

WH Group (288 HK)

US hog futures rallied as trade tensions ease

US lean hog futures rallied last Friday as news said China will exempt additional tariff on certain volume purchase of US pork. Given China's hog shortage and US pork's deep price discount to China's, we expect China to import more pork from US in 4Q19E, which should support US pork and hog prices.

- Lean hog futures soared.** US lean hog future (Oct 2019) price jumped 6% last Friday (+11% over last two trading days) as various pieces of news showed China-US trade tension is easing. (1) On 13 Sep, according to Xinhua News, China supports enterprises to purchase certain amount of US pork and soy bean based on market principles and WTO rules. The Customs Tariff Commission of State Council would exclude additional tariffs on those items. (2) On 12 Sep, MOC said Chinese firms have started to inquire about prices for US agricultural goods including pork. (3) USDA reported that China bought 10,878 tonnes of US pork in the week ended 5 Sep, its biggest purchases since May 2019. (4) China and US officials will meet this week to discuss trade topics, according to Reuters.
- China's hog balance continued to fall sharply in Aug.** According to MOARA, hog balance and sow balance fell 38.7% (vs 32.2% in Jul) and 37.4% (vs 31.9% in Jul) YoY, respectively, in Aug 2018. We estimate the MoM decline of hog balance and sow balance were 9.9% and 9.1%, respectively, in Aug 2019. Compared to the MoM decline of 9% in Jul 2019, we did not see the fall of hog and sow balances eased in Aug. Given that it needs around 18 months to increase hog supply, we expect China's hog price to stay high in 4Q19 and 2020 on tight supply.
- Expect a better 4Q19.** We think the exemption of addition tariff and easing of China-US trade tensions are positive to WH, given that US hog price and pork carcass price trade at around 59% and 69% discount to those of China, respectively. Before China announced to increase US pork import tariff by 5-10% on 23 Aug with effective date on 1 Sep, US hog and pork carcass prices traded at 49% and 54% discount to relevant prices in China before such announcement. Given the China's hog shortage and US pork's deep price discount to China's, we expect China to import more pork from US in 4Q19E, which should support US pork and hog prices.
- Maintain Buy.** Our SOTP-based TP HK\$9.20 represents 14.3x FY19E P/E. **Catalyst:** China reduces import tariffs or increases pork imports on US pork. **Risk:** Packaged meat and fresh pork margins below expectation.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (US\$ mn)	22,379	22,605	23,217	24,240	24,268
Net profit (US\$ mn)	1,127	1,047	1,215	1,317	1,347
Adj. net profit (US\$ mn)	1,090	1,046	1,215	1,317	1,347
Adj. EPS (US\$)	0.075	0.071	0.083	0.090	0.092
YoY growth (%)	1.0	(4.9)	16.2	8.3	2.3
Adj. P/E (x)	12.7	13.3	11.5	10.7	10.4
P/B (x)	1.9	1.8	1.6	1.5	1.4
Yield (%)	3.6	2.7	3.9	4.2	4.3
Adj. ROAE (%)	15.8	13.8	14.9	14.7	13.8
Net gearing (%)	22	30	24	16	9

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price HK\$9.20
(Previous TP) HK\$9.20
Up/Downside +24%
Current Price HK\$7.44

China Staples Sector

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Stock Data

Mkt Cap (HK\$ mn)	109,448
Avg 3 mths t/o (HK\$ mn)	317.50
52w High/Low (HK\$)	9.95/5.25
Total Issued Shares (mn)	14,664

Source: Bloomberg

Shareholding Structure

Rise Grand	35.94%
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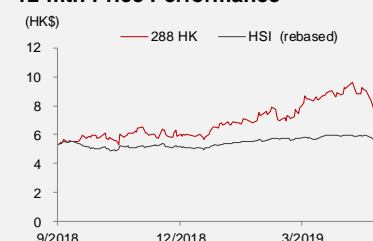
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-20.0%	11.9%
3-mth	1.2%	0.4%
6-mth	-4.6%	1.2%

