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China Consumer Staples

A diverging 1H; mix upgrade and cost savings were keys to stay relevant

- **1H ended with 3 beats, 3 misses and 5 in-lines.** The wrap-up of 1H/ 2Q earnings season has largely reset market expectation with latest earnings forecasts, management guidance and hence a refreshed 2H outlook. In the near term, in our view, when the PPI-CPI scissor gap continues to narrow, market likely refocuses on the legitimation of any GPM expansion for staple players. Meanwhile, lockdown risks prompt us to reside with plays that enjoy high online sales mix, and more importantly, relevant to the upcoming Double 11 campaign. That said, we are not entirely negative to offline foot traffic and in our base case, we expect commercial activities to sequentially recover towards the end of the year in which festive sentiment and promotions should catalyze impulsive and revenge spending. Our sub-sector preference: beer/ cosmetics > beverages/ dairy/ e-cig. Our top picks remain CRB/ Proya.
- **Beer:** breweries (with revenue/ NI/ recurring NI +6.2%/ +9.7%/ +32.3% YoY) outperformed the F&B average (revenue/ NI +4.4%/ +9.3%/ +11.3% YoY). Both CRB and Tsingtao delivered c.7% ASP uptick subsequent to price hikes initiated last year and earlier this year. On the other hand, CRB achieved better cost savings with a c.2pp recurring EBIT margins expansion.
- **Cosmetics**: brand owners (revenue/ NI/ recurring NI -2.6%/ +34.4%/ 37.6% YoY) offered steadier results relative to manufacturers (revenue/ NI/ recurring NI -3.6%/ -69.0%/ -80.2% YoY). Among the former, Botanee and Proya significantly outperformed the rest, as a proof of their success in brand equity, channel distribution and single-product strategy.
- **Dairy:** underperformance (with revenue/ NI/ recurring NI +7.1%/ -5.4%/ -4.7% YoY) to the F&B average was largely due to bottlenecks in inter-city logistics and hiccups in premiumization. IMF demand was weak, due to macro overhangs such as declining new births. 4 out of 5 major A/H IMF producers, including Feihe, Ausnutria, Yashili, H&H, recorded declines in NI (over 30% for the first three). In contrast, Beingmate surprised with +44%/ +28% revenue/ NI growth YoY upon completion of channel restructuring.
- **Beverages:** the segment missed the sector average as a result of an abrupt 100%+ packaging cost (such as LLDPE) increase since 2Q20. Relative to its A/H peers, Nongfu exhibited notable resilience with DD growth in both top- and bottom-line, thanks to strong growth in tea beverages.

Valuation summary

Name	Ticker	Rating	Price (LC)	TP (LC)	Mkt Cap (US$ mn)	P/E (x) FY21A	P/E (x) FY22E	EV/EBITDA (x) FY21A	EV/EBITDA (x) FY22E	ROE (%) FY21A	ROE (%) FY22E
CR Beer	291 HK	BUY	51.4	72.4	21,243	33.2	29.9	5.5	4.9	16.8	17.3
TB	168 HK	BUY	70.6	86.0	12,262	24.2	21.7	3.2	3.0	13.3	13.7
Bud APAC	1876 HK	BUY	21.2	28.4	35,683	34.2	28.6	3.1	2.9	9.2	10.3
Yili	600887 CH	BUY	33.2	43.0	30,738	21.5	18.2	4.0	3.8	19.8	22.1
Mengniu	2319 HK	BUY	32.5	50.0	16,350	21.1	14.3	2.6	2.3	12.9	13.5
Feihe	6186 HK	BUY	6.0	8.4	6,752	8.1	6.9	2.5	2.5	41.8	44.0
Nongfu	9633 HK	BUY	44.0	57.0	62,968	50.4	42.0	16.7	13.6	33.2	32.4
Smoore	6969 HK	BUY	13.0	25.1	10,077	18.4	11.8	3.1	2.7	19.9	26.4
RELX	RLX US	BUY	1.3	2.5	1,988	7.0	6.5	0.8	0.7	9.2	9.1
Botanee	300957 CH	BUY	168.2	251.0	10,302	57.4	41.2	12.5	10.2	21.8	24.8
Proya	603605 CH	BUY	151.1	184.0	6,147	58.8	43.6	12.5	10.3	21.4	24.0
Jahwa	600315 CH	BUY	30.3	39.2	2,980	34.6	26.6	2.8	2.6	7.8	9.5

