



YaSheng Group (OTCQB: HERB) Analyst Report

Analyst Research Report Written by

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Osman Ghani is a CFA charter-holder and has prior experience in working in Investment banking, corporate finance, and business advisory services. His prior work experience includes working on a number of sectors including Healthcare, manufacturing, IT, real estate, financial services, and business services. He is currently completing his Phd in Finance from the Warwick Business School, University of Warwick, and has a undergraduate and graduate degrees in Accounting and Finance from the London School of Economics. He is also a qualified chartered accountant and a member of the Institute of Chartered Accountants in England and Wales, and he also holds the CAIA designation.

Ticker: *HERB*

Recommendation: *BUY*

Current Price: *\$1.60 Target Price: \$13.20*

Highlights:

- ✧ HERB is a diversified group that designs, develops, manufactures, and markets farming and side-line products, including chemical materials and products, textiles, construction materials and livestock.
- ✧ The company has generated significant growth in revenue and earnings over the past few years and has been able to increase its operating profit margin year on year.
- ✧ The company has also recently entered into agreements with HEMP Inc and with IBC International to respectively import hemp related products, and to develop and license infant and toddler formulas.
- ✧ We estimate that the current market price is undervalued and that the expected price should be closer to **\$13.2**. This represents a **725%** premium over the current market price.

Business Description

YaSheng Group (OTCQB: HERB), through its subsidiaries, designs, develops, manufactures, and markets farming and side-line products; chemical materials and products; textiles; construction materials; and livestock and poultry primarily in the People's Republic of China. The company was founded in 1998 and is based in Redwood City, California. YaSheng Group is a subsidiary of Gansu YaSheng Industrial Group Co., Ltd.

The company engages in cultivating, processing, marketing, and distributing various food and agro-by-products, which include field crops, such as cotton, corns, barley, wheat, flax, and alfalfa; vegetables, including onions, potatoes, beet, and peas; fruits comprising apples, pears, and apricots; specialty crops consisting of hops, wolfberries, cumin, hemp, and liquorices; and seeds, such as black melon, sunflower, corn, and flax seeds.

The Company is also involved in animal husbandry activities, and also provides animal food products consisting of chicken and eggs. The company's chicken operations include breeding and raising chickens, as well as processing live chickens into fresh, frozen, and value-added chicken products.

The company also manufactures construction materials that include ordinary Portland cement under the Tiger-Hunting Mountain brand name; and designs, develops, and markets new technologies related to agriculture and genetic biology. The company sells its products to direct customers; and to food processors, supermarkets, and wholesale stores through distributors. YaSheng Group also exports its products.

Overview of the Global Food Products Industry

According to Market Line, the global food products market grew by 5.2% in 2011 to reach a total value of \$4,126.3 Billion.

According to Market Line, by 2016, the global food products market is expected to have a total value of \$5,201 Billion, which represents an increase of 26% over the value in 2011.

Within the global food products market, the largest segment, representing nearly 40.6% of the total value is the Asia-Pacific region.

Kraft Foods Inc is the leading company in the global food products industry, accounting for nearly 1.4% of the total value.

The global food product market had total revenues of \$4,126.3 Billion in 2011, representing a compound annual growth rate (CAGR) of 4.3% between 2007 and 2011. The European and Asia-Pacific markets grew with CAGRs of 3.5% and 4.9% respectively, to reach values of \$1,276 billion and \$1,675.4 billion in 2011.

The agricultural products segment had total revenue of \$2,073.6 billion or 50.3%, while the packaged goods segment contributed revenue of \$2,052.7 billion or 49.7% of the aggregate revenue.

The performance of the industry is forecast by MarketLine to accelerate, with a forecast CAGR of 4.7% for 2011-2016, which is expected to grow the aggregate value to \$5,201 billion by 2016. The European and Asia-Pacific segments are forecast to grow with CAGRs of 3.6% and 5.5% respectively, to reach values of \$1,523.6 billion and \$2,187.5 billion by 2016.

Figure 1: Global Food products market value for 2007-2011 (in \$Billions)

