

JPM-pp1

Asia Pacific Equity Research

17 March 2015

Uni-President China Holdings Ltd (220 HK)

Neutral

Price: HK\$5.57

13 Mar 2015

Price Target: HK\$5.50

PT End Date: 31 Dec 2015

First take: Operating profit in line, earnings miss on lower associate income

UPC announced net profit of RMB286mn, down c69% y/y at headline level; down 43% y/y at recurring level and c20% below our estimates which was 13% below consensus estimates. The miss at recurring profit level is due to lower than expected associate income and higher than expected effective tax rate. In fact at operating profit level UPC reported RMB372mn operating profit which came 7% above our estimate thanks to better than expected beverage margins in 2H. We think results could be slightly disappointing for consensus which was higher than our estimates. We remain cautious on the name as we believe the stock trades at demanding multiples at 26x 15E and 23x 16E on our numbers which: i) already build in a very optimistic scenario for the new noodles product, and ii) better beverage margins with the help of low PET costs. We believe success of Gemian is still uncertain and even if successful as we have seen in the past, we are likely to see major competitors coming up with a similar product, taking away some market share. We remain Neutral given the strong earnings turnaround expected in FY15, which we think is in the price.

- **Noodles back into black:** Noodles sales were flat in 2H14, lower than our estimate of 5% growth. However as expected this segment's profit is back into black. Noodles posted RMB22mn operating profit in 2H14 (in line with our estimate of RMB19mn) following the losses posted since 1H13. This was mainly due to a cease fire in promotional wars in noodles segment between the major players in our view.
- **Beverages' weak top line but flat margins:** Beverage sales were down 14% y/y during 2H14 and came c9% below our estimates. We were expecting some erosion in EBIT margins due to weak sales but UPC managed to maintain beverage EBIT margin flat y/y at 1.4%. We reckon this could be due to savings at raw material front. Though it is worth noting that 1.4% is the lowest level the company has reported for 2H beverage margins so far.

Table 1: 2H14 product segment breakdown vs JPM estimates

RMB mn	2H13	2H14A	%chg y/y	2H14E	Actual/Est
Revenue Breakdown					
Beverage	6,890	5,913	-14.2%	6,459	-8.5%
Instant noodles	4,049	4,021	-0.7%	4,228	-4.9%
Others	186	187	0.7%	344	-45.6%
Total	11,125	10,121	-9.0%	11,032	-8.3%
EBIT breakdown					
Beverage	98	82	-16.6%	-13	na
Instant noodles	-82	22	-127.3%	19	21.2%
Others	296	-149	-150.2%	-76	na
Total	312	-44	-114.1%	-70	-36.9%
EBIT margin breakdown					
Beverage	1.4%	1.4%		-0.2%	
Instant noodles	-2.0%	0.6%		0.4%	
Total	2.8%	-0.4%		-0.6%	

Source: J.P. Morgan estimates, Company data.

Table 2: FY14 product segment breakdown vs JPM estimates

RMB mn	FY13	FY14A	%chg y/y	FY14E	Actual/Est
Revenue Breakdown					
Beverage	15,152	14,005	-7.6%	14,551	-3.8%
Instant noodles	7,826	7,960	1.7%	8,168	-2.5%
Others	352	523	48.7%	680	-23.1%

Total	23,329	22,488	-3.6%	23,399	-3.9%
EBIT breakdown					
Beverage	597	702	17.7%	608	15.6%
Instant noodles	-143	-94	-34.4%	-98	-4.0%
Others	478	-237	-149.6%	-164	44.4%
Total	932	372	-60.1%	346	7.5%
EBIT margin breakdown					
Beverage	3.9%	5.0%		4.2%	
Instant noodles	-1.8%	-1.2%		-1.2%	
Total	4.0%	1.7%		1.5%	

Source: J.P. Morgan estimates, Company data.

