

WH Group (288 HK)

US hog price boosted by German pork export ban

China, Korea and Japan banned German's pork export. We expect certain orders would switch to US and this would benefit WH's US businesses. Since 1H20 results were announced on 11 Aug, share price has dropped 8% but US market fundamentals have been recovering and US hog price has risen 18%. Furthermore, market cap of WH's Shuanghui equity interests is greater than WH's market cap, implying Smithfield is free. Maintain Buy on undemanding valuation.

- **What's new.** US lean hog future price +8% in two successive trading days. Germany's agriculture ministry said pork exports to China and some other non-EU countries have stopped after a case of ASF was confirmed. China, Korea and Japan had banned import of German pork products.
- **Germany was the biggest pork producer in EU in 2019.** In 2019, Germany exported a total of 977k tonnes of pork meat and offal products to China, Korea and Japan, representing around 10.5% market share of global pork export trade. In 1H20, China, Korea and Japan were top 3 pork meat and offal products exporting countries for Germany, representing 66%, 9% and 3% of its total export volume (571.4k tonnes), respectively. The ban of Germany pork export would benefit other major pork exporting countries like Spain, US and Brazil. If 25% of such volume (244.2k tonnes) is shifted to US, this represents 2%/7% of US pork production/export volume in 2020E.
- **US market is recovering. (1) Hog production:** US hog price has rebounded 18% since 1H20 results were reported (Figure 3). **(2) Fresh pork:** Utilization rate of hog processing recovers to around 90% (vs 85% in Aug). 3Q20-to-date gross profit spread has been expanded YoY (Figure 17). **(3) Packaged meat:** sales volume is expected to recover mildly in 3Q20E. For 3Q20E epidemic-related costs, it would be notably less than 2Q20 because salary payment to staff infected and quarantined, inspection and equipment expenses and donation expenses would be reduced QoQ.
- **Maintain Buy.** German pork export ban could boost US hog and pork prices. US market contributed 49% and 30% of WH's total revenue and segment profit, respectively, in 1H20. The increase of hog price is favorable to hog production profitability. Though most of US profit came from packaged meat segment (88% of US profit in 1H20), the increase of hog price would increase hog production profitability, but would not hurt margin of packaged meat segment because there is price adjustment mechanism when hog price fluctuates. Our SOTP-based TP HK\$8.20 represents 14.0x FY20E P/E. **Catalysts:** severe AFS outbreak in Germany and US economy fully reopens.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (US\$ mn)	22,605	24,103	25,440	26,795	27,751
Net profit (US\$ mn)	1,047	1,380	1,108	1,480	1,625
Adj. net profit (US\$ mn)	1,046	1,378	1,108	1,480	1,625
Adj. EPS (US\$)	0.071	0.094	0.075	0.101	0.110
YoY growth (%)	(4.9)	31.5	(19.7)	33.6	9.8
Consensus EPS (US\$)	na	na	0.093	0.104	0.111
Adj. P/E (x)	11.8	9.0	11.3	8.4	7.7
P/B (x)	1.6	1.4	1.4	1.2	1.1
Yield (%)	3.0	4.8	3.8	5.1	5.6
Adj. ROAE (%)	13.8	16.8	12.4	15.3	15.2

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$8.20
(Previous TP	HK\$8.20)
Up/Downside	+24%
Current Price	HK\$6.62

China Staples Sector

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Stock Data

Mkt Cap (HK\$ mn)	97,566
Avg 3 mths t/o (HK\$ mn)	281.85
52w High/Low (HK\$)	8.90/ 5.92
Total Issued Shares (mn)	14,720.8

Source: Bloomberg

Shareholding Structure

Rise Grand	35.83%
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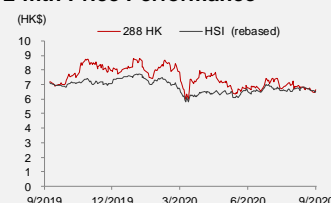
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-8.3%	-6.9%
3-mth	-2.5%	-2.6%
6-mth	-15.6%	-13.1%

