

Tingyi



BUY (from HOLD)

Highly palatable

Key points:

- Consumption of instant noodle moving to higher-end products
- Palm oil price softened to favor gross margin.
- Gaining market share for diluted juice drinks and bottled water.
- Beneficiary of rising domestic consumption and defensive nature to inflation.
- Target at HK\$11.25. BUY

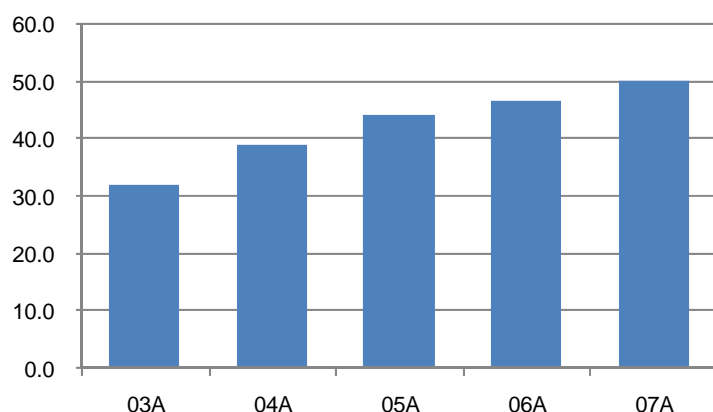
Overlook. Tingyi, with its popular "Master Kong" brand, is one of China's leading F&B companies. We expect its growth momentum to come from:

- Industry's organic growth.
- Product upgrades.
- Market share expansion in some sub-markets.
- Softer raw materials prices.

Instant noodle division

Instant noodle industry. The growth rate of China's instant noodle consumption slowed from 21.9% in 2004 to 7.1% in 2007, suggesting that the market is maturing. We expect it to pick up in 2008 based on 1Q data and stay at single digits in the long term.

Chart 1: China's consumption of instant noodle (pieces m)



Source: World Instant Noodle Association

China Consumer

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Stock data

Price	HK\$8.64
Target price	HK\$11.25 (+30%)
12 mth range	HK\$8.44-13.56
Market cap.	US\$6,194.5m
Daily t/o, 3 mth	US\$6.8m
Free float %	25.1%
Ticker	322.HK/0322 HK

Financial summary

Year to Dec	06A	07A	08F	09F	10F
T/O (US\$m)	2,331.7	3,215.4	4,302.0	5,091.6	5,892.4
NP (US\$m)	148.9	194.8	268.6	321.2	375.7
EPS (US\$)	0.027	0.035	0.048	0.057	0.067
EPS Δ%	20.4	31.2	37.7	19.6	17.0
P/E (x)	41.6	31.7	23.0	19.3	16.5
P/B (x)	6.78	6.02	5.40	4.83	4.33
EV/EBITDA (x)	18.5	13.6	10.5	9.0	7.9
Yield (%)	2.2	2.4	3.0	3.7	4.4
ROE (%)	16.7	20.1	24.7	26.5	27.7
ROCE (%)	17.7	19.7	24.9	30.8	32.4
N. Gear. (%)	11.7	16.0	19.3	16.9	13.3

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+5.2	-2.2	+5.9
Actual price changes (%)	-4.0	-21.0	+0.2

	08F	09F	10F
Consensus EPS (US\$)	0.044	0.055	0.067
Previous forecasts (US\$m)	n.a.	n.a.	n.a.
Previous EPS (US\$)	n.a.	n.a.	n.a.