Source: Company data, CMBIGM estimates

MARKET PERFORM (Maintain)

China Consumer Staples

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Investment thesis

A habitual consumption pattern, an ongoing premiumization trajectory and an effective cost pass-through are structural merits that F&B players offer amid cost inflation.

Related Reports

1. Yili Industrial (600887 CH) – 2Q largely in line; and yet a revised 2H outlook prompts for an earnings cut – 1 Sep, 2022
2. Botanee Biotech (300957 CH) – 2Q in line; new brands in anti-aging and baby care to sustain growth – 30 Aug, 2022
3. Nongfu Spring (9633 HK) – 1H22 beat on GPM; tea beverage should continue to drive growth over 2H – 26 Aug, 2022
4. Proya Cosmetics (603605 CH) – 2Q in line with full year guidance maintained – 26 Aug, 2022
5. Jahwa (600315 CH) – 2Q miss; but the worst is likely behind us – 22 Aug, 2022
6. CR Beer (291 HK) – 1H22 beat on better cost efficiency; our top pick over 2H22 – 18 Aug, 2022
7. Budweiser APAC (1876 HK) 2Q results largely in line; solid premiumization efforts mitigated volume headwind – 29 Jul, 2022
8. China Feihe (6186 HK) – 1H softer than expected; a lower 2022E despite a sequentially better 2H – 22 Jul, 2022
9. Smoore Int'l (6969 HK) – Preliminary results came in better than we expected – 18 Jul, 2022

- **E-cig:** regulatory headwind is largely settled but subsequent impact to sales, and the overall competition landscape, is waited to be seen, in our view. Corporate guidance is fragile, and an unsynchronized restocking cycle has temporarily weighed on overseas sales performance.

Figure 1: Key 1H financial summary for sub-sectors we monitored

Sector	Revenue 2022/6/30 (Rmb mn)	NI 2022/6/30 (Rmb mn)	Recurring NI 2022/6/30 (Rmb mn)	Revenue y-y 2022/6/30	NI y-y 2022/6/30	Recurring NI y-y 2022/6/30
Pre-processed food	11,537	1,039	849	16.4%	28.4%	46.2%
Seasonings	59,652	10,296	9,887	19.3%	42.1%	45.5%
Beer	79,874	12,265	11,256	6.2%	9.7%	32.3%
Baijiu	184,855	70,100	69,435	15.8%	21.1%	21.5%
F&B	847,763	132,185	126,275	4.4%	9.3%	11.3%
Dairy	175,442	14,324	13,293	7.1%	-5.4%	-4.7%
Soft drink	94,304	8,886	8,538	6.3%	-9.1%	-9.3%
Snacks	78,380	5,245	3,979	8.2%	-15.6%	-22.1%
Personal care	38,547	3,140	3,022	10.8%	-28.5%	-28.2%
E-cig	44,334	4,839	4,909	19.8%	-36.9%	-29.6%
Cosmetics	19,484	709	545	-2.9%	-25.3%	-31.0%

