

# CLOVER CORPORATION (CLV.ASX)

## Strong growth with infant formula boom

### Investment Highlights:

#### ❖ Significant performance

Clover Corporation reported NPAT of \$3.19m for the half-year ended 31 January 2018. Revenue from ordinary activities were \$31.03m, up 59.39% from last year. Basic and Diluted EPS were 1.93 cents compared to 0.63 cents last year.

#### ❖ High quality products

Its encapsulation process minimises the 'fishy' smell and taste that can come with other fish oil products while still ensuring maximum nutritional value is delivered. This is achieved through exclusive use of a microencapsulation process developed in conjunction with the CSIRO.

#### ❖ Revenue driven by growth in Chinese demand

Clover has contracts with many of the leading infant formula manufacturers around the world and that gives the company exposure to the booming Chinese market.

#### ❖ Expectation of potential growth

Expectation of increase in Clover's gross margin from contract renegotiations, cost of goods sold (COGS) savings and an improved product mix.

European Union (EU) regulations require a doubling of DHA content in infant formula by 2020, which should lead to increased demand for oils and powders.

**Recommendation:** Hold. An expected EPS for FY 2018-2020 is 4.11c, 6.28c and 10.33c.

**Risk:** Economic decline, Food Safety Incident,

Change in company management

20/06/2018

**Recommendation:** Hold

**Current Price:** \$1.59

**Target Price:** \$2.00

### Company overview

ASX Code: CLV

Market Cap: 282,460,700

Quoted Shares On Issue: 161,181,696

52 weeks high: \$1.81

52 weeks low: \$0.61

Price/NTA: 9.00

EPS: 3.5c

PE ratio: 48.86

Quick Ratio: 1.8

Current Ratio: 3.8

### Relative price performance



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## 1. Industry

### 1.1 EPA/DHA Ingredients Market to exceed \$4bn by 2022

EPA/DHA ingredients market size should be worth over USD 4 billion at the end of 2022; according to a new research report by Global Market Insights, Inc.

Pharmaceutical applications may witness highest gains at above 5.5%. It is used to reduce cholesterol levels in the body which may further fuel product demand. Increase in research spending for product innovation to improve effectiveness may create new opportunities in the industry.

China omega 3 market size from infant formulas may register over USD 50 million at the end of forecast period. Intake of ingredients promotes eyes, brain and nerve development, which should favor industry growth. EPA/DHA ingredients are used as an in the preparation of infant formula which results in health benefits. Some of the companies engaged in infant formula production are investing in research to expand product portfolio.

### 1.2 Global baby food and infant formula market

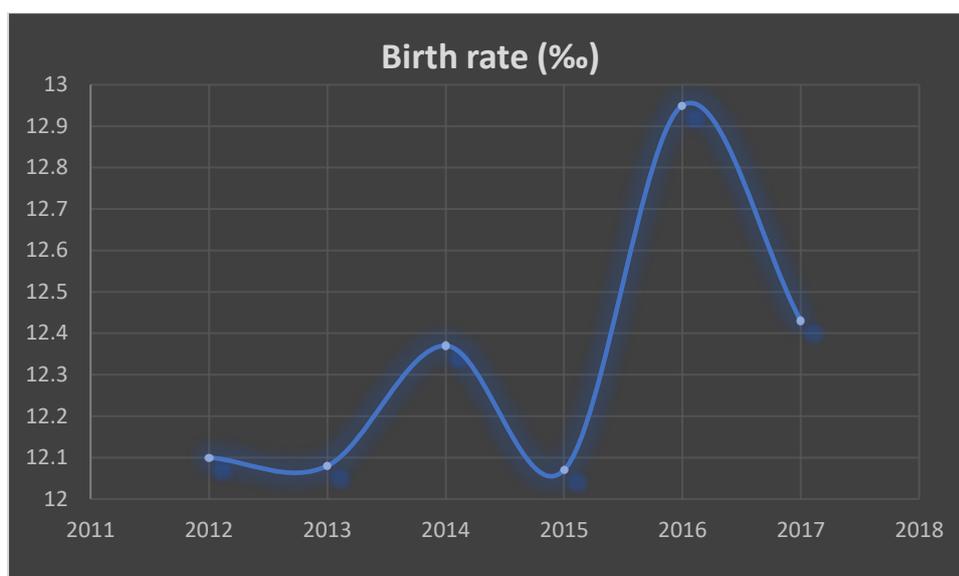
Baby food and infant formula are food products specifically made for babies till the age of two years. Infant formula serves as a replacement of mother's milk as it exhibits similar nutritional attributes. Over the years, parents have shifted to packaged baby foods owing to the convenience and better nutrition offered by these products. The latest report, "Baby Food and Infant Formula Market: Global Industry Trends, Share, Size, Growth, Opportunity and Forecast 2018-2023", finds that the global baby food and infant formula market reached a value of US\$ 50 Billion in 2017