Price Chart

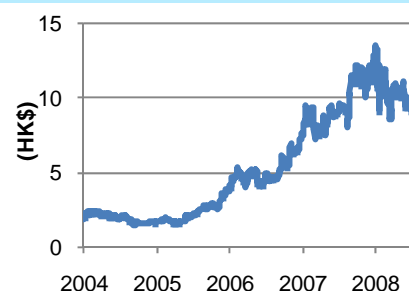
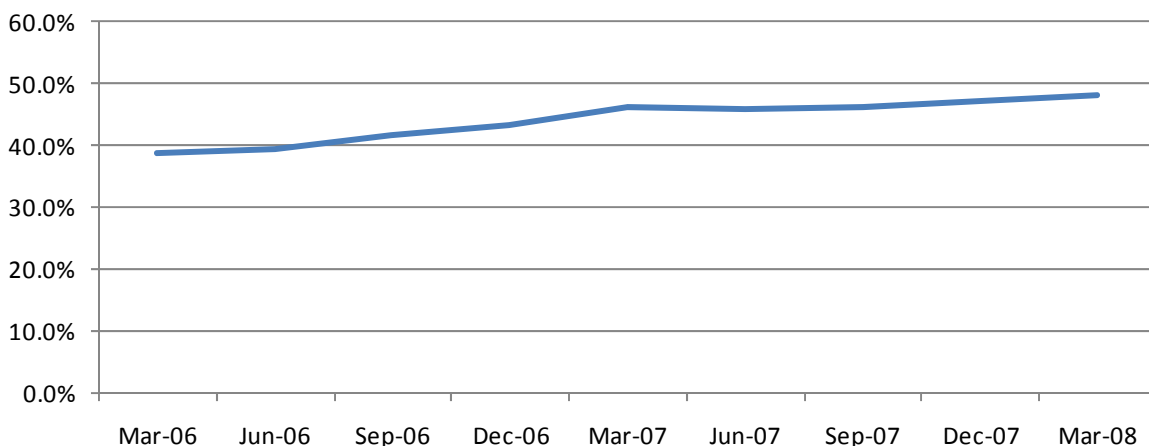


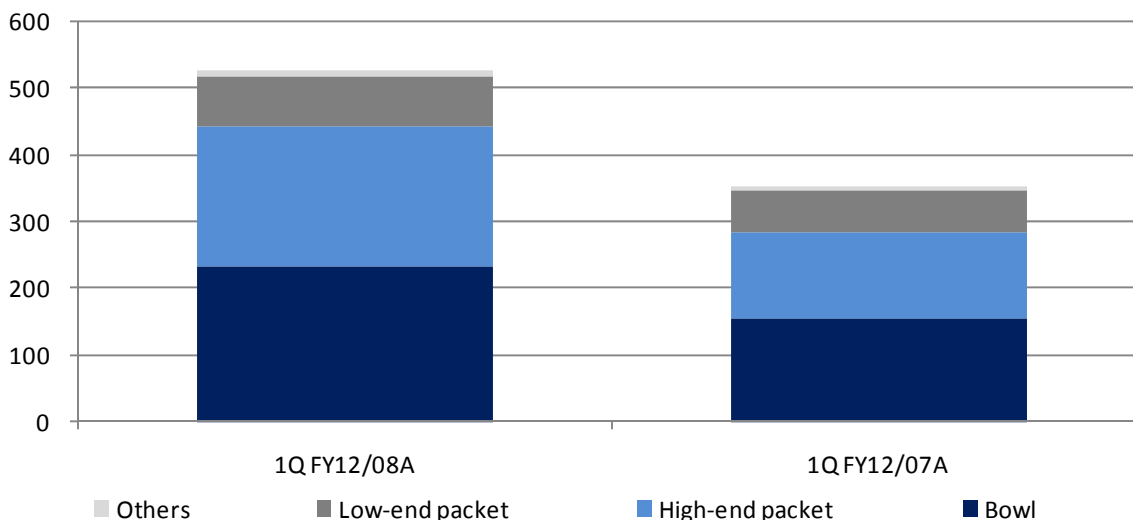
Chart 2: Tingyi's instant noodle market share (sales value)



Source: ACNielsen

Shift to high-end products. Apart from organic factors, a shift to high-end noodle products prompted by rising livings standards in China will fuel growth. In 1Q FY12/08A, Tingyi's sales of high-end bowl instant noodles rose 50.3% and 23.3% for the low-end packet type.

