

Want Want China Holdings

Expect further de-rating on stagnant earnings growth [EXTRACT]

2014 results preview: revenue decline highlights structural issues

We expect Want Want China's (WW) net profit to drop 8% to US\$634m on a 1% revenue decline in 2014. In comparison, we expect Mengniu and Yili's revenue to achieve double-digit growth in 2014, suggesting WW is losing market share in the dairy segment. We attribute the margin squeeze mainly to higher milk powder costs and the company's negative operating leverage. However, we believe the revenue decline is more structural, due to fierce competition and a lack of product innovation, which has become even more prominent in a sluggish consumption environment. As evidence, we estimate WW's revenue declined 7% in H214 versus 6% growth in H114.

2015 outlook: pricing strategy and new product innovation will be focus

We expect 18% earnings growth in 2015, mainly due to our forecast of a 30% decline in the cost of imported milk powder, which could recover in 2016. We believe investment in marketing and branding activities to reverse declining revenue will offset some of the cost benefits. We do not feel WW's entry into the cold-temperature yoghurt segment will have a breakthrough in the near term given the company's lack of access to cold-chain infrastructure.

Expecting stagnant earnings growth in future

In our view, WW's earnings recovery in 2015 will be cyclical. Since March 2013, we have been of the view that WW's profitability has structurally peaked, given its under-investment in A&P spending compared to its consumer peers. We believe margin dilution over the next few years will be much higher than management expectations given: 1) WW does not have a good track-record in new product management; and 2) its reliance on traditional channels will pose increasing challenges as consumers shift to more modern trade channels.

Valuation: maintain Sell rating; cut price target from HK\$8.82 to HK\$7.67

We cut our 2014/2015/2016 earnings estimates 7%/3%/6% and expect a 4% earnings CAGR over the same period. Our new price target is a result of our lower long-term growth estimates and our near-term earnings cuts. We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool, assuming a WACC of 8.1%, and implying 19x 2016E PE, at the lower-end of the historical PE band.

Equities

China
Food Products

12-month rating **Sell**

12m price target **HK\$7.67**
Prior: HK\$8.82

Price **HK\$8.55**

RIC: 0151.HK **BBG:** 151 HK

Trading data and key metrics

52-wk range HK\$13.06-8.55

Market cap. HK\$113bn/US\$14.6bn

Shares o/s 13,252m (ORD)

Free float 42%

Avg. daily volume ('000) 15,390

Avg. daily value (m) HK\$146.1

Common s/h equity (12/14E) US\$2.15bn

P/BV (12/14E) 6.8x

Net debt / EBITDA (12/14E) NM

EPS (UBS, diluted) (US\$)

	From	To	% ch	Cons.
12/14E	0.05	0.05	-7.49	0.05
12/15E	0.06	0.06	-2.64	0.06
12/16E	0.05	0.05	-5.53	0.06

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Highlights (US\$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenues	2,947	3,359	3,818	3,774	3,802	3,916	4,111	4,335
EBIT (UBS)	522	711	883	786	934	847	847	850
Net earnings (UBS)	419	554	687	634	745	681	684	689
EPS (UBS, diluted) (US\$)	0.03	0.04	0.05	0.05	0.06	0.05	0.05	0.05
DPS (US\$)	0.02	0.03	0.03	0.03	0.04	0.03	0.03	0.03
Net (debt) / cash	412	496	802	779	853	979	1,097	1,220
Profitability/valuation	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
EBIT margin %	17.7	21.2	23.1	20.8	24.6	21.6	20.6	19.6
ROIC (EBIT) %	60.5	70.3	78.6	62.4	63.9	53.0	49.8	47.1
EV/EBITDA (core) x	19.4	19.4	18.7	15.4	12.9	13.8	13.6	13.3
P/E (UBS, diluted) x	28.2	28.7	27.6	23.0	19.6	21.4	21.3	21.2
Equity FCF (UBS) yield %	3.5	2.4	3.6	2.4	3.5	3.6	3.5	3.5
Net dividend yield %	2.2	2.4	2.4	2.9	3.4	3.1	3.1	3.2

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of HK\$8.55 on 27 Feb 2015 22:39 HKT

Investment Thesis

Want Want China Holdings

Investment case

We have a Sell rating on Want Want as we expect the stock to de-rate further due to stagnant earnings growth. We believe WW's profitability has structurally peaked and think margin dilution in the future will be much higher than market expectations, due to: 1) its under-investment in advertising and promotion spending compared to consumer peers; 2) lack of a good track record in new product management; and 3) the increasing challenges from consumers' shifting to modern trade. We expect an earnings recovery in 2015, but think it will be cyclical, as we estimate the cost of imported milk powder will decline 30%.

