

JPM-pp1

Asia Pacific Equity Research

23 March 2015

Tingyi (Cayman Islands) Holding Corp (322 HK)

Neutral

Price: HK\$18.50

20 Mar 2015

Price Target: HK\$20.00

PT End Date: 31 Dec 2015

4Q sales very weak, noodles margin improvement has not come through yet

Tingyi announced USD400mn net profit for FY14, down 2% y/y and 7% below our estimate which was 10% below consensus. Earnings miss was due to: i) sales coming 2% below our estimates; iii) OPM 20bps lower than expected leading to 4% miss at the EBIT level; and with iii) associates profit coming lower than expected; net profit was dragged down. On 4Q14 standalone basis: i) sales were particularly weak and down 16% y/y; and ii) on the margin front noodles did not show improvement on y/y basis while iii) beverage margin showed some improvement at the EBIT level. With noodles margin improvement lagging, we find the results disappointing.

- **On 4Q standalone basis, sales were particularly weak:** 4Q14 sales were down by 16% y/y (decelerating further from 3Q14 decline of 13%). Noodles segment was weak with sales down 18% y/y in 4Q14 (vs 2% decline in 3Q14) and beverages (Tingyi and Pepsi together) trend was slightly better – declining 14% y/y in 4Q14 (vs. 20% y/y decline in 3Q14).
- **4Q noodles EBIT margins worse and beverage EBIT margins slightly better than expected:** Noodles posted 28.8% GPM margin for 4Q14, which was flat y/y basis vs. our expectation of some slight improvement; and at the same time noodles EBIT margin was down y/y basis. This is worrying as we have seen UPC improve its noodles margins in 2H14 while Tingyi seems to be lagging. Beverage reported better than expected margins. In 4Q14, beverage GPM (Tingyi and Pepsi together) came at 21.5% which is down c300bps y/y but better than our estimate. At the EBIT level, beverages loss was slightly better than expected and slightly higher than 4Q13 despite the sharp decline in top line.

Table 1: Tingyi 4Q14 results vs JPM estimates

USD mn	4Q13	4Q14A	y/y chg	4Q14E	Actual/Est
Sales revenue	2,128	1,780	-16.4%	2,011	-11.5%
Gross profit	586	460	-21.4%	526	-12.5%
Gross margin	27.5%	25.9%		26.2%	
Other income	56	55		55	-0.1%
Total Opex	(635)	(548)	-13.7%	(587)	-6.7%
EBIT	7	(32)	-548.6%	(58)	-44.3%
EBIT margin	0.3%	-1.8%		-2.9%	
Net interest income	(9)	(14)		(7)	100.5%
Associates	1	(7)		7	-206.9%
Pretax profit	(1)	(53)	na	(6)	830.1%
Tax	(28)	(5)	-83.7%	(9)	-46.2%
Effective tax rate	na	8.6%		na	
Minority interests	55	67		54	22.6%
Net profit	26	9	-65.3%	40	-77.5%
Net margin	1.2%	0.5%		2.0%	
Recurring net profit	26	9	-65.3%	40	-77.5%
Recurring net profit margin	1.2%	0.5%		2.0%	

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

Table 2: Tingyi FY14 results vs JPM estimates

USD mn	FY13	FY14A	y/y chg	FY14E	Actual/Est
Sales revenue	10,941	10,238	-6.4%	10,470	-2.2%
Gross profit	3,310	3,118	-5.8%	3,184	-2.1%
Gross margin	30.3%	30.5%		30.4%	

Other income	164	155		157	-1.6%
Total Opex	(2,781)	(2,594)	-6.7%	(2,633)	-1.5%
EBIT	693	679	-2.0%	708	-4.2%
EBIT margin	6.3%	6.6%		6.8%	
Net interest income	14	8		12	-36.8%
Associates	16	7		21	-65.2%
Pretax profit	723	694	-4.1%	741	-6.4%
Tax	(229)	(209)	-8.7%	(213)	-1.9%
Effective tax rate	-31.6%	-30.1%		-28.7%	
Minority interests	(86)	(84)		(98)	-14.1%
Net profit	409	400	-2.0%	430	-6.9%
Net margin	3.7%	3.9%		4.1%	
Recurring net profit	409	400	-2.0%	430	-6.9%
Recurring net profit margin	3.7%	3.9%		4.1%	

