

Want Want China

151 HK

Target (HKD): **11.60 → 11.00**

Upside: **37.8%**

17 Mar price (HKD): **7.98**

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

Weak 2014 results a good entry point

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- 2014 net profit off 9.7% YoY, in line with our expectation
- But revenue-growth recovery and operating-margin improvement are in sight
- WWC remains our top sector pick, supported by potential buyback. Buy (1) reaffirmed

■ What's new

Want Want China (WWC) reported 2014 net earnings of USD619m, down 9.7% YoY but in line with our expectation. While we revise down our earnings forecasts and 12-month TP, we remain positive on the stock given our expectation of: 1) a sales growth recovery for rice crackers in 2015, 2) more new product initiatives and promotions in hypermarkets and supermarkets (KA channels), and 3) disciplined advertising and promotion (A&P) cost control. Buy (1) reiterated.

■ What's the impact

Star products in the making. New products contributed 5% of WWC's revenue in 2014, in line with prior guidance. In particular, the "sip & slurp" series supported 28% YoY growth in WWC's popsicle snack revenue. Potential star products planned for 2015 include: 1) cold-chain items such as pudding snacks and yogurts co-developed with Morinaga (2201 JP, Not rated), and 2) low-sugar "hot kid" milk. We

expect its new products to target young consumers, while new flavours and health concepts appeal to parents and other new customers.

Dividend likely to increase again. WWC's dividend payout ratio for 2014 fell to 51%, from 67% in 2013, on negative free cashflow and increased capex (USD354m). Its inventory level also surprised on the downside, at 97 days (2013: 81 days), with a high average procurement price of milk powder and slowdown in daily beverage sales resulting in a decline in operating cashflow. We expect WWC to continue to distribute all of its free cashflow as dividends, translating to a 75% payout ratio for 2015-17E, backed by: 1) a recovery in earnings growth to 13% YoY in 2015 and 20% YoY in 2016E, and 2) reduced capex requirements and a significant fall in inventory days. Alternatively, the company could use its strong cash inflows to buy back more shares (it spent USD39m on buybacks in 2014).

Balancing KA sales growth and selling cost control. KA channels accounted for less than 10% of WWC's revenue in 2013-14. Management intends to invest in promotions for these channels by introducing more promoters, preparing product piles with new designs and packaging, and offering some cold-chain items exclusively to KA channels. Through enhanced scale economies and a relocation of resources, management expects to keep A&P costs to less than 4% of revenue in the future (2014: 3.7%).

■ What we recommend

We revise down 2015-16E EPS by 5-6% to factor in the increased selling expenses in 2014; we also introduce 2017E forecasts. In turn, we lower

our 12-month TP to HKD11.0 from HKD11.6, on an unchanged 2015E PER of 24.6x (the stock's past-5-year average). Given our view that an earnings growth recovery is now in sight, we believe WWC should at least trade on par with its historical average valuation. The main risk to our call: higher-than-expected promotional expenses.

■ How we differ

Our 2016-17E EPS are above the Bloomberg consensus, as we are more optimistic about the impact of product-mix upgrades on margins.

Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	0.5	0.5	n.a.
Net profit change	(5.6)	(4.8)	n.a.
Core EPS (FD) change	(5.5)	(4.6)	n.a.

Source: Daiwa forecasts

Share price performance



12-month range	7.97-13.06
Market cap (USDbn)	13.56
3m avg daily turnover (USDm)	18.92
Shares outstanding (m)	13,192
Major shareholder	Eng-meng Tsai (48.0%)

Financial summary (USD)

Year to 31 Dec	15E	16E	17E
Revenue (m)	4,095	4,530	5,012
Operating profit (m)	971	1,119	1,261
Net profit (m)	753	872	987
Core EPS (fully-diluted)	0.057	0.066	0.075
EPS change (%)	21.9	15.7	13.3
Daiwa vs Cons. EPS (%)	(0.7)	4.9	11.7
PER (x)	18.0	15.6	13.7
Dividend yield (%)	4.2	4.8	5.5
DPS	0.043	0.050	0.056
PBR (x)	5.5	4.9	4.3
EV/EBITDA (x)	11.6	10.0	8.7
ROE (%)	33.3	33.1	33.4