Upside scenario

In our upside scenario, we assume WW posts overall revenue growth of 8% in 2015 and 2016, in line with its consumer peers, (our base case is 1%/3% growth in 2015/2016), due to better-than-expected new product launches, resulting in 6%/10% earnings upside in 2015/2016. Assuming 21x 2016E PE, the current average multiple for the China staples sector, our implied upside valuation is HK\$9.32/share.

Downside scenario

In our downside scenario, we assume WW's recurring EBIT margin in 2016 declines to 16%, its five-year historical low in 2011, versus our base case of 19%, on higher-than-expected advertising and promotion expenses, resulting in 16% earnings downside in 2016E. Assuming 2016E PE of 17x, close to the historical trough, if the stock is further de-rated, our implied downside valuation is HK\$5.77/share.

Upcoming catalysts

Higher-than-expected margin dilution could further de-rate the stock. Better-than-expected revenue growth could be a positive catalyst.

12-month rating

Sell

12m price target

HK\$7.67

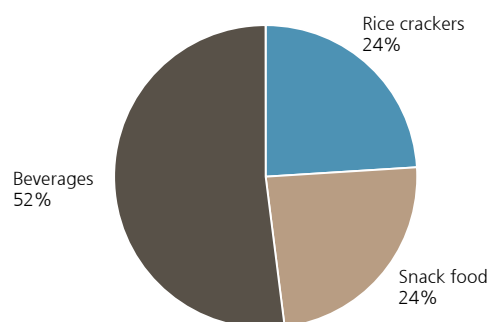
Business description

Want Want China Holdings' (Want Want) products include rice crackers, dairy products, beverages, and snack foods. It is focused on the China market, and is the market leader for most of its products. The 'Hot-kid' logo is one of the most widely-recognised F&B brands in China, and is particularly well-known among the younger generation. As at end-2013, Want Want had 36 production bases and 95 factories in China, with a network of around 8,000 distributors.

Industry outlook

We expect growth to slow for flavoured milk consumption in China, as we believe the segment is saturated. We believe the growth of flavoured milk products was mainly due to structural supply constraints for raw milk in China in the past; however, as large dairy processors become more proactive in upstream integration, plain milk penetration in rural areas might accelerate. Furthermore, competition in the children's milk segment is intense, and we expect further product diversification. As a result, we believe WW's Hot-kid milk is facing structural risk.

Revenue by product segment, 2013 (%)



Source: Company data

EBIT by product segment

(US\$ m)	2012	2013	2014E	2015E	2016E
Operating profit	711	883	786	934	847
Rice crackers	146	185	NA	NA	NA
Snack food	184	204	NA	NA	NA
Beverages	434	560	NA	NA	NA

Source: Company data, UBS estimates

This is an extract from our sector report, China Consumer Staples Sector—Will consumer staples companies benefit from another oil-led commodity crunch, as in 2009? published on 2 March 2015. For more detail, please refer to the longer report.

Want Want China Holdings (0151.HK)

