

JPM-pp1

Asia Pacific Equity Research

16 March 2015

# Want Want China Holdings Ltd (151 HK)

Underweight

Price: HK\$8.00

13 Mar 2015

Price Target: HK\$7.00

PT End Date: 31 Dec 2015

FY14 preview - reporting on 17 March 2015

Want Want is expected to report its FY14 result on 17 March, 2015 during lunch break. The company will hold its briefing at 4:00pm Hong Kong time.

- **Challenges ahead, de-rating likely to continue.** We expect Want Want to report USD625mn net profit for FY14, down 9% y/y on the back of weak sales performance. This implies 19% y/y decline for 2H14 earnings. Weak results will be a non event as the company recently issued a profit warning noting that sales and net profit for FY14 is likely to be down low single digit and mid-to-high single digit y/y, respectively. Post the profit warning we downgraded Want Want (WW) to UW as we believe further de-rating is on the way as potential margin recovery on the back of input cost correction takes the back seat and focus is now on top line slowdown. WW used to be a core holding among China consumer names given its: i) dominant market share in niche categories with little competitive pressure, ii) strong pricing power which meant that it was able to pass on input cost increases via ASP increase and reported strong margin expansion when input costs corrected as it had little need to boost A&P, and iii) on the back of all these had strong top line driven both by volume and ASP. We believe all these pillars have cracked. With a structural slowdown in top line growth (due to high penetration and tough competition) and almost no pricing power left (which likely means not benefitting from input costs correction as it used to do) we believe the stock's de-rating which just started will continue.

- **2H14 estimates:** For 2H14 we expect 7% y/y decline in sales as we model very weak rice cracker sales (partly due to the calendar shift in Chinese New Year, leading to 20 days short of sales period for gift pack this year compared to last year) and decline in dairy and beverage sales as well given tough competition WW is facing in this segment. We believe given weak sales performance WW has still been using high-cost milk powder inventory throughout 2H14. Given high costs and declining sales we expect overall GPM and EBIT margin to be down 280bps and 340bps y/y, respectively in 2H14. We expect 2H14 net profit to be down 19% y/y on the back of these factors.

- **2015 expectations:** For FY15 we are modeling 9% increase in consolidated sales for now which builds in a recovery in rice cracker sales (better seasonality) and c6% y/y growth in dairy and beverage segment. We believe our sales estimates for the dairy segment could have downside risk if WW is unable to address the competition. Given the decline in whole milk powder cost during 2014, we expect WW to benefit from low input costs in FY15 and model in some recovery in EBIT margins (250bps expansion). However, we believe there could be downside risk to this as well if the company chooses to use entire GPM expansion to boost sales which is a bigger issue now.

- **Major issues to focus on during the results briefing:** 1) Management thoughts on how to address slowing dairy segment sales (particularly hot kids milk). 2) Update on new products 3) Thoughts on promotion efforts to boost sales in 2015.

Table 1: JPM's estimates on Want Want's 2H14 and FY14 results

USDmn	2H13	2H14E	% chg y/y	FY13	FY14E	% chg y/y
Sales revenue	2,063	1,914	-7%	3,818	3,767	-1%
Gross profit	862	746	-14%	1,586	1,493	-6%
Gross margin	41.8%	39.0%		41.5%	39.6%	
Other income	37	53	46%	78	94	20%
Total operating expenses	-413	-413	0%	-781	-806	3%
EBIT	486	387	-20%	883	781	-12%
EBIT margin	23.6%	20.2%		23.1%	20.7%	
Net interest income (expense)	27	24	-10%	49	56	14%
Associates	1	2		2	2	
Pretax profit	514	412	-20%	934	839	-10%
Tax	-135	-106	-22%	-247	-214	-13%
Effective tax rate	-26%	-26%		-26%	-26%	
Minority interests	1	1		1	1	
<b>Net profit</b>	<b>380</b>	<b>307</b>	<b>-19%</b>	<b>687</b>	<b>625</b>	<b>-9%</b>

Net margin	18.4%	16.0%	18.0%	16.6%
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Source: Company reports. Source: Company data, Bloomberg and J.P. Morgan estimates.