Source: FactSet, Daiwa forecasts

■ **Want Want: 2014 results by segment**

	2014	2013	YoY (%)	2H14	2H13	YoY (%)	1H14	1H13	YoY (%)	Comment
Rice crackers (18% of 2014 operating profit)										
Sales (USD m)	812	910	-11	508	590	-14	304	320	-5	Gift pack sales declined 30% YoY to USD175m in 2014 and accounted for 22% of revenue (2013: 27%). Core brand rice crackers sales were also affected by a shift in the timing of Lunar New Year (LNY), though the impact was partially offset by new products. With a longer sales period related to LNY (from 71 days in 2014 to 101 days in 2015), we expect this segment's revenue growth to recover to 11% YoY in 2015 and show a slight improvement in gross margin.
GPM (%)	39.9	40.8	-0.9pp	40.7	43.6	-2.9pp	38.6	35.6	+3.0pp	
OPM (%)	18.8	20.3	-1.5pp	20.2	24.9	-4.7pp	16.5	11.8	+4.7pp	
Operating profit (USD m)	153	185	-17	102	147	-30	50	38	33	
Snack food (25% of 2014 operating profit)										
Sales (USD m)	963	900	7	405	412	-2	558	488	14	Snacks were the only segment to show both YoY volume and price increases in 2014, supported by new products. The segment's operating margin declined YoY in 2H14, as demand for the new star product, "sip and slurp" yogurt, was weak in the winter. With new snacks such as puddings and cookies to be launched in 2015, we expect the gross margin and revenue to improve further in 2015.
GPM (%)	44.9	43.0	+1.9pp	44.5	43.4	+1.1pp	45.2	42.7	+2.5pp	
OPM (%)	22.4	22.7	-0.4pp	19.1	21.3	-2.2pp	24.7	23.9	+0.8pp	
Operating profit (USD m)	215	204	5	77	87	-12	138	117	18	
Beverages (57% of 2014 operating profit)										
Sales (USD m)	1,993	1,999	0	1,006	1,057	-5	987	942	5	Milk powder costs were up 27% YoY on average in 2014, driving down the gross margin by 3.5pp YoY. However, the gross margin stabilised in 2H14 at 38%, and management expects the gross margin on beverages to improve in 2015. O-bubble drinks' revenue was up by a double-digit percentage in 2014, and WWC introduced nectars and functional drinks to tap the increasing demand for more wholesome products. We expect 1H15 revenue growth to remain sluggish due to a high base of comparison ahead of a significant improvement in 2H15.
of which hot kid milk	1,785	1,800	-1	912	948	-4	873	852	2	
GPM (%)	38.4	41.3	-2.9pp	38.3	40.2	-1.9pp	38.5	42.5	-4.0pp	
OPM (%)	24.5	28.0	-3.5pp	24.4	27.2	-2.8pp	24.6	28.9	-4.4pp	
Operating profit (USD m)	488	560	-13	245	287	-15	243	273	-11	

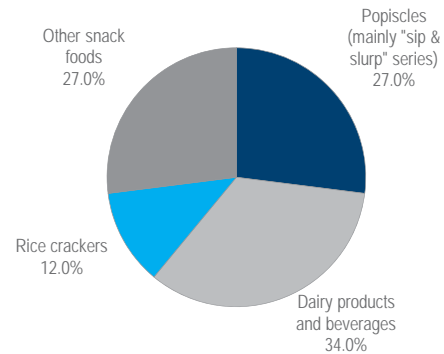
Source: Company, Daiwa

■ **Want Want: product pile featuring new rice cracker products and new O-bubble drink with souvenir**