Source: Bloomberg

12-mth Price Performance

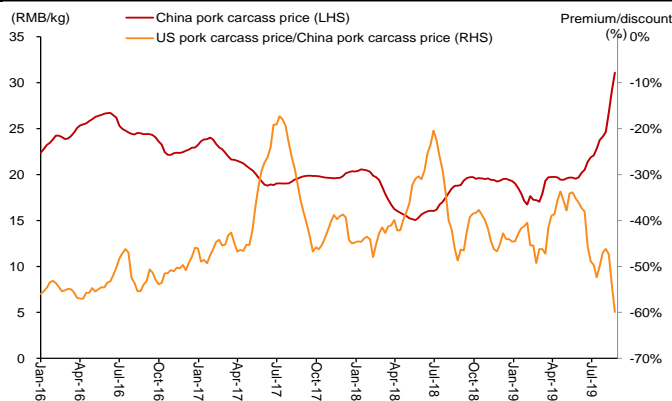


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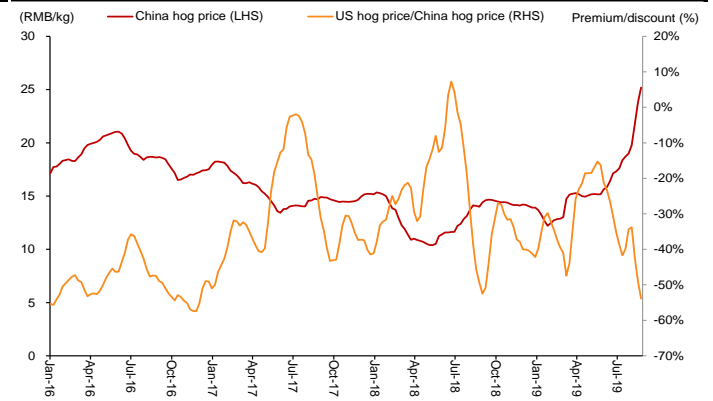
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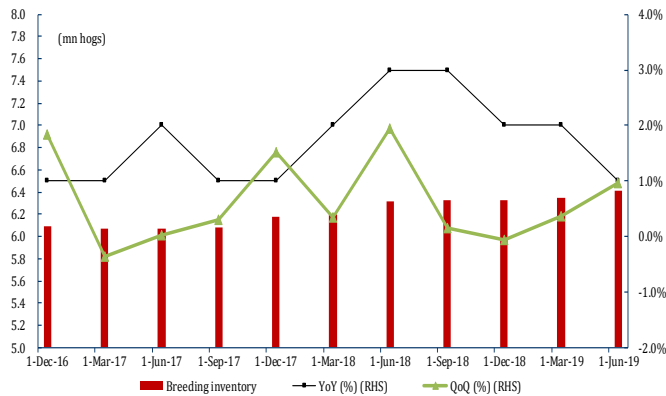
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Figure 1: US pork carcass price traded at 60% discount to China pork carcass price on 25 Aug 2019