Today, the parents are ready to spend on high-quality, expensive baby foods to ensure the well-being of their infants. Rising health concerns towards the overall development of the baby and growing number of malnutritional cases are the key factors driving the growth of the market. Furthermore, increasing awareness among people about the various health benefits of feeding baby foods to infants and young babies is fuelling the demand for baby foods across the globe. Increasing number of working women and the need for convenient and portable nutrition for their babies has created a large market for baby foods and infant formula. Additionally, increasing spending on children's healthcare coupled with continuous innovation and aggressive marketing by various baby food manufacturers has facilitated the global baby food and infant formula market. According to the report, the market is expected to reach a value of US\$ 69 Billion by 2023, registering a CAGR of 5.5% during 2018-2023.

### 1.3 China-led boom in baby formula

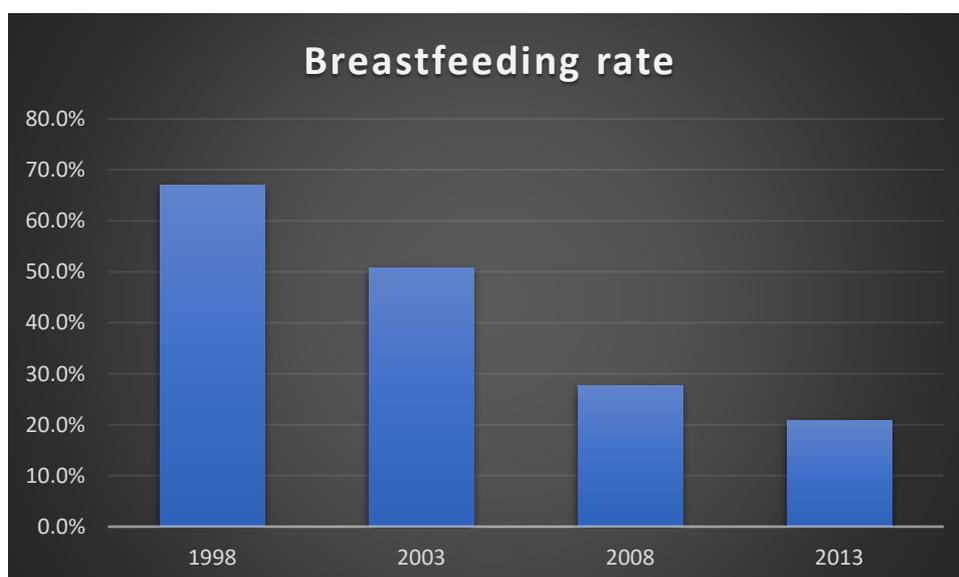
#### 1.31 Birth rate has increased

The birth rate of China has increased since Chinese populace freed from the shackles of the abolished one chined policy in 2016. Birth rate of 2016 and 2017 is 12.95 ‰, 12.43‰ respectively, which is obviously higher than the previous 5 years.



### 1.32 Baby formula instead of breast nursing

With the increase in the proportion of working women, breastfeeding rate has begun to decline year by year, from 67% in 1998 to 27.6% in 2008. According to the data from Chinese Centre for Disease Control and Prevention, breastfeeding rate of China was 20.8% in 2013, far below international average breastfeeding rate 38%. There is no official date after that.



### 1.33 Oversea baby formula is predominant in China

The 2008 Chinese milk scandal involved milk and infant formula along with other food materials and components being adulterated with melamine. Of an estimated 300,000 victims in China, six babies died from kidney stones and other kidney damage and an estimated 54,000 babies were hospitalized. Since the scandal erupted, Chinese consumers lost confidence on native infant formula and foreign brands became predominant in China.

