

China / Hong Kong Company Update

China Foods

Bloomberg: 506 HK EQUITY | Reuters: 0506.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

7 Sep 2022

BUY

Last Traded Price (6 Sep 2022): HK\$2.44 (HSI : 19,203)
Price Target 12-mth: HK\$3.88 (59% upside) (Prev HK\$3.80)

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What's New

- Strong product mix enhancement and opex saving initiatives drove EBIT margin enhancement in 1H22
- Material cost pressure to lessen in 2H; will continually support margin
- COVID pandemic lockdowns remain a concern, but favourable weather should enable better volume trend ahead. Raise earnings by 5% in FY22E/FY23E; maintain BUY

Firm demand

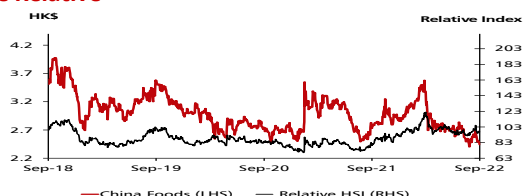
Investment Thesis

Volume driven by new products and recovering demand. We expect beverage sales volume to grow by 3% in FY22F (FY21: +13.5%), supported by new product launches and rising consumption per capita. For comparison, China's annual consumption per capita of carbonated beverages stood at 5.7 litres versus Vietnam 8.5 litres, according to Euromonitor.

Average selling price to rise on changing product mix. We forecast the ASP to rise in 2022, driven by product innovation and a change in the packaging mix towards mini and slim cans and popular flavours including the "Sugar-Free" and "Fiber+" series.

Opex savings to offset raw material cost pressures. We are positive that opex savings would partly offset higher PET and syrup prices.

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	17,249	19,784	21,256	23,086
EBITDA	1,657	1,859	2,074	2,120
Pre-tax Profit	1,253	1,423	1,637	1,761
Net Profit	499	572	671	722
Net Pft (Pre Ex) (core profit)	499	572	671	722
Net Profit Gth (Pre-ex) (%)	19.4	14.8	17.3	7.5
EPS (RMB)	0.18	0.20	0.24	0.26
EPS (HK\$)	0.20	0.23	0.27	0.29
EPS Gth (%)	19.4	14.8	17.3	7.5
Diluted EPS (HK\$)	0.20	0.23	0.27	0.29
DPS (HK\$)	0.10	0.12	0.14	0.15
BV Per Share (HK\$)	2.00	2.08	2.23	2.39
PE (X)	12.1	10.6	9.0	8.4
P/Cash Flow (X)	2.7	5.6	2.7	2.5
P/Free CF (X)	3.7	16.8	3.5	3.2
EV/EBITDA (X)	4.4	4.1	3.4	3.1
Net Div Yield (%)	4.1	4.9	5.6	6.0
P/Book Value (X)	1.2	1.2	1.1	1.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	10.5	11.3	12.6	12.6
Earnings Rev (%)			9	2
Consensus EPS (RMB)			0.22	0.25
Other Broker Recs:		B:5	S:0	H:0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Valuation:

Our valuation is based on a 4.6x FY23F EV/EBITDA, equivalent to its 1SD 3 year trading average (previously 6x FY22F EV/EBITDA).

Where we differ:

Our earnings forecast is lower than the consensus, as we factor in a lower gross profit margin estimate. We remain optimistic about the group's performance in raising consumption per capita in sparkling drinks in key operating regions.

Key Risks to Our View:

Resurgence of COVID-19 cases, food safety concerns, and/or raw material cost volatility.

At A Glance

Issued Capital (m shrs)	2,797
Mkt Cap (HKm/US\$m)	6,825 / 869
Major Shareholders (%)	
COFCO Corporation	74.1
Free Float (%)	25.9
3m Avg. Daily Val. (US\$m)	0.30
GICS Industry: Consumer Staples / Food, Beverage & Tobacco	



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China Foods

WHAT'S NEW

Sugar-free sparkling beverages gaining momentum

Beverage volume to recover, with uncertainty from COVID lockdowns remaining. We expect China Foods to see sales volume recovery h-o-h in 2H22, as the consumption appetite gradually improves from 1H22 and the weather trend becomes favourable. That said, there were intermittent impacts from electricity limitations in Sichuan, Chongqing, and Hunan during Jul-Aug, which had temporarily impacted production, as well as continuous ad hoc lockdowns since (Sept) (Chengdu), which will temporarily hurt retail spendings. We expect sparkling beverages to remain the core growth driver, with a strong response towards sugar-free sparkling over traditional sparkling beverages. The company expects sugar-free sparkling beverages to account for 15%-20% of total revenue in the next three years. We forecast an earnings growth of 12% in 2H22 and 8% in FY23E.

