Working capital turnover decreased to 0.7 times in 2014 from 1.8 times in 2013, as the company increased its stock of base wine. Working capital turnover may continue to decline until the company is able to sell more premium and high-end products, which require aged vintage base wine. In 2015, the company plans to increase its base wine stock to 225 million liters from 158 million liters in 2014. For inventory turnover to remain the same revenues would have to grow by 42%.

Given the expected inventory build, capital efficiency ratios should decline. With the assumptions below post-2015, the company can grow at roughly 15% without needing external financing.

- Working capital turnover declines to 0.5
- Fixed capital declines to 1.0, historically half as much fixed capital is required to support working capital.
- Overall invested capital turnover declines to 0.33
- Turnover ratios level after 2015
- Operating margin remains flat at 40%

- ROIC declines to 10%

Assuming no change in turnover ratios from 2014 and operating margin remains flat, Honworld can grow at roughly 20% without any external financing.

Unique Activities

Only unique activities that competitors cannot replicate can create sustained excess profitability. If competitors can replicate an activity, excess profitability will lead to replication eliminating excess profits. What does Honworld do that is unique? First, the company is the only competitor within the top four cooking wine producers naturally brewing its product. Honworld was able to switch near the end of the 2011 and growth as taken off so this can easily be replicated. Honworld was able to be the first, which resonates with customers from a positioning stand point but positioning is not a competitive advantage.

The taste of the product is not easily replicated and could potentially lead to customer captivity. Distinct tastes in foods are often difficult to replicate leading to habit when purchasing particularly on low costs, experience goods where a strong, consistent brand lowers search costs.

The amount the company can spend on fixed costs such as distribution expense and research and development is very difficult to replicate. Honworld's sales are 2.16 times larger than its closest competitor, 3.21 time larger than its second largest competitor, 6.00 times larger its third largest competitor, and 10.62 time larger than its fourth largest competitor and closest naturally brewed competitor.

Top 5 Cooking Wine Producers in China	2012 Retail Sales Value Market Share	2012 Retail Sales Volume Market Share	Production Method
Honworld Group	13.8%	5.8%	Naturally Brewed
Beijing Wang Zhi He Food Group Co., Ltd	6.4%	3.6%	Chemically Produced
Beijing Lao Cai Chen Food Co., Ltd	4.3%	2.4%	Chemically Produced
Hengshun Vinegar Industry Co., Ltd	2.3%	1.4%	Chemically Produced
Chengdu Julong Food Co., Ltd	1.3%	0.8%	Naturally Brewed
Total Top 5 Producers	**28.1%**	**14.0%**	

Source: Euromonitor, Company data

The size affect of higher sales is amplified by the company's premium pricing and higher gross margins than peers. The company is able to spend that much more on distribution, advertising, and research and development than its closest competitors. This is important particularly in a growing market as the Honworld can reach that many more customers than its peers through its distribution network and advertising allowing it to acquire a disproportionate amount of new customer. Capturing new customers is particularly important in a market with customer captivity and economies of scale. This size advantage matters in the local market. In a market that is moving from many regional markets with many tastes to a homogenous national market, the local market is the national market increasing the importance of size on a national level rather than at a regional level.

MANAGEMENT

Background

The Chairman, founder and Chief Executive Officer is Mr. Chen Weizhong. Mr. Chen is 43 and holds a 53.62% stake in Honworld, aligning his incentives with minority shareholders. His ancestors were shareholders in a predecessor company, prior to the communist revolution. Given his family history with the business and the Lao Heng He brand, Mr. Chen may see Honworld as a family legacy.

It seems the business is his passion. In December 2008, Mr. Chen contributed 5.3 million liters of base wine with 10 to 20 Wine Years and approximately 6.0 million liters of base wine with over 20 Wine Years. He started accumulating the base wine when he entered the condiment business in 1990. The accumulation of base wine started well before Mr. Chen founded his first condiment company (Zhong Wei) in 1995, which did not require base wine for its products, and well before purchasing the Lao Heng He brand in June 2005.

His integrity is evidenced by the donation of the 11.3 million liters to the company, which had an estimated fair value of RMB7.0 million, and his transfer of his secret recipe to the company for RMB1. Using a low end of recent inventory costs (RMB5.0 per liter), this base wine now costs RMB56.5 million to reproduce.

Strategy

Mr. Chen seems to have a strong understanding of strategy. The company stated any acquisition should create economic value for the company. The use of the term economic value is rarely seen in any company never mind an Asian company with a market capitalization under HK$5 billion.

Honworld pioneered naturally brewed cooking wine using traditional production methods. The company is executing its differentiation strategy and telling the appropriate marketing story allowing the company to garner a premium price and maintain pricing power. In addition, given the company's size advantage, the high expenditure on fixed costs in the form of distribution expense and research and development are keys to cementing Honworld's competitive position and consolidating the market. The size advantage and expenditures on fixed costs are particularly important as the company speaks of converging tastes within China leading to a national market with one taste rather than a regional market with diverse tastes. With economies of scale relative size in a market matters, the shift from local market to national market relative size on a national level becomes much more important than relative size in local markets. A national market with fixed costs increases the minimum efficient scale increasing the market share on a national level required to compete.