## 2. Company - leading supplier of DHA

Clover Corporation is a key member of the infant formula supply chain, with its strong position in the encapsulated tuna oil market being due to the high quality of its product.

The key ingredient is docosahexaenoic acid (DHA) – an omega-3 fatty acid crucial for brain health, in particular, but also important for heart and eye health – which is mostly derived from tuna oil.

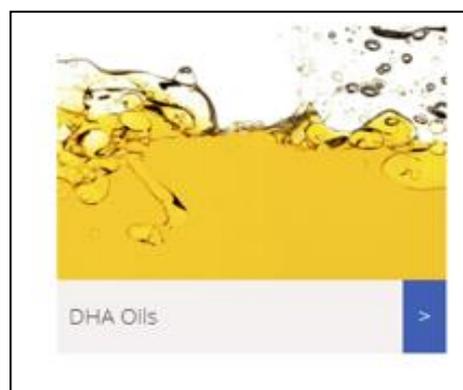
A number of oils are used interchangeably by formula manufacturers to introduce omega-3 and omega-6 content, but DHA is the most essential as it assists in replicating the properties of natural breast milk.

### 2.1 Products

#### 2.11 DHA Oils

Nu-Mega HiDHA® tuna oils

CLV's products are sourced from high quality tuna oil. Utilising the latest extraction technologies, crude oil is supplied under strict industry specifications. Through years of experience in tuna oil purification we have developed an expertise which allows further refining, delivering a highly refined tuna oil which meets infant formula and pharmaceutical standards.



Ocean Gold®

CLV's products are cold pressed, super refined tuna oils. It is a non winterised product cloudy at room temperature. This natural triglyceride oil contains approximately 27% DHA and 35% total omega-3 fatty acids

#### 2.12 DHA powders

Nu-Mega Driphorm® powders

Nu-MegaDriphorm® powders utilise CSIRO's (Commonwealth Scientific and Industrial Research Organisation) MicroMax® technology under exclusive licence to microencapsulate nutritional oils. The patented technology allows up to a 50% oil payload with superior odour and taste masking. With a proven track record since 2001, Nu-Mega Driphorm powders are internationally recognised as the benchmark for quality and stability. Nu-Mega Driphorm powders are used in a wide range of infant formula, follow-on formula, growing up milks and food applications.



## Nu-Mega Driphorm® HA

For non-dairy application Nu-Mega Driphorm® HA is recommended. Cow's milk protein allergy affects around 2-6% of children with the highest prevalence during the first year of life. Nu-Mega Driphorm® HA utilises a patented carbohydrate technology which meets regulatory guidelines around the world.

## 2.2 Microencapsulation – world class technology

Clover utilises a number of microencapsulation technologies that enable nutritional oils, such as tuna, fish, algal and fungal oils, to be added to infant formula, foods and beverages.

Developed through extensive research and development, clover proprietary technologies protect sensitive oils from oxidation allowing them to be incorporated into a range of end applications. In addition to their superior protection capabilities, all of the microencapsulated products reach the highest standards of purity, stability and sensory performance.

Clover's superior microencapsulation technology enables nutritional oils, such as tuna, fish, algal and fungal oils, to be added to infant formula, foods and beverages. Developed through

extensive research and development, clover proprietary technologies protect those sensitive oils from oxidation, allowing them to be incorporated into a range of applications. All of clover's products reach the highest standards of purity, stability and performance, allowing you to maximise and deliver nutrition whilst masking unpleasant taste and odour.

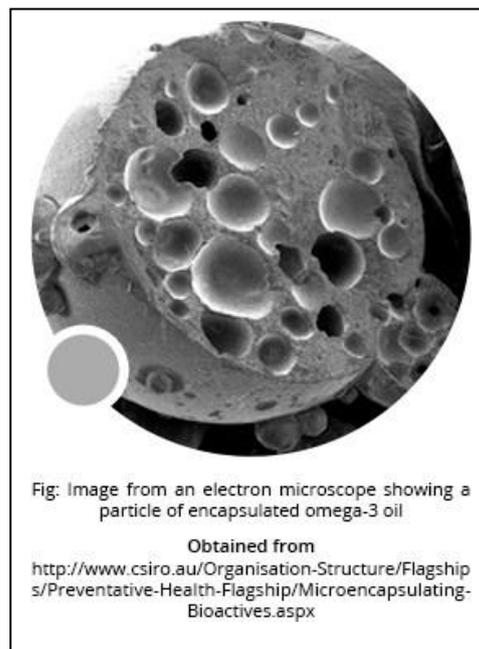


Fig: Image from an electron microscope showing a particle of encapsulated omega-3 oil

