

# Tenwow (1219 HK)

## Overweight

Target price (HKD)	3.60
Share price (HKD)	2.64
Forecast dividend yield (%)	2.7
Potential return (%)	39.1

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Dec	2014 a	2015 e	2016 e
HSBC EPS	0.17	0.19	0.22
HSBC PE	12.7	11.2	9.5
Performance	1M	3M	12M
Absolute (%)	-1.5	17.3	-22.4
Relative <sup>A</sup> (%)	0.0	10.8	-32.8

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

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## Disclaimer & Disclosures

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

OW: Mix improvement led growth continues

- **2014 net profit surged 21% yoy on 8% sales growth; gross margin expanded 1.2ppt and EBIT margin also up 0.5ppt**
- **Sales of its higher-margin own-brand products have been fairly strong year-to-date given continuous geographical expansion, new product offerings, and low comparison base**
- **Maintain Overweight and raise our target price to HKD3.60 (from HKD3.50) on EPS rollover**

**Solid 2014 results.** Despite the challenging macro environment, Tenwow's 2014 performance was solid. Net profit was up 21% yoy to RMB345m on the back of 8% revenue growth. The results were in-line with consensus forecast, but it was 4% above our estimates. Margin expansion was the key growth driver given rising contribution from the higher margin own-brand business, in which it increased to 33% of sales in 2014 from 30% in 2013. The group gross margin improved 1.2ppt and the EBIT margin also gained 0.5ppt. Geographic expansion outside its core Eastern China remained the key growth driver of its own-brand products as contributions from Southern, Northern and Western China increased to 17% of revenue in 2014 from 7% in 2013. The company declared a final DPS of HKD4.06cents, and the dividend payout was unchanged at 30%.

**Positive 2015 outlook.** We believe new products like the mineral water, the "V-Planet" cocktail beverage, and candies should be a key sales growth driver for its own-brand business in 2015. According to management, the sales momentum of its own-brand products have been fairly strong year-to-date given distributor additions, new product offerings, and a later Chinese New Year this year, in which most of the orders were shifted to 1Q15. Gross margin should also continue to improve given change of revenue mix and lower input costs as a result of sharp decline in PET prices. Having said that, A&P and sales personnel costs should also increase with geographic expansion and it will offset part of the gain in the gross margin.

**Valuation and risks.** We view Tenwow as an under-followed F&B play, with the potential to be re-rated as the company transforms itself from a distribution business to an F&B brand in its own right. We look for 16% earnings CAGR over 2015-17e, and the current valuation of 11x 2015 PE for 15% earnings growth and 2.7% dividend yield look undemanding. **Key downside risks** include food safety issues, the government's austerity measures, competition, and execution risks on geographic expansion.

Index <sup>A</sup>	HANG SENG INDEX
Index level	24,469
RIC	1219.HK
Bloomberg	1219 HK

Source: HSBC

Enterprise value (CNYm)	4255
Free float (%)	28
Market cap (USDm)	706
Market cap (HKDm)	5,474

Source: HSBC

## Financials & valuation

### Financial statements

Year to	12/2014a	12/2015e	12/2016e	12/2017e
<b>Profit &amp; loss summary (CNYm)</b>				
Revenue	5,084	5,488	6,209	6,834
EBITDA	570	665	771	863
Depreciation & amortisation	-54	-70	-78	-82
Operating profit/EBIT	517	594	693	781
Net interest	-76	-90	-95	-95
PBT	471	535	631	721
HSBC PBT	471	535	631	721
Taxation	-114	-126	-150	-172
Net profit	345	396	467	533
HSBC net profit	345	396	467	533

### Cash flow summary (CNYm)

Cash flow from operations	300	560	52	835
Capex	-395	-240	-180	-180
Cash flow from investment	-352	-217	-157	-157
Dividends	-104	-106	-121	-143
Change in net debt	286	-127	336	-424
FCF equity	-220	210	-238	546

### Balance sheet summary (CNYm)

Intangible fixed assets	169	207	244	279
Tangible fixed assets	746	855	898	937
Current assets	4,221	4,470	4,885	5,325
Cash & others	1,161	1,289	953	1,379
Total assets	5,565	5,992	6,519	7,068
Operating liabilities	1,335	1,459	1,625	1,768
Gross debt	1,570	1,570	1,570	1,572
Net debt	409	282	617	193
Shareholders funds	2,585	2,875	3,221	3,611
Invested capital	2,725	2,870	3,534	3,482