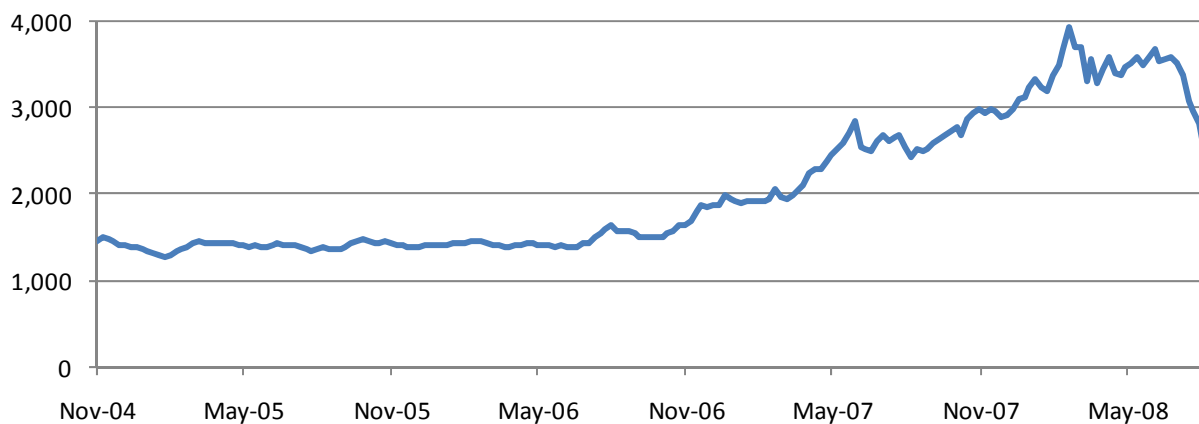
Chart 3: Tingyi's instant noodle sales mix



Source: Company data

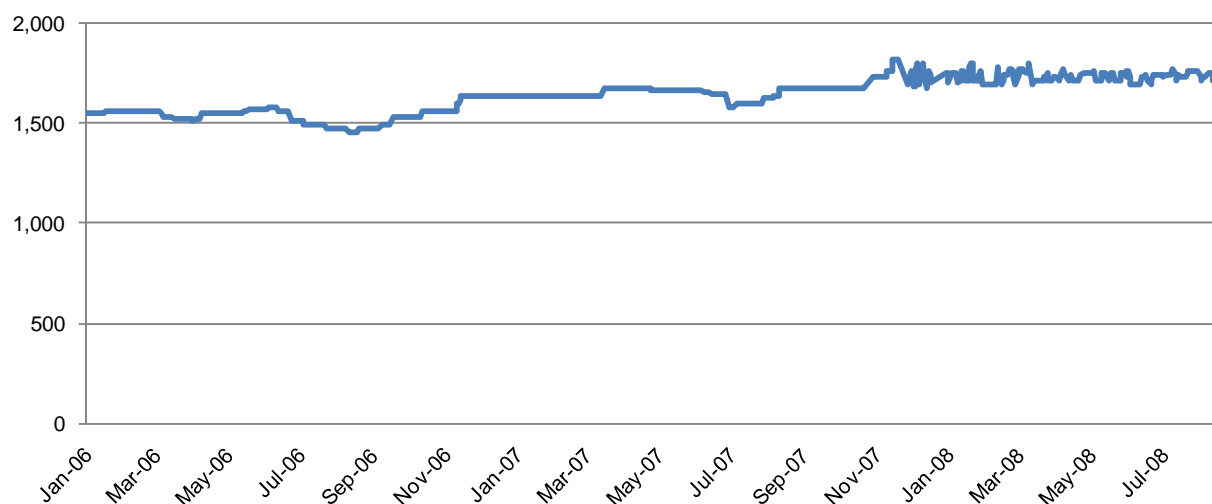
Gross margins. The sales mix change will also favor gross margins. After the company's price adjustments (majority in Jun and Dec 2007 before the introduction of the National Development and Reform Commission's price interference policy in Jan 2008), the segmental gross margin expanded 2.2pcp in 1Q FY12/08A to 27.1%. Given the recent collapse of the palm oil price (12-18% of noodle costs), we expect the gross margin to improve on a full-year basis.