As the market shifts from regional to national and consolidation occurs, it will be very difficult for smaller players to get into distributors networks as distributors only have limited resources leading to an inability to get shelf space at retailers creating another advantage for larger players. There is also potential for customer captivity making size more important as a strong brand on a low priced, experience good lowers the search cost for customers and leads to habit-forming behavior.

The key strategic measures for Honworld is market share and gross profitability relative to peers to ensure its scale advantage is intact. To make sure the company is fully taking advantage of its scale, expenditures on strategic fixed costs such as distribution expense and research and development should be maximized while remaining efficient. Customer captivity and strength of product is illustrated by premium pricing coupled with a high market share and gross margin.

The large expenditures on distribution expenses and research and development hurt current profitability, but the ability to withstand short-term pain in favor of greater profitability in the long-term points to a long-term vision, which is crucial to continued strong performance in the company.

Execution

Operationally, the company is also executing very well. The company's products are being received very well as illustrated by the company's growth, ability to increase prices, and premium prices combined with the largest market share. The company is effectively building out its distribution network. It is also positioning its products in the right segments and not allowing its premium brand image to deteriorate by selling mass-market products. The company is also spending heavily on fixed costs leveraging its size advantage over competitors. The best measure of operational efficiency is ROIC. Honworld has performed very well over the past few years with ROIC well above the company's cost of capital averaging 20.7% from 2010 to 2014. In 2014, there was a decline in ROIC due to the influx of capital from the IPO, investments in inventory, investment in productive assets that have not been utilized, investment in distribution network and investment in research and development.

Profitability	2010	2011	2012	2013	2014	2011- 2014 Avg
Return on assets	5.0%	6.9%	20.6%	23.9%	10.9%	13.5%
Return on tangible equity	40.6%	56.7%	74.2%	58.9%	16.9%	49.4%
Return on tangible invested capital	9.7%	17.4%	29.7%	35.9%	15.5%	21.7%
Return on net tangible operating assets	13.7%	22.2%	42.1%	43.9%	18.2%	28.0%
FCF return on tangible invested capital	-90.3%	-12.2%	-36.3%	7.4%	-50.4%	-36.4%
FCF return on net tangible operating assets	-89.7%	-22.0%	-31.9%	8.4%	-50.9%	-37.2%
Gross profit to total assets	10.6%	15.7%	40.3%	43.0%	20.0%	25.9%

Source: Company data, Reperio Capital Research estimates

Given the growth of the company and the capital requirements to support the growth, it is best to eliminate capital expenditures on growth to identify the true underlying profitability of the business, which is accomplished by creating an income statement on a per liter sold, creating a balance sheet on a per liter of base wine, and linking the two.

Per Liter of Base Wine Inventory	2010	2011	2012	2013	2014	CAGR
Base wine inventory (mn liters)	11.8	21.3	29.4	55.4	158.4	91.6%
Investment in inventory	1.82	3.01	3.90	5.90	5.24	30.3%
Net investment in other working capital	4.07	1.05	2.95	(0.57)	0.66	-36.6%
Fixed capital investment	1.51	2.33	5.28	3.68	3.35	22.0%
Total investment requirement	**7.40**	**6.38**	**12.13**	**9.01**	**9.25**	**5.7%**
COGS per liter sold/Cost of inventory per liter of base wine inv.	121%	88%	70%	77.2%*	80.1%*	
						Average
NOPAT per liter of volume sold	0.79	0.87	1.77	2.60	2.39	1.68
Total investment requirement per liter of volume sold	8.93	5.62	8.52	6.95	7.41	7.48
IC turnover	0.39	0.80	0.66	1.24	1.09	0.84
ROIC	**8.9%**	**15.5%**	**20.8%**	**37.4%**	**32.3%**	**23.0%**

Source: Company data, * denotes estimate

After eliminating the affect on profitability from distortions from growth investments, the company was able to maintain a ROIC over 30% for the past two years and averaged 22.7% since 2010.

In the short to medium term, profitability will probably in the form of ROIC will remain depressed due to the inventory and related asset build to support future growth and high levels of fixed costs to build out the distribution network and create new products. Over the longer term, assuming the company does not over build inventory, Honworld should reap the rewards of current investments given the ability to capture value through economies of scale and customer captivity.

Capital Allocation

There are no current capital allocation issues. The company is focused on its premium products, all of which have profitability above the cost of capital. There is a potential issue if the company continues to build inventory levels. The current levels support growth in the business, but if the inventory levels and associated assets increase too much and the company is unable to increase its gross margin through high prices from aged vintage base wine, the profitability derived from the brand and economies of scale are eliminated by poor capital efficiency.