Source: Wind, CMBIGM estimates

2Q/ 1H results summary

- **Proya (603605 CH, BUY)**: 1H22 in line and again notably outperforming the industry. Management expects sales momentum to moderate in 3Q while re-edge up in 4Q for Double 11, and remains confident to achieve the targets of ⩾ 25%/ 23%/ 22% revenue and NI growth YoY for 2022-24E as per the new ESOP plan initiated in Jul. Offline channels could still be under pressure in 2H, but we expect Proya to be able to maintain steady growth in the MTL term, driven by continuous upgrade of existing hero products (Red Rubby, Anti-Double series), creation of new hero products (Advanced Original Repair series potentially) and expansion of younger brands/ categories, such as Timage, the company's core makeup brand which doubled its revenue in 1H, Hapsode, a mass brand for young skin which turned profitable and Off and Relax, a high-end hair care brand which achieved breakeven in 1H22.
- **Botanee (300957 CH, BUY)**: 2Q slightly below us but in line with consensus. It was the major outperformer among listed Chinese cosmetic brand owners. Core brands and existing hero products maintained steady momentum in 1H22, while new star products are emerging (eg. Winona sunscreens and serums). Relatively younger brand, Winona Baby, has been expanding steadily and its growth momentum could edge up in 4Q upon the launch of new product series in Sep. The company's newly launched anti-aging luxury brand, Aoxmed, could become a new growth driver, which will launch two collections (Zhuanyan and Cuiyan) in Sep for 2B channels and one (Meiyan) for 2C channels in 1H23. The company targets to achieve RMB15bn sales in functional skincare in 3-5 years and become a leading brand in China's baby care (7.5% expected CAGR in 2021-26E per Euromonitor) and luxury anti-aging (17.8% expected CAGR in 2021-26E) segments.
- **Jahwa (600315CH, BUY)**: 2Q miss, with both revenue (-23.8% YoY) and net loss (RMB41.7mn vs RMB117mn net profit in 2Q21) below our/ market estimates and GPM at 56.3%, -7.5pp YoY. The company underperformed the cosmetics sector in 1H, of which strict lockdown policy in Mar-May in Shanghai was the main drag. Of note, HPC maintained positive growth at 1.3% YoY in 1H22, thanks to the strong brand awareness and resilience of the core personal care brand Liushen (+1% YoY in 1H). Management targets at least DD topline growth and faster bottom-line growth in 2H22, and accelerated topline growth in 2023E. The worst for Jahwa is likely behind, in our view, and we remain positive on the company's recovery in 2H22/2023E, given its more diversified business segments among major domestic peers, streamlined product portfolio which could help increase the efficiency in the use of resources, a rich pipeline of new launches in 2H and a well-on-track rejuvenation strategy of core brand Liushen.
- **CRB (291HK, BUY)**: 1H22 beat, with recurring EBIT growing 17% YoY to RMB5.2bn, thanks to a 7.7% uptick in ASP, which mitigated a 1% volume decline and higher raw mat costs, and 3.4pp saving in SG&A ratio underpinned by a higher operation efficiency and a more optimized resources allocation. Premium/ sub-premium shipment grew 10% YoY in 1H and management remained positive on the premiumization trend in China's beer market in the next 3-5 years. We expect 2H22/ 2022E volume growth to be back to LSD, driven by recovery of Snow Draft/ SuperX which grew at LSD YoY in 1H, being negatively affected by a high exposure to on-trade channels (c.70-80% of their sales volume), and continued strong momentum of Heineken (+30% YoY in 1H). Sales volume growth was back to be positive in Jul and to mid-teens in Aug already, helped by hot weather across many regions in China. Raw material cost pressure could also marginally ease in

2H as management revised down annual cost increment to RMB1.2-1.3bn, from previously RMB1.5-1.6bn.

- **Budweiser (1876 HK, BUY)**: 2Q in line, with normalised EBITDA -5.6% YoY to US$569mn, mainly dragged by China, where city-wise lockdown weighed on sales volume with a 6.5% decline, mitigated by strong performance in Korea and India. We expect 2H China volume to revive to positive LSD growth with a steady 2%+ ASP uptick, and the region's FY revenue flattish YoY with a slightly lower normalised EBITDA margin at 35-36%. We expect South Korea to keep recovering steadily, where all lockdown restrictions in on-premise channels were lifted, revenue/ EBITDA grew by DD/ strong DD, thanks to solid growth in volume and ASP, with market share gain for the company in 1H. Management expects the strong momentum in India to continue as well, where volumes recovered to above pre-pandemic levels, revenue/ EBITDA recorded strong growth and premium and super premium volumes doubled in 1H, driven by demographic advantage and growing middle class in the country.