Obtained from  
<http://www.csiro.au/Organisation-Structure/Flagships/Preventative-Health-Flagship/Microencapsulating-Bioactives.aspx>

## 2.3 History of innovation

Today Clover continues to focus on improving human health through nutrition and has become a global leader in the delivery of stable omega-3 and omega-6 products into the infant nutrition and medical foods market with a reputation of excellence and quality.

1988

Nu-Mega Lipids JV with Heinz and access to a novel supply of marine omega-3 oil.

1996

A world first introduction of LCPUFA (Long Chain Poly Unsaturated Fatty Acids) via capsules into infant formula.

1998

Began world's first supply of microencapsulated LCPUFA (Long Chain Poly Unsaturated Fatty Acids) into infant formula.

2002

First in the world to market next generation 50% oilloaded technology.

2003

Developed high temperature stable delivery technology, partnering with a well-known Australian brand, which went on to be one of the most successful functional food launches in the world (adjusted for PPP and population).

2003-2007

Nu-Mega Ingredients formed via JV between Clover Corporation and Food Spectrum.

2007

Nu-Mega Ingredients became 100% subsidiary of Clover Corporation, a consistently profitable, strong, technical, manufacturing and sales organization.

2013

Global leader in delivery of stable micronutrients to the global infant nutrition and special medical market with a reputation for excellence in everything it does.

## 3. Competitors

### 3.1 Global competitors

There are three main competitors: Dutch groups DSM, Germany's BASF and FrieslandCampina.

#### 3.11 DSM

DSM ingredients enhance the taste, texture, quality, nutritional value and success of the world's favorite food, beverage and dietary supplement brands. DSM's portfolio of food ingredients is used in everything from dairy, baking, fruit juice, beer, wine, savory and functional food segments.

Life's DHA is a vegetarian source of DHA and mainly focus on US market.

## life'sDHA®

Share

life'sDHA® is a vegetarian source of Docosahexaenoic Acid (DHA) omega-3 from algae that provides important brain and eye benefits throughout life.



Most people incorrectly believe that fish produce their own DHA, when in fact it's the algae in their food chain that makes them a rich source of DHA.

life'sDHA® goes straight to the source, resulting in a sustainable, high quality product rich in DHA omega-3.

WHAT IS life'sDHA

Benefits

Applications

Cases

life'sDHA® from algae is a vegetarian source of DHA. It's produced, from start to finish in an FDA-inspected facility with controls in place to ensure the highest quality. life'sDHA® comes from non-genetically modified source and is the only DHA currently used in US infant formulas.

### 3.12 BASF

BASF is the pioneer in omega-3, with its foundations in Norway in 1838. BASF is world leader in high-concentrate omega-3 fatty acids for pharmaceuticals, and has leading positions in dietary supplements and clinical nutrition categories.

#### Nutrition & Health

Additives for the food and feed industries, such as vitamins, carotenoids, sterols, enzymes, emulsifiers and omega-3 fatty acids

Flavors and fragrances, such as geraniol, citronellol, L-menthol and linalool

Excipients for the pharmaceutical industry and selected, high-volume active pharmaceutical ingredients, such as ibuprofen and omega-3 fatty acids

#### Performance Products

Our Performance Products lend stability, color and better application properties to many everyday products. Our product portfolio includes vitamins and other food additives in addition to ingredients for pharmaceuticals, personal care and cosmetics, as well as hygiene and household products. Other products from this segment improve processes in the paper industry, in oil, gas and ore extraction, and in water treatment. They furthermore enhance the efficiency of fuels and lubricants, the effectiveness of adhesives and coatings, and the stability of plastics.