Capital Allocation	2010	2011	2012	2013	2014	Sum
Cash flow from operations	**10**	**32**	**145**	**217**	**238**	**642**
Working capital investment	11	(19)	(85)	(213)	(662)	(968)
Fixed capital investment	(5)	(32)	(20)	(59)	(335)	(451)
Free cash flow	**17**	**(19)**	**39**	**(55)**	**(759)**	**(777)**
Other investing	(33)	(23)	(146)	88	27	(86)
Cash from/(to) debtholders	(0)	(0)	1	-	(43)	(43)
Cash from/(to) shareholders	20	78	99	26	962	1,184
Total change in cash	**4**	**35**	**(7)**	**59**	**187**	**279**

Source: Company data

As illustrated above, the company is allocating a significant amount of cash flow to inventory to buffer against raw materials prices and to support future growth. Building inventory to account for future growth makes sense as long as there is a plan to increase capital efficiency as growth slows. Building inventory to account for raw material costs makes little sense as the company is essentially taking a view on commodity prices. Very few people are able to make a macroeconomic assessment and be accurate.

The company's allocation of capital (18.5% of sales in 2013 & 2014) to distribution expense and research and development are moat enhancing given the presence of economies of scale, the company's current size advantage, and potential customer captivity.

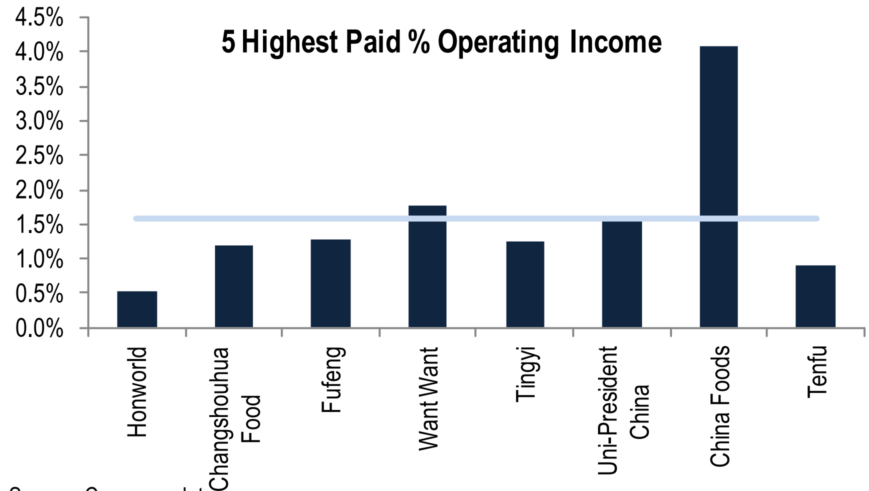
In 2015, the company is paying its first dividend of RMB0.10 per share roughly a 25% payout ratio, or RMB51.875 million. At the time of the IPO, the owners did not sell shares but offered new shares so a dividend to release capital to the owners make some sense, but in the context of the financing requirements of future growth and the excess profits the company currently earns in reinvestment opportunities, it would be wiser to keep the capital for reinvestment.

Salaries

Five Highest Paid Employees	2010	2011	2012	2013	2014
Five highest paid employees (RMB mn)	0.13	0.15	0.39	0.32	1.16
% of operating income	1.19%	0.52%	0.26%	0.15%	0.44%

Source: Company data

Management's salaries are not excessive. Overall, the five highest paid employees received RMB1.16 million or 0.44% of operating income in 2014. From 2010 to 2014, the five highest paid employees received 0.51% of operating income. This does not seem to be excessive value extraction for the strength of the company's performance and a peer group average of 1.57%.



Source: Company data

Accounting

		Condiment Producers				Food & Beverage Producers			
Accounting	Honworld	Changshouhua Food	Fufeng	Want Want	Tingyi	Uni-President China	China Foods	Tenfu	Huiyuan Juice
Buildings	20	Shorter of lease terms or 20 years	15-20	20-60	10-30	20	5.56-50	20	30
Machinery	5-20	10	8-10	2-15	5-12	10	3.03-16.67	10	13–18
Vehicles	3-5	4-5	5-8	5-20		3-5		5-10	5–8
Furniture, fittings and equipment	5	3-5	3-8	2-15	5	3-5		3-10	3–6
Commercialized research and development	5-7								
Land rights use		Lease term	40-70	20-70				34-50	30-50
Water rights							40		
Scultpures and Exhibits								20	
Software			10			5	5-8	5	10
Trademarks				10				10	30
License rights									10
Distribution network and customer relationships									4.2-18.5
Leasehold improvements	Lease term			Lease term		Shorter of lease term or 5 years			
Investment properties				10-40		40		20	
Patents			20						
Depreciation Method	Straight line	Straight line	Straight line	Straight line	Straight line	Straight line	Straight line	Straight line	Straight line

Source: Company data

The company's accounting policies are in-line with peers and do not seem to be overly aggressive. Commercialized research and development amortized over 5-7 years may appear aggressive but it is in-line with the business' economics.

Related Party Transactions/Corporate Governance

Auditors are Ernst and Young so Honworld is unlikely to have any influence over the auditors. There are no related party transactions or other corporate governance issues.

Reporting

Management does not report key business metrics needed to do a proper business analysis. Each year the company reports revenues from each product category but nothing more. Much more transparency is needed, at a minimum, volume of each product category, ASP of each product category, gross margin for each product category, inventory by age, number of distributors, and market share should be reported.

