

Consumer & Retail
Food Products
 Equity – China

Underweight

Target price (HKD)	17.00
Share price (HKD)	18.36
Potential return (%)	-7.4

Note: Potential return equals the percentage difference between the current share price and the target price

Performance	1M	3M	12M
Absolute (%)	-4.4	11.0	-14.0
Relative ^A (%)	-1.6	5.1	-23.0

Index^A HANG SENG INDEX

RIC 0322.HK
 Bloomberg 322 HK

Market cap (USDm) 13,264
 Market cap (HKDm) 102,891

Enterprise value (USDm) 14541
 Free float (%) 33

Note: (V) = volatile (please see disclosure appendix)

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Tingyi (322 HK)

UW: Caffeine boost from Starbucks

- ▶ **Tingyi has signed an agreement with Starbucks for the manufacturing and distribution of Starbucks' RTD products**
- ▶ **We believe the impact on sales and earnings will be limited in the near term given small category size**
- ▶ **Reiterate Underweight with an unchanged TP of HKD17**

What's new? Starbucks and Tingyi announced that they have entered into an agreement to manufacture and expand the distribution of Starbucks ready-to-drink (RTD) products throughout mainland China. Starbucks will be responsible for providing coffee expertise, brand development and future product innovation, while Tingyi will manufacture and sell Starbucks' RTD portfolio to retailers in China. According to the agreement, Tingyi plans to leverage its strength in production and distribution to increase the market share of Starbucks' RTD products in China.

RTD coffee market is still small in China. We do not think the cooperation with Starbucks will have a significant impact on Tingyi's sales and earnings in the near term; however, we believe the cooperation with Starbucks will help to further widen Tingyi's product offering and penetrate the high-end segment. According to Euromonitor, the current market size for RTD coffee is only cRMB4.6bn, compared to RMB104bn for RTD tea. Starbucks is a small player with 5% market share by retail value and 1% market share by sales volume. Key players in the RTD coffee market in China are Nestle and Suntory, with a combined 70% market share. Despite its small market size, the RTD coffee market in China is expected to grow by c20% pa in the next few years on the back of rising outdoor activities and higher penetration of young consumers.

Capex and margins. Tingyi expects the production of Starbucks products to commence in 2016, and we think it may need to incur capex for the production of Starbucks' products given different packaging requirements. In addition, margins for the manufacturing of Starbucks' products should be higher than existing beverage margins given the premium price point of Starbucks' products.

Earnings preview. Tingyi is scheduled to release its 2014 results on 23 March, and we are looking for net profit of USD426m, up 3% yoy, and revenue of USD10,450m, down 4.5% yoy. Our 2014 and 2015 earnings estimates are 4% and 11% below consensus, respectively. **Key upside risks** include: 1) higher-than-expected sales volume or market share gains, 2) a fast turnaround in the Pepsi business, and 3) lower-than-expected effective tax rate.

Financials & valuation

Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Profit & loss summary (USDm)				
Revenue	10,941	10,450	10,910	11,848
EBITDA	1,197	1,226	1,334	1,561
Depreciation & amortisation	-452	-485	-503	-520
Operating profit/EBIT	744	741	830	1,041
Net interest	-37	-40	-40	-40
PBT	723	720	813	1,028
HSBC PBT	723	720	813	1,028
Taxation	-229	-205	-228	-288
Net profit	409	426	486	588
HSBC net profit	409	426	486	588

Cash flow summary (USDm)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Cash flow from operations	1,282	1,087	1,111	1,306
Capex	-852	-700	-700	-700
Cash flow from investment	-843	-699	-699	-699
Dividends	-207	-213	-243	-294
Change in net debt	-220	-175	-169	-313
FCF equity	381	369	389	579

Balance sheet summary (USDm)

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Intangible fixed assets	420	420	420	420
Tangible fixed assets	5,485	5,700	5,897	6,077
Current assets	2,410	2,523	2,720	3,091
Cash & others	1,250	1,425	1,593	1,906
Total assets	8,424	8,753	9,146	9,697
Operating liabilities	2,637	2,664	2,715	2,820
Gross debt	1,676	1,676	1,676	1,676
Net debt	426	251	83	-230
Shareholders' funds	2,880	3,093	3,336	3,631
Invested capital	4,428	4,554	4,729	4,864