Table 2: Revenue, Gross Profit and EBIT breakdown by product category

USDmn	2H13	2H14E	% chg y/y	FY13	FY14E	% chg y/y
<b>Revenue breakdown</b>						
Rice crackers	590	502	-15%	910	806	-11%
Dairy products & beverages	1,057	1,010	-4%	1,999	1,997	0%
Snack foods	412	397	-4%	900	955	6%
Others	5	5	4%	9	9	0%
<b>Total</b>	<b>2,063</b>	<b>1,914</b>	<b>-7%</b>	<b>3,818</b>	<b>3,767</b>	<b>-1%</b>
<b>Gross profit breakdown</b>						
Rice crackers	257	205	-20%	371	323	-13%
Dairy products & beverages	425	367	-14%	826	747	-10%
Snack foods	178	169	-5%	387	421	9%
Others	2	5	210%	2	3	5%
<b>Total</b>	<b>862</b>	<b>746</b>	<b>-14%</b>	<b>1,586</b>	<b>1,493</b>	<b>-6%</b>
<b>EBIT breakdown</b>						
Rice crackers	147	95	-35%	185	145	-21%
Dairy products & beverages	287	224	-22%	560	467	-17%
Snack foods	87	83	-5%	204	221	8%
Unallocated costs	-35	-16	-55%	-65	-52	-21%
<b>Total EBIT</b>	<b>486</b>	<b>387</b>	<b>-20%</b>	<b>883</b>	<b>781</b>	<b>-12%</b>

Source: Company reports. Source: Company data, Bloomberg and J.P. Morgan estimates.

## Investment Thesis

We reiterate UW on Want Want (WW). We believe further de-rating is on the way as potential margin recovery on the back of input cost correction takes the back seat and focus is now on top line slowdown. WW used to be a core holding among China consumer names given its: i) dominant market share in niche categories with little competitive pressure; ii) strong pricing power which meant that they were able to pass on input cost increases via ASP increase and reported strong margin expansion when input costs corrected as they had little need to boost A&P; and iii) on the back of all these had strong top line driven both by volume and ASP. We believe all these pillars have cracked. With a structural slowdown in top line growth (due to high penetration and tough competition) and almost no pricing power left (which likely means not benefitting from input costs correction as they used to do), we believe the stock's de-rating which just started will continue.

## Valuation

Our Dec-15 PT of HK\$7 is based on 16x one-year forward P/E, 2-standard deviation below the historical mean as growth rates are lower than in the past.

## Risks to Rating and Price Target

Risks to our UW rating and price target include: i) a stronger-than-expected margin recovery in 2015 which should kick in after 1Q, thanks to low milk powder price and likely lead to decent earnings growth this year; and ii) seasonal sales momentum, which might mean we are likely to have strong 1Q15 sales given the shift in CNY.

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## Consumer

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<http://gps-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=503771&shareClassServerId=4&chartDesignation=1&actionType=C>

Date	Rating	Share Price (HK\$)	Price Target (HK\$)
09-Feb-10	N	5.08	5.20
10-Mar-10	N	5.86	5.40
28-Jun-10	N	6.57	5.80
25-Aug-10	N	6.06	5.80
04-Nov-10	OW	7.43	8.80
17-Jul-11	N	7.29	8.00
24-Aug-11	N	6.28	6.50
12-Oct-11	N	6.89	6.00
07-Mar-12	N	7.52	7.00
02-Jul-12	N	9.76	7.60
30-Aug-12	N	10.14	8.50
16-Jan-13	N	10.16	9.00
05-Mar-13	N	11.08	9.50
27-Aug-13	N	10.42	10.00
12-Mar-14	N	10.86	10.50
26-Jul-14	N	10.60	10.20
25-Nov-14	N	10.22	9.90
11-Feb-15	UW	8.73	7.00

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