### Ratio, growth and per share analysis

Year to	12/2014a	12/2015e	12/2016e	12/2017e
<b>Y-o-y % change</b>				
Revenue	7.6	7.9	13.1	10.1
EBITDA	13.1	16.5	16.0	12.0
Operating profit	13.7	15.0	16.6	12.7
PBT	16.9	13.7	17.8	14.2
HSBC EPS	-3.5	13.5	17.8	14.2

### Ratios (%)

Revenue/IC (x)	2.1	2.0	1.9	1.9
ROIC	15.8	16.2	16.5	17.0
ROE	14.0	14.5	15.3	15.6
ROA	8.2	8.5	9.0	9.3
EBITDA margin	11.2	12.1	12.4	12.6
Operating profit margin	10.2	10.8	11.2	11.4
EBITDA/net interest (x)	7.5	7.4	8.1	9.1
Net debt/equity	15.5	9.6	18.7	5.2
Net debt/EBITDA (x)	0.7	0.4	0.8	0.2
CF from operations/net debt	73.5	198.9	8.5	432.5

### Per share data (CNY)

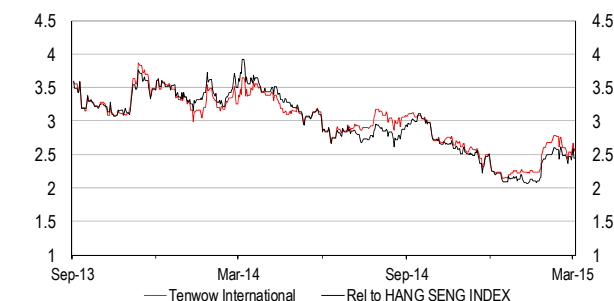
EPS reported (fully diluted)	0.17	0.19	0.22	0.25
HSBC EPS (fully diluted)	0.17	0.19	0.22	0.25
DPS	0.05	0.06	0.07	0.08
Book value	1.25	1.39	1.55	1.74

### Valuation data

Year to	12/2014a	12/2015e	12/2016e	12/2017e
EV/sales	0.9	0.8	0.7	0.6
EV/EBITDA	7.7	6.4	5.9	4.8
EV/IC	1.6	1.5	1.3	1.2
PE*	12.7	11.2	9.5	8.3
P/Book value	1.7	1.5	1.4	1.2
FCF yield (%)	-5.5	5.3	-6.0	13.9
Dividend yield (%)	2.4	2.7	3.2	3.7

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

### Price relative



Source: HSBC

Note: price at close of 20 Mar 2015

# Results review

- ▶ Net profit was up 21% yoy in 2014 to RMB345m on the back of 8% revenue growth
- ▶ Own-brand revenue was up 19% yoy, while the third-party brand revenue was up 3% yoy
- ▶ The group gross margin improved 1.2ppt and the EBIT margin also gained 0.5ppt.

## Tenwou - 2014 results summary

Year to Dec 31 (RMBm)	2013	2014	% yoy	1H14	% yoy	2H14	% yoy
<b>Revenue</b>	<b>4,725</b>	<b>5,084</b>	<b>8%</b>	<b>2,259</b>	<b>-2%</b>	<b>2,825</b>	<b>17%</b>
Cost of sales	(3,988)	(4,230)	6%	(1,895)	-5%	(2,336)	17%
<b>Gross profit</b>	<b>736</b>	<b>854</b>	<b>16%</b>	<b>364</b>	<b>17%</b>	<b>490</b>	<b>15%</b>
Distribution cost	(156)	(211)	35%	(90)	4%	(121)	75%
Administrative expenses	(140)	(143)	2%	(72)	12%	(71)	-7%
Other income - net	23	19	-16%	10	103%	9	-48%
Other losses - net	(9)	(2)	-73%	(0)	-99%	(2)	-68%
<b>EBIT</b>	<b>454</b>	<b>517</b>	<b>14%</b>	<b>212</b>	<b>29%</b>	<b>305</b>	<b>5%</b>
Finance income	9	21	136%	10	246%	11	83%
Finance costs	(91)	(97)	6%	(50)	20%	(47)	-6%
Profit from associates	1	1	-9%	0	-26%	0	189%
Profit from JCE	30	30	-2%	7	-2%	23	-2%
<b>PBT</b>	<b>403</b>	<b>471</b>	<b>17%</b>	<b>179</b>	<b>35%</b>	<b>293</b>	<b>8%</b>
Tax	(106)	(114)	8%	(48)	39%	(66)	-7%
MI	(11)	(12)	8%	(5)	61%	(7)	-13%
<b>Net income</b>	<b>286</b>	<b>345</b>	<b>21%</b>	<b>125</b>	<b>33%</b>	<b>220</b>	<b>15%</b>
<b>Margins</b>							
Gross margin	15.6%	16.8%	1.2 ppt	16.1%	2.6 ppt	17.3%	-0.2 ppt
EBIT margin	9.6%	10.2%	0.5 ppt	9.4%	2.3 ppt	10.8%	-1.2 ppt
Net margin	6.1%	6.8%	0.7 ppt	5.5%	1.5 ppt	7.8%	-0.1 ppt
<b>Key ratios</b>							
Distribution cost to sales ratio	3.3%	4.2%	0.8 ppt	4.0%	0.2 ppt	4.3%	1.4 ppt
Admin expense to sales ratio	3.0%	2.8%	-0.2 ppt	3.2%	0.4 ppt	2.5%	-0.6 ppt
Effective tax rate	26.2%	24.2%	-2.0 ppt	27.0%	0.8 ppt	22.4%	-3.7 ppt