Key data Performance Products<sup>1</sup> (million €)

|                                | 2017         | 2016         | Change in % |
|--------------------------------|--------------|--------------|-------------|
| Sales                          | 16,217       | 15,558       | 4           |
| Thereof Dispersions & Pigments | 5,398        | 5,086        | 6           |
| Care Chemicals                 | 5,079        | 4,735        | 7           |
| <b>Nutrition &amp; Health</b>  | <b>1,844</b> | <b>1,932</b> | <b>(5)</b>  |
| Performance Chemicals          | 3,896        | 3,805        | 2           |
| EBITDA                         | 2,427        | 2,577        | (6)         |
| Income from operations (EBIT)  | 1,510        | 1,678        | (10)        |
| EBIT before special items      | 1,416        | 1,777        | (20)        |

**Nutrition & Health – Sales by region**

(Location of customer)

|   |                                    |     |
|---|------------------------------------|-----|
| 1 | Europe                             | 41% |
| 2 | North America                      | 18% |
| 3 | Asia Pacific                       | 30% |
| 4 | South America, Africa, Middle East | 11% |



### 3.13 FrieslandCampina

With annual revenue of 12.1 billion euros, FrieslandCampina is one of the world’s largest dairy companies.

FrieslandCampina sells ingredients and half-finished products to manufacturers of infant nutrition, the food industry and the pharmaceutical sector around the world.

### 3.2 Native competitors

There is no other DHA manufacturers in Australia or New Zealand, which means CLV is a leading supplier of DHA in the form of encapsulated or powdered tuna oil additives for the food and pharmaceutical industries.

“We are a little business very focused on doing one thing well” CEO Peter Davey says.

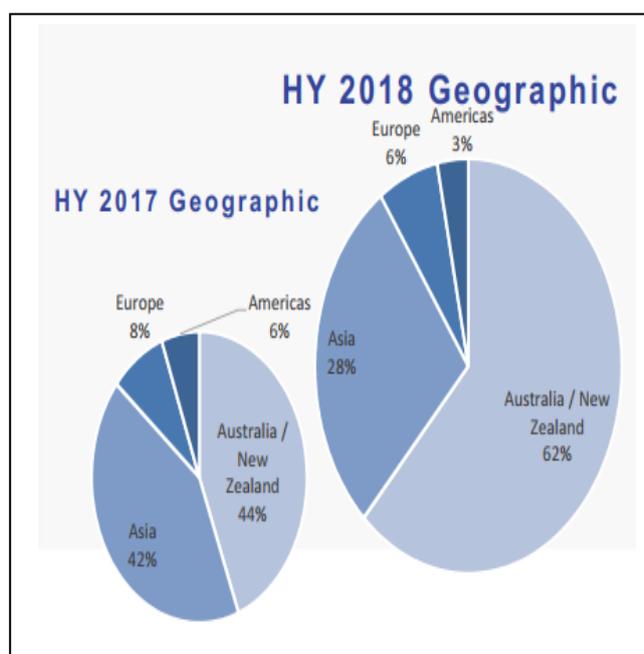
## 4. Potential growth point

### 4.1 Europe

Europe is the biggest single infant formula market and by January 2020 any baby formula sold there must contain double the current requirement (as measured by calorific content).

Despite Australia’s “clean and green” hype, The Netherlands is the biggest single exporter to China, followed by New Zealand, Ireland, France and Germany.

While formula sold outside of Europe won’t require the super-sized DHA dose, Europe tends to drive global regulations and other countries are likely to follow the lead: “There’s a perception if the Europeans can get together and make it work, then others will follow.”



These new rules should lead to increased demand for oils and powders as brands increase their DHA content. Clover's EU sales are currently low, but this is a key growth area as it is quite a strict regulatory environment.

Currently, EU sales only accounts for 6% but it is a good opportunity to expand Europe market.