Source: Bloomberg

12-mth Price Performance



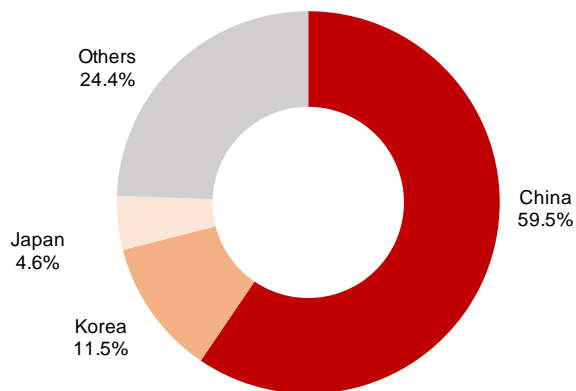
Source: Bloomberg

Auditor: EY

Related Reports

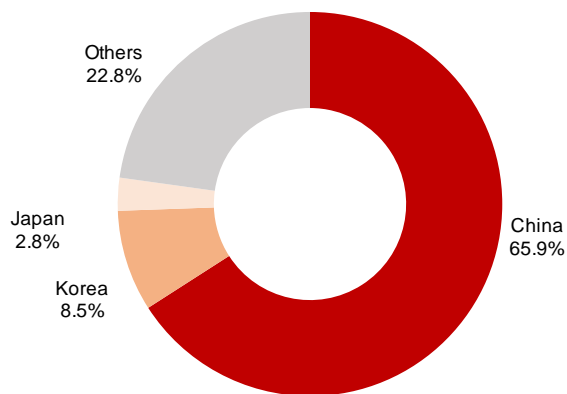
1. "WH Group – 1H20 results below on epidemic-related costs" – 12 Aug 2020
2. "WH Group – Maintain Buy on undemanding valuation" – 13 Jul 2020
3. "WH Group – 1Q20 results on track" – 29 Apr 2020
4. "WH Group – FY19 results beat; 1Q20E NP growth still good" – 25 Mar 2020
5. "WH Group – 4Q19 momentum continued and a positive 2020" – 13 Jan 2020

Figure 1: Germany's frozen and fresh meat and offal products export volume by country in 2019



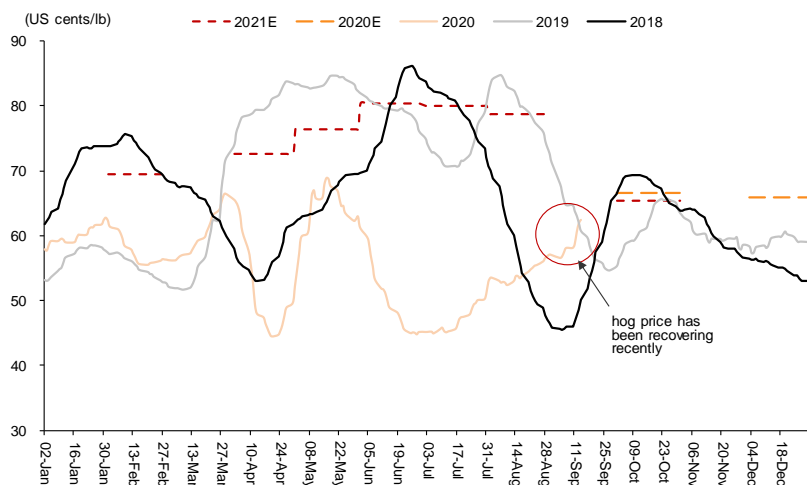
Source: European Commission

Figure 2: Germany's pork export was even more dependent on these three countries in 1H20