With the exception of not reporting key business metrics, management is passionate about the business, treats minority shareholders as partners, understands strategy, and executes its strategy efficiently. Management is allocating capital appropriately for now but inventory levels needs to be watched. Finally, management is young enough to build an organization to a national condiment business in the next twenty to thirty years.

Director's Biographies

Mr. Chen Weizhong, aged 43, is the Chairman of the Board, founder, and chief executive officer of Honworld. He is primarily responsible for overall strategic planning, recipes use and control, distribution network expansion, and overall business operations. He has over 20 years of experience in the Chinese condiment industry. He possesses unique information about the research, development and intellectual property related to the company's products, including the trade-secret recipes of fermentation starter and cooking wine spices.

Mr. Chen started his career in the condiment industry as early as 1990 and accumulated extensive experience in the condiment industry, especially in production, research and development, and sales and marketing.

Before founding Honworld in 2005, he was Chairman and general manager of Zhejiang Zhong Wei Brewing Co., Ltd. from 1995 to 2012. Mr. Chen completed a business administration advance class at Zhejiang University in 2008. Mr. Chen has been a member of the China Condiment Industrial Association since 2008. He is also Chairman of the Huzhou Rice Wine Industrial Association since 2012.

Zhong Wei and its brand have received a number of awards in recent years.

2010

- National Flagship Enterprise in Agricultural Industrialization
- China's Best Ten Condiment Producer

2011

- Famous Brand in Zhejiang Province

Mr. Sheng Mingjian, aged 40, is the vice general manager and executive Director. Mr. Sheng is primarily responsible for the management of the company's financing activities and assisting Mr. Chen with the management of overall business operations. He has more than 10 years of experience in the condiment industry with extensive management experience in capital and business operations. Before joining Honworld in 2006, he was the general manager of Zhong Wei from 2001 to 2006.

Mr. Wang Chao, aged 37, is the managing director of sales and marketing and an executive Director. Mr. Wang is primarily responsible for the company's sales and marketing. He has 15 years of experience in the condiment industry. Mr. Wang joined Huzhou Lao Heng He Brewing Factory in 1998 where he worked in various departments, including business operation department and finance department. Since 2006, Mr. Wang worked in management positions in Huzhou Lao Heng He's customer service center and sales and marketing department. Mr. Wang graduated from Zhejiang Electronic Polytechnic School in 1998.

Mr. Zhang Bihong, aged 39, is a non-executive Director. Mr. Zhang has more than 18 years of experience in the areas of auditing, tax, asset valuation, and financial management. He is currently a certified tax agent in China (issued by China Certified Tax Agents Association on June 2, 2000). Mr. Zhang is primarily responsible for the company's investor relation work.

Prior to joining Honworld in 2012, Mr. Zhang served as the director and chief financial officer of Tianli Agritech, Inc., a company listed on NASDAQ (Stock Code: OINK), from 2010 to 2011. He was a partner of Beijing Zhong Cheng Xin An Rui Accounting Firm from 2008 to 2009. Mr. Zhang was the senior manager at BDO Reanda Xin Public Accountants from 2005 to 2008 and served as a senior manager at Inner Mongolia Zhong Tian Hua Zheng Accounting Firm from 1995 to 2005. Mr. Zhang graduated from Inner Mongolia Agricultural College in 1995 with a diploma in economics (accounting).

Mr. Shen Zhenchang, aged 68, is an independent non-executive Director. Mr. Shen has more than 40 years of experience in the cooking wine industry. From 1971 to 2006, Mr. Shen worked with China Shaoxing Rice Wine Group (previously known as Shaoxing City Rice Wine Corporation). Before his retirement from the China Shaoxing Rice Wine Group in 2006, Mr. Shen was the director of its office of general affairs. Mr. Shen is a member of the China Brewing Industry Association (rice wine branch), where he has been the deputy council director and secretary general since 2000.

Additionally, Mr. Shen currently serves as a member of National Wine Brewing Standard Technology Committee, a judge at the reviewing committee of China Alcoholic Drinks Association Science Technology Award, and the deputy director of the editorial board of China Rice Wine magazine.

Mr. Ma Chaosong, aged 42, is an independent non-executive Director. Mr. Ma is a senior accountant (issued by the Beijing Senior Specialized Technique Qualification Evaluation Committee on January 6, 2006), certified public accountant (issued by the Chinese Institute of Certified Public Accountants on September 28, 1999), certified tax agent (issued by China Certified Tax Agents Association on May 11, 2012), and certified public valuer (issued by China's Ministry of Finance on April 24, 2012) in China. Since 2000, Mr. Ma has been the Chairman of Beijing Xin Li Heng Tax Agency Co., Ltd. He has more than 11 years of experience in auditing, accounting, and taxation. In May 2011, Mr. Ma was appointed as an independent director of China National Complete Plant Import & Export Corp. Ltd. From 1997 to 1999, Mr. Ma was a project manager at Zhong Ce Accounting Firm.

In 1997, Mr. Ma graduated from the Research Institute of Fiscal Science, Ministry of Finance of the PRC, with a master's degree in accounting. He graduated from Renmin University of China in 1994 with a bachelor's degree in accounting.