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

Table 3: Tingyi revenue, gross profit and EBIT breakdown

Sales (USDmn)	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14A	4Q14E
Instant noodles	1,105	888	1,153	1,186	1,150	884	1,132	972	1,146
Beverage	1,020	1,349	1,514	689	1,124	1,296	1,058	576	634
Pepsi	442	438	646	170	430	482	671	164	164
Bakery	57	42	55	49	53	36	47	42	52
Others	24	58	22	34	45	4	46	26	
Total sales revenue	2,648	2,775	3,390	2,128	2,782	2,723	2,954	1,780	2,011
% chg y/y (USD)									
Instant noodles	7.3%	5.3%	11.1%	13.1%	4.1%	-0.5%	-1.8%	-18.1%	-3.4%
Beverage	24.8%	4.9%	22.7%	48.9%	10.2%	-3.9%	-30.1%	-16.4%	-7.9%
Pepsi	na	9.0%	10.0%	20.1%	-2.7%	10.0%	3.9%	-3.7%	-3.7%
Bakery	-3.6%	-23.5%	-14.3%	-12.8%	-7.3%	-12.7%	-13.6%	-14.6%	5.6%
Others	12.6%	198.0%	-5.3%	46.7%	91.4%	-93.6%	104.1%	-23.7%	
Total sales revenue	37.4%	6.5%	15.1%	22.8%	5.0%	-1.9%	-12.9%	-16.4%	-5.5%
Gross profit									
Instant noodles	333	248	343	342	322	233	337	280	340
Beverage	303	439	545	162	386	478	364	118	123
Pepsi	113	127	190	48	113	138	214	42	42
Bakery	22	15	21	20	19	12	17	16	21
Total	775	845	1,104	586	845	865	947	460	526
GPM									
Instant noodles	30.2%	28.0%	29.8%	28.8%	28.0%	26.3%	29.8%	28.8%	29.7%
Beverage	29.7%	32.5%	36.0%	23.6%	34.3%	36.9%	34.4%	20.4%	19.4%
Pepsi	25.5%	29.0%	29.5%	28.2%	26.3%	28.6%	31.9%	25.5%	25.5%
Bakery	38.2%	35.1%	38.4%	40.2%	36.5%	33.4%	36.2%	38.1%	40.7%
Total	29.3%	30.4%	32.6%	27.5%	30.4%	31.8%	32.1%	25.9%	26.2%
EBIT (incl interest income)									
Instant noodles	140	79	152	120	139	82	167	96	137
Beverage	46	79	196	-126	105	129	92	-132	-148
Pepsi	0	2	2	-1	10	7	10	-1	-1
Bakery	1	-7	-3	-3	-1	-5	-2	0	-3
Total	185	173	351	-2	245	213	277	-48	-14
EBIT margin (incl interest income)									
Instant noodles	12.7%	8.9%	13.2%	10.1%	12.1%	9.3%	14.8%	9.9%	12.0%
Beverage	4.5%	5.9%	12.9%	-18.3%	9.3%	10.0%	8.7%	-23.0%	-23.3%
Pepsi	0.0%	0.5%	0.3%	-0.6%	2.4%	1.5%	1.5%	-0.8%	-0.8%
Bakery	2.3%	-15.9%	-4.7%	-6.4%	-1.4%	-13.6%	-3.5%	-0.4%	-5.8%
Total	7.0%	6.2%	10.3%	-0.1%	8.8%	7.8%	9.4%	-2.7%	-0.7%

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

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.

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.

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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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
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	24.70	22.50
12-Oct-11	N	21.30	20.00
22-Mar-12	N	23.55	22.50
17-Apr-12	N	21.65	19.00
29-May-12	N	19.18	16.50
21-Aug-12	N	20.85	18.00
19-Nov-12	UW	22.95	16.00
19-Mar-13	UW	20.75	14.50
21-May-13	UW	20.05	14.20
27-Aug-13	UW	19.12	13.20
18-Nov-13	UW	22.85	17.70
24-Mar-14	UW	20.35	18.00
20-May-14	UW	21.80	18.50
24-Sep-14	OW	19.88	22.00
17-Nov-14	N	18.98	18.50
25-Feb-15	N	19.52	20.00

<http://gps-app.amer.jpmchase.net:6080/server/console/chart/?shareClassId=502049&shareClassServerId=4&chartDesignation=1&actionType=C>

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