- **Tsingtao Beer (168 HK, BUY)**: 1H results in line with us but HSD above consensus, thanks to better-than-expected GPM as a result of strong premiumization trajectory. The 5% top-line growth was slower than 7% of our top pick, CRB, given a slower ASP uptick. Premium brands in general was up by a HSD, despite a few of them were weighed by lockdowns. Meanwhile, a 41% GPM was well supported when input cost pressure was mitigated.

- **Yili (600887 CH, BUY)**: 1H22 in line. 2Q GPM stood at 32.2%, up 1.1% YoY, thanks to higher IMF contribution which typically offers higher GPM than other businesses. Management guided for DD revenue growth for 2H and an at least flattish NPM for 2022E, and commented that July's sales momentum has shown sequential improvement albeit insignificant. Macro uncertainties still drag domestic consumption sentiment, however, dairy demand should remain steadfast over 2H considering its inelastic nature. We expect a rising consumer health awareness to keep liquid milk demand in check, while new SKU launches should help defend market share for yoghurts. Meanwhile, growth momentum for frozen dairy SKUs and IMF could decelerate.

- **Mengniu (2319 HK, BUY)**: 1H22 soft as expected. Chilled products performed weakly in 1H but we see scope of a sequential recovery considering the recovery of consumer sentiment and reducing impact to logistics. In view of a DD sales growth in July, management is confident to extent the momentum throughout 2H. Management maintained its full-year revenue guidance of high SD to DD growth (implying DD growth for 2H revenue), with only a minor revision to margins target from a 0.5pp to 0.2-0.3pp expansion. The growth will be driven by steady momentum in UHT milk and possible acceleration in premium SKUs during the upcoming festive season, healthy channel inventory and nevertheless a low base, while product mix upgrade and cost control will drive the OPM improvement.

- **Feihe (6186 HK, BUY)**: 1H22 softer than expected, as a result of macro overhangs including declining birth rate and weak consumption sentiment and the company's "fresh strategy", in which Feihe aims to clear up obsolete channel inventory to prepare for the enactment of the new national standards (early-2023) and to stabilize retail pricing. Management targets 26-27% NPM for 2022E (2021: 30.4%) and delays the 30% market share target (vs 2023 previously) by 1-2 years as a result of macro headwinds and intensifying competition. While management confirmed the restructuring/ and destocking has almost (c.90%) completed, we anticipate 2H revenue growth to revive to positive, and reach c.10% growth for 2023E. GPM could trend down for

2022E/23E due to potential dilution from a rising contribution of children/ adult milk powder, which typically offer a lower GPM than infancy milk powder. We also expect SG&A ratio to surge in 2022E due to the aforementioned restructuring.

- **Nongfu (9633HK, BUY)**: 1H22 beat on strong growth of tea beverage and a steady GPM at 59.3%. Tea beverage/ packaged water/ juices/ functional beverage grew +51.6%/ +4.8%/ +4.2%/ +0.9% YoY in 1H, respectively. Management maintained DD sales growth target for 2022E, while expecting cost pressure to increase in 2H, due to the clear-up of lower-cost PET inventory and rising oil prices, which could lead to a GPM at 56-57% (2021: 59.5%) for the full 2022E. The company will keep controlling selling expenses in 2H, which could partially compensate the margin pressure from raw mat cost increase, in our view. We expect the strong momentum in tea beverages to continue in 2H. Meanwhile, packaged water could recover, especially for small bottles, should there be no further large-scale lockdowns. Juices could accelerate but functional beverages likely remain under pressure, in our view, as the resumption of outdoor activities should be gradual.

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