Chart 4: Malaysian palm oil board crude palm oil fob spot price (US\$/tonne)



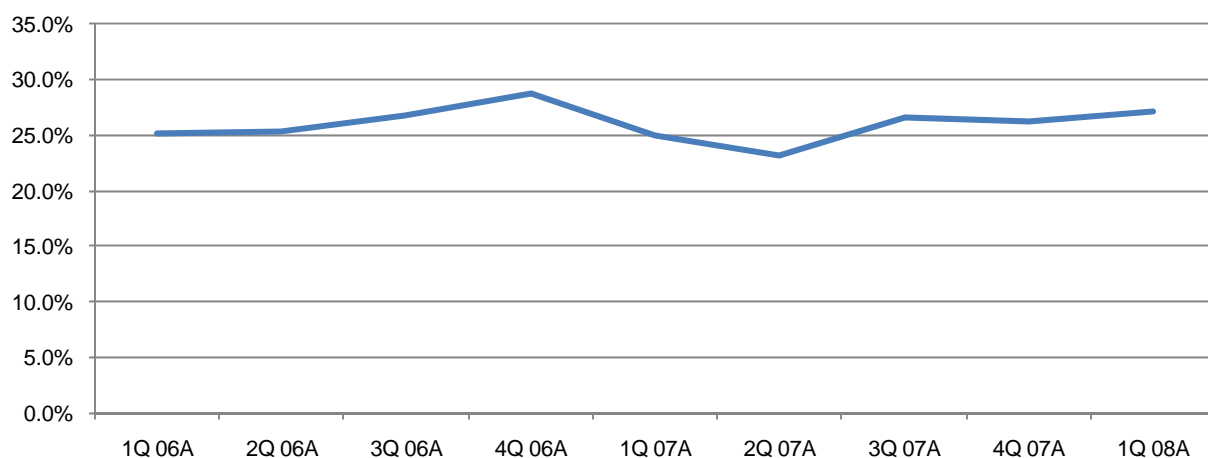
Source: Bloomberg

Chart 5: China's wheat price (RMB/tonne)



Source: National Grain & Oil Information Centre

Chart 6: Tingyi's gross margin in instant noodle segment



Source: Company data

Beverage division

Beverages. China's beverage sector is expected to grow at a CAGR of 14.6% in 2006-2011 according to Datamonitor. We expect RTD tea products, which are considered healthier than their alternatives, to

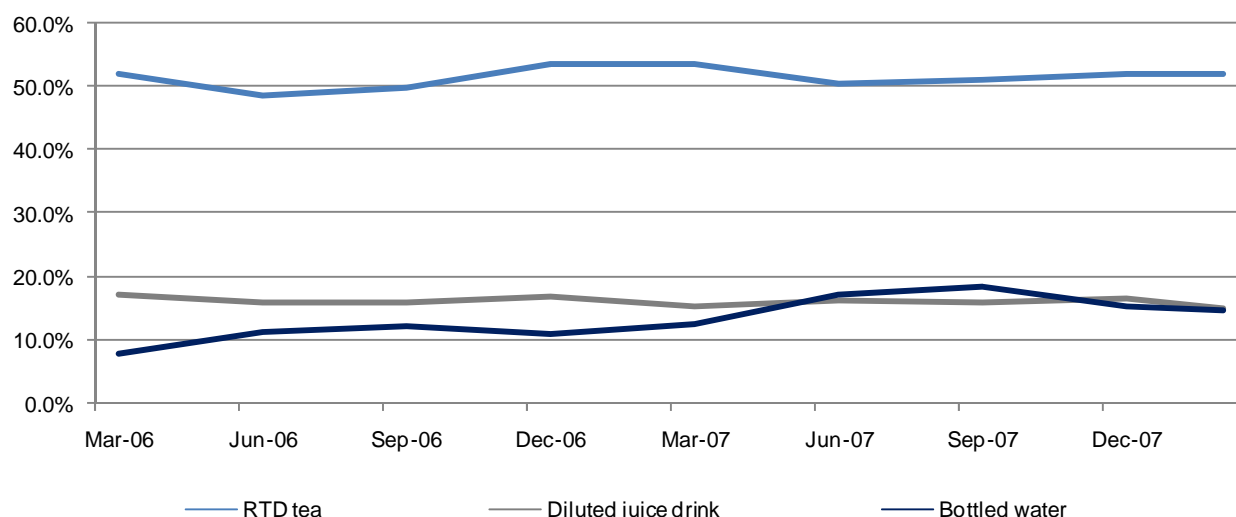
outperform. Master Kong is a dominant RTD tea brand with 43.5% of the market in 1Q FY12/08A.

