

Tingyi Cayman Islands

322 HK

Target (HKD): 20.00 → 18.60

Upside: 4.8%

23 Mar price (HKD): 17.74

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

Cost control to drive earnings

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- 2014 reported net profit fell by 2% YoY on sluggish noodle sales in 4Q14
- Management says it will focus on cost controls to enhance profit margin in the face of weak revenue-growth outlook
- Reiterate Outperform (2); lowering TP to HKD18.60

■ What's new

Tingyi's 2014 net profit missed our expectation and that of the Bloomberg consensus by 9%, mainly due to low noodle sales in 4Q14. Notably, USD73m of the cost was related to the termination benefits of some Pepsi staff. We believe this obligation will be reduced to USD35m per year on average over 2015-16. Although we reduce our revenue estimates on weakening demand and low contribution from new products in the near term, we are confident in Tingyi's cost-saving efforts and believe that these, along with lower raw material costs, can translate into operating-margin expansion in 2015.

■ What's the impact

Noodles: We expect revenue from the noodles segment to increase by 3% YoY in 2015 (after a decline of 18% in 4Q14) as the impact of the tainted-oil issue in Taiwan subsides. That said, management is cautious on revenue growth in 1H15 due to a high base effect and destocking by some distributors. We expect the

noodle segment's gross margin to expand by 1pp YoY (vs. 2014) on lower raw material costs.

Beverages: Tingyi is likely to focus on product diversification and leverage its international partners' R&D strength to develop new products, according to management. Based on the latest co-operation agreement with Starbucks (not rated), Tingyi will produce Starbucks-brand bottled coffee and energy drinks exclusively in China. Tingyi said its R&D team will focus on new-product development for traditional products such as tea and juices. We believe Tingyi can maintain its leadership in the bottled-tea market and resume market-share gains in bottled-water products due to its large national production network.

Cost controls: Tingyi's SG&A declined YoY as a ratio of revenue, from 24.3% in 2013 to 23.8% in 2014, despite declining revenue and higher expenses, due to its voluntary retirement plan for Pepsi unit staff. We expect more cost-saving measures and lower expenses from retirement-benefit obligations to drive down SG&A to 23.5% in 2015 and 22.8% in 2016, thus supporting operating-margin expansion. Hence, we cut our EPS estimates by only 3% and 8% for 2015-16, despite larger revenue cuts of 6-9%. Capex should also be lowered to USD600-700m in 2015, from USD1.5bn in 2014. We introduce our 2017 forecasts, for which we forecast a 5% YoY increase in EPS.

■ What we recommend

We now have a 12-month target price of HKD18.60 (formerly HKD20), based on our revised 2015E EPS and an unchanged 24.3x PER. Our target PER is based on a 10% discount to

Tingyi's past-5-year average 12-month forward PER of 27x, reflecting an EPS CAGR moderation to 15% for 2014-17E (vs. 18% for 2007-13). We reaffirm our Outperform (2) rating, supported by strong operating-margin expansion in 2015. The main risk to our call: food-safety issues.

■ How we differ

Our 2015-16E operating margins are above the Bloomberg consensus due to our optimism on cost control, notably at the Pepsi unit.

Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	(5.8)	(9.3)	n.a.
Net profit change	(2.6)	(8.0)	n.a.
Core EPS (FD) change	(2.6)	(8.0)	n.a.

Source: Daiwa forecasts

Share price performance



12-month range	16.24-23.20
Market cap (USDbn)	12.80
3m avg daily turnover (USDm)	12.82
Shares outstanding (m)	5,600
Major shareholder	Wei Ing-chou (36.9%)

Financial summary (USD)

Year to 31 Dec	15E	16E	17E
Revenue (m)	10,583	11,054	11,813
Operating profit (m)	987	1,031	1,092
Net profit (m)	549	586	614
Core EPS (fully-diluted)	0.098	0.105	0.110
EPS change (%)	37.2	6.6	4.9
Daiwa vs Cons. EPS (%)	0.1	0.6	n.a.
PER (x)	23.3	21.8	20.8
Dividend yield (%)	2.1	2.3	2.4
DPS	0.049	0.052	0.055
PBR (x)	3.8	3.5	3.2
EV/EBITDA (x)	10.3	9.5	8.7
ROE (%)	17.1	16.6	15.9