Income statement (US\$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Revenues	2,947	3,359	3,818	3,774	-1.1	3,802	0.7	3,916	4,111	4,335
Gross profit	1,025	1,328	1,586	1,501	-5.4	1,679	11.9	1,612	1,643	1,682
EBITDA (UBS)	593	796	985	896	-9.0	1,066	18.9	993	1,008	1,028
Depreciation & amortisation	(70)	(85)	(102)	(111)	8.2	(131)	18.8	(146)	(162)	(178)
EBIT (UBS)	522	711	883	786	-11.0	934	18.9	847	847	850
Associates & investment income	0	1	2	2	0.0	2	0.0	2	2	2
Other non-operating income	0	0	0	0	-	0	-	0	0	0
Net interest	16	38	49	57	16.4	57	-0.6	59	62	66
Exceptionals (incl goodwill)	0	0	0	0	-	0	-	0	0	0
Profit before tax	538	749	934	844	-9.6	993	17.6	907	910	918
Tax	(119)	(195)	(247)	(211)	14.6	(248)	-17.6	(227)	(228)	(229)
Profit after tax	420	554	687	633	-7.8	744	17.6	680	683	688
Preference dividends and Minorities	0	0	1	1	0.0	1	0.0	1	1	1
Extraordinary items	0	0	0	0	-	0	-	0	0	0
Net earnings (local GAAP)	419	554	687	634	-7.8	745	17.6	681	684	689
Net earnings (UBS)	419	554	687	634	-7.8	745	17.6	681	684	689
Tax rate (%)	22.0	26.0	26.5	25.0	-5.5	25.0	0.0	25.0	25.0	25.0
Per share (US\$)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
EPS (UBS, diluted)	0.03	0.04	0.05	0.05	-7.8	0.06	17.6	0.05	0.05	0.05
EPS (local GAAP, diluted)	0.03	0.04	0.05	0.05	-7.8	0.06	17.6	0.05	0.05	0.05
EPS (UBS, basic)	0.03	0.04	0.05	0.05	-7.8	0.06	17.6	0.05	0.05	0.05
Net DPS (US\$)	0.02	0.03	0.03	0.03	-7.8	0.04	17.6	0.03	0.03	0.03
Book value per share	0.10	0.12	0.15	0.16	10.8	0.18	11.7	0.20	0.22	0.23
Average shares (diluted)	13,225.54	13,225.54	13,225.54	13,225.54	0.0	13,225.86	0.0	13,225.86	13,223.22	13,223.22
Balance sheet (US\$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Cash and equivalents	1,437	1,499	2,060	2,037	-1.1	2,111	3.6	2,237	2,355	2,478
Other current assets	666	769	851	815	-4.2	784	-3.8	834	887	946
Total current assets	2,103	2,268	2,911	2,852	-2.0	2,895	1.5	3,070	3,242	3,424
Net tangible fixed assets	891	1,046	1,236	1,495	21.0	1,630	9.0	1,758	1,884	2,009
Net intangible fixed assets	0	0	0	0	-	0	-	0	0	0
Investments / other assets	130	147	202	203	0.8	205	0.8	207	208	210
Total assets	3,123	3,461	4,348	4,551	4.7	4,729	3.9	5,034	5,333	5,643
Trade payables & other ST liabilities	742	831	1,104	1,098	-0.6	1,031	-6.1	1,111	1,185	1,267
Short term debt	775	350	410	410	0.00	410	0.00	410	410	410
Total current liabilities	1,517	1,181	1,515	1,508	-0.4	1,441	-4.4	1,522	1,595	1,677
Long term debt	250	653	847	847	0.0	847	0.0	847	847	847
Other long term liabilities	24	24	34	34	0.0	34	0.0	34	34	34
Preferred shares	0	0	0	0	-	0	-	0	0	0
Total liabilities (incl pref shares)	1,791	1,858	2,396	2,389	-0.3	2,322	-2.8	2,403	2,476	2,558
Common s/h equity	1,330	1,595	1,943	2,153	10.8	2,400	11.5	2,625	2,851	3,079
Minority interests	3	8	9	8	-8.3	7	-9.1	7	6	5
Total liabilities & equity	3,123	3,461	4,348	4,551	4.7	4,729	3.9	5,034	5,333	5,643
Cash flow (US\$m)	12/11	12/12	12/13	12/14E	% ch	12/15E	% ch	12/16E	12/17E	12/18E
Net income (before pref divs)	419	554	687	634	-7.8	745	17.6	681	684	689
Depreciation & amortisation	70	85	102	111	8.2	131	18.8	146	162	178
Net change in working capital	62	(14)	191	29	-84.9	(36)	-	31	21	23
Other operating	27	(9)	(28)	(59)	-112.2	(59)	0.5	(61)	(65)	(68)
Operating cash flow	579	616	953	714	-25.1	782	9.5	797	801	822
Tangible capital expenditure	(168)	(238)	(265)	(370)	-39.7	(266)	28.1	(274)	(288)	(303)
Intangible capital expenditure	0	0	0	0	-	0	-	0	0	0
Net (acquisitions) / disposals	0	(1)	(2)	0	-	0	-	0	0	0
Other investing	(54)	(5)	(7)	0	-	0	-	0	0	0
Investing cash flow	(222)	(244)	(273)	(370)	-35.3	(266)	28.1	(274)	(288)	(303)
Equity dividends paid	(259)	(378)	(460)	(424)	7.8	(499)	-17.6	(456)	(457)	(461)
Share issues / (buybacks)	0	0	0	0	-	0	-	0	0	0
Other financing	2	88	36	57	57.18	57	-0.56	59	62	66
Change in debt & pref shares	381	(22)	255	0	-	0	-	0	0	0
Financing cash flow	123	(312)	(169)	(367)	-117.4	(442)	-20.4	(397)	(395)	(395)
Cash flow inc/(dec) in cash	480	60	511	(23)	-	74	-	126	118	123
FX / non cash items	51	2	50	0	-	0	-	0	0	0
Balance sheet inc/(dec) in cash	531	62	561	(23)	-	74	-	126	118	123