Results Summary

1H22 net earnings rose 19% to Rmb481m. Revenue rose 6% to Rmb11,894m. While sales volume dropped 4% y-o-y, optimisation of product and packaging structure helped improved ASP mix. Gross profit margin contracted 2.7ppt to 36.2% due to increases in material costs. On the other

hand, distribution and selling expenses contracted 3.8ppt to 25.7% through a series of optimisation and integration measures. Adjusted EBIT rose 21% to Rmb1,126m.

The company has committed to the development of its Smart Retail Business, with over 20,000 vending machines to cover >5m customers. The company will continue expanding its coverage area, with a target to become the largest smart retail digital platform.

Company Background

China Foods holds an exclusive franchise to manufacture, market, and distribute products under the Coca-Cola series, which encompasses 19 provincial-level administrative regions, covering approximately 50% of China's population. The company provides consumers with 11 major types of beverages, namely sparkling drinks, juices, water, milk drinks, energy drinks, tea, coffee, functional nutrition drinks, sports drinks, plant-based protein drinks, and alcoholic drinks under 24 brands.

Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

China Foods

Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (RMB m)					
Carbonated	12,621	13,314	15,052	15,967	17,417
Juices	2,270	2,065	2,531	3,007	3,157
Water	1,508	1,301	1,486	1,455	1,602
Others	774	569	715	827	909
Total	17,172	17,249	19,784	21,256	23,086

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	17,172	17,249	19,784	21,256	23,086
Cost of Goods Sold	(10,898)	(10,424)	(12,724)	(13,927)	(15,037)
Gross Profit	6,274	6,826	7,061	7,329	8,049
Other Opng (Exp)/Inc	(5,249)	(5,583)	(5,663)	(5,720)	(6,320)
Operating Profit	1,025	1,243	1,398	1,609	1,729
Other Non Opng (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	41	36	29	32	36
Net Interest (Exp)/Inc	(54)	(25)	(4)	(4)	(4)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	1,013	1,253	1,423	1,637	1,761
Tax	(237)	(300)	(348)	(393)	(423)
Minority Interest	(358)	(455)	(502)	(573)	(616)
Preference Dividend	0	0	0	0	0
Net Profit	418	499	572	671	722
Net Profit before Except.	418	499	572	671	722
EBITDA	1,387	1,657	1,859	2,074	2,120
Growth					
Revenue Gth (%)	9.7	0.4	14.7	7.4	8.6
EBITDA Gth (%)	17.8	19.4	12.2	11.5	2.2
Opg Profit Gth (%)	33.3	21.2	12.5	15.1	7.5
Net Profit Gth (%)	30.2	19.4	14.8	17.3	7.5
Margins & Ratio					
Gross Margins (%)	36.5	39.6	35.7	34.5	34.9
Opg Profit Margin (%)	6.0	7.2	7.1	7.6	7.5
Net Profit Margin (%)	2.4	2.9	2.9	3.2	3.1
ROAE (%)	9.5	10.5	11.3	12.6	12.6
ROA (%)	3.0	3.4	3.8	4.3	4.3
ROCE (%)	9.5	11.2	12.2	13.3	12.9
Div Payout Ratio (%)	29.3	49.9	51.8	50.0	50.0
Net Interest Cover (x)	19.1	49.6	311.5	402.2	432.3

Source: Company, DBS HK

China Foods

Interim Income Statement (RMB m)

FY Dec	1H2020	2H2020	1H2021	2H2021	1H2022
Revenue	9,401	7,848	11,219	8,566	11,894
Cost of Goods Sold	(5,766)	(4,657)	(6,857)	(5,866)	(7,583)
Gross Profit	3,635	3,191	4,362	2,699	4,311
Other Oper. (Exp)/Inc	(2,896)	(2,686)	(3,428)	(2,235)	(3,183)
Operating Profit	739	504	934	464	1,128
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	13	22	42	(13)	30
Net Interest (Exp)/Inc	(15)	(10)	(2)	(2)	(2)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	737	516	974	449	1,156
Tax	(177)	(123)	(228)	(120)	(275)
Minority Interest	(230)	(225)	(341)	(161)	(398)
Net Profit	330	168	405	168	483
Net profit bef Except.	330	168	405	168	483
Growth					
Revenue Gth (%)	(1.6)	3.0	19.3	9.1	6.0
Opg Profit Gth (%)	4.7	57.7	26.5	(8.0)	20.7
Net Profit Gth (%)	13.4	33.1	22.5	(0.3)	19.4
Margins					
Gross Margins (%)	38.7	40.7	38.9	31.5	36.2
Opg Profit Margins (%)	7.9	6.4	8.3	5.4	9.5
Net Profit Margins (%)	3.5	2.1	3.6	2.0	4.1