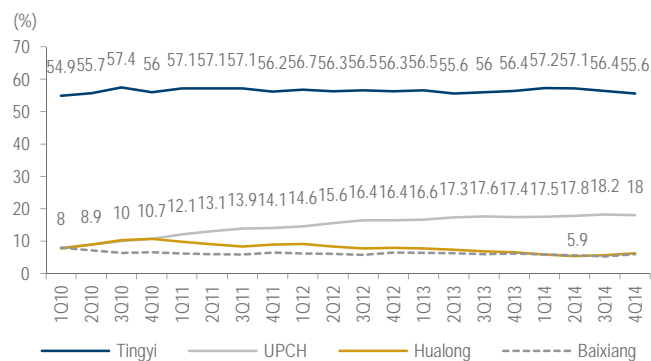
Source: FactSet, Daiwa forecasts

■ **Tingyi: 2014/4Q results highlights by segment (LHS) and 2014/4Q profit and loss (RHS)**

	2014	2013	YoY (%)	4Q14	YoY (%)	3Q14	YoY (%)		USD m	2014	2013	YoY (%)	Our estimates	Var (%)	4Q14	YoY (%)
(1) Instant noodles									Noodles	4,138	4,332	(4)	4,433	(7)	972	(18)
Sales (USD m)	4,138	4,332	(4)	972	(18)	1,132	(2)		Beverage	5,800	6,268	(7)	5,837	(1)	739	(14)
Gross margin (%)	28.3	29.2	-0.9pp	28.8	-0.0ppt	29.8	0.0ppt		Instant Food	179	203	(12)	243	(26)	42	(14)
Operating margin (%)	11.7	11.3	0.4ppt	8.5	-0.3ppt	13.5	1.5ppt		Revenue	10,238	10,941	(6)	10,652	(4)	1,780	(16)
EBIT (USD m)	425	437	(3)	83	(21)	153	10		COGS	-7,120	-7,631	(7)	-7,272	(2)	-1,319	(14)
Net profit (USD m)	360	337	7	56	(24)	119	10		Gross profit	3,118	3,310	(6)	3,379	(8)	460	(21)
Net margin%	8.7	7.8	0.9ppt	5.8	-0.4ppt	10.5	1.1ppt		Operating costs	-2,139	-2,313	(8)	-2,216	(4)	-435	(11)
(2) Beverage									Selling costs	-2,594	-2,781	(7)	-2,644	(2)	-497	(13)
Bottled tea	2,442	2,292	7	319	2	626	(17)		Operating income	733	730	0	876	(16)	12	(125)
Bottled water	1,193	1,141	5	134	(16)	350	(26)		Profit before tax	694	723	(4)	838	(17)	-53	n.a.
Bottled juice	1,314	1,340	(2)	97	(41)	248	(40)		Tax	-209	-229	(9)	-239	(13)	-5	(84)
Carbonated drinks	1,410	1,495	(6)	190	(14)	505	(4)		MI	-84	-86	(2)	-160	(47)	67	22
Sales (USD m)	5,800	6,268	(7)	739	(14)	1,729	(20)		Reported profit	400	409	(2)	439	(9)	9	(66)
Gross margin (%)	31.9	30.8	1.2ppt	21.5	-3.7ppt	33.4	-0.7ppt		Recurring profit	400	394	2	439	(9)	9	(66)
Operating margin (%)	4.1	3.2	0.9ppt	-17.4	-3.4ppt	6.6	-3.2ppt		Reported EPS (USD)	0.072	0.073	(2)	0.078	(9)	0.002	(66)
EBIT (USD m)	258	239	8	-129	n.m.	113	(46)		Our							
Net profit (USD m)	72	71	1	-60.0	n.m.	37.4	(53)		Margins and ratio (%)	2014	2013	+/-pp	estimates	Var pp	4Q14	+/-pp
Net margin%	1.2	1.1	0.1ppt	-8.1	-2.2ppt	2.2	-1.5ppt		Gross margin	30.5	30.3	0.2	31.7	-1.3	25.9	1.2
(3) Instant food									Operating margin	7.2	6.7	0.5	8.2	-1.1	0.7	2.0
Sales (USD m)	179	203	(12)	42	(14)	47	(14)		Effective tax rate	30.1	31.6	-1.5	28.5	1.6	-8.6	-5.2
Gross margin (%)	36.2	38.1	-1.9ppt	38.1	-2.1ppt	36.2	-2.2ppt		SG&A /Rev	23.8	24.3	-0.5	24.8	0.5	27.9	-0.5
Operating margin (%)	-10.2	-5.4	-5ppt	-7.4	2ppt	-8.8	-2ppt		Payout ratio	49.9	51.8	-1.9	46.5	3.4		-0.7
EBIT (USD m)	-18.6	-15.2	22	-3	(36)	-4.141	11									
Net profit (USD m)	-17.5	-14.1	n.m.	-4.1	n.m.	-4.1	n.m.									