Table 3: UPC 2H14 results vs JPM estimates

RMB mn	2H13	2H14A	%chg y/y	2H14E	Actual/Est
Sales revenue	11,125	10,121	-9.0%	11,032	-8.3%
COGS	(7,490)	(6,832)	-8.8%	(7,640)	-10.6%
Gross profit	3,635	3,289	-9.5%	3,392	-3.1%
Gross margin	32.7%	32.5%		30.7%	
Other income	585	351	-40.1%	254	38.1%
as % of sales	5.3%	3.5%		2.3%	
Total operating expenses	(3,908)	(3,683)	-5.7%	(3,716)	-0.9%
as % of sales	-35.1%	-36.4%		-33.7%	
EBIT	312	-44	-114.2%	-70	-36.9%
EBIT margin	2.8%	-0.4%		-0.6%	
Recurring EBIT	60	(44)		(70)	-36.9%
Recurring EBIT margin	0.5%	-0.4%		-0.6%	
Interest income	81	61	-24.8%	79	-23.1%
Interest expenses	-46	-39	-15.9%	-120	-67.4%
Associates	40	-18	-143.9%	119	-114.8%
Pretax profit	387	-40	-110.3%	8	na
Tax	-45	-30	-33.8%	-2	na
Effective tax rate	-11.7%	74.9%		-20.8%	
Net profit	342	(70)	-120.5%	6	na
Net margin	3.1%	-0.7%		0.1%	
Recurring net profit	90	(70)		6	
Recurring net margin	0.8%	-0.7%		0.1%	

Source: J.P. Morgan estimates, Company data.

Table 4: UPC FY14 results vs JPM estimates

RMB mn	FY13	FY14A	%chg y/y	FY14E	Actual/Est
Sales revenue	23,329	22,488	-3.6%	23,399	-3.9%
COGS	(15,549)	(15,179)	-2.4%	(15,987)	-5.1%
Gross profit	7,780	7,308	-6.1%	7,412	-1.4%
Gross margin	33.3%	32.5%		31.7%	
Other income	949	424	-55.3%	328	29.5%
as % of sales	4.1%	1.9%		1.4%	
Total operating expenses	(7,796)	(7,361)	-5.6%	(7,394)	-0.4%
as % of sales	-33.4%	-32.7%		-31.6%	
EBIT	932	372	-60.1%	346	7.5%
EBIT margin	4.0%	1.7%		1.5%	
Recurring EBIT	448	372	-17.0%	346	7.5%
Recurring EBIT margin	1.9%	1.7%		1.5%	
Interest income	179	105	-41.3%	124	-14.8%
Interest expenses	-84	-147	75.6%	-228	-35.4%
Associates	88	85	-3.9%	221	-61.6%
Pretax profit	1,116	415	-62.8%	463	-10.4%
Tax	-200	-129	-35.3%	-101	28.0%
Effective tax rate	-17.9%	-31.1%		-21.8%	
Net profit	916	286	-68.8%	362	-21.1%
Net margin	3.9%	1.3%		1.5%	
Recurring net profit	501	286	-43.0%	362	
Recurring net margin	2.1%	1.3%		1.5%	

Source: J.P. Morgan estimates, Company data.

Table 5: UPC's semi-annual revenue, gross profit and EBIT trends

RMB mn	1H11	2H11	1H12	2H12	1H13	2H13	1H14	2H14
Revenue Breakdown								
Beverage	5,834	4,855	7,114	6,800	8,262	6,890	8,092	5,913

Instant noodles	2,794	3,143	3,420	3,849	3,777	4,049	3,939	4,021
Others	172	135	114	109	166	186	336	187
Total	8,799	8,133	10,648	10,758	12,204	11,125	12,367	10,121
EBIT breakdown								
Beverage	145	84	430	335	498	98	620	82
Instant noodles	52	113	178	48	-60	-82	-116	22
Others	-41	-91	-66	-42	182	296	-88	-149
Total	156	105	541	341	620	312	416	-44
EBIT margin breakdown								
Beverage	2.5%	1.7%	6.0%	4.9%	6.0%	1.4%	7.7%	1.4%
Instant noodles	1.9%	3.6%	5.2%	1.2%	-1.6%	-2.0%	-2.9%	0.6%
Total	1.8%	1.3%	5.1%	3.2%	5.1%	2.8%	3.4%	-0.4%

Source: Company data.