Table 1: Beverage sales value in China

	2006 (RMBm)	2004 - 06 CAGR (%)
Carbonated soft drinks	17,934	9.6
Juice	11,835	12.5
Bottled water	7,431	14.0
TRD tea	7,400	32.2
Functional drinks	2,601	(3.1)
Total	47,201	12.9

Source: ACNielsen

Chart 7: Tingyi's market shares for beverage products



Source: ACNielsen

Table 2: Adjusted market share

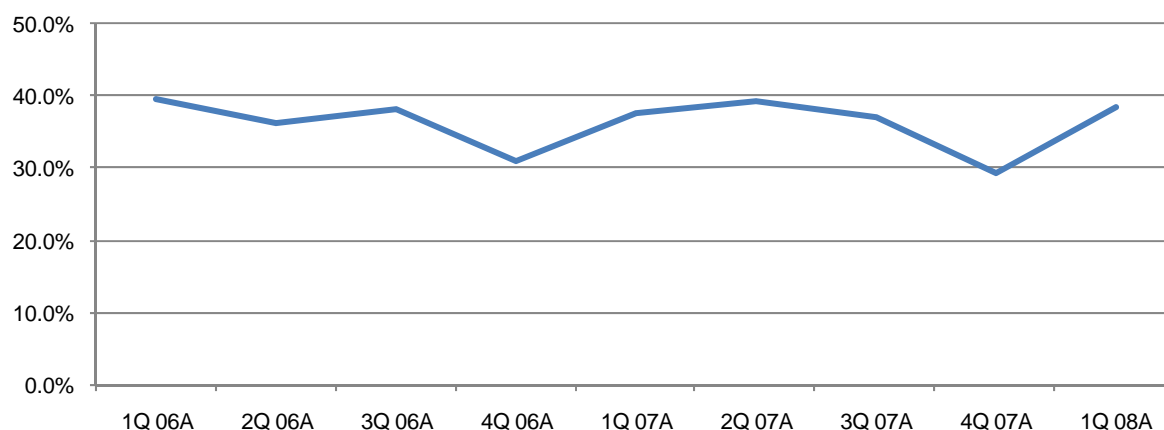
	New database		Old database	
	Mar-08	Mar-07	Feb-08	Feb-07
RDT tea	43.5%	49.0%	52.0%	54.5%
Diluted juice drinks	16.7%	15.2%	14.9%	16.9%
Bottled water	16.0%	15.2%	14.7%	12.6%

Source: ACNielsen

RDT tea market. Tingyi's RTD tea market share shrunk 5.5pcp YoY in 1Q FY12/08A, partly because of a one-off drastic change in the sample structure, according to AC Nielsen, a market research company who provides the survey. We have embedded a cautious assumption of a 5.0pcp market share drop in FY12/08F in our forecast but in the long run expect the company to maintain its market position.

Diluted juice drinks and bottled water. Market shares of Tingyi's diluted juice drinks and bottled water expanded in 1Q FY12/08A but the company's penetration is still low compared with RTD tea. We expect market share expansion in these segments to continue given the company's strong brand and solid track record.