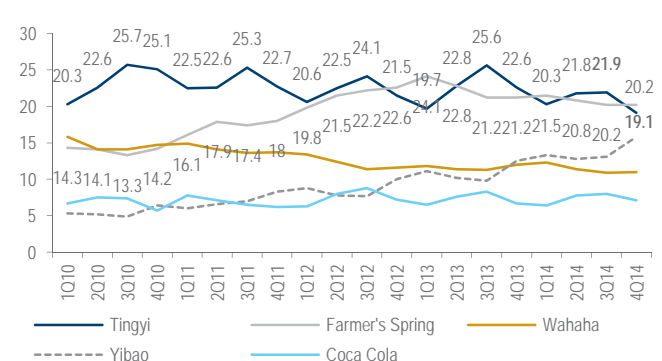
Source: Company

■ **Market share changes – instant noodles (by value)**



Source: AC Nielsen, Company

■ **Market share changes – bottled water (by volume)**



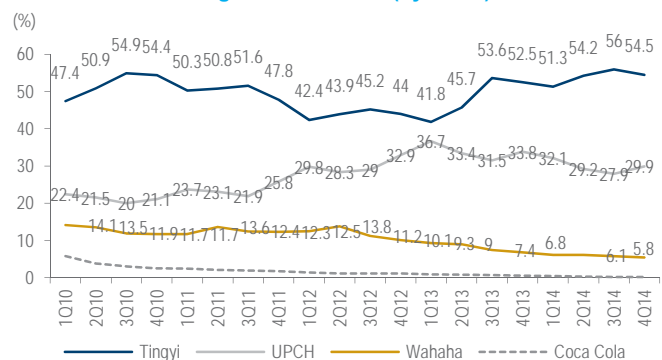
Source: AC Nielsen, Company

■ **Latest cost trends**

(CNY / tonne)	% of (Segment's) COGS	4Q14	YoY%	QoQ %
Flour (price with 13% tax)	12%-18% (noodles)	3460	1	3
Palm oil (price with 13% tax)	12%-15% (noodles)	5940	1.2	-4
PET resin (price with 17% tax)	-60% (Beverage)	9200	-11	-10
Sugar (price with 17% tax)	-10% (Beverage)	4960	-13	-1.5

Source: Company

■ **Market share changes – bottled tea (by value)**



Source: AC Nielsen, Company

Financial summary

■ Key assumptions

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales growth YoY - instant noodles	27.0	22.5	10.2	9.4	(4.5)	2.6	1.8	5.0
Sales growth YoY - beverages	38.9	13.2	23.3	27.1	(7.5)	3.0	6.3	8.1
Gross margin % - instant noodles	28.8	27.2	30.0	29.2	28.3	29.3	26.5	26.0
Gross margin % - beverages	28.5	25.7	29.6	30.8	31.9	34.6	34.5	34.4
Selling and distribution expense ratio (%)	16.8	16.8	20.3	21.1	20.9	20.6	19.7	19.4