Source: European Commission

Figure 3: German pork ban accelerated the recovery of US hog price



Source: Bloomberg, CMBIS

Figure 4: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	25,440	26,795	27,751	25,829	26,613	27,072	-2%	1%	3%
Gross Profit	5,075	5,410	5,554	5,257	5,540	5,669	-3%	-2%	-2%
Operating Profit	1,874	2,374	2,565	2,078	2,283	2,408	-10%	4%	7%
Net profit	1,108	1,480	1,625	1,348	1,537	1,621	-18%	-4%	0%
Gross Margin	20.0%	20.2%	20.0%	20.4%	20.8%	20.9%	-0.4ppt	-0.6ppt	-0.9ppt
Operating Margin	7.4%	8.9%	9.2%	8.0%	8.6%	8.9%	-0.6ppt	+0.3ppt	+0.3ppt
Net Margin	4.4%	5.5%	5.9%	5.2%	5.8%	6.0%	-0.8ppt	-0.3ppt	-0.1ppt

Source: Bloomberg, CMBIS estimates

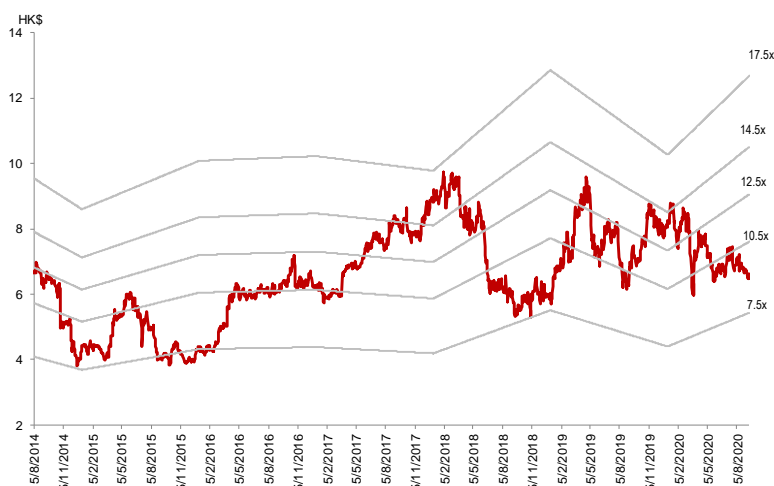
Figure 5: SOTP-based valuation

Segment	FY20 P/E	FY20E net profit (US\$mn)	Valuation (US\$mn)	Remarks
US & Europe businesses	10.0	438.9	4,389	10x FY20E P/E
China business	16.6	668.6	11,099	30% discount on HK listed peers' average 23.7x FY20E P/E
Total			15,488	
Value per share (HK\$)			8.2	
Implied FY20E P/E			14.0	

	Price (RMB)	Issue shares (mn)	Value (HK\$mn)	
Market cap of WH			97,510	
Mkt value of Shaughui stakes	53.1	3,319.3	144,175	based on 73.41% equity stakes and 11 Sep closing price
Implied Smithfield value			(46,665)	