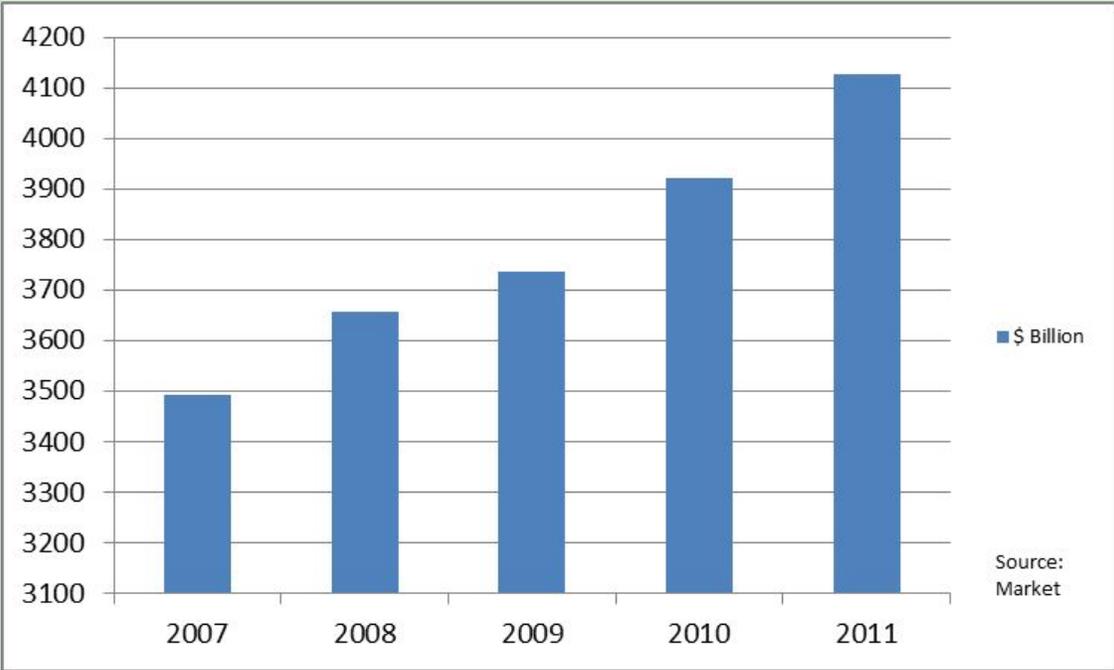


Figure 2: Geographical Revenues

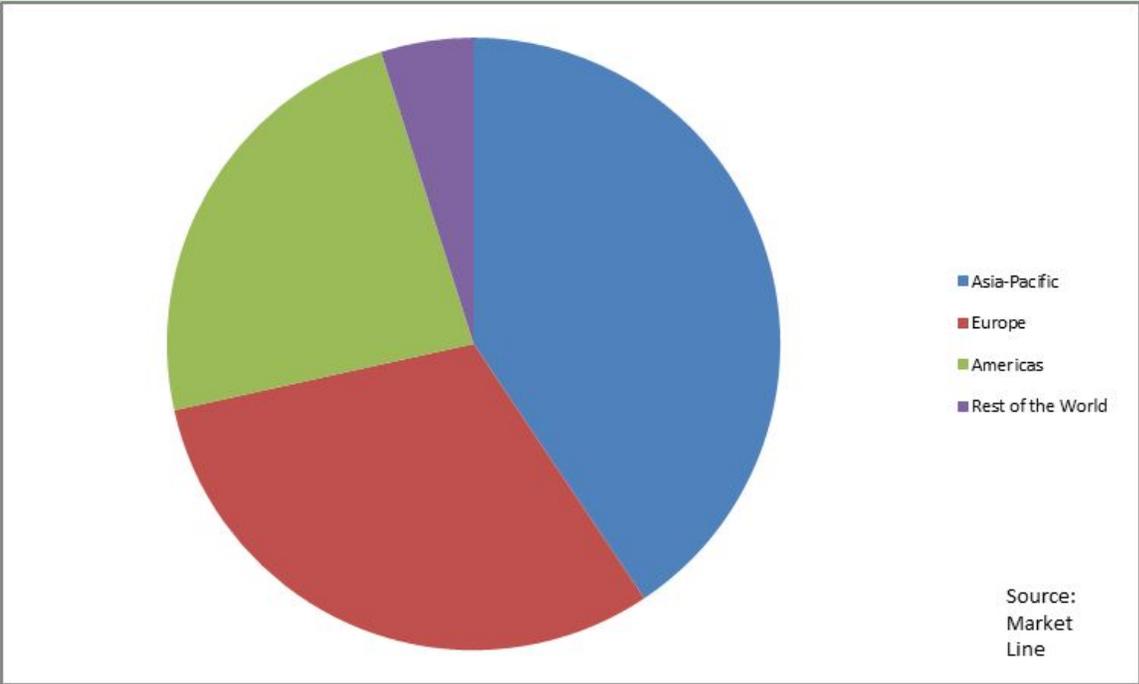
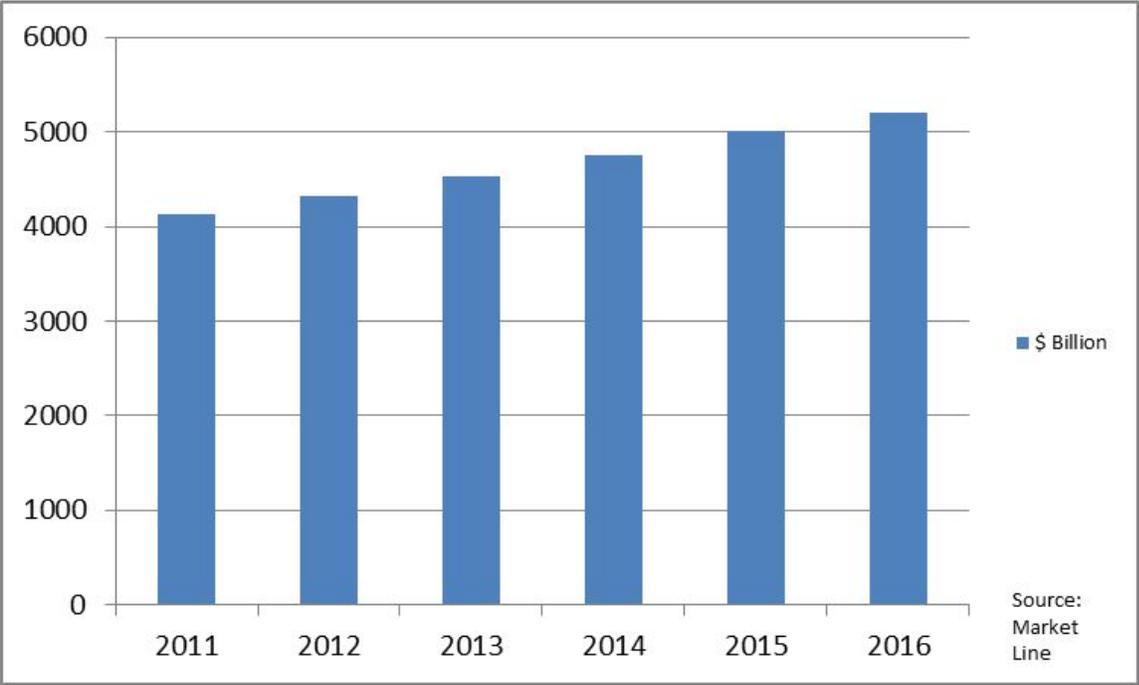