## 4.2 China

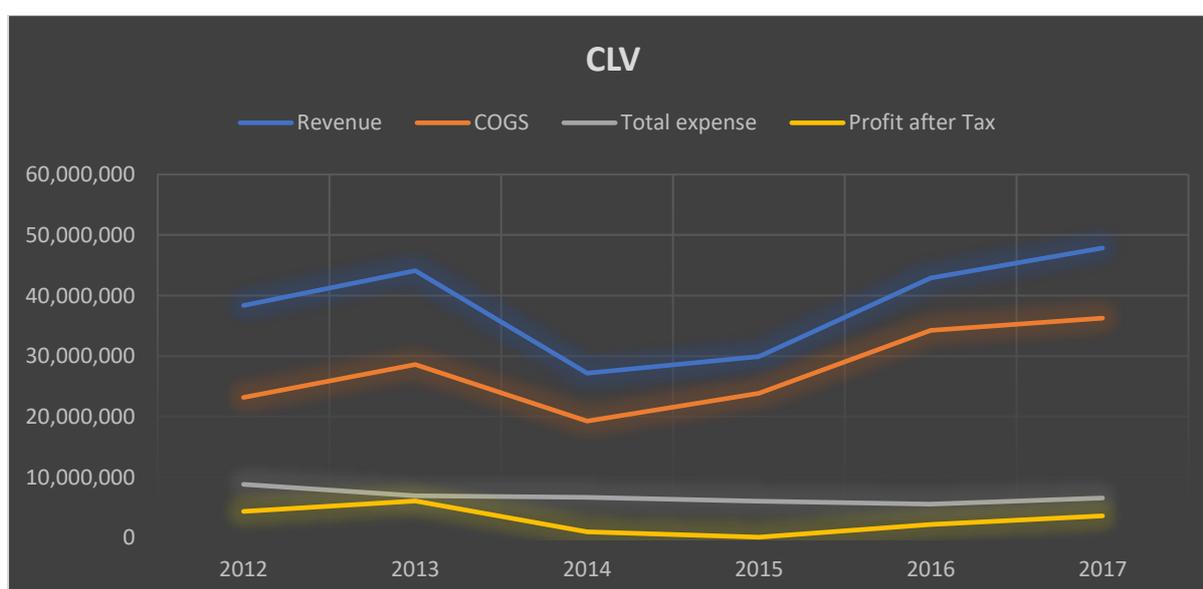
The Chinese market is valued at circa US\$20 billion and is anticipated to expand 5–10% per annum over the same period. Most countries will see continued increases in demand for formula, but rapid growth in China is grabbing the majority of headlines.

Key customers have achieved or are in the process of receiving their CFDA accreditation to market and to sell up to three brands in the Chinese market.

## 4.3 Margins

We expect gross margins to widen to more than 30% by 2021 from around 24% currently. Key to this is Clover buying its own spray dryer, rather than renting drying time from other manufacturers, which currently accounts for around 35% of cost of goods sold (COGS). Clover's product is high-quality but also very expensive, and such an investment gives the company the option to pass some of the COGS savings on to customers while retaining margin benefits.

From income statement, we add up all expenses, compare with the revenue and cost of good sold, it can be seen that the total expense is stable while COGS changes by a percentage as sales varies. Therefore, with the COGS control, profits will surge dramatically.



## 4.4 New Products

- Clover's Hypoallergenic DHA product is now an ingredient across multiple goat IF brands.
- A new highly concentrated DHA product which delivers 60% oil loading in a powder form is being used in gummies targeting the child and seniors' segments.

- Clover is continuing to invest in new product development with a pipeline of new products targeting additional segments and next generation delivery systems.