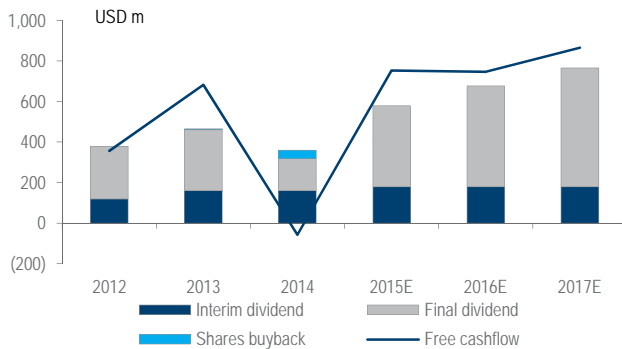
Source: Company, Daiwa

■ **Want Want: revenue breakdown of new products (2014)**



Source: Company

■ **Want Want: free cashflow and cash return to shareholders (USDm)**



Source: Company, Daiwa forecasts

■ **Want Want: balance sheet and cash conversion cycle analysis**

	2011	2012	2013	1H14	2014	2015E	2016E	2017E
Inventory days	71	78	81	101	97	95	81	81
-raw materials and packaging	n.a.	n.a.	50	72	70	n.a.	n.a.	
Receivable days	16	18	16	13	14	12	12	12
Payable days	37	40	42	37	39	34	35	35
Cash conversion cycle	50	56	55	77	73	74	58	58
USD m								
Inventory	410	461	534	701	667	538	594	656
Receivables	256	308	317	93	272	284	300	317
Payables	211	231	281	171	197	232	256	282
Accruals and other payables	481	539	738	496	526	538	595	657

Source: Company, Daiwa forecasts

Financial summary

■ **Key assumptions**

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales growth YoY - rice crackers	34.3	30.0	(0.6)	12.0	(10.8)	11.2	9.1	9.1
Sales growth YoY - beverages	33.8	30.6	22.6	17.0	(0.3)	5.0	11.1	11.1
Sales growth YoY - snacks	22.0	36.1	14.8	8.4	7.0	13.4	11.1	11.1
Gross margin % - rice crackers	40.8	37.6	39.0	40.8	39.9	41.9	42.2	42.4
Gross margin % - beverages	34.6	33.4	39.5	41.3	38.4	41.9	42.1	42.3
Gross margin % - snacks	40.7	34.5	40.4	43.0	44.9	45.2	45.1	44.9

■ **Profit and loss (USDm)**

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Rice crackers	629	817	812	910	812	903	985	1,074
Beverages	1,067	1,394	1,709	1,999	1,993	2,092	2,325	2,583
Other Revenue	548	736	838	909	970	1,100	1,221	1,356
Total Revenue	2,244	2,947	3,359	3,818	3,775	4,095	4,530	5,012
Other income	41	61	46	78	73	74	76	77
COGS	(1,400)	(1,922)	(2,031)	(2,232)	(2,256)	(2,342)	(2,586)	(2,857)
SG&A	(447)	(564)	(664)	(781)	(816)	(856)	(900)	(972)
Other op. expenses	0	0	0	0	0	0	0	0
Operating profit	439	522	711	883	777	971	1,119	1,261
Net-interest inc./(exp.)	4	16	38	49	53	49	60	74
Assoc./forex/extraord./others	0	0	1	2	(1)	0	0	0
Pre-tax profit	443	538	749	934	830	1,020	1,179	1,335
Tax	(84)	(119)	(195)	(247)	(210)	(265)	(307)	(347)
Min. int./pref. div./others	0	0	0	(1)	(1)	(1)	(1)	(1)
Net profit (reported)	359	420	554	686	619	753	872	987
Net profit (adjusted)	359	420	554	686	619	753	872	987
EPS (reported)(USD)	0.027	0.032	0.042	0.052	0.047	0.057	0.066	0.075
EPS (adjusted)(USD)	0.027	0.032	0.042	0.052	0.047	0.057	0.066	0.075
EPS (adjusted fully-diluted)(USD)	0.027	0.032	0.042	0.052	0.047	0.057	0.066	0.075
DPS (USD)	0.023	0.020	0.029	0.035	0.024	0.043	0.050	0.056
EBIT	439	522	711	883	777	971	1,119	1,261
EBITDA	500	596	798	988	899	1,108	1,269	1,423

■ **Cash flow (USDm)**

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	443	538	749	934	830	1,020	1,179	1,335
Depreciation and amortisation	61	74	88	105	122	137	150	162
Tax paid	(72)	(82)	(186)	(222)	(210)	(265)	(307)	(347)
Change in working capital	(16)	54	(14)	191	(418)	168	9	10
Other operational CF items	(4)	(16)	(38)	(50)	(53)	(49)	(60)	(74)
Cash flow from operations	412	568	598	958	271	1,011	972	1,086
Capex	(171)	(224)	(243)	(273)	(354)	(250)	(250)	(250)
Net (acquisitions)/disposals	0	0	0	0	0	0	0	0
Other investing CF items	0	0	0	0	0	0	0	0
Cash flow from investing	(171)	(224)	(243)	(273)	(354)	(250)	(250)	(250)
Change in debt	287	381	(22)	255	158	0	0	0
Net share issues/(repurchases)	(8)	0	0	(5)	(38)	(4)	0	0
Dividends paid	(317)	(259)	(299)	(419)	(460)	(402)	(596)	(684)
Other financing CF items	(4)	67	26	49	12	128	86	100
Cash flow from financing	(41)	189	(294)	(121)	(327)	(278)	(510)	(584)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	200	533	61	564	(410)	483	212	252
Free cash flow	241	345	355	685	(83)	761	722	836