Investment Thesis

We have tweaked up our FY15 estimates by c5% as we model low PET costs to benefit the beverage segment slightly. The share price has corrected c15% (vs HSI +3%) since Nov 2014, but the stock is still trading at demanding multiples in our view with 35x 15E and 24x 16E on our numbers which: i) already build in a very optimistic scenario for the new noodles product, and ii) better beverage margins with the help of low PET costs. We believe success of Gemian is still uncertain and even if successful as we have seen in the past, we are likely to see major competitors coming up with a similar product, taking away some market share. We remain Neutral given the strong earnings turnaround expected in FY15, which we think is in the price.

Valuation

Our Dec-15 PT of HK\$5.5 is based on P/E of 21x one year forward earnings, which is 1-standard deviation below the average P/E.

Risks to Rating and Price Target

Key upside and downside risks to our rating and price target include: 1) the successful launch of new products, and 2) the promotional environment unexpectedly getting better/worse with competitors cutting back on promotions.

Consumer

AC

Ebru Sener Kurumlu

(852) 2800-8521

ebru.sener@jpmorgan.com

Bloomberg JPMA KURUMLU <GO>

Shen Li, CFA

(852) 2800 8523

shen.w.li@jpmorgan.com

George Hsu

(852) 2800-8559

george.hsu@jpmorgan.com

Dylan Chu

(852) 2800-8537

dylan.chu@jpmorgan.com

J.P. Morgan Securities (Asia Pacific) Limited

www.jpmorganmarkets.com

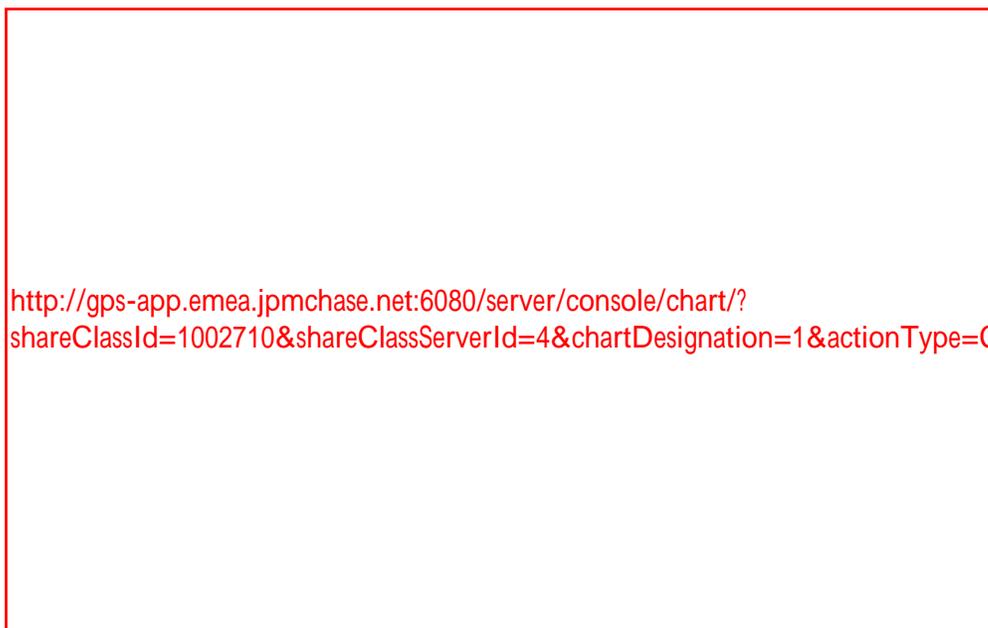
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21-Jun-09	N	3.91	3.50
28-Aug-09	N	4.39	4.70
01-Feb-10	N	4.73	5.00
27-Apr-10	UW	4.88	4.40
23-Aug-10	UW	4.53	4.00
07-Sep-11	N	4.22	4.50
12-Oct-11	N	4.34	4.20
19-Feb-12	N	4.82	4.00
05-Jun-12	UW	6.46	5.00
27-Aug-12	UW	7.83	5.80
10-Oct-12	UW	9.30	6.80
16-Jan-13	N	9.20	8.30
26-Mar-13	N	10.08	8.00
09-Aug-13	N	7.06	6.50
20-Mar-14	UW	7.24	4.00
26-Jul-14	UW	6.61	3.50
24-Sep-14	N	7.31	6.50
25-Nov-14	N	7.24	6.00
25-Feb-15	N	6.14	5.50

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