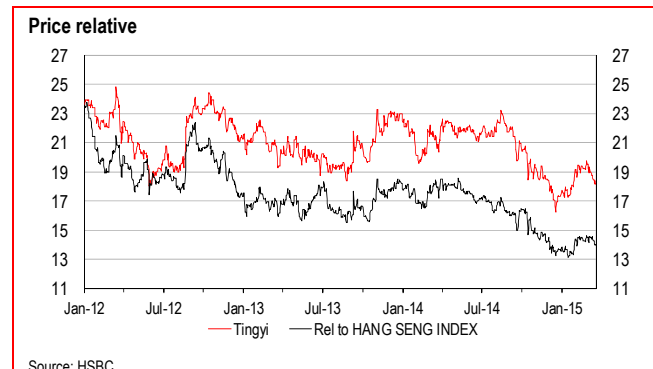
Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Y-o-y % change				
Revenue	18.8	-4.5	4.4	8.6
EBITDA	-4.2	2.4	8.8	17.0
Operating profit	-13.6	-0.5	12.1	25.4
PBT	-13.2	-0.5	13.0	26.5
HSBC EPS	12.4	3.2	14.1	21.0
Ratios (%)				
Revenue/IC (x)	2.5	2.3	2.4	2.5
ROIC	11.8	11.8	12.9	15.6
ROE	15.1	14.3	15.1	16.9
ROA	6.5	6.3	6.9	8.2
EBITDA margin	10.9	11.7	12.2	13.2
Operating profit margin	6.8	7.1	7.6	8.8
EBITDA/net interest (x)	32.0	30.5	33.2	38.8
Net debt/equity	10.9	5.9	1.8	-4.6
Net debt/EBITDA (x)	0.4	0.2	0.1	-0.1
CF from operations/net debt	300.7	432.4	1340.7	
Per share data (USD)				
EPS reported (fully diluted)	0.07	0.08	0.09	0.10
HSBC EPS (fully diluted)	0.07	0.08	0.09	0.10
DPS	0.04	0.04	0.04	0.05
Book value	0.51	0.55	0.59	0.64

Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	1.3	1.4	1.3	1.2
EV/EBITDA	12.2	11.9	10.9	9.2
EV/IC	3.3	3.2	3.1	2.9
PE*	32.5	31.5	27.6	22.8
P/Book value	4.7	4.3	4.0	3.7
FCF yield (%)	2.7	2.6	2.7	4.0
Dividend yield (%)	1.5	1.6	1.8	2.2

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 18 Mar 2015

Valuation and risks

We use DCF to value Tingyi as we believe its strong brand positioning and large distribution network should allow the company to generate steady cash flow and returns. For the DCF valuation, we assume beta of 0.9, risk-free rate of 3.5% and risk premium of 6.0%, resulting in a WACC of 8.9%. We assume terminal growth rate to be 1.0%.

Risks

Key upside risks to our rating and estimates include: 1) higher-than-expected sales volume or market share gains, 2) a fast turnaround in the Pepsi business, and 3) lower-than-expected effective tax rate. Potential negative catalysts include: 1) higher-than-expected A&P spending and 2) a sharp increase in input costs.

Disclosure appendix

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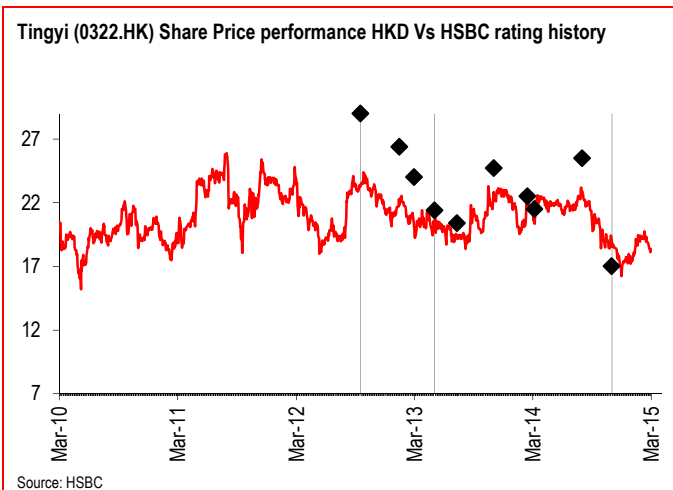
*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

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Neutral (Hold)	39%	(28% of these provided with Investment Banking Services)
Underweight (Sell)	20%	(20% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities



Recommendation & price target history

From	To	Date
N/A	Overweight	03 October 2012
Overweight	Neutral	20 May 2013
Neutral	Underweight	17 November 2014
Target Price	Value	Date
Price 1	29.00	03 October 2012
Price 2	26.40	31 January 2013
Price 3	24.00	18 March 2013
Price 4	21.40	20 May 2013
Price 5	20.40	28 July 2013
Price 6	24.70	18 November 2013
Price 7	22.50	02 March 2014
Price 8	21.50	24 March 2014
Price 9	25.50	18 August 2014
Price 10	17.00	17 November 2014

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
TINGYI	0322.HK	18.36	18-Mar-2015	4, 6, 7

Source: HSBC

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