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (USDm)

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	906	1,437	1,499	2,060	1,650	2,133	2,345	2,598
Inventory	339	410	461	534	667	545	602	665
Accounts receivable	101	160	166	164	132	144	159	176
Other current assets	107	96	142	152	140	140	140	140
Total current assets	1,454	2,103	2,268	2,911	2,589	2,963	3,247	3,580
Fixed assets	758	891	1,046	1,236	1,448	1,564	1,669	1,760
Goodwill & intangibles	1	1	1	1	1	1	1	1
Other non-current assets	77	128	146	201	246	246	246	246
Total assets	2,290	3,123	3,461	4,348	4,284	4,774	5,162	5,586
Short-term debt	294	775	350	410	518	518	518	518
Accounts payable	184	211	231	281	197	235	259	286
Other current liabilities	386	531	599	823	578	598	655	718
Total current liabilities	864	1,517	1,181	1,515	1,293	1,351	1,433	1,523
Long-term debt	350	250	653	847	898	898	898	898
Other non-current liabilities	0	24	24	34	35	35	35	35
Total liabilities	1,214	1,791	1,858	2,396	2,226	2,284	2,366	2,456
Share capital	264	264	265	265	264	264	264	264
Reserves/R.E./others	809	1,065	1,331	1,679	1,786	2,218	2,525	2,859
Shareholders' equity	1,073	1,330	1,595	1,943	2,050	2,482	2,789	3,123
Minority interests	3	3	8	9	8	8	8	8
Total equity & liabilities	2,290	3,123	3,461	4,348	4,284	4,774	5,162	5,586
EV	13,294	13,143	13,063	12,754	13,322	12,838	12,626	12,374
Net debt/(cash)	(262)	(413)	(496)	(802)	(234)	(717)	(929)	(1,182)
BVPS (USD)	0.081	0.101	0.121	0.147	0.155	0.188	0.211	0.237

■ Key ratios (%)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	31.2	31.3	14.0	13.7	(1.1)	8.5	10.6	10.6
EBITDA (YoY)	22.7	19.3	33.9	23.8	(9.1)	23.3	14.5	12.2
Operating profit (YoY)	23.4	19.0	36.0	24.3	(12.0)	25.0	15.3	12.7
Net profit (YoY)	14.5	16.9	32.0	23.8	(9.8)	21.8	15.7	13.3
Core EPS (fully-diluted) (YoY)	14.5	16.9	31.9	23.7	(9.7)	21.9	15.7	13.3
Gross-profit margin	37.6	34.8	39.5	41.5	40.2	42.8	42.9	43.0
EBITDA margin	22.3	20.2	23.8	25.9	23.8	27.1	28.0	28.4
Operating-profit margin	19.6	17.7	21.2	23.1	20.6	23.7	24.7	25.2
Net profit margin	16.0	14.2	16.5	18.0	16.4	18.4	19.2	19.7
ROAE	34.8	34.9	37.9	38.8	31.0	33.3	33.1	33.4
ROAA	17.7	15.5	16.8	17.6	14.3	16.6	17.5	18.4
ROCE	28.6	25.6	28.6	30.4	23.2	26.3	27.6	28.8
ROIC	48.8	47.0	51.9	57.5	39.0	39.9	45.5	48.9
Net debt to equity	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Effective tax rate	19.0	22.0	26.0	26.5	25.3	26.0	26.0	26.0
Accounts receivable (days)	14.2	16.2	17.7	15.8	14.3	12.3	12.2	12.2
Current ratio (x)	1.7	1.4	1.9	1.9	2.0	2.2	2.3	2.4
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	83.2	61.6	68.3	67.1	51.6	75.2	75.2	75.1
Free cash flow yield	1.8	2.5	2.6	5.0	n.a.	5.6	5.3	6.2

Source: FactSet, Daiwa forecasts

■ Company profile

Want Want China is the leading producer of rice crackers and flavoured milk drinks in China, with market shares of about 70% and 40%, respectively, in terms of revenue for 2013, based on our estimates. The company also makes dairy products and savoury and sweet snack foods.

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