Source: Company data, HSBC

## Strong own-brand revenue growth

Total sales grew 8% to RMB5,084m, mainly driven by the own-brand business. By segment, the own-brand business accounted for 33% of total sales and saw 19% growth to RMB1,703m, with food and snacks up 2%, non-alcoholic beverage up 57% and alcohol up 5%. The food and snack business saw a sequential improvement in 2H from 1H, with yoy sales growth up from -11% to +13%. Non-alcoholic beverages also continued to post strong growth of 32% in 2H, boosted by the positive response for the “Charcoal Roasted” series and “VitC VitE” series launched last year, and the marketing campaigns on its “Fruit Tea” series.

For third-party brands business, sales went up 2.5% for the full year, up 17% in 2H vs 12% decline in 1H, mainly driven by alcoholic beverages (73% of third-party brand sales) which turned to a positive growth of 20% in 2H14 from -9% in 1H14, since the company had more sales through the direct channels at higher prices and has focused more on low- to mid-end wine and beer which are less vulnerable to the government’s anti-corruption measures.

Tenwow - Revenue breakdown by brands, 2013-14

Year to Dec 31 (RMBm)	2013	2014	% yoy	1H14	% yoy	2H14e	% yoy
Own brand	1,427	1,703	19%	824	22%	879	17%
Third-party brand	3,298	3,381	3%	1,435	-12%	1,946	17%
<b>Total</b>	<b>4,725</b>	<b>5,084</b>	<b>8%</b>	<b>2,259</b>	<b>-2%</b>	<b>2,825</b>	<b>17%</b>
<b>Own brand products</b>							
- Food and snacks	710	725	2%	284	-11%	441	13%
- Non-alcoholic beverages	428	672	57%	369	85%	303	32%
- alcoholic beverages	238	250	5%	157	13%	93	-7%
- Others	51	57	11%	14	-22%	42	29%
<b>Third-party brand products</b>							
- Food and snacks	830	717	-14%	326	-21%	390	-6%
- Non-alcoholic beverages	57	58	1%	21	-28%	37	30%
- alcoholic beverages	2,329	2,465	6%	1,044	-9%	1,421	20%
- Others	81	142	74%	44	23%	98	114%
<b>Total</b>	<b>4,725</b>	<b>5,084</b>	<b>8%</b>	<b>2,259</b>	<b>-2%</b>	<b>2,825</b>	<b>17%</b>

Source: Company data, HSBC

Tenwow - Revenue breakdown by region, 2013-14

Year to Dec 31 (RMBm)	2013	2014	%yoy	1H14	%yoy	2H14	%yoy
Eastern China	2,852	2,740	-4%	1,232	-12%	1,507	4%
Central China	1,444	1,483	3%	717	1%	766	4%
Southern China	276	542	97%	226	33%	316	197%
Northern China	29	154	424%	42	192%	112	645%
Western China	24	166	589%	42	377%	124	711%
<b>Total</b>	<b>4,625</b>	<b>5,084</b>	<b>10%</b>	<b>2,259</b>	<b>-2%</b>	<b>2,825</b>	<b>22%</b>

Source: Company data, HSBC

## Higher gross margin

Gross margin for 2014 expanded by 1.2ppt to 16.8%, thanks to better product mix (towards higher margin own-brand products). Own-brand and third-party brand gross margins were 28.7% and 10.8% respectively, up 0.7ppt and 0.6ppt. For own-brand business, the gross margin improvement largely resulted from lower raw material costs and higher percentage of internal production. The increase for third-party brand business was due to higher sales mix through the direct channels which offered better

margins. SG&A to sales ratio increased by 0.7ppt to 7.0% with higher staff costs and A&P spending in 2014, and the group EBIT margin was up 0.5ppt to 10.2%.