Mr. Lei Jiasu, aged 59, is an independent non-executive Director. Currently, Mr. Lei is the director of the Research Centre of Chinese Enterprise Growth and Economic Security in Beijing Tsinghua University. Since 1996, he has been a lecturer in the School of Economics and Management of Beijing Tsinghua University. Between 1994 and 1996, he worked as a post-doctoral researcher in Beijing Tsinghua University. From 1983 to 1989, Mr. Lei taught as a lecturer in Xi'an Electronic and Technology University.

In 2001, Mr. Lei was awarded the title of professor by Beijing Tsinghua University. He graduated as a doctoral research fellow from the School of Economics and Management of Beijing Tsinghua University in 1993.

Management Biographies

Mr. Chen Weizhong, aged 43, is the Chairman of the Board, founder, CEO, and executive Director. His biography is listed above.

Mr. Sheng Mingjian, aged 40, is the vice general manager and an executive Director. His biography is listed above.

Mr. Wang Chao, aged 37, is the managing director of sales and marketing and an executive Director. His biography is listed above.

Mr. Wan Peiyao, aged 43, is the director of production. He is primarily responsible for Honworld's production management. He has more than 11 years of experience in the condiment and cooking wine industry. Mr. Wan joined Honworld in 2005, and has worked in various departments, including workshop operation department, cooking wine production department, and plant operation department.

Prior to joining the company, Mr. Wan was the plant manager and executive assistant to the general manager of Huzhou Ganchang Wine Company from 2000 to 2005. Mr. Wan passed the test for first-class sommelier of China in December 2012.

Mr. Wan graduated from Zhejiang University of Technology with a bachelor's degree in Industrial Engineering (Biochemistry) in 1995.

Ms. Zhao Yaqin, aged 37, is the financial controller, responsible for the company's financing, account and tax matters. She has more than 11 years of experience in the areas of financial management, accounting practices, and tax arrangements. She joined Honworld in 2005 as manager of the finance department and became the financial controller in 2012. Prior to Honworld, Ms. Zhao was the manager of finance department of Zhong Wei from 2003 to 2005.

Ms. Zhao received a diploma in accounting from the Central Radio and Television University in 2006.

VALUATION

Asset Valuation

To value Honworld based on the company's assets two valuations are used, a liquidation valuation and an asset reproduction valuation. Liquidation value is the net current asset value, which equates to current assets minus total liabilities. Net current asset value is an extremely conservative measure of the company's value. If the industry is not viable then the liquidation value is the appropriate valuation methodology.

Reproduction value is the cost to replicate the company's assets to reach an equivalent competitive position. Honworld's reproduction value replicates book value, as the majority of assets are either current assets or recently added longer term assets, both of which are assumed to be fairly valued on the balance sheet. In addition, distribution expense and R&D expense is depreciated on a straight line basis over five years. The non-depreciated fixed cost asset is added to the book value of the company as these expenses need to be replicated to build a competitive position similar to Honworld's current position. Reproduction value is appropriate if no competitive advantage exists in the industry, as all excess profits will be competed away.

Asset Valuation	2015 Target Price (HK$)	2015 Upside
Liquidation value	1.74	-72%
Reproduction value	3.26	-49%

Source: Reperio Capital Research estimates

As illustrated above, Honworld is trading well above its liquidation value (HK$1.74 per share) and reproduction value (HK$3.26). Given Honworld's profitability, potential to sustain excess profits and growth in the market asset valuations are probably no as useful as earnings based valuations. Reproduction value does provide a useful benchmark in case the company is not able to build a competitive advantage and profitability reverts to the cost of capital intrinsic value will revert to reproduction value.

Earnings Valuations

The expected return calculation eliminates the need for any forecasting but assumes current earnings are normalized earnings and the return on invested capital remains stable. The expected return for Honworld is calculated using NOPAT, dividend yield, reinvested earnings, return on invested capital, franchise value, and organic growth. Honworld has an expected return of 17.3% per year. The company is current trading on an EBIT Yield of 9.1%. Using a normalized tax rate of 25% the NOPAT yield is 7.0%. The company is paying out 25% in dividends leading to a dividend yield of 1.8% with the remaining 5.3% of the NOPAT yield reinvested at 20%, roughly the historical average, leads to a value of reinvested earnings of 7.9%. The company should be able to grow organically at 5% leading to an overall expected return of 17.3%.

Expected Return	TTM
NOPAT yield	7.0%
-Dividend yield	1.8%
=Reinvested earnings yield	5.3%
xFranchise value	2.00
=Value of reinvested earnings	10.6%
+Dividend yield	1.8%
+Organic growth	5.0%
Expected return	**17.3%**

Source: Reperio Capital Research estimates

If you assume a return on invested capital of 15%, the expected return is 14.7%. The table below shows the expected return sensitivity to changes in the return on invested capital and organic growth.

