

JPM-pp1

Asia Pacific Equity Research

30 March 2015

## Tsingtao Brewery - H (168 HK)

Neutral

Price: HK\$52.35

30 Mar 2015

Price Target: HK\$52.00

PT End Date: 31 Dec 2015

## Weak 4Q14 with sharp decline in volumes

Tsingtao reported weak operating results for 4Q14. Although 4Q is the low season and has little relevance for FY14, it is worth highlighting that results were quite poor even for low-season 4Q. In 4Q14 volume was down 14% y/y, and with a continuing decline in blended ASPs, revenue was down 19% y/y. With weak volumes GPM was down 460ppt y/y and Tsingtao posted a Rmb427mn loss at the EBIT level, which worsened from the 4Q13 EBIT loss of cRmb290mn. This print marks the worst 4Q performance at the operating level for the last 5 years. The loss at the EBIT level was worse than our estimate as well. Tsingtao's 4Q bottom line was saved by tax credits and lower minority stake, so the net loss came in at Rmb189mn, almost in line with last year but still below our estimate due to the EBIT miss. It seems like the "controlled slow SG&A spending trend" which saved some margins in 2Q and 3Q did not work well in 4Q, as SG&A expenses surged again. With these figures, FY14 sales and EBIT growth were 3% y/y each with EBIT coming in c9% below our FY14 estimate. We expect weak results to disappoint the market as well.

Tsingtao's renewed management strategy to focus on the core Tsingtao brand in FY15 rather than purely seek market share with lower-tier brands in the portfolio may help c30bp GPM expansion in FY15, as per our estimate. We maintain our Neutral rating.

Table 1: Tsingtao 4Q14 results vs J.P. Morgan estimates

Rmb MM	4Q13	4Q14A	% chg y/y	4Q14E	Actual/Est
<b>Revenue</b>	<b>4,098</b>	<b>3,313</b>	<b>-19%</b>	<b>4,181</b>	<b>-20.8%</b>
Gross profit	1,023	676	-34%	993	-32.0%
Gross margin	25.0%	20.4%		23.8%	
SG&A	-1,312	-1,102	<b>-16%</b>	-1,234	<b>-10.7%</b>
as % of sales	-32.0%	-33.3%		-29.5%	
<b>Operating profit</b>	<b>-289</b>	<b>-427</b>	<b>-48%</b>	<b>-241</b>	<b>76.9%</b>
Operating margin	-7.1%	-12.9%		-5.8%	
Investment income	-21	-41		-25	64.0%
Net financial expenses	72	65		80	-19.1%
Non-operating income	185	190		191	-0.4%
Non-operating expenses	-58	-37		-56	-33.2%
<b>PBT</b>	<b>-120</b>	<b>-250</b>	<b>-109%</b>	<b>-55</b>	<b>357.3%</b>
Tax expense	-115	43		-42	-201.9%
Tax rate	95.7%	-17.1%		76.8%	
<b>PAT</b>	<b>-234</b>	<b>-208</b>	<b>11%</b>	<b>-97</b>	<b>114.3%</b>
Minority	43	18		-12	
<b>Net income to shareholders</b>	<b>-192</b>	<b>-189</b>	<b>1%</b>	<b>-109</b>	<b>73.9%</b>
Net margin	-4.7%	-5.7%		-2.6%	
<b>Recurring Net profit</b>	<b>-192</b>	<b>-189</b>	<b>1%</b>	<b>-109</b>	<b>73.9%</b>
Net margin	-4.7%	-5.7%		-2.6%	

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

Table 2: Tsingtao 2H14 results vs J.P. Morgan estimates

Rmb MM	2H13	2H14A	% chg y/y	2H14E	Actual/Est
<b>Revenue</b>	<b>13,320</b>	<b>12,091</b>	<b>-9%</b>	<b>12,959</b>	<b>-6.7%</b>
Gross profit	4,047	3,427	-15%	3,744	-8.5%
Gross margin	30.4%	28.3%		28.9%	
SG&A	-3,486	-2,974	<b>-15%</b>	-3,106	<b>-4.2%</b>
as % of sales	-26.2%	-24.6%		-24.0%	
<b>Operating profit</b>	<b>561</b>	<b>453</b>	<b>-19%</b>	<b>638</b>	<b>-29.1%</b>
Operating margin	4.2%	3.7%		4.9%	
Investment income	-3	-11		5	-316.6%
Net financial expenses	156	161		176	-8.7%
Non-operating income	264	247		248	-0.3%
Non-operating expenses	-65	-49		-68	-27.3%

<b>PBT</b>	<b>904</b>	<b>803</b>	<b>-11%</b>	<b>998</b>	<b>-19.6%</b>
Tax expense	-367	-221		-306	-27.8%
<i>Tax rate</i>	-40.5%	-27.5%		-30.6%	
<b>PAT</b>	<b>538</b>	<b>582</b>	<b>8%</b>	<b>692</b>	<b>-16.0%</b>
Minority	41	4		-27	-113.8%
<b>Net income to shareholders</b>	<b>578</b>	<b>585</b>	<b>1%</b>	<b>666</b>	<b>-12.1%</b>
<i>Net margin</i>	4.3%	4.8%		5.1%	
<b>Recurring Net profit</b>	<b>578</b>	<b>585</b>	<b>1%</b>	<b>666</b>	<b>-12.1%</b>
<i>Net margin</i>	4.3%	4.8%		5.1%	