Figure 3: Global Food products market forecast: 2011-2016.



YaSheng Group

Yasheng Group, founded over 30 years ago, is a US holding company that conducts primarily agricultural operations in the Northwest of China. Today it is one of China's leading producers and marketers with six major product segments including field crops, vegetables, fruit, specialty crops, hops, hemp, seeds, beef and poultry. Yasheng is a supplier of high-quality agricultural products to world-famous conglomerates such as McDonald's, KFC, Tsingtao Beer, and Pepsi. The company is led by a highly qualified management team and has total assets of approximately \$2 billion, over 15,000 employees, and a history of strong sales and earnings growth.

In February 2014, the company announced that it had successfully shipped its first shipment of hulled hemp seeds to the US. The shipment is a first step in an agreement made last year between HEMP Inc and Yasheng to contract farm approximately 600 mu of hemp in China for import to the US. Yasheng is currently preparing to ship the remainder of the crop in the form of fibre, chaff and hulled seeds. The two companies are currently negotiating a new contract for the 2014 planting season.

Yasheng is expanding its industrial hemp production in response to growing worldwide demand for the crop based on the high nutritional value of the seeds and the antimicrobial properties of the plant's fibre. Hemp production is also increasingly attractive due to the lack of need for pesticides or herbicides, and the relatively small amount of water and fertilizer required for cultivation.

According to The Hemp Industries Association, 2012 retail sales for hemp products in the US exceeded \$500 million. It is estimated that there are more than 25,000 products on the global market today made from hemp materials.

In February of 2014, Yasheng established Hemp Route Limited, a subsidiary created to manage the international distribution of its hemp products.

In December 2013, HERB announced that it has entered into a Joint Venture with IBC International LLC (a Utah-based food manufacturer), to form Angel Star Nutrition LLC — a Delaware-based Limited Liability Company. The purpose of the new venture is to produce powdered infant formula and other nutrition products for distribution worldwide.

Yasheng Group and IBC have worked closely over the past 34 months to develop and license infant and toddler formulas for importation into mainland China to address China's increasing demand for foreign-made milk powder. During this period Yasheng Group has acquired the necessary licenses from China's CIQ to begin commercial shipment importation, while IBC has secured the necessary FDA and USDA approvals and plant certifications to begin production and exportation of powdered Infant formula.