Expected Return Sensitivity					
	Organic growth				
Franchise value	0.0%	2.5%	5.0%	7.5%	10.0%
-	1.8%	4.3%	6.8%	9.3%	11.8%
0.50	4.4%	6.9%	9.4%	11.9%	14.4%
1.00	7.0%	9.5%	12.0%	14.5%	17.0%
1.50	9.7%	12.2%	14.7%	17.2%	19.7%
2.00	12.3%	14.8%	17.3%	19.8%	22.3%
2.50	15.0%	17.5%	20.0%	22.5%	25.0%
3.00	17.6%	20.1%	22.6%	25.1%	27.6%

Source: Reperio Capital Research estimates

When valuing Honworld based on its earnings, three valuation methods are used a residual income valuation, a DCF valuation, and an earnings power valuation. Intrinsic value is determined by averaging the three valuations. Three different models are used to corroborate the valuation of other methodologies. All models have a five-year forecast period with a four-year fade to the terminal assumptions in year ten. The key assumptions used in the all earnings based valuations are listed below.

Key Value Driver Assumptions	First 5 Years	Terminal Rate
Discount rate	10.0%	10.0%
Tax rate	25.0%	25.0%
Fixed capital turnover	1.17	2.33
Working capital turnover	0.67	1.34

Source: Reperio Capital Research estimates

A discount rate of 10% is used in all valuations. The tax rate used is 25% as it is the regulatory tax rate. On March 7, 2014, Honworld received approval of new and advanced technology enterprise status allowing the company to pay a 15% tax rate for three years ending 2015 including the retroactive tax rate for 2013. From 2016 onwards, the company's tax rate will revert to the statutory 25%. Given only one future year has a 15% tax rate, it has minimal effect on intrinsic value therefore, the statutory tax rate is more appropriate.

Honworld is currently building its inventory along with the other working capital and fixed capital needed to support its inventory build. The company increased its base wine inventory from 55 million liters in 2013 to 158 million liters in 2014. It plans a further increase to 225 million liters in 2015. The inventory build is to support future growth and to provide a buffer against raw material prices. The first table shows fixed capital turnover, working capital turnover and invested capital turnover under different scenarios.

Capital Efficiency	FC Turnover	WC Turnover	IC Turnover
Per liter of sales volume	2.33	1.34	0.84
Current- 2014	1.33	0.72	0.47
Historic peak	6.80	1.80	1.04
Historic average	3.31	1.20	0.72
Historic trough	1.33	0.52	0.41

Source: Reperio Capital Research estimates

The table below shows a time series of working capital turnover, fixed capital turnover and total invested capital turnover under three scenarios; historic turnover, turnover assuming base wine inventory equivalent to one year of sales or a per liter basis, and turnover assuming two years of base wine inventory. Assuming an inventory at a specific level relative to sales eliminates the effect of investment for growth.

Capital Efficiency	2010	2011	2012	2013	2014	Average
Working capital turnover- actual	0.54	1.53	1.67	1.80	0.72	1.25
Fixed capital turnover- actual	2.04	2.21	2.17	2.60	1.26	2.06
Invested capital turnover- actual	**0.43**	**0.90**	**0.95**	**1.06**	**0.46**	**0.76**
Working capital turnover- 1 year	0.49	1.26	1.17	2.10	1.70	1.34
Fixed capital turnover- 1 year	1.91	2.20	1.52	3.03	3.00	2.33
Invested capital turnover- 1 year	**0.39**	**0.80**	**0.66**	**1.24**	**1.09**	**0.84**
Working capital turnover- 2 year	0.24	0.63	0.59	1.05	0.85	0.67
Fixed capital turnover- 2 year	0.95	1.10	0.76	1.52	1.50	1.17
Invested capital turnover- 2 year	**0.19**	**0.40**	**0.33**	**0.62**	**0.54**	**0.42**

Source: Company data, Reperio Capital Research estimates

Given the growth in assets to accommodate future growth, capital efficiency is expected to decline to the average turnover assuming two years of base wine inventory over the next five years and then fade to a terminal rate of one year of base wine inventory as growth slows. The tables below show 2015 upside sensitivity to various fixed capital turnover and working capital turnover rates, assuming 0% growth and 40% operating margins into perpetuity. The first table below shows 2015 intrinsic value upside sensitivity to changes in the fixed capital turnover rate and working capital turnover rate during the first five years of the forecast period.

2015 Intrinsic Value Sensitivity- Forecasted FC Turnover & WC Turnover

Forecasted FC turnover \ Forecasted WC turnover	0.25	0.50	0.75	1.00	1.25	1.50
1.00	-68%	-24%	-10%	-3%	1%	3%
1.50	-61%	-17%	-3%	4%	8%	10%
2.00	-58%	-14%	1%	7%	11%	14%
2.50	-56%	-12%	2%	9%	13%	15%
3.00	-55%	-11%	3%	10%	14%	16%
3.50	-54%	-10%	4%	11%	15%	17%

Source: Reperio Capital Research estimates

There is 10% downside to 2015 intrinsic value using current fixed capital turnover of 1.17 and working capital turnover of 0.67. If the company is able to improve capital efficiency to average efficiency with one year of base wine inventory (fixed capital turnover = 2.33, working capital turnover = 1.34), there is 14% upside.