Source: Company data, Bloomberg, CMBIS estimates

Figure 6: P/E band



Source: Bloomberg, Company data, CMBIS estimates

Figure 7: The discount of US pork carcass price to China's was 74% on 6 Sep 2020



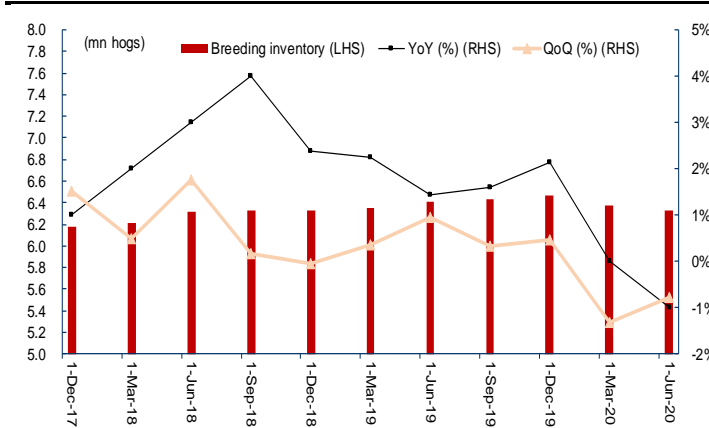
Source: Bloomberg, CMBIS

Figure 8: The discount of US hog price to China's was 77% on 2 Sep 2020



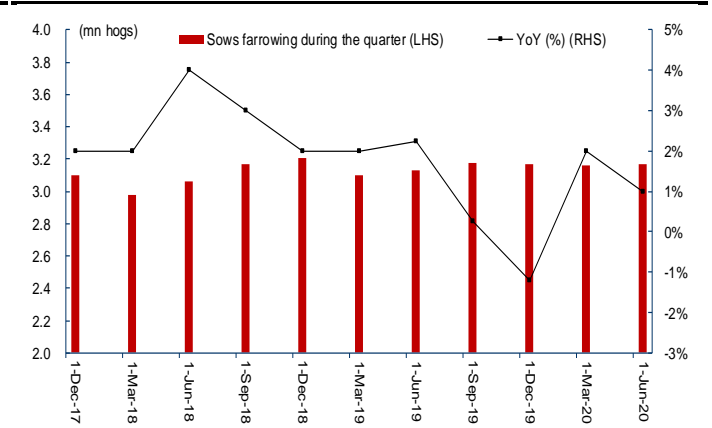
Source: Bloomberg, CMBIS

Figure 9: Growth of US breeding hog inventory was down 1% in the quarter ended 1 Jun 2020



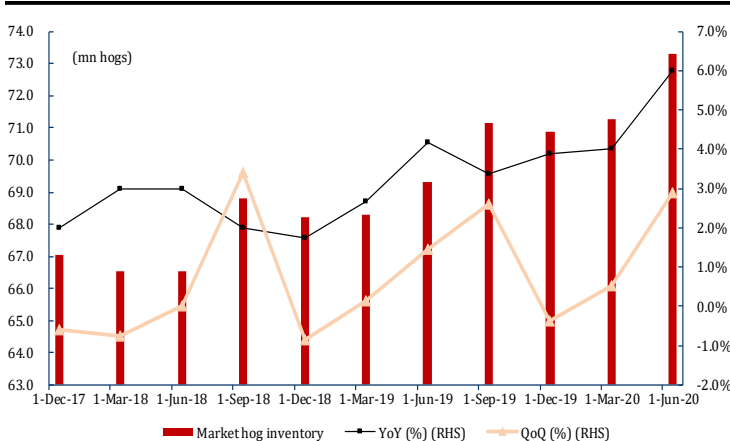
Source: USDA, CMBIS

Figure 10: Number of sows farrowing during the quarter ended 1 Jun 2020 up 1%



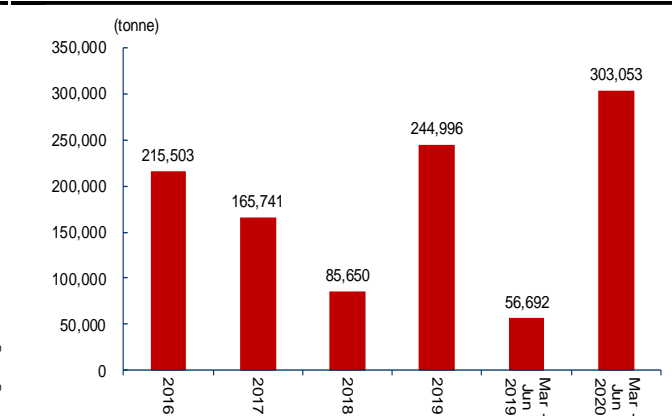
Source: USDA, CMBIS

Figure 11: Growth of US market hog inventory was 6% in the quarter ended 1 Jun 2020 due to epidemic