Gross margin. In 1Q FY12/08A, the segmental gross margin widened 0.7pcp YoY to 38.4%. As prices of two major raw materials (PET resin - 60.0% of PET drink cost and sugar- 10.0% of PET drink cost) are stabilizing, the sales mix will be the main factor influencing the gross margin, in our view. We believe the overall gross margin in FY12/08 may dip slightly as we expect some market share contraction in RTD tea, which carries the highest gross margin in the beverage segment.

Chart 8: Tingyi's gross margin in beverage segment

Source: Company data

Bakery division

In 1Q FY12/08A, turnover rose 37.2% to US\$33.8m. The company's share of the sandwich cracker market expanded from 19.1% to 25.5%. Since the segment accounts for less than 5.0% of the company's total turnover it has no material impact on the overall performance.

1Q results summary.

Turnover rose 43.6% to US\$969.1m, with US\$524.9m from the instant noodle segment (up 49.4% YoY), US\$384.1m from the beverage segment (up 38.6%) and US\$33.8m from the bakery segment (up 37.2%). The gross margin expanded 1.0pcp to 32.4%, with improvements in every business division. Net profit increased 33.6% to US\$65.1m.

Forecast and valuation

We estimate FY12/08F turnover at US\$4,302.0m and net profit at US\$268.6m. We expect the bottom line to grow at a CAGR of 24.5% from FY12/07A to FY12/10F. The company's major strength is its strong brand and extensive distribution network. We view it as a beneficiary of China's increasing consumption and a defensive player in the current inflationary environment (high food prices to stimulate demand for cheaper instant noodle products). Our target price for the counter is HK\$11.25, which represents 30.0x FY12/08F P/E.

Table 3: Peers comparison

Company name	Ticker	Fiscal Year end	Mkt Cap (US\$m)	His P/E(x)	Curr-Yr Fwd P/E(x)	Nxt-Yr Fwd P/E(x)	ROE (%)
Uni-President	220 HK	12/2007	1,385.3	18.7	15.8	12.6	11.0
China Green	904 HK	04/2008	831.3	12.0	10.8	8.7	24.6
Huiyuan	1886 HK	12/2007	753.7	7.5	13.4	10.5	20.6
Mengniu	2319 HK	12/2007	4,447.5	29.3	24.5	18.7	23.1
Tingyi*	322 HK	12/2007	6,194.5	31.7	23.0	19.3	20.1

Source: Bloomberg, SBI E2-Capital

Note: * Estimates from SBI E2-Capital

Table 4: P&L

Year to Dec (US\$m)	06A	07A	08F	09F	10F
Revenue	2,331.7	3,215.4	4,302.0	5,091.6	5,892.4
Cost of sales	(1,579.3)	(2,199.9)	(2,932.4)	(3,465.3)	(4,003.8)
Gross profit	752.4	1,015.5	1,369.7	1,626.3	1,888.6
Other net income	37.4	51.3	46.0	50.0	52.0
Distribution expenses	(445.8)	(614.9)	(814.1)	(953.4)	(1,091.5)
Administrative expenses	(56.2)	(73.2)	(93.6)	(105.7)	(116.5)
Other operating expenses	(47.0)	(50.2)	(51.6)	(62.9)	(74.0)
Finance costs	(10.9)	(19.4)	(21.5)	(22.9)	(23.6)
Share of results of associates	6.9	8.1	9.7	10.7	11.7
Profit before taxation	236.7	317.2	444.5	542.1	646.7
Income tax	(23.9)	(36.3)	(57.5)	(78.3)	(103.1)
Profit for the period	212.8	280.9	386.9	463.8	543.6
Attributable to:					
Equity holders of the Company	148.9	194.8	268.6	321.2	375.7
Minority interests	63.9	86.1	118.3	142.6	167.9
EPS - Basic (US\$)	0.027	0.035	0.048	0.057	0.067
Proposed DPS (US\$)	0.025	0.027	0.033	0.041	0.049
Proposed dividend	136.9	150.3	184.4	229.1	273.8

Source: Company data, SBI E2-Capital

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