On a semi-annual basis, the gross margin was down 0.2ppt yoy in 2H14 and EBIT margin was also down 1.2ppt yoy in 2H14 to 10.8%, mainly due to the higher staff cost and A&P expenses. However, the group effective tax rate dropped from by 4ppt yoy to 22% in 2H14, which helped to mitigate the decline in EBIT margin. And net-net, the group's net margin was largely unchanged at around 8% level in 2H14.

#### Tenwow - Margin breakdown by product

Year to 31 Dec	2013	2014	yoy	1H14	yoy	2H14e	yoy
Own-brand business	28.0%	28.7%	0.7ppt	25.5%	0.4ppt	31.7%	1.1ppt
Third-party brand business	10.2%	10.8%	0.6ppt	10.7%	2.0ppt	10.9%	-0.8ppt
<b>Total</b>	<b>15.6%</b>	<b>16.8%</b>	<b>1.2ppt</b>	<b>16.1%</b>	<b>2.6ppt</b>	<b>17.3%</b>	<b>-0.2ppt</b>
<b>Own branded products</b>							
- Food and snacks	31.9%	28.4%	-3.5ppt	23.7%	-4.4ppt	31.5%	-3.6ppt
- Non-alcoholic beverages	24.7%	27.2%	2.6ppt	25.7%	-0.4ppt	29.1%	5.7ppt
- alcoholic beverages	23.2%	34.6%	11.3ppt	28.3%	10.7ppt	45.1%	14.1ppt
- Others	22.5%	23.3%	0.8ppt	24.7%	7.7ppt	22.9%	-2.7ppt
<b>Third party brand products</b>							
- Food and snacks	6.1%	6.5%	0.4ppt	6.1%	-0.5ppt	6.9%	1.3ppt
- Non-alcoholic beverages	7.5%	4.8%	-2.6ppt	10.0%	2.4ppt	2.0%	-5.4ppt
- alcoholic beverages	11.9%	12.5%	0.6ppt	12.4%	2.7ppt	12.5%	-1.6ppt
- Others	6.4%	5.8%	-0.6ppt	5.7%	1.4ppt	5.8%	-2.2ppt
<b>Total</b>	<b>15.6%</b>	<b>16.8%</b>	<b>1.2ppt</b>	<b>16.1%</b>	<b>2.6ppt</b>	<b>17.3%</b>	<b>-0.2ppt</b>

Source: Company data, HSBC

## Cash and balance sheet

Cash conversion cycle deteriorated from 90 days to 118 days in 2014, mainly due to longer receivable days and shorter payable days, while inventory turnover was flat. Receivable days went up from 130 days to 153 days, likely due to lengthened credit terms for distributors/hypermarkets. Payables days were down from 103 days to 98 days.

Tenwow generated positive operating cash flow of RMB303m in 2014, compared to -RMB346m in 2013. We expect the company to see positive operating cash flow in the coming years on the back of solid earnings growth. As of the end of 2014, the company had a net debt of RMB409m, with net gearing at 16%, up from 5% at the end of 2013. The company declared a final dividend of HKD4.06cents or RMB3.27 cents per share, representing 30% payout including the interim dividend.