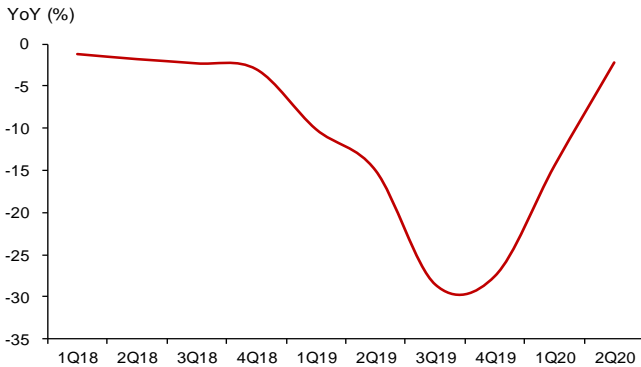
Source: USDA, CMBIS

Figure 12: China's pork import vol. from US between Mar and Jun 2020 jumped by more than four times YoY



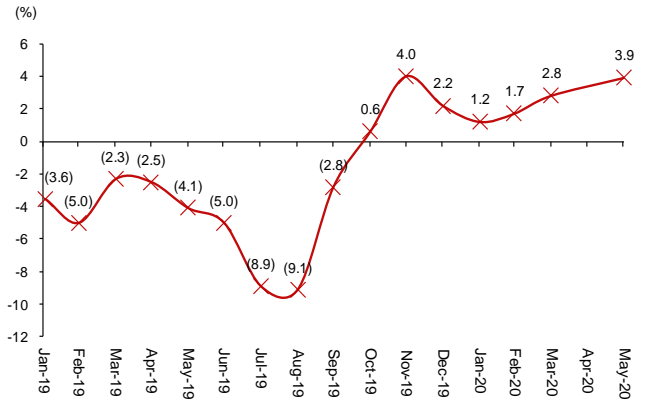
Source: WIND, CMBIS

Figure 13: The YoY decline of hog inventory narrowed to 2.2% in 2Q20



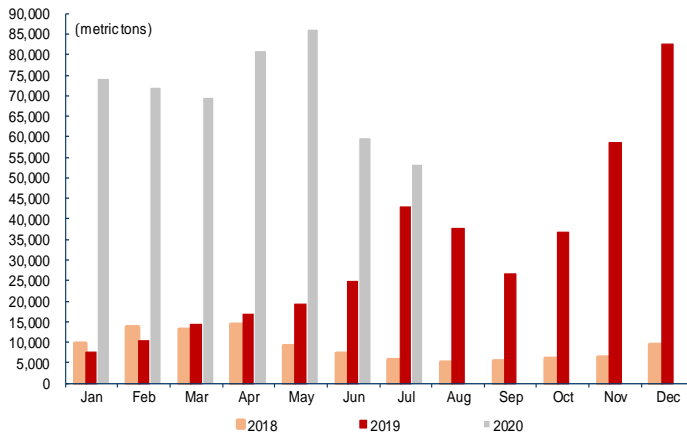
Source: WIND, CMBIS

Figure 14: Sow balance MoM growth accelerated to 3.9% in May 2020



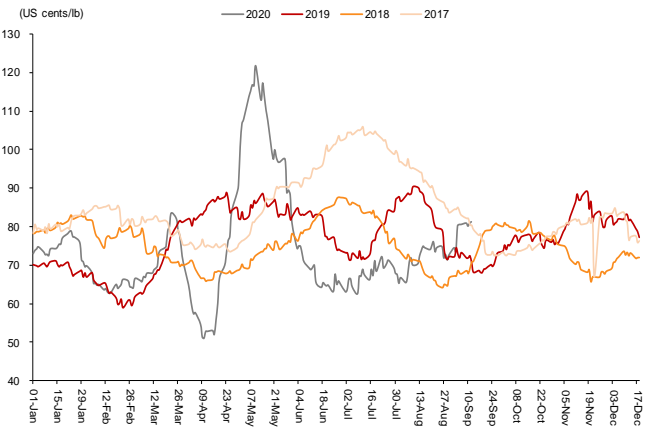
Source: WIND, CMBIS

Figure 15: US pork export volume to China kept going up in 2020



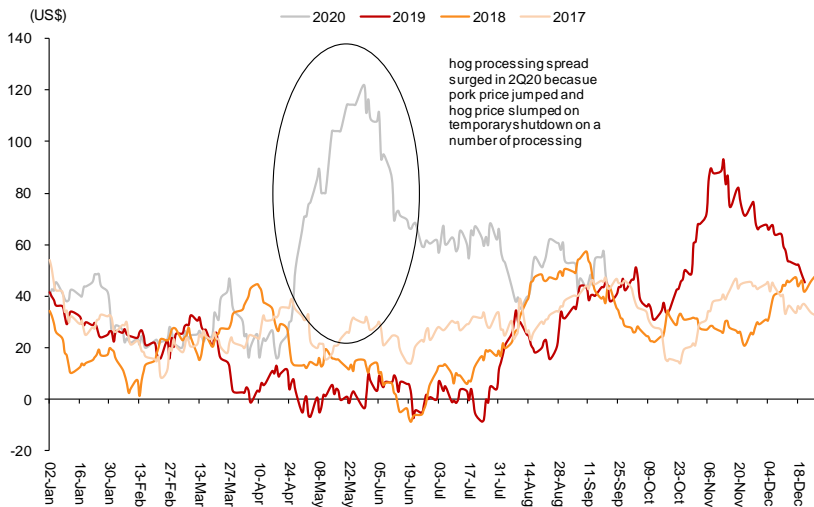
Source: US meat export federation

Figure 16: US pork price chart



Source: Bloomberg, CMBIS estimates

Figure 17: 3Q20-to-date US pork packers margins has improved YoY



Source: Bloomberg, CMBIS

Figure 18: Major assumptions for US market

(US\$mn)	FY18	FY19	FY20E	FY21E	FY22E
Packaged meat segment					
External revenue	7,773	7,814	7,385	7,924	8,084
growth %	-0.4%	0.5%	-5.5%	7.3%	2.0%