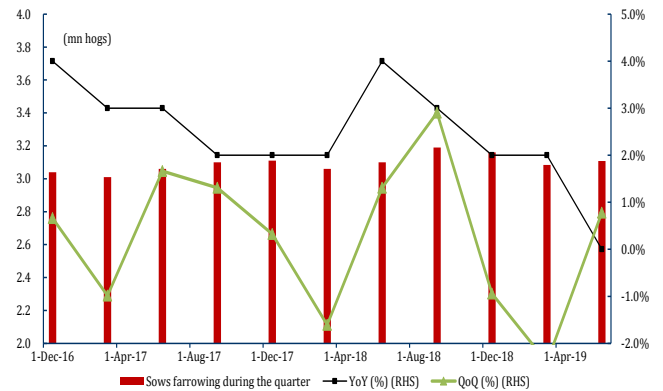
Source: Bloomberg, CMBIS

Figure 2: US hog price traded at 54% discount to China hog price on 28 Aug 2019


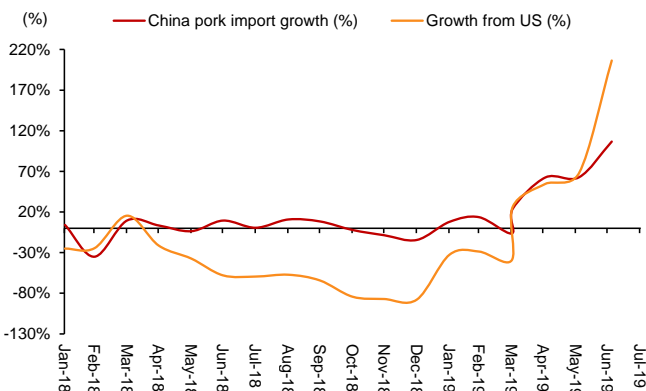
Source: Bloomberg, CMBIS

Figure 3: Growth of US breeding hog inventory softened from 3% in Sep 2018 to 1% in Jun 2019


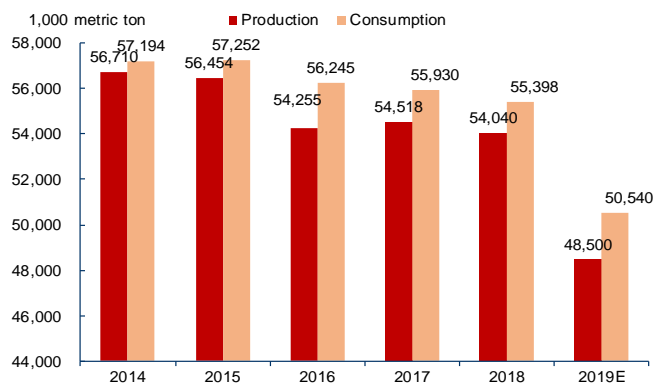
Source: USDA, CMBIS

Figure 4: Number of sows farrowing during the quarter also moderated to flat in the quarter ended 1 Jun 2019


Source: USDA, CMBIS

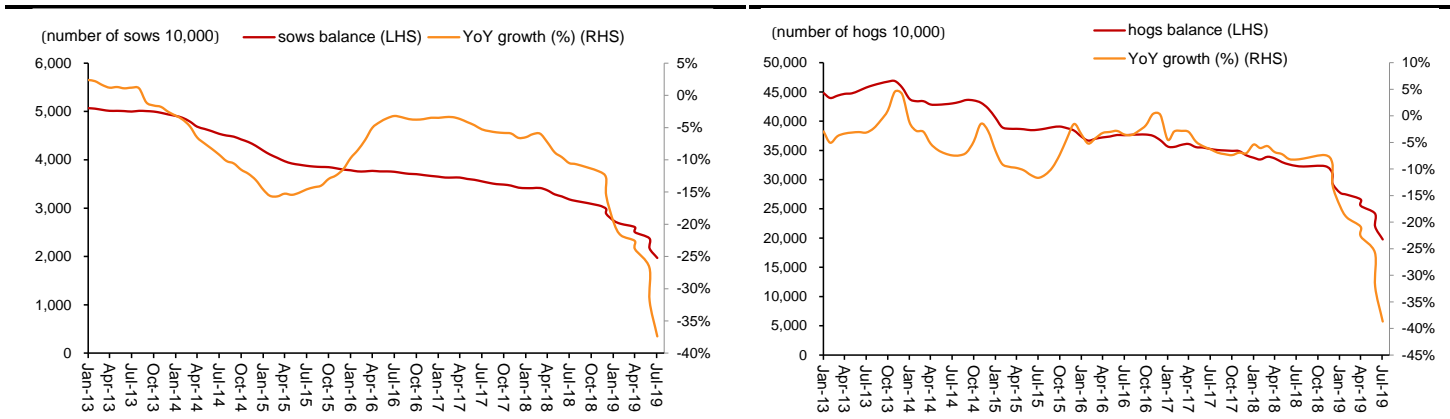
Figure 5: China's pork import from US jumped 207% YoY in Jul 2019