The second table shows upside to 2015 intrinsic value sensitivity to changes in the fixed capital turnover rate and working capital turnover terminal assumptions in year 10.

2015 Intrinsic Value Sensitivity- Terminal FC Turnover & WC Turnover

Terminal FC turnover \ Terminal WC turnover	0.50	0.75	1.00	1.25	1.50	1.75
0.50	-160%	-125%	-107%	-97%	-89%	-84%
1.00	-107%	-72%	-54%	-43%	-36%	-31%
1.50	-89%	-54%	-36%	-26%	-18%	-13%
2.00	-81%	-45%	-27%	-17%	-10%	-5%
2.50	-75%	-40%	-22%	-11%	-4%	1%
3.00	-72%	-36%	-18%	-8%	-1%	4%

Source: Reperio Capital Research estimates

If Honworld is unable to improve capital efficiency over its capital efficiency with two years of base wine inventory, there is 26% downside from current prices as ROIC will be slightly above the cost of capital therefore valuation should not be that much different from the reproduction value.

The table below shows Honworld's intrinsic value under various sales growth and operating margin scenarios. Historical average operating margins are 36%, which is probably a little conservative. Before 2012, the company did not naturally brew its cooking wine therefore it could not command a premium price on its products, and the company distributed its products primarily through Zhong Wei leading to a lower gross margin. Although the historical average may not be an accurate reflection of current profitability, it is useful to illustrate incase the company's pricing power erodes leading to lower operating margins and an ROIC closer to the cost of capital.

Current margins are 40% and the most accurate reflection of current profitability. The company has averaged roughly 40% operating margins since producing naturally brewed cooking wine and decreasing Zhong Wei's significance in distribution. If the company is able to build a competitive advantage and take advantage of scale, fixed costs as a percentage of sales will shrink leading to expanding operating margins in the future. The company is in the process of building its moat therefore fixed expenses should be as high as possible while still be efficient to make the minimum efficient scale as high as possible to limit the number of competitors able to compete in the market.

Peak margins are the highest margins the company achieved, 43.3% in 2012. This margin represents the potential of the business if the company is able to leverage fixed costs into higher profitability.

Earnings Based Valuations (DCF/EVA/EPV)	2015 Target Price (HK$)	2015 Upside	2020 Target Price (HK$)	2020 Upside
No growth, Hist. ave margins	5.13	-19%	8.76	38%
No growth, Current margins	5.69	-10%	9.60	52%
No growth, Peak margins	6.15	-3%	10.30	63%
5% growth, Hist. ave margins	8.99	42%	15.20	140%
5% growth, Current margins	10.10	60%	16.94	168%
5% growth, Peak margins	11.01	74%	18.37	190%
5% forecast period growth, 0% terminal growth, Current margins	6.35	0%	11.40	80%
10% forecast period growth, 0% terminal growth, Current margins	7.21	14%	13.66	116%
15% forecast period growth, 0% terminal growth, Current margins	8.34	32%	16.51	161%
20% forecast period growth, 0% terminal growth, Current margins	9.81	55%	20.06	217%
10% forecast period growth, 5% terminal growth, Current margins	11.89	88%	21.19	235%
15% forecast period growth, 5% terminal growth, Current margins	14.23	125%	26.60	320%
20% forecast period growth, 5% terminal growth, Current margins	17.25	172%	33.46	429%
Average earnings valuations upside	**9.40**	**48%**	**17.08**	**170%**

Source: Reperio Capital Research estimates

As illustrated, the market is pricing in roughly 5% growth over the next five years fading to 0% terminal rate at current margins. In the short term, margins may contract as Honworld spends on growing the business, but in the longer run margins should be close to the current level if not higher if the company is successful in achieving the competitive advantages discussed in the report and take advantage of the operating leverage associated with fixed costs. If no competitive advantage exists, there is likely to be many years of market growth decreasing the competitive rivalry within the market leading to excess profitability for 5-10 years, maybe more. 5% growth fading to 0% terminal growth with current margins offers 80% upside over the next 5 years.

The base case is 10% during the forecast period fading to 0% growth into perpetuity with current margins, offers 14% upside to 2015 intrinsic value and 116% upside to 2020 intrinsic value. The 10% growth over the next few years is conservative enough to provide a sufficient margin of safety as it is half the current growth rate of the overall market. 0% growth into perpetuity does account for any pricing power or growth into a national player so it seems conservative enough to provide a sufficient margin of safety. This valuation is meant to be very conservative to ensure a sufficient margin of safety. The market is growing at twice the forecast period growth rate used and the company may be in the early stages of moving from a regional company to a national company as the company's key regions account for roughly 90% of the company's sales but only account for 26% of the country's population and 35% of its GDP.