Source: Company, DBS HK

China Foods

Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	5,063	4,973	5,061	5,096	5,206
Invts in Associates & JVs	770	792	912	912	912
Other LT Assets	4,506	4,534	4,345	4,365	4,365
Cash & ST Invts	854	1,939	1,633	2,752	3,961
Inventory	1,890	1,834	1,933	1,717	1,854
Debtors	878	812	817	866	922
Other Current Assets	488	227	466	466	466
Total Assets	14,448	15,110	15,168	16,174	17,685
ST Debt	607	0	0	0	0
Creditors	3,856	4,328	6,188	6,246	6,754
Other Current Liab	2,270	2,223	281	281	281
LT Debt	0	20	0	0	0
Other LT Liabilities	403	459	310	310	310
Shareholder's Equity	4,540	4,954	5,157	5,532	5,918
Minority Interests	2,772	3,125	3,232	3,805	4,421
Total Cap. & Liab.	14,448	15,110	15,168	16,174	17,685
Non-Cash Wkg. Capital	(2,870)	(3,679)	(3,252)	(3,478)	(3,793)
Net Cash/(Debt)	248	1,919	1,633	2,752	3,961
Debtors Turn (avg days)	7.4	6.7	6.7	5.8	5.8
Creditors Turn (avg days)	49.4	43.6	35.5	299.7	288.9
Inventory Turn (avg days)	63.9	62.4	66.0	47.8	43.3
Asset Turnover (x)	1.2	1.2	1.3	1.4	1.4
Current Ratio (x)	0.6	0.7	0.7	0.9	1.0
Quick Ratio (x)	0.3	0.4	0.4	0.6	0.7
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	115.9	2,823.8	N/A	N/A	N/A
Z-Score (X)	2.3	2.5	2.6	2.6	2.6

Source: Company, DBS HK

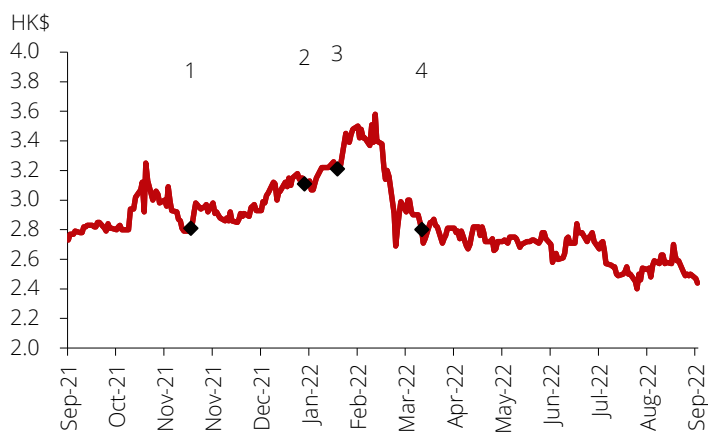
Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	1,013	1,253	1,423	1,637	1,761
Dep. & Amort.	399	547	600	465	391
Tax Paid	(208)	(267)	(357)	(393)	(423)
Assoc. & JV Inc/(loss)	(41)	(36)	(29)	(32)	(36)
(Pft)/ Loss on disposal of FAs	(123)	64	(33)	0	0
Chg in Wkg.Cap.	775	666	(504)	574	712
Other Operating CF	86	(12)	(26)	0	0
Net Operating CF	1,901	2,214	1,074	2,251	2,405
Capital Exp.(net)	(703)	(565)	(714)	(500)	(500)
Other Invts.(net)	11	44	(217)	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	13	34	0	0
Other Investing CF	147	133	49	0	0
Net Investing CF	(545)	(375)	(847)	(500)	(500)
Div Paid	(96)	(122)	(249)	(297)	(336)
Chg in Gross Debt	(588)	(630)	(66)	0	0
Capital Issues	1	2	3	0	0
Other Financing CF	(82)	(64)	(184)	(336)	(361)
Net Financing CF	(764)	(814)	(496)	(632)	(697)
Currency Adjustments	0	0	0	0	0
Chg in Cash	592	1,026	(269)	1,119	1,209
Opg CFPS (RMB)	0.40	0.55	0.56	0.60	0.61
Free CFPS (RMB)	0.43	0.59	0.13	0.63	0.68

Source: Company, DBS HK

China Foods

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	16-Nov-21	HK\$2.79	HK\$3.88	Buy
2:	21-Jan-22	HK\$3.15	HK\$3.88	Buy
3:	9-Feb-22	HK\$3.26	HK\$3.88	Buy
4:	30-Mar-22	HK\$2.85	HK\$3.80	Buy

Source: DBS HK

Analyst: Alison Fok

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

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FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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