■ Profit and loss (USDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Instant noodles	2,932	3,592	3,960	4,332	4,138	4,244	4,320	4,538
Beverage	3,532	3,999	4,931	6,268	5,800	5,977	6,356	6,872
Other Revenue	218	266	321	341	300	362	378	404
Total Revenue	6,681	7,857	9,212	10,941	10,238	10,583	11,054	11,813
Other income	46	131	255	201	209	180	200	200
COGS	(4,782)	(5,770)	(6,457)	(7,631)	(7,120)	(7,130)	(7,564)	(8,111)
SG&A	(1,247)	(1,512)	(2,164)	(2,663)	(2,438)	(2,490)	(2,503)	(2,654)
Other op.expenses	(92)	(73)	(75)	(118)	(156)	(156)	(156)	(156)
Operating profit	606	633	771	730	733	987	1,031	1,092
Net-interest inc./(exp.)	(7)	(9)	(33)	(37)	(47)	(78)	(69)	(63)
Assoc/forex/extraord./others	147	39	94	30	7	7	7	7
Pre-tax profit	747	663	832	723	694	916	970	1,036
Tax	(134)	(163)	(228)	(229)	(209)	(252)	(262)	(280)
Min. int./pref. div./others	(136)	(80)	(145)	(86)	(84)	(115)	(122)	(142)
Net profit (reported)	477	420	460	409	400	549	586	614
Net profit (adjusted)	340	380	369	394	400	549	586	614
EPS (reported)(USD)	0.085	0.075	0.082	0.073	0.072	0.098	0.105	0.110
EPS (adjusted)(USD)	0.061	0.068	0.066	0.070	0.072	0.098	0.105	0.110
EPS (adjusted fully-diluted)(USD)	0.061	0.068	0.066	0.070	0.072	0.098	0.105	0.110
DPS (USD)	0.043	0.038	0.032	0.035	0.036	0.049	0.052	0.055
EBIT	606	633	771	730	733	987	1,031	1,092
EBITDA	810	911	1,092	1,118	1,186	1,450	1,538	1,632

■ Cash flow (USDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	747	663	832	723	694	916	970	1,036
Depreciation and amortisation	203	278	321	388	452	463	507	540
Tax paid	(96)	(130)	(138)	386	(223)	(232)	(224)	(233)
Change in working capital	215	464	(158)	273	284	(354)	(1)	100
Other operational CF items	(1,050)	4	25	18	38	70	61	56
Cash flow from operations	19	1,279	882	1,788	1,245	863	1,313	1,500
Capex	(966)	(1,349)	(882)	(896)	(1,100)	(650)	(650)	(650)
Net (acquisitions)/disposals	0	0	0	0	(380)	0	0	0
Other investing CF items	0	0	0	0	0	0	0	0
Cash flow from investing	(966)	(1,349)	(882)	(896)	(1,480)	(650)	(650)	(650)
Change in debt	299	616	234	192	952	(582)	(247)	0
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(192)	(239)	(210)	(180)	(197)	(200)	(275)	(293)
Other financing CF items	93	(36)	(85)	57	47	(126)	(120)	(122)
Cash flow from financing	201	341	(61)	69	802	(908)	(641)	(415)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(746)	271	(60)	961	568	(695)	22	435
Free cash flow	(947)	(70)	1	892	145	213	663	850