Sales by Region (RMB mn)	2012	8 mths Aug 2013	8 mths Aug 2013 % of Total	Population (mn)	GDP per capita (RMB)	GDP (RMB mn)
Zhejiang Province	98	79	24%	55	73,152	4,015,313
Shanghai	17	55	17%	24	97,555	2,366,372
Guangdong Province	52	47	15%	106	63,452	6,753,831
Liaoning Province	45	39	12%	44	65,210	2,862,719
Shandong Province	41	34	11%	97	61,055	5,942,721
Beijing	31	40	12%	22	99,214	2,134,688
Rest of China	52	29	9%	1,009	43,516	43,910,015
Total sales	**337**	**323**				
China				1,357	50,086	67,985,660
Honworld's key regions				348	74,243	24,075,645
Honworld's sales % China				**26%**		**35%**

Source: Company data, National Bureau of Statistics, Provincial Statistics Bureaus

In addition, the company has a very strong brand image as illustrated by premium pricing and high market share. The company also has pricing power as illustrated by recent price increases, stable gross margins, and a product that is a low priced experience good, which may lead to growth well past the first ten years.

RISKS

Honworld lacks a long operating history with financial statements only going back to 2010. In addition, the company has only been trading as a public company since January 2014.

Honworld has a significant customer concentration. In 2014, the largest customer accounted for 21.7% of total revenue and the five largest customers accounted for 71.3% of total revenue.

Honworld has a significant supplier concentration. In 2014, the largest supplier accounted for 21.2% of the Group's total purchases and the five largest suppliers accounted for 66.8% of total purchases.

Honworld is growing at a rapid pace with significant capital requirements. If the company decreases capital efficiency or grows too fast, outside capital may be needed leading to dilution. Capital efficiency is a key driver of profitability. If it were to remain weak, valuations would suffer.

Honworld's profitability could be hurt by expansion outside of its key markets. The company generates a significant portion of its revenues from a few key markets. As the company expands its distribution network, its products may not be as well known and may not command the premium received in its key markets leading to weaker profitability.

If Honworld is not able to build a competitive advantage, the company may not be able to recoup the investment in distribution and research and development through premium prices leading to these investments destroying value.

If economies of scale are present in the market and the company is unable to maintain its size advantage over peers, its competitive position may weaken, competitive rivalry may intensify, and profitability will deteriorate.

If regional tastes do not become national tastes, markets will remain fragmented eliminating the company size advantage and increasing investment requirements as advertising must be done locally rather than nationally.

The current valuation is pricing in continuation of current margins. If the company's competitive position weakens and its pricing power diminishes the market may devalue to company.

The company raw materials are agricultural products, which may increase in value. If raw materials increase in value and the company is not able to pass on those raw material cost increases profitability will suffer.

The rapid growth of the company may outpace the growth of the necessary internal controls and infrastructure for management to handle the growth leading to potential bad debts, or deterioration of the company's brand.

The company sells naturally brewed products. If the main cooking wine competition shifts its production from chemically produced to naturally brewed, the company's premium pricing may disappear and its position within the market may weaken.

The company outsources distribution. If distributors sell the company's products at a lower price than the company desires, it may hurt the company's premium brand.

If the company's products were contaminated, it would destroy the company's brand.

An economic slowdown in China leads to weaker than expected demand and an inability to raise prices.

FINANCIAL STATEMENTS

INCOME STATEMENT (RMB mn)	2010	2011	2012	2013	2014
Total Revenue	**36**	**109**	**337**	**530**	**668**
Gross Profit	13	46	193	313	386
Selling and Distribution Expense	(1)	(16)	(24)	(26)	(40)
Adminstrative Expenses	(1)	(1)	(23)	(74)	(81)
Operating Profit	**11**	**29**	**146**	**213**	**265**
Other Income	1	10	5	12	4
Financial Income (expense)	(4)	(12)	(15)	(18)	(23)
Profit before Tax	**8**	**28**	**135**	**207**	**246**
Income Tax	(2)	(7)	(37)	(33)	(35)
Profit after Tax	**6**	**20**	**98**	**174**	**212**

BALANCE SHEET (RMB mn)	2010	2011	2012	2013	2014
Cash	12	52	2	44	218
Accounts Receivables	41	58	78	89	188
Inventory	21	64	115	327	830
Other Current Assets	34	71	128	65	167
PP&E	5	37	132	181	503
Intangibles	-	-	0	0	-
Other Non-Current Assets	12	13	23	23	30
Total Assets	**126**	**295**	**478**	**729**	**1,936**
Accounts Payable	23	66	48	106	176
Other NIBCLs	5	41	71	79	75
ST Debt	77	146	206	233	309
LT Debt	-	-	10	-	109
Other Liabilities	6	6	9	14	13
Total Liabilities	**111**	**259**	**345**	**432**	**682**
Equity	15	36	133	296	1,254
Shares Outstanding, basic end	375	375	375	375	519
Shares Outstanding, diluted end	375	375	375	375	519

CASH FLOW STATEMENT (RMB mn)	2010	2011	2012	2013	2014
Cash Flow from Operations	**10**	**32**	**145**	**217**	**238**
Working Capital Investment	11	(19)	(85)	(213)	(662)
Fixed Capital Investment	(5)	(32)	(20)	(59)	(335)
Free Cash Flow	**17**	**(19)**	**39**	**(55)**	**(759)**
Other Investing	(33)	(23)	(146)	88	27
Cash from/(to) Debtholders	(4)	(12)	(15)	(18)	(66)
Cash from/(to) Shareholders	20	78	99	26	962

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