Source: WIND, CMBIS

Figure 6: China's pork import is estimated to grow by 41% in 2019E


Source: USDA

Figure 7: Sows balance in China fell 37% YoY in Aug 2019 **Figure 8: Hogs balance in China fell 39% YoY in Aug 2019**



Source: WIND, CMBIS

Source: WIND, CMBIS

Figure 9: SOTP-based valuation

Segment	FY19 P/E	FY19 net profit (US\$mn)	Valuation (US\$mn)	Remarks
US & Europe businesses	12.0	714.8	8,578	lower from 14x to 12x FY19E P/E
China business	17.6	500.2	8,804	30% discount on HK listed peers' average 25.1x FY19 P/E
Total			17,382	
Value per share (HK\$)			9.2	
Implied FY19 P/E			14.3	

Source: Company data, Bloomberg, CMBIS estimates

Figure 10: P/E band

Source: Bloomberg, Company data, CMBIS estimates

Figure 11: Major assumptions for US market

(US\$mn)	FY17	FY18	FY19E	FY20E	FY21E
Packaged meat segment					
External revenue	7,807	7,773	7,846	8,004	8,165
growth %	9.6%	-0.4%	0.9%	2.0%	2.0%
Sales volume (mn metric tons)	1.45	1.46	1.45	1.46	1.47
growth %	3.3%	0.9%	-0.5%	0.5%	1.0%
ASP (US\$/ton)	5,395	5,324	5,404	5,485	5,540
growth %	6.1%	-1.3%	1.5%	1.5%	1.0%
OP margin	9.3%	10.1%	11.4%	11.7%	11.9%
Fresh pork segment					
External revenue	4,961	4,790	4,983	5,285	4,891
growth %	11.7%	-3.4%	4.0%	6.1%	-7.4%
Hog processed (mn heads)	34.43	33.95	34.29	34.63	33.94
growth %	8.0%	-1.4%	1.0%	1.0%	-2.0%
OP/head (US\$)	12.6	1.4	1.0	1.0	4.0
Hog production segment					
External revenue	510	619	676	710	668
growth %	-35.8%	21.4%	9.2%	5.1%	-5.9%
Hog produced (mn heads)	16.38	16.47	17.13	17.47	17.12
growth %	4.8%	0.5%	4.0%	2.0%	-2.0%
OP/head (US\$)	(4.2)	(8.9)	8.0	19.0	5.0
Total external revenue	13,278	13,182	13,505	13,998	13,724
Packaged meat	7,807	7,773	7,846	8,004	8,165
Fresh pork	4,961	4,790	4,983	5,285	4,891
Hog production	510	619	676	710	668
Segment profit	923	615	974	1,202	1,084
growth %	3.9%	-33.4%	58.4%	23.4%	-9.8%
Packaged meat	726	785	895	937	972
Fresh pork	433	48	34	35	136
Hog production	(68)	(147)	137	332	86
Others	(168)	(71)	(92)	(102)	(110)
Segment profit margin	7.0%	4.7%	7.2%	8.6%	7.9%

