

Downgrade due to rich valuation

China F & B

Tingyi (322 HK, HK\$6.41)

HOLD (downgraded from BUY)

Target price: HK\$5.84 (-8.8%)

Results summary:

- For 3Q FY12/06, turnover increased 17.2% YoY to US\$702m while net profit was up 15.2% YoY to US\$60.7m. For the first nine months of 2006, turnover rose 25.4% YoY to US\$1,813.6m. Net profit came in at US\$127.2m, up 16.7%, which was in line with expectations. The key driver of top-line growth mainly came from the 42.7% increase in beverage sales to US\$367m in 3Q FY12/06.
- Beverage accounted for 52.3% of the group's turnover compared with only 42.9% in 3Q FY12/05. Instant noodles accounted for 40% of the total turnover while bakery segment generated around 4.3% sales. Pre-tax profit increased 13.7% to US\$91.6m and EBITDA grew 13.7% to US\$121.0m.
- Overall gross margin showed an improvement from 33.36% in 3Q FY12/05 to 34.15% in 3Q FY12/06 because of the increase of the sales portion of high margin beverage products and the stable sales growth of high-end packet noodles and bowl noodles. However, both operating and net margin slightly dropped by 0.2 pcp and 0.1 pcp respectively. In 3Q FY12/06, its distribution expenses as a percentage of total sales amounted to 18.7%, up 0.87 pcp from a year ago. Raw material costs, excluding flour, palm oil (+10 % from 3Q FY12/05), sugar (+55% from 3Q FY12/05) and PET plastic resin (+10% from 3Q FY12/05), still remained at a high level in 3Q FY12/06. A&P costs accounted for 10.7% of total sales (13.9% in 2Q FY12/06).

Table 1: 3Q FY12/06 results

3 months to Sep	Turnover (US\$m)	Gross profit (US\$m)	Gross margin (%)	Pre-tax profit (US\$m)	Tax rate (%)	Net profit (US\$m)	EPS Basic (US cents)
FY12/06	702.2	239.8	34.2	91.6	8.8	60.7	1.09
FY12/05	599.2	199.9	33.4	80.6	9.2	52.7	0.94
YoY (%)	17.2	20.0		13.7		15.2	16.0

Source: Company data

Table 2: Nine-month results

9 months to Sep	Turnover (US\$m)	Gross profit (US\$m)	Gross margin (%)	Pre-tax profit (US\$m)	Tax rate (%)	Net profit (US\$m)	EPS Basic (US cents)
FY12/06	1,813.6	605.8	33.4	203.6	8.8	127.2	1.19
FY12/05	1,445.9	467.1	32.3	168.2	9.2	109.0	1.01
YoY (%)	25.4	29.7		21.1		16.7	16.9

Source: Company data

Table 3: Financial summary

Year to Dec	Net profit US\$m	EPS US\$	EPS Δ %	P/E X	P/B X	EV/EBITDA X	Yield %	ROE %	ROCE %	N. Gearing %
04A	286.4	0.051	699.7	16.0	5.8	27.1	1.4	41.8	3.7	10.1
05A	123.5	0.022	(56.9)	37.2	5.3	11.7	2.8	14.8	16.8	Cash
06F	152.2	0.027	23.2	30.2	5.1	9.8	1.8	17.6	19.9	Cash
07F	190.3	0.034	25.0	24.1	4.2	7.4	2.3	21.1	23.9	Cash
08F	238.0	0.043	25.0	19.3	3.5	6.6	2.8	23.8	28.2	Cash

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Table 4: Turnover breakdown

(US\$m)	3Q05	% of total	3Q06	% of total	% Change
Instant noodles	295	49	281	40	(4.7)
Beverage	257	43	367	52	42.7
Bakery	28	5	30	4	8.4
Others	19	3	24	4	24.7
Total	599	100	702	100	17.2

Source: Company data

Operation highlights:

Low-end noodles dragged down profits. Instant noodle sales slightly dropped by 4.7% to US\$281m, accounting for 40% of total group turnover (3Q FY12/05: 49.3%). Gross margin of instant noodles was 26.66%, up 2.26 pcp compared to that of 3Q FY12/05. Due to the setting-up of factories and the delay of new developed products, the Fu-man-Duo low-end noodles performed unsatisfactory. According to AC Nielsen, the 3Q FY12/06 sales value growth in China's instant noodles was a negative growth of 1.15% and also a negative growth of 7.86% by sales volume.

In our view, the medium term industry growth may be a little sluggish but we don't rule out the longer-term growth potential as PRC consumers only consumed less than 20 packs per year while the consumption in Japan, Taiwan and HK reaches more than 40 packs per year. In terms of value, Tingyi was ranked first with a 41.4% market share in China's instant noodles market, 28.4 pcp higher than that of the second player, Hualong. In September, the market share of Master Kong noodles further increased to 65.15% and 58.93% respectively for the high-ended packet noodles and bowl noodles.

Table 5: Instant noodle sales by products

(US\$m)	3Q05	3Q06	YoY %
Bowl	107	116	7.9
High end packet	104	107	3.0
Low end packet	74	52	(30.1)
Others	10	6	(35.6)
Total	295	281	(4.7)

Source: Company data

Beverage is the key driver. Beverage sales rose 42.68% to US\$366.6m, accounting for 52.21% of total group turnover, compared to 50% in 3Q FY12/05. In terms of value, Tingyi was ranked first with a 50.0% market share in the RTD tea segment, while it was ranked second with a 12.4% market share in the bottle water and third with a market share of 15.9% in the diluted juice drinks segment in China. Gross margin for beverage segment dropped 4.97pcp to 37.11% as sugar price and cost of lower-margin bottle water surged.

Table 6: Beverage sales by products

(%)	3Q05	3Q06
Tea	66	61
Juice	19	17
Water	13	21
Total	100	100

Source: Company data

Bakery. For the bakery segment, sales rose 8.4% to US\$30m, contributing 4% of total group turnover. In terms of value, Tingyi was ranked second with a 24.5% market share in the sandwich cracker market in China, according to AC Nielsen.

New production lines in 2007. Tingyi will invest in 43 more beverage production lines in 2007 (27 for bottle water, 12 for juice and RTD tea products). It will enhance its production scale of beverage products especially for the bottle water segment.

Valuation. Although we are still bullish on Tingyi's long-term business outlook, the current valuation is rich. We have downgraded our recommendation from BUY to HOLD. The share price rose 44% since our upgrade report dated 20 July 2006. Our target price has also been revised to HK\$5.84 (was HK\$5.30) based on 22x FY12/07F P/E.