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

Table 3: Tsingtao FY14 results vs J.P. Morgan estimates

Rmb MM	FY13	FY14A	% chg y/y	FY14E	Actual/Est
<b>Revenue</b>	<b>28,291</b>	<b>29,049</b>	<b>3%</b>	<b>29,917</b>	<b>-2.9%</b>
Gross profit	9,055	8,967	-1%	9,285	-3.4%
<i>Gross margin</i>	32.0%	30.9%		31.0%	
SG&A	-7,183	-7,045	-2%	-7,177	-1.8%
as % of sales	-25.4%	-24.3%		-24.0%	
<b>Operating profit</b>	<b>1,872</b>	<b>1,922</b>	<b>3%</b>	<b>2,108</b>	<b>-8.8%</b>
<i>Operating margin</i>	6.6%	6.6%		7.0%	
Investment income	229	24		40	-40.1%
Net financial expenses	251	335		350	-4.4%
Non-operating income	564	469		470	-0.2%
Non-operating expenses	-248	-71		-89	-20.8%
<b>PBT</b>	<b>2,667</b>	<b>2,683</b>	<b>1%</b>	<b>2,879</b>	<b>-6.8%</b>
Tax expense	-692	-663		-748	-11.4%
<i>Tax rate</i>	-25.9%	-24.7%		-26.0%	
<b>PAT</b>	<b>1,975</b>	<b>2,020</b>	<b>2%</b>	<b>2,130</b>	<b>-5.2%</b>
Minority	-2	-29		-60	-50.7%
<b>Net income to shareholders</b>	<b>1,973</b>	<b>1,990</b>	<b>1%</b>	<b>2,071</b>	<b>-3.9%</b>
<i>Net margin</i>	7.0%	6.9%		6.9%	
<b>Recurring Net profit</b>	<b>1,704</b>	<b>1,990</b>	<b>17%</b>	<b>2,071</b>	<b>-3.9%</b>
<i>Net margin</i>	6.0%	6.9%		6.9%	

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

Table 4: Quarterly volume trend

Volumes (mn hl)	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Main brand	9.5	12.5	14.0	6.9	10.5	13.5	14.3	6.7	11.7	14.0	na	na
Secondary brand	6.9	12.9	12.4	3.9	7.8	14.0	15.2	5.0	10.1	17.3	na	na
<b>Total</b>	<b>16.4</b>	<b>25.4</b>	<b>26.4</b>	<b>10.8</b>	<b>18.3</b>	<b>27.5</b>	<b>29.5</b>	<b>11.7</b>	<b>21.8</b>	<b>31.3</b>	<b>28.4</b>	<b>10.0</b>
<b>% chg y/y</b>												
Main brand	1.1%	14.7%	13.8%	-5.5%	10.1%	8.3%	2.1%	-2.9%	11.9%	3.4%	na	na
Secondary brand	23.2%	11.2%	17.0%	2.6%	13.5%	8.3%	22.6%	28.2%	29.0%	23.8%	na	na
<b>Total</b>	<b>9.3%</b>	<b>12.9%</b>	<b>15.3%</b>	<b>-2.7%</b>	<b>11.5%</b>	<b>8.3%</b>	<b>11.7%</b>	<b>8.3%</b>	<b>19.2%</b>	<b>13.8%</b>	<b>-3.7%</b>	<b>-14.2%</b>

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

## Investment Thesis

Remain Neutral. The stock has declined c8% YTD (vs HSI up c5%) and we think the current valuation is fair. We are also encouraged by the renewed management strategy to focus on the core Tsingtao brand in FY15 rather than purely seeking market share with lower tier brands in the portfolio, which we estimate will lead to GPM expansion in FY15

## Valuation

Our Dec-15 PT of HK\$52 is based on 24x one year forward PE which is 2 standard deviations below the historical mean given the notable slowdown in earnings growth.

## Risks to Rating and Price Target

Upside risks to our rating and price target include a sudden sharp drop in input costs, management cutting A&P spending notably, and management focusing more on the Tsingtao brand, which could lead to stronger-than-expected margin improvement.

Key downside risks include sales mix continuing to deteriorate, if the F&B channel continues to be hit by anti-extravagance policies (Tsingtao earns >60% of sales from F&B), and an increase in input costs.

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27-Aug-07	OW	22.85	30.00
12-Nov-07	OW	24.85	33.50
14-Jan-08	OW	33.80	44.00
27-Apr-08	OW	20.80	33.80
02-Feb-09	OW	14.88	21.00
15-Apr-09	N	18.60	17.50
07-Aug-09	N	26.90	28.00
11-Nov-09	UW	35.80	29.00
12-Apr-10	UW	40.30	34.00
16-Aug-10	UW	38.70	35.50
07-Dec-10	N	42.95	40.00
28-Jul-11	N	50.40	44.50
12-Oct-11	UW	40.40	35.00
14-Jan-12	UW	42.25	32.00
11-Apr-12	UW	44.20	33.00
21-Aug-12	UW	43.80	32.00
28-Mar-13	UW	48.05	33.00
27-Apr-13	UW	52.85	36.00
30-Aug-13	UW	58.00	47.00
30-Oct-13	UW	62.40	49.00
10-Apr-14	UW	59.05	45.00
24-Sep-14	UW	55.65	50.00
25-Nov-14	N	54.95	52.00

<http://gps-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=502036&shareClassServerId=4&chartDesignation=1&actionType=C>

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