Source: Company data, CMBIS estimates

Figure 12: Major assumptions for China market

(US\$mn)	FY17	FY18	FY19E	FY20E	FY21E
Packaged meat segment					
External revenue	3,312	3,458	3,338	3,490	3,631
growth %	-1.0%	4.4%	-3.5%	4.5%	4.0%
Sales volume (mn metric tons)	1.58	1.60	1.58	1.60	1.63
growth %	-1.4%	1.1%	-1.0%	1.0%	2.0%
ASP (Rmb/ton)	14,126	14,303	14,746	15,262	15,567
growth %	2.2%	1.3%	3.1%	3.5%	2.0%
OP margin %	20.9%	20.6%	17.5%	15.5%	19.0%
Fresh pork segment					
External revenue	3,888	3,584	3,639	3,701	3,536
growth %	-7.3%	-7.8%	1.5%	1.7%	-4.5%
Hog processed (mn heads)	14.27	16.31	15.49	13.94	14.64
growth %	15.5%	14.3%	-5.0%	-10.0%	5.0%
OP/head (Rmb)	48.8	72.7	79.0	45.0	50.0
Hog production segment					
External revenue	11	8	7	7	7
growth %	-21.4%	-27.3%	-7.0%	0.8%	-9.0%
Hog produced (mn heads)	0.31	0.29	0.27	0.26	0.26
growth %	0.0%	-6.1%	-9.0%	-4.0%	0.0%
OP/head (Rmb)	498.0	113.0	-300.0	-200.0	-150.0
Total external revenue					
	7,446	7,328	7,301	7,545	7,556
Packaged meat	3,312	3,458	3,338	3,490	3,631
Fresh pork	3,888	3,584	3,639	3,701	3,536
Hog production	11	8	7	7	7
Others	235	278	315	347	382
Segment profit					
	525	922	783	662	832
growth %	-36.2%	75.6%	-15.1%	-15.4%	25.6%
Packaged meat	692	712	584	541	690
Fresh pork	103	179	175	90	105
Hog production	23	5	(11)	(7)	(5)
Others	(293)	26	35	39	43
Segment profit margin					
	7.1%	12.6%	10.7%	8.8%	11.0%

Source: Company data, CMBIS estimates

Figure 13: Major assumptions for Europe market

(US\$m)	FY17	FY18	FY19E	FY20E	FY21E
Packaged meat segment					
External revenue	658	916	989	1,134	1,277
growth %	8.4%	39.2%	8.0%	14.6%	12.6%
Sales volume (mn metric tons)	0.24	0.29	0.31	0.34	0.37
growth %	11.6%	18.0%	8.0%	10.0%	10.0%
ASP (EUR/ton)	3,105	3,818	3,627	3,881	4,075
growth %	-0.5%	23.0%	-5.0%	7.0%	5.0%
OP margin	2.6%	5.5%	5.4%	6.2%	7.5%
Fresh pork segment					
External revenue	677	762	925	1,011	1,105
growth %	24.7%	12.6%	21.4%	9.3%	9.4%
Hog processed (mn heads)	5.09	5.83	6.82	7.50	8.25
growth %	0.6%	14.6%	17.0%	10.0%	10.0%
OP/head (EUR)	2.5	3.9	-4.0	-4.0	-2.0
Hog production segment					
External revenue	51	61	69	73	69
growth %	41.7%	19.6%	13.0%	5.3%	-4.6%
Hog produced (mn heads)	3.53	4.17	4.30	4.42	4.56
growth %	8.9%	18.0%	3.0%	3.0%	3.0%
OP/head (EUR)	32.4	8.2	25.0	30.0	23.0
Total external revenue	1,655	2,095	2,411	2,696	2,988
Packaged meat	658	916	989	1,134	1,277
Fresh pork	677	762	925	1,011	1,105
Hog production	51	61	69	73	69
Others	269	356	428	479	537
Segment profit	135	113	145	184	190
growth %	75.3%	-16.3%	28.1%	27.1%	3.5%
Packaged meat	17	50	53	71	95
Fresh pork	11	19	(24)	(26)	(14)
Hog production	101	29	95	114	88
Others	6	15	21	25	21
Segment profit margin	8.2%	5.4%	6.0%	6.8%	6.4%

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (US\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	22,379	22,605	23,217	24,240	24,268
China	7,446	7,328	7,301	7,545	7,556
US	13,278	13,182	13,505	13,998	13,724
EUR	1,655	2,095	2,411	2,696	2,988
Cost of sales	(17,766)	(18,103)	(18,406)	(19,098)	(19,260)
Gross profit	4,613	4,502	4,811	5,142	5,008
Other income and gains	113	98	86	88	95
SG&A expenses	(2,753)	(2,871)	(2,917)	(3,104)	(2,918)
Operating profit	1,973	1,729	1,980	2,126	2,184
Finance cost	(198)	(115)	(132)	(112)	(111)
Other expenses	(326)	(74)	(74)	(74)	(74)
Other gains/(losses)	7	(21)	0	0	0
Share of profit of associate	8	8	3	3	4
Share of profit of JV	14	23	18	20	22
Profit before tax	1,478	1,550	1,795	1,964	2,025
Income tax	(165)	(293)	(372)	(427)	(440)
Non-controlling interests	(186)	(210)	(208)	(220)	(238)
Net profit	1,127	1,047	1,215	1,317	1,347
Adj. net profit	1,090	1,046	1,215	1,317	1,347