## 5. Valuation and prediction

### 5.1 PE



## 5.2 Financial predictions

| <b>Income statement</b>  |             | 2016     | 2017     | 2018E    | 2019E    | 2020E    |
|--|-------------|----------|----------|----------|----------|----------|
| shares on issue  | 165,181,696 |          |          |          |          |          |
| <b>Revenue</b>   |             | 42,920   | 47,864   | 63,000   | 81,900   | 106,470  |
| <b>Cost of goods sold</b>                                      |             | (34,257) | (36,279) | (45,990) | (59,787) | (74,529) |
| <b>Gross profit</b>  |             | 8,663    | 11,585   | 17,010   | 22,113   | 31,941   |
| Other income / (expenses)                                      |             | 278      | -476     | (450)    |          |          |
| Marketing and sales expenses                                   |             | (2,217)  | (2,163)  | (2,400)  | (2,600)  | (2,800)  |
| Administration and corporate expenses                          |             | (2,454)  | (2,821)  | (3,200)  | (3,400)  | (3,600)  |
| Research and development expenses                              |             | (1,162)  | (1,113)  | (1,600)  | (1,800)  | (2,000)  |
| Other expense  |             |          |          |          |          |          |
| Total expense  |             | (5,555)  | (6,573)  | (7,650)  | (7,800)  | (8,400)  |
| <b>Profit before income tax</b>                                |             | 3,108    | 5,012    | 9,360    | 14,313   | 23,541   |
| Income tax (expense)/credit                                    |             | (895)    | (1,373)  | (2,574)  | (3,936)  | (6,474)  |
| <b>Profit after tax for the period attributable to men</b>     |             | 2,213    | 3,639    | 6,786    | 10,377   | 17,067   |
| Other comprehensive (loss)/profit                              |             |          |          |          |          |          |
| Items that may be reclassified subsequently to profit or loss: |             |          |          |          |          |          |
| Foreign currency translation adjustments                       |             | (148)    | (38)     | (50)     | (80)     | (100)    |
| Other comprehensive (loss)/profit for the period               |             | (148)    | (38)     | (50)     | (80)     | (100)    |
| Total comprehensive (loss)/income for the period               |             | 2,065    | 3,601    | 6,736    | 10,297   | 16,967   |
| Earnings per share (EPS)                                       |             |          |          |          |          |          |
| <b>Basic earnings per share (cent per share)</b>               |             | 1.34     | 2.20     | 4.11     | 6.28     | 10.33    |
| <b>Diluted earnings per share (cent per share)</b>             |             | 1.34     | 2.20     | 4.11     | 6.28     | 10.33    |

## AITCH INVESTMENT

| Balance sheet                        | 2016          | 2017          | 2018E         | 2019E         | 2020E          |
|--------------------------------------|---------------|---------------|---------------|---------------|----------------|
|                                      | \$000         |               |               |               |                |
| <b>Current assets</b>                |               |               |               |               |                |
| Cash & cashequivalents               | 8,230         | 5,916         | 12,000        | 15,600        | 20,280         |
| Trade and other receivables          | 10,865        | 12,125        | 15,000        | 19,500        | 25,350         |
| Inventories                          | 13,632        | 18,811        | 30,000        | 39,000        | 50,700         |
| Other current assets - prepayments   | 374           | 763           | 850           | 950           | 1,100          |
| <b>Total current asset</b>           | <b>33,101</b> | <b>37,615</b> | <b>57,850</b> | <b>75,050</b> | <b>97,430</b>  |
| <b>Non-current assets</b>            |               |               |               |               |                |
| Available for sale listed investment | 7             | 5             | 8             | 12            | 14             |
| property,plant and quipment          | 2,695         | 2,262         | 2,800         | 3,500         | 4,200          |
| Deferred tax assets                  | 2,111         | 852           | 1,000         | 1,500         | 1,900          |
| Intangible assets                    | 1,907         | 1,907         | 1,907         | 1,907         | 1,907          |
| <b>Total non-current asset</b>       | <b>6,720</b>  | <b>5,026</b>  | <b>5,715</b>  | <b>6,919</b>  | <b>8,021</b>   |
| <b>Total assets</b>                  | <b>39,821</b> | <b>42,641</b> | <b>63,565</b> | <b>81,969</b> | <b>105,451</b> |
| <b>Current liabilities</b>           |               |               |               |               |                |
| Trade and other payables             | 8453          | 9243          | 19000         | 25000         | 32000          |
| Current tax liabilities              | 468           | 148           | 500           | 800           | 1040           |
| Short-term provisions                | 505           | 526           | 1500          | 1900          | 2470           |
| <b>Total current liabilities</b>     | <b>9426</b>   | <b>9917</b>   | <b>21000</b>  | <b>27700</b>  | <b>35510</b>   |
| <b>Non-current liabilities</b>       |               |               |               |               |                |
| Deferred tax liabilities             | 146           | 120           | 100           | 150           | 130            |
| Long -term provisions                | 35            | 28            | 33            | 35            | 34             |
| <b>Total non-current liabilities</b> | <b>181</b>    | <b>148</b>    | <b>133</b>    | <b>185</b>    | <b>164</b>     |
| <b>Total liabilities</b>             | <b>9607</b>   | <b>10065</b>  | <b>21133</b>  | <b>27885</b>  | <b>35674</b>   |
| <b>Net assets</b>                    | <b>30,214</b> | <b>32,576</b> | <b>42,432</b> | <b>54,084</b> | <b>69,777</b>  |
| <b>Total Equity</b>                  | <b>30,214</b> | <b>32,576</b> | <b>42,432</b> | <b>54,084</b> | <b>69,777</b>  |