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Want Want China Holdings (0151.HK)

Valuation (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
P/E (local GAAP, diluted)	28.2	28.7	27.6	23.0	19.6	21.4	21.3	21.2
P/E (UBS, diluted)	28.2	28.7	27.6	23.0	19.6	21.4	21.3	21.2
P/CEPS	24.1	24.8	24.0	19.6	16.6	17.6	17.2	16.8
Equity FCF (UBS) yield %	3.5	2.4	3.6	2.4	3.5	3.6	3.5	3.5
Net dividend yield (%)	2.2	2.4	2.4	2.9	3.4	3.1	3.1	3.2
P/BV x	8.9	10.0	9.8	6.8	6.1	5.6	5.1	4.7
EV/revenues (core)	3.9	4.6	4.8	3.7	3.6	3.5	3.3	3.2
EV/EBITDA (core)	19.4	19.4	18.7	15.4	12.9	13.8	13.6	13.3
EV/EBIT (core)	22.0	21.7	20.8	17.6	14.8	16.2	16.2	16.1
EV/OpFCF (core)	22.0	21.7	20.8	17.5	14.7	16.2	16.2	16.1
EV/op. invested capital	NM	NM	NM	NM	9.4	8.6	8.1	7.6
Enterprise value (US\$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Market cap.	11,852	15,902	19,025	14,611	14,611	14,611	14,611	14,611
Net debt (cash)	(337)	(454)	(649)	(791)	(816)	(916)	(916)	(916)
Buy out of minorities	3	8	9	8	7	7	6	5
Pension provisions/other	0	0	0	0	0	0	0	0
Total enterprise value	11,517	15,456	18,385	13,828	13,802	13,702	13,701	13,700
Non core assets	(3)	(3)	(6)	(6)	(6)	(6)	(6)	(6)
Core enterprise value	11,514	15,453	18,378	13,822	13,796	13,695	13,694	13,694
Growth (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Revenue	31.3	14.0	13.7	-1.1	0.7	3.0	5.0	5.4
EBITDA (UBS)	18.9	34.2	23.9	-9.0	18.9	-6.8	1.5	2.0
EBIT (UBS)	19.0	36.0	24.3	-11.0	18.9	-9.4	0.0	0.5
EPS (UBS, diluted)	17.0	32.0	24.1	-7.8	17.6	-8.6	0.4	0.8
Net DPS	-13.2	45.9	21.6	-7.8	17.6	-8.6	0.4	0.8
Margins & Profitability (%)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Gross profit margin	34.8	39.5	41.5	39.8	44.2	41.2	40.0	38.8
EBITDA margin	20.1	23.7	25.8	23.7	28.0	25.4	24.5	23.7
EBIT margin	17.7	21.2	23.1	20.8	24.6	21.6	20.6	19.6
Net earnings (UBS) margin	14.2	16.5	18.0	16.8	19.6	17.4	16.6	15.9
ROIC (EBIT)	60.5	70.3	78.6	62.4	63.9	53.0	49.8	47.1
ROIC post tax	47.1	52.0	57.7	46.7	47.9	39.7	37.3	35.3
ROE (UBS)	34.9	37.9	38.8	30.9	32.7	27.1	25.0	23.2
Capital structure & Coverage (x)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Net debt / EBITDA	(0.7)	(0.6)	(0.8)	(0.9)	(0.8)	(1.0)	(1.1)	(1.2)
Net debt / total equity %	(30.9)	(30.9)	(41.1)	(36.0)	(35.4)	(37.2)	(38.4)	(39.6)
Net debt / (net debt + total equity) %	(44.8)	(44.8)	(69.7)	(56.4)	(54.9)	(59.2)	(62.3)	(65.4)
Net debt/EV	(3.6)	(3.2)	(4.4)	(5.6)	(6.2)	(7.1)	(8.0)	(8.9)
Capex / depreciation %	NM	NM	NM	NM	NM	187.4	178.0	170.7
Capex / revenue %	5.7	7.1	6.9	9.8	7.0	7.0	7.0	7.0
EBIT / net interest	NM	NM	NM	NM	NM	NM	NM	NM
Dividend cover (UBS)	1.6	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Div. payout ratio (UBS) %	61.8	68.3	66.9	66.9	66.9	66.9	66.9	66.9
Revenues by division (US\$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	2,947	3,359	3,818	3,774	3,802	3,916	4,111	4,335
Total	2,947	3,359	3,818	3,774	3,802	3,916	4,111	4,335
EBIT (UBS) by division (US\$m)	12/11	12/12	12/13	12/14E	12/15E	12/16E	12/17E	12/18E
Others	522	711	883	786	934	847	847	850
Total	522	711	883	786	934	847	847	850

