

JPM-pp1

Asia Pacific Equity Research

20 March 2015

Tingyi (Cayman Islands) Holding Corp (322 HK)

Neutral

Price: HK\$18.72

19 Mar 2015

Price Target: HK\$20.00

PT End Date: 31 Dec 2015

FY14 Preview - Reporting on 23 March 2015

Tingyi is expected to report FY14 result on 23 March, 2015 during lunch break. The company will hold its briefing around 4:00pm on 23 March, 2015, Hong Kong time.

- **We expect weak 4Q sales; noodles margin improvement likely to save FY15 earnings.** We believe Tingyi's top line growth remained lackluster in 4Q14. Management sticks to the cautious tone for top line growth guidance for 2015 noting that growth remains challenging for both noodles and beverages. While top line remains challenging, we continue to believe that 2015 will be a year of margin recovery. Stock price is up c6% YTD as i) worries about potential negative impact from food safety issues in Taiwan on China business were unwarranted and got corrected and ii) lower input costs are providing more comfort on margin improvement expectations for 2015. 2015 margin recovery expectations are likely to further support share price over the next 6-9 months, but we find it difficult to argue for a sustainable re-rating from current levels as category growth remains challenging for both noodles and beverages. We continue to believe Tingyi is on the right track with its focus on product innovation and upgrades in the long run, but it will take time for these to contribute to top line.
- **4Q14 and FY14 expectations:** For 4Q14 we are expecting c6% y/y decline in sales, loss at EBIT level, but after minority we expect US\$40mn net profit, which is an improvement over 4Q13 net profit of US\$15mn thanks to better noodles margins. 4Q is low season for beverage business, which means it is typically loss making and swings on y/y numbers could be big. For FY14 we expect Tingyi to report 4% y/y decline in sales and 5% y/y increase in net profit. Our FY14 earnings estimates are c5% below consensus estimates.
- **Noodles:** While noodle sales declined c2% for 3Q14, net profits grew c10% helped by GPM improvements and OPEX savings as company gradually phased out free sausage promotions. We expect ASP increases and removal of free sausages for noodles to continue to be a tailwind going into 4Q14 and FY15. For FY15, we are forecasting c5% sales growth and 16% earnings growth (implying margin expansion of 93bps).
- **Beverage:** Given that big part of Pepsi restructuring is finalized we now expect that one-off costs related to Pepsi integration will not continue in 2015. We are also building some decline in PET costs as well, however expecting most of it to be used for promotions. Management remains cautious on top-line growth for FY15 given the slowdown in tea (volumes down c10% in 3Q14) and juice market (traditional juices are particularly weak). Therefore, if sales growth does not come through there could be risk to our margin estimates. For FY15, we are forecasting c5% sales growth and c35% net profit growth for beverages (Master Kong beverages plus Pepsi).

Table 1: JPM's estimates for Tingyi's 4Q14, 2H14 and FY14 results

USD mn	4Q13	4Q14E	y/y chg	2H13	2H14E	y/y chg	FY13	FY14E	y/y chg
Sales revenue	2,128	2,011	-5.5%	5,518	4,965	-10.0%	10,941	10,470	-4.3%
Gross profit	586	526	-10.2%	1,690	1,474	-12.8%	3,310	3,184	-3.8%
Gross margin	27.5%	26.2%		30.6%	29.7%		30.3%	30.4%	
Other income	56	55		81	73		164	157	
Total Opex	(635)	(587)	-7.6%	(1,431)	(1,289)	-9.9%	(2,781)	(2,633)	-5.3%
EBIT	7	(58)	-905.1%	341	258	-24.4%	693	708	2.2%
EBIT margin	0.3%	-2.9%		6.2%	5.2%		6.3%	6.8%	
Net interest income	(9)	(7)		8	7		14	12	
Associates	1	7		10	11		16	21	
Pretax profit	(1)	(6)	na	359	276	-23.1%	723	741	2.5%
Tax	(28)	(9)	-69.7%	(110)	(85)	-22.6%	(229)	(213)	-7.0%
Effective tax rate	na	149.4%		-30.5%	-30.7%		-31.6%	-28.7%	
Minority interests	55	54		(38)	7		(86)	(98)	
Net profit	26	40	54.6%	212	198	-6.4%	409	430	5.3%
Net margin	1.2%	2.0%		3.8%	4.0%		3.7%	4.1%	
Recurring net profit	26	40	54.6%	212	198	-6.4%	409	430	5.3%
Recurring net profit margin	1.2%	2.0%		3.8%	4.0%		3.7%	4.1%	

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

Table 2: Tingyi's sales trend

USD mn	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14E
Instant noodles	1,105	888	1,153	1,186	1,150	884	1,132	1,146
Beverage	1,020	1,349	1,514	689	1,124	1,296	1,058	634
Pepsi	442	438	646	170	430	482	671	164