| Cashflow  | 2016           | 2017           | 2018E          | 2019E          | 2020E          |
|---|----------------|----------------|----------------|----------------|----------------|
|   | \$000          |                |                |                |                |
| <b>Cash flows from operating activities</b>                 |                |                |                |                |                |
| Receipts from customers                                     | 37,338         | 46,081         | 62,000         | 80,000         | 104,000        |
| Payments to suppliers and employees                         | (37,397)       | (46,270)       | (56,000)       | (70,800)       | (85,000)       |
| Interest received   | 76             | 47             | 60             | 50             | 80             |
| Income tax received/(paid)                                  | (80)           | (453)          | (700)          | (900)          | (1,100)        |
| <b>Net cash inflow/ (outflow) from operating activities</b> | <b>(63)</b>    | <b>(595)</b>   | <b>5,360</b>   | <b>8,350</b>   | <b>17,980</b>  |
| <b>Net cash outflow from investing activities</b>           | <b>(19)</b>    | <b>(480)</b>   | <b>(600)</b>   | <b>(2,000)</b> | <b>(3,000)</b> |
| Dividends paid  | (1,239)        | (1,239)        | (2,478)        | (3,220)        | (5,796)        |
| <b>Net cash outflow from financing activities</b>           | <b>(1,239)</b> | <b>(1,239)</b> | <b>(2,478)</b> | <b>(3,220)</b> | <b>(5,796)</b> |
| <b>Net increase/(decrease) in cash held</b>                 | <b>(1,321)</b> | <b>(2,314)</b> | <b>2,282</b>   | <b>3,130</b>   | <b>9,184</b>   |
| Cash &cash equivalents at the beginning of the period       | 9,551          | 8,230          | 5,916          | 8,198          | 11,328         |
| <b>Cash and cash equivalents at the end of the period</b>   | <b>8,230</b>   | <b>5,916</b>   | <b>8,198</b>   | <b>11,328</b>  | <b>20,512</b>  |

## AITCH INVESTMENT

| Financial Ratios             | 2016      | 2017     | 2018E    | 2019E    | 2020E    |
|------------------------------|-----------|----------|----------|----------|----------|
| <b>Growth Rates</b>          |           |          |          |          |          |
| Growth of Net Sales          | 43.44%    | 11.52%   | 31.62%   | 30.00%   | 30.00%   |
| Growth of Earning before Tax | 77600.00% | 61.26%   | 86.75%   | 52.92%   | 64.47%   |
| Growth of Net Income         | 2113.00%  | 64.44%   | 86.48%   | 52.92%   | 64.47%   |
| <b>Profitability</b>         |           |          |          |          |          |
| Gross profit margin          | 20.18%    | 24.20%   | 27.00%   | 27.00%   | 30.00%   |
| Net profit margin            | 5.16%     | 7.60%    | 10.77%   | 12.67%   | 16.03%   |
| ROE                          | 7.32%     | 11.17%   | 15.99%   | 19.19%   | 24.46%   |
| <b>Liquidity Ratios</b>      |           |          |          |          |          |
| Quick Ratio                  | 2.07      | 1.896138 | 1.32619  | 1.301444 | 1.315967 |
| Current Ratio                | 3.5116698 | 3.792982 | 2.754762 | 2.709386 | 2.743734 |
| <b>Indicator per share</b>   |           |          |          |          |          |
| EPS(cent)                    | 1.34      | 2.20     | 4.11     | 6.28     | 10.33    |
| Book value(dollar)           | 0.1829137 | 0.197213 | 0.256881 | 0.327421 | 0.422426 |
| <b>Valuation ratios</b>      |           |          |          |          |          |
| PE                           | 119.40299 | 72.72727 | 38.92944 | 25.47771 | 15.48887 |
| PB                           | 8.7472931 | 8.11305  | 6.228571 | 4.886671 | 3.787648 |

## 6. Risks

Economic decline,

Food Safety Incident

Change in company management

## 7. Reference

## 8. General Advice Warning and Disclosure