Cash flow summary

YE 31 Dec (US\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Profit before tax	1,501	1,411	1,795	1,964	2,025
Depreciation and amortization	394	441	469	501	514
Change in working capital	(321)	(570)	(341)	(65)	(2)
Others	(62)	(27)	(359)	(372)	(428)
Net cash from operating	1,512	1,255	1,564	2,028	2,109
Capex & investments	(530)	(811)	(800)	(600)	(600)
Interest received	12	6	17	15	20
Others	(266)	(412)	(58)	(57)	(56)
Net cash from investing	(784)	(1,217)	(841)	(642)	(636)
Change of borrowings	64	4	0	(200)	(300)
Dividend paid	(668)	(795)	(447)	(728)	(790)
Others	13	1	0	0	0
Net cash from financing	(591)	(790)	(447)	(928)	(1,090)
Net change in cash	137	(752)	276	458	383
Cash at the beginning	1,121	1,250	498	773	1,231
Exchange difference	(9)	0	0	0	0
Cash at the end	1,250	498	773	1,231	1,615

Balance sheet

YE 31 Dec (US\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	9,592	9,838	10,191	10,313	10,425
PPE	5,037	5,300	5,644	5,756	5,855
Goodwill	3,580	3,581	3,572	3,563	3,554
JV/associates	295	352	374	397	423
Others	680	605	601	597	593
Current assets	5,666	5,460	6,145	6,757	7,129
Cash and pledged deposits	1,440	579	855	1,313	1,686
Inventory	1,905	2,022	2,391	2,477	2,474
Trade receivables	989	1,135	1,166	1,217	1,218
Others	1,332	1,724	1,734	1,750	1,750
Current liabilities	3,499	3,328	3,472	3,566	3,565
Borrowings	901	860	960	960	960
Trade payables	1,076	977	1,005	1,041	1,039
Other payables	1,472	1,430	1,470	1,523	1,521
Others	50	61	37	43	44
Non-current liabilities	3,537	3,552	3,470	3,300	3,001
Borrowings	2,297	2,259	2,159	1,959	1,659
Deferred revenue	601	695	713	743	744
Others	639	598	598	598	598
Minority Interest	777	672	808	847	888
Total net assets	8,222	8,418	9,394	10,203	10,989
Shareholders' equity	7,445	7,746	8,586	9,356	10,110

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
China	33.3	32.4	31.4	31.1	31.1
US	59.3	58.3	58.2	57.7	56.6
EUR	7.4	9.3	10.4	11.1	12.3
P&L ratios (%)					
Gross profit margin	20.6	19.9	19.8	20.5	20.6
Operating profit margin	8.8	7.6	8.5	8.8	9.0
Net profit margin	5.0	4.6	5.2	5.4	5.6
Adj. net profit margin	4.9	4.6	5.2	5.4	5.6
Payout ratio	44.7	40.0	45.0	45.0	45.0
Balance sheet ratios					
Current ratio (x)	1.6	1.4	1.8	1.9	2.0
Receivables turnover days	15	17	18	18	18
Payables turnover days	20	21	19	19	20
Inventory turnover days	37	40	43	46	47
Asset turnover (x)	1.5	1.5	1.4	1.4	1.4
Net gearing ratio (%)	22	30	24	16	9
Returns (%)					
Adj. ROAE	15.8	13.8	14.9	14.7	13.8
Adj. ROAA	8.8	8.2	9.0	9.2	9.2
Per share data					
Adj. EPS (US\$)	0.075	0.071	0.083	0.090	0.092
DPS (HK\$)	0.27	0.20	0.29	0.31	0.32
BVPS (US\$)	0.51	0.53	0.58	0.64	0.69

Source: Company data, CMBIS estimates

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