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	893	600	838	1,250	1,183	894	1,042	1,515
Inventory	310	313	478	481	387	388	411	441
Accounts receivable	128	155	233	260	238	241	247	259
Other current assets	357	368	419	419	535	535	535	535
Total current assets	1,688	1,436	1,968	2,410	2,343	2,058	2,235	2,749
Fixed assets	2,923	4,030	5,002	5,485	5,860	6,430	6,550	6,637
Goodwill & intangibles	0	0	29	28	27	27	27	27
Other non-current assets	281	343	474	501	976	557	557	557
Total assets	4,891	5,809	7,473	8,424	9,206	9,073	9,369	9,971
Short-term debt	457	701	500	1,017	1,382	800	800	800
Accounts payable	1,084	974	1,043	1,252	896	897	952	1,021
Other current liabilities	687	753	1,252	1,357	1,358	1,360	1,435	1,530
Total current liabilities	2,228	2,428	2,795	3,625	3,636	3,058	3,187	3,351
Long-term debt	177	549	985	660	1,247	1,247	1,000	1,000
Other non-current liabilities	117	145	197	213	227	255	284	315
Total liabilities	2,522	3,123	3,976	4,498	5,110	4,559	4,471	4,666
Share capital	27	28	28	28	28	28	28	28
Reserves/R.E./others	1,794	2,072	2,523	2,852	3,006	3,355	3,666	3,988
Shareholders' equity	1,821	2,100	2,551	2,880	3,034	3,383	3,694	4,016
Minority interests	548	587	946	1,046	1,062	1,131	1,204	1,289
Total equity & liabilities	4,891	5,809	7,473	8,424	9,206	9,073	9,370	9,971
EV	13,092	14,040	14,311	14,166	15,205	14,980	14,659	14,272
Net debt/(cash)	(259)	650	647	426	1,446	1,153	758	285
BVPS (USD)	0.326	0.376	0.457	0.515	0.542	0.604	0.660	0.717

■ Key ratios (%)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	31.5	17.6	17.2	18.8	(6.4)	3.4	4.5	6.9
EBITDA (YoY)	(2.8)	12.5	19.9	2.3	6.1	22.3	6.1	6.1
Operating profit (YoY)	(3.5)	4.4	21.8	(5.3)	0.5	34.6	4.5	5.9
Net profit (YoY)	(11.3)	11.9	(2.9)	6.7	1.6	37.2	6.6	4.9
Core EPS (fully-diluted) (YoY)	(11.3)	11.9	(2.9)	6.6	1.5	37.2	6.6	4.9
Gross-profit margin	28.4	26.6	29.9	30.3	30.5	32.6	31.6	31.3
EBITDA margin	12.1	11.6	11.9	10.2	11.6	13.7	13.9	13.8
Operating-profit margin	9.1	8.1	8.4	6.7	7.2	9.3	9.3	9.2
Net profit margin	5.1	4.8	4.0	3.6	3.9	5.2	5.3	5.2
ROAE	20.7	19.4	15.9	14.5	13.5	17.1	16.6	15.9
ROAA	8.2	7.1	5.6	5.0	4.5	6.0	6.4	6.4
ROCE	23.1	18.2	17.3	13.8	11.9	14.9	15.6	15.8
ROIC	26.0	17.5	15.0	11.7	10.4	12.8	13.3	14.2
Net debt to equity	n.a.	31.0	25.3	14.8	47.7	34.1	20.5	7.1
Effective tax rate	18.0	24.6	27.4	31.6	30.1	27.5	27.0	27.0
Accounts receivable (days)	6.6	6.6	7.7	8.2	8.9	8.3	8.1	7.8
Current ratio (x)	0.8	0.6	0.7	0.7	0.6	0.7	0.7	0.8
Net interest cover (x)	93.1	67.6	23.6	19.5	15.6	12.7	15.0	17.3
Net dividend payout	50.0	50.0	39.2	48.2	49.9	50.0	50.0	50.0
Free cash flow yield	n.a.	n.a.	0.0	7.0	1.1	1.7	5.2	6.6

Source: FactSet, Daiwa forecasts

■ Company profile

Tingyi Cayman Islands (Tingyi) is the world's largest producer of largest instant noodles, and has a leading 56.4% market share in China (in terms of revenue for 2013). The company's beverage unit, owned jointly with Pepsi and Asahi Group, has shares of 52%, 26% and 24% of the China markets for ready-to-drink (RTD) tea, juice drinks and bottled water, respectively, by revenue, for 2013.

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