Yasheng Group and IBC will be co-owners of Angel Star Nutrition LLC, with each party holding a 50% stake in the venture. Under the new agreement, Yasheng Group will retain all marketing rights for products produced by the venture and distributed in China, Hong Kong and Taiwan. The parties will work together to develop markets for Angel Star products in other countries. Angel Star products are currently in various stages of governmental approval in Vietnam, the Philippines, Indonesia and Mexico. Angel Star expects to expand its line of products into other areas of nutrition supplementation over the next 36 months — including products for aging adults and pregnant women, as well as supplements specifically designed for use by diabetics — an increasing problem in China.

According to the China Dairy Industry Association, the infant formula milk powder market in China has had an average annual increase of 22.9% since 2000 and is now the second largest in the world. It is estimated that the infant formula market will reach \$12.0 billion in 2013 and that China will become the worlds' largest consumer of infant milk powder in the near future, with over 20 million new-borns every year. Recent changes in China's one-child policy are expected to spur additional growth in this segment.

Financial position

Table 1: Income statement for 2008-2012 (key variables)

\$'000	2008	2009	2010	2011	2012
Revenue	736,213	739,630	849,454	949,131	993,103
Gross Profit	81,206	84,254	105,853	121,605	133,185
Revenue growth	12%	0%	15%	12%	5%
Gross profit margin	11%	11%	12%	13%	13%
Operating Profit	76,820	79,863	99,073	115,620	126,642
Operating margin	10%	11%	12%	12%	13%

Table 1 above shows that the company has experienced significant growth in revenue over the past few years. The company has been also able to maintain and improve its gross profit margin. The operating margin for the period is significant and has grown steadily over the past five years.

[Table 2: Balance sheet for 2008-12 \(key variables\)](#)

\$'000	2008	2009	2010	2011	2012
Total Assets	1,727,518	1,749,423	1,862,290	2,057,504	2,159,983
Total liabilities	200,235	141,611	108,803	98,441	69,215
Net tangaible Assets	1,527,283	1,607,812	1,753,487	1,959,063	2,090,768
Growth in Total assets	7%	1%	6%	10%	5%
Growth in Total liabilities	-20%	-29%	-23%	-10%	-30%
Cash	7,880	8,010	10,117	10,714	10,980

Table 2 shows the company has been able to grow its total assets over the past few years, while at the same time, reduce its liabilities, and thereby increase the Net asset position of the company. The balance of cash has also increased significantly from being around \$7.9 million in 2008 to nearly \$11 million in 2012.

Table 3: Cash flow for 2008-12 (key variables)

\$'000	2008	2009	2010	2011	2012
Net cash from operating activities	69,942	39,648	65,288	86,020	23,703
Net cash from investing activities	- 141,950	- 17,561	- 40,373	- 77,639	- 11,122
Net cash from financing	- 30,573	- 21,998	- 24,462	- 939	- 13,204

Table 3 shows the cash flow statement for 2008-12. The operating cash flow has been significant and positive for the five year period. Operating cash flow was down in 2012 due to an increase in inventories of nearly \$86 million.

Table 4: Revenue for the last four quarters

\$'000	Dec-12	Mar-13	Jun-13	Sep-13
Revenue	300,851	205,156	192,745	290,003
% growth	0%	-32%	-6%	50%

Table 4 shows that the revenue growth has been very volatile for the last four quarters. The total revenue for the last four quarters is \$989 million, and the net income was \$172 million, which represents a net profit margin of 17.4%.

Value of the company

Even if we ignore the potential revenue and earnings growth expected in 2014 due to the HEMP Inc and the Angel Star Nutrition agreements, HERB still looks undervalued compared to its earnings.

Based on the earnings of the last four quarters, we obtain earnings per share (EPS) of \$1.13 using the shares outstanding balance of 155.1 million.

Using the industry average Price/Earnings (P/E) ratio of 17.5.

We obtain an estimated Price of \$19.79.

However, only 14.15 million of the shares of free float, with the remaining 90.87% closely held.

We need to use a closed company discount of 33% to take into account the thinly traded nature of the company.

We obtain an adjusted value per share of **\$13.2**.

This represents a premium over the current market price of **725%**.

Summary

Yasheng Group (OTC: HERB) , through its subsidiaries, designs, develops, manufactures, and markets farming and sideline products; chemical materials and products; textiles; construction materials; and livestock and poultry primarily in the People's Republic of China. The company engages in cultivating, processing, marketing, and distributing various food and agro-by products, which include field crops, such as cotton, corns, barley, wheat, flax, and alfalfa; vegetables, including onions, potatoes, beet, and peas; fruits comprising apples, pears, and apricots; specialty crops consisting of hops, wolfberries, cumin, hemp, and liquorices; and seeds, such as black melon, sunflower, corn, and flax seeds.

The revenue and earnings generation of the company, the growing operating and net income margins, suggest to us that the company should be a **BUY**.

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