Source: Company accounts, UBS estimates. (UBS) metrics use reported figures which have been adjusted by UBS analysts.

Forecast returns

Forecast price appreciation	-10.3%
Forecast dividend yield	3.4%
Forecast stock return	-6.9%
Market return assumption	9.4%
Forecast excess return	-16.3%

Statement of Risk

We believe the key risks for the consumer industry include: 1) any significant slowdown in the economy and consumption; 2) competition; 3) cost inflation; 4) price resistance; 5) a change in government policies; 6) regulation; and 7) forex; and 8) refinancing risks.

The company's raw materials costs are uncertain because of highly volatile agricultural prices globally. Want Want relies on third-party distributors and logistics companies to distribute and transport its products. Therefore, delays will impact the company's sales and reputation. A low effective tax rate is also a risk for the company, in our view.

Required Disclosures

This report has been prepared by UBS Securities Asia Limited, an affiliate of UBS AG. UBS AG, its subsidiaries, branches and affiliates are referred to herein as UBS.

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage ¹	IB Services ²
Buy	FSR is > 6% above the MRA.	47%	37%
Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	11%	21%
Short-Term Rating	Definition	Coverage ³	IB Services ⁴
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%

Source: UBS. Rating allocations are as of 31 December 2014.

1:Percentage of companies under coverage globally within the 12-month rating category. 2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category. 4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: **Forecast Stock Return (FSR)** is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

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UBS AG Hong Kong Branch: Christine Peng, CFA; Erica Poon Werkun, CFA. **UBS Securities Co. Limited:** Anne Huang.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Want Want China Holdings¹⁶	0151.HK	Sell	N/A	HK\$8.55	27 Feb 2015

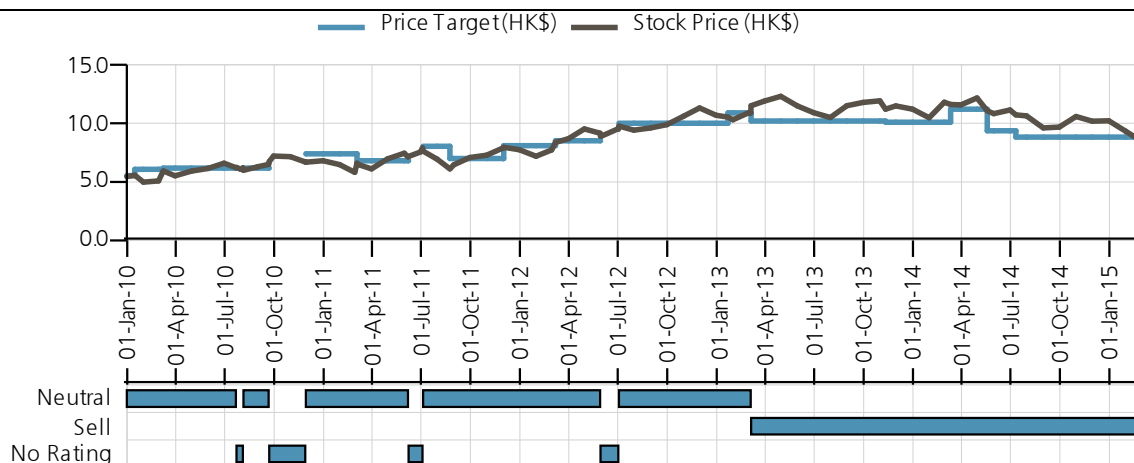
Source: UBS. All prices as of local market close.

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Want Want China Holdings (HK\$)



Source: UBS; as of 27 Feb 2015

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