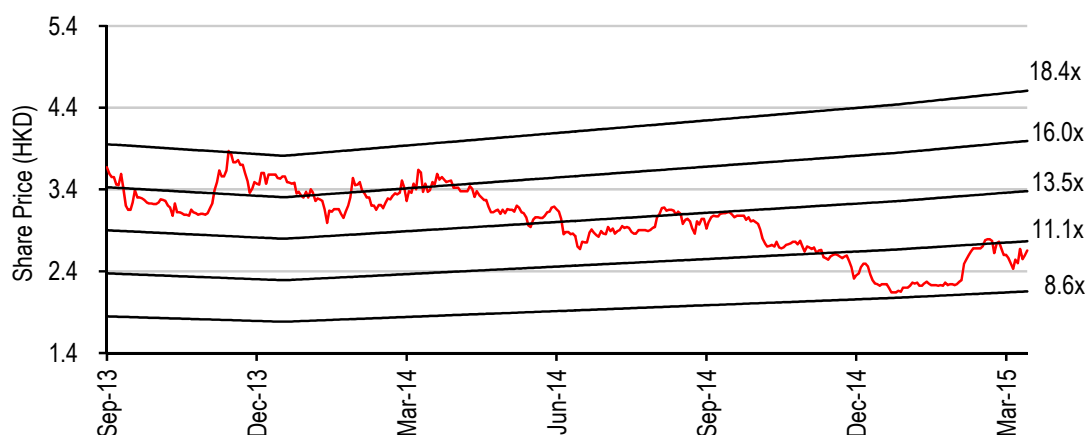
## Valuation and risks

We use PE to value Tenwow as we believe it better reflects the company's near-term earnings momentum. We raise our target price from HKD3.50 to HKD3.60 due to EPS rollover, and our target price of HKD3.60 is based on 16x 12-month forward PE, which is derived from the historical average forward PE since its IPO in September 2013.

Under our research model, for stocks without a volatility indicator, the Neutral band is 5ppts above and below the hurdle rate for China stocks of 9.0%. Our target price implies a potential total return of 39.1% (including 2.7% FY15e dividend yield), above the Neutral band, therefore we retain our Overweight rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

Key downside risks include social and political risks involving the government's austerity measures, which impact the consumption of alcohol, relationships with foreign brands, food safety issues, raw material price fluctuations affecting own-brand production costs, execution risk related to expansion outside of its core markets, and competition.

Tenwow - 12-month forward PE band



Source: Thomson Reuters Datastream, HSBC estimates

Tenwow - Income Statement, 2013-2017e

Year to Dec 31 (RMBm)	2013	2014	2015e	2016e	2017e
<b>Sales</b>	<b>4,725</b>	<b>5,084</b>	<b>5,488</b>	<b>6,209</b>	<b>6,834</b>
Cost of sales	(3,988)	(4,230)	(4,509)	(5,061)	(5,535)
<b>Gross profit</b>	<b>736</b>	<b>854</b>	<b>979</b>	<b>1,148</b>	<b>1,299</b>
Distribution cost	(156)	(211)	(232)	(270)	(294)
Administrative expenses	(140)	(143)	(172)	(206)	(247)
Other income - net	23	19	21	24	26
Other losses - net	(9)	(2)	(2)	(2)	(2)
<b>EBIT</b>	<b>454</b>	<b>517</b>	<b>594</b>	<b>693</b>	<b>781</b>
Finance income	9	21	20	15	15
Finance costs	(91)	(97)	(110)	(110)	(110)
Profit from associates	1	1	1	1	1
Profit from JCE	30	30	31	32	34
<b>PBT</b>	<b>403</b>	<b>471</b>	<b>535</b>	<b>631</b>	<b>721</b>
Tax	(106)	(114)	(126)	(150)	(172)
MI	(11)	(12)	(13)	(15)	(16)
<b>Net income</b>	<b>286</b>	<b>345</b>	<b>396</b>	<b>467</b>	<b>533</b>
<b>Margins</b>					
Gross margin	15.6%	16.8%	17.8%	18.5%	19.0%
EBITDA margin	10.7%	11.2%	12.1%	12.4%	12.6%
EBIT margin	9.6%	10.2%	10.8%	11.2%	11.4%
Net margin	6.1%	6.8%	7.2%	7.5%	7.8%
<b>Key ratios</b>					
Distribution cost to sales ratio	3.3%	4.2%	4.2%	4.4%	4.3%
Admin expense to sales ratio	3.0%	2.8%	3.1%	3.3%	3.6%
Other income to sales ratio	0.5%	0.4%	0.4%	0.4%	0.4%
Effective tax rate	26.2%	24.2%	23.6%	23.7%	23.8%