Bakery	57	42	55	49	53	36	47	52
Others	24	58	22	34	45	4	46	15
Total sales revenue	2,648	2,775	3,390	2,128	2,782	2,723	2,954	2,011
% chg y/y (USD)								
Instant noodles	7.3%	5.3%	11.1%	13.1%	4.1%	-0.5%	-1.8%	-3.4%
Beverage	24.8%	4.9%	22.7%	48.9%	10.2%	-3.9%	-30.1%	-7.9%
Pepsi	na	9.0%	10.0%	20.1%	-2.7%	10.0%	3.9%	-3.7%
Bakery	-3.6%	-23.5%	-14.3%	-12.8%	-7.3%	-12.7%	-13.6%	5.6%
Others	12.6%	198.0%	-5.3%	46.7%	91.4%	-93.6%	104.1%	-54.7%
Total sales revenue	37.4%	6.5%	15.1%	22.8%	5.0%	-1.9%	-12.9%	-5.5%
As % of total sales								
Instant noodles	41.7%	32.0%	34.0%	55.7%	41.3%	32.5%	38.3%	57.0%
Beverage	38.5%	48.6%	44.7%	32.4%	40.4%	47.6%	35.8%	31.5%
Pepsi	16.7%	15.8%	19.0%	8.0%	15.5%	17.7%	22.7%	8.2%
Bakery	2.2%	1.5%	1.6%	2.3%	1.9%	1.3%	1.6%	2.6%
Others	0.9%	2.1%	0.7%	1.6%	1.6%	0.1%	1.5%	0.8%

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

Investment Thesis

We believe Tingyi's top-line growth remained lackluster in 4Q14. Management maintains its cautious tone for top-line growth guidance for 2015, noting that growth remains challenging for both noodles and beverages. While the top line remains challenging, we continue to believe that 2015 will be a year of margin recovery and margins are likely to be better than our earlier estimates. Now we are building in a slight improvement in beverage margin given that: i) we lower our PET price estimates along with oil price decline and ii) we now expect that one-off costs related to Pepsi integration will not continue in 2015. 2015 margin recovery expectations are likely to further support the share price over the next six to nine months, but we find it difficult to argue for a sustainable re-rating from current levels as category growth remains challenging for both noodles and beverages. We continue to believe Tingyi is on the right track with its focus on product innovation and upgrades in the long run, but we believe it will take time for these to contribute to the top line.

Valuation

Our Dec-15 PT is HK\$20. We value Tingyi at a 28x one-year forward P/E, which is 1 standard deviation below the historical mean, given that growth has slowed down and returns have come down over the past three years. The PT increase is due to multiple change and earnings tweaks.

Risks to Rating and Price Target

Downside risks (albeit short-term) to our rating and price target include: 1) FY15 sales are likely to be weak, given the challenging market for both noodles and beverages. We suggest focusing beyond this weak sales performance into profitability; and 2) consensus numbers for FY14 and FY15 are 4% and 10% above our estimates, respectively, building in a recovery in sales in 2H14 and relatively strong sales momentum in FY15, as well, but we note that it is unlikely to be the case for 2H14. In the medium term, we believe the main risk is promotions starting to intensify again.

Upside risks to our rating and price target include: 1) a sudden sharp improvement in beverages sales via strong product development and market-share gains, and similarly better-than-expected sales in noodles on the back of market-share gains, 2) a further sharp decline in input costs leading to notable gross margin expansion and 3) Pepsi margins coming through better than expected.

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13-Nov-06	N	6.41	6.80
21-Mar-07	UW	8.09	6.76
02-May-07	UW	7.76	7.00
28-May-07	UW	9.24	7.20
22-Aug-07	N	8.46	9.00
23-Jan-08	N	10.00	12.10
24-Jan-08	OW	10.00	12.20
24-Apr-08	N	10.50	11.40
26-Aug-08	N	9.00	9.50
26-May-09	N	11.56	11.30
17-Aug-09	N	14.90	13.60
16-Nov-09	N	18.26	17.40
23-Mar-10	UW	18.80	16.50
17-May-10	UW	16.46	14.20
16-Aug-10	UW	18.96	15.00
16-Nov-10	UW	20.20	16.50
21-Mar-11	N	18.84	18.00
01-Apr-11	N	19.02	17.00
17-May-11	N	20.95	20.30
28-Jul-11	N	24.30	23.50
24-Aug-11	N	22.60	22.50
12-Oct-11	N	21.85	20.00
22-Mar-12	N	23.40	22.50
17-Apr-12	N	21.50	19.00
29-May-12	N	19.46	16.50
21-Aug-12	N	19.86	18.00
19-Nov-12	UW	23.30	16.00
19-Mar-13	UW	19.96	14.50
21-May-13	UW	20.55	14.20
27-Aug-13	UW	18.38	13.20
18-Nov-13	UW	21.80	17.70
24-Mar-14	UW	20.90	18.00
20-May-14	UW	21.95	18.50
24-Sep-14	OW	20.10	22.00
17-Nov-14	N	19.42	18.50
25-Feb-15	N	19.34	20.00

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