Source: Company data, HSBC estimates

Tenwou - Balance sheet, 2013-2017e

Year to Dec 31 (RMBm)	2013	2014	2015e	2016e	2017e
PP&E	520	746	855	898	937
Land use rights	86	93	131	167	203
Intangible assets	9	61	61	61	61
Investment in associates	27	28	28	29	29
Investment in JCE	369	401	432	464	498
Deferred income tax assets	13	15	15	15	15
<b>Non-current assets</b>	<b>1,025</b>	<b>1,344</b>	<b>1,522</b>	<b>1,634</b>	<b>1,743</b>
Inventories	742	708	927	1,040	1,137
Trade and other receivables	1,917	2,352	2,255	2,892	2,809
Cash and cash equivalents	1,078	693	820	485	911
Restricted cash	118	468	468	468	468
<b>Current assets</b>	<b>3,855</b>	<b>4,221</b>	<b>4,470</b>	<b>4,885</b>	<b>5,325</b>
Trade and other payables	1,040	1,235	1,359	1,525	1,668
Current income tax liabilities	74	74	74	74	74
Borrowings	1,231	1,524	1,524	1,524	1,524
Current portion of deferred income on gov't grants	3	3	3	3	3
<b>Current liabilities</b>	<b>2,347</b>	<b>2,836</b>	<b>2,960</b>	<b>3,126</b>	<b>3,269</b>
Borrowings	88	46	46	46	46
Deferred income tax liabilities	12	26	26	26	26
Deferred income on gov't grants	25	23	23	23	23
<b>Non-current liabilities</b>	<b>125</b>	<b>95</b>	<b>95</b>	<b>95</b>	<b>95</b>
Share capital & premium	1,550	1,428	1,428	1,428	1,428
- o/w Share capital	165	165	165	165	165
- o/w Share premium	1,385	1,263	1,263	1,263	1,263
Other reserves	169	201	201	201	201
Retained earnings	642	956	1,246	1,592	1,982
<b>Shareholders equity</b>	<b>2,361</b>	<b>2,585</b>	<b>2,875</b>	<b>3,221</b>	<b>3,611</b>
Minority interests	46	49	62	77	93
<b>Total equity and MI</b>	<b>2,407</b>	<b>2,634</b>	<b>2,937</b>	<b>3,298</b>	<b>3,704</b>
<b>Liquidity</b>					
Total debt (RMB M)	1,319	1,570	1,570	1,570	1,570
Cash and cash equivalents (RMB M)	1,196	1,161	1,289	953	1,379
Net cash/(debt) (RMB M)	(123)	(409)	(282)	(617)	(191)
Net debt/equity	5%	16%	10%	19%	5%
Current ratio	1.6x	1.5x	1.5x	1.6x	1.6x
Quick ratio	1.3x	1.2x	1.2x	1.2x	1.3x
Total inventory days (avg)	62	63	66	71	72
Total receivable days (avg)	130	153	153	151	152
Total payable days (avg)	103	98	105	104	105
<b>Cash conversion cycle (days)</b>	<b>90</b>	<b>118</b>	<b>114</b>	<b>118</b>	<b>119</b>

Source: Company data, HSBC estimates

# Disclosure appendix

## Analyst Certification

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## Important disclosures

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## Rating definitions for long-term investment opportunities

### Stock ratings

HSBC assigns ratings to its stocks in this sector on the following basis:

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## Rating distribution for long-term investment opportunities

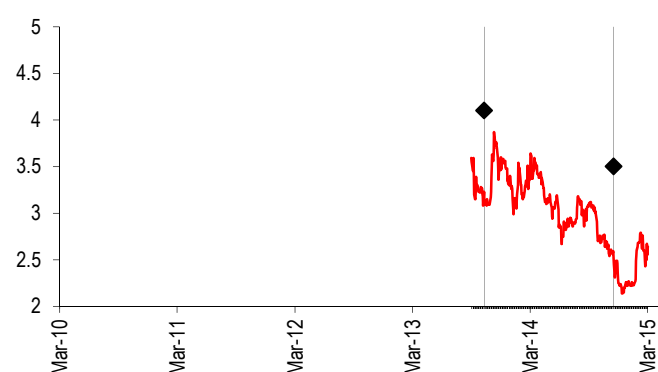
As of 20 March 2015, the distribution of all ratings published is as follows:

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## Share price and rating changes for long-term investment opportunities

Tenwow International (1219.HK) Share Price performance HKD Vs HSBC

rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight (V)	28 October 2013
Overweight (V)	Overweight	04 December 2014
Target Price	Value	Date
Price 1	4.10	28 October 2013
Price 2	3.50	04 December 2014

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
TENWOW INTERNATIONAL	1219.HK	2.64	20-Mar-2015	1, 5, 7

Source: HSBC

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