Sales volume (mn metric tons)	1.46	1.45	1.39	1.46	1.47
growth %	0.9%	-0.5%	-4.5%	5.2%	1.0%
ASP (US\$/ton)	5,324	5,378	5,324	5,431	5,485
growth %	-1.3%	1.0%	-1.0%	2.0%	1.0%
OP margin	10.1%	10.8%	8.2%	11.6%	12.0%
Fresh pork segment					
External revenue	4,790	4,467	4,423	4,740	4,720
growth %	-3.4%	-6.7%	-1.0%	7.2%	-0.4%
Hog processed (mn heads)	33.95	34.51	33.13	35.92	36.63
growth %	-1.4%	1.7%	-4.0%	8.4%	2.0%
OP/head (US\$)	1.4	4.3	4.5	5.0	5.0
Hog production segment					
External revenue	619	877	912	959	948
growth %	21.4%	41.7%	4.0%	5.1%	-1.1%
Hog produced (mn heads)	16.47	17.68	18.03	18.40	18.76
growth %	0.5%	7.4%	2.0%	2.0%	2.0%
OP/head (US\$)	(8.9)	4.7	(6.0)	1.0	(1.0)
Total external revenue	13,182	13,158	12,720	13,622	13,752
Packaged meat	7,773	7,814	7,385	7,924	8,084
Fresh pork	4,790	4,467	4,423	4,740	4,720
Hog production	619	877	912	959	948
Segment profit	615	932	506	956	965
growth %	-33.4%	51.5%	-45.7%	88.9%	1.0%
Packaged meat	785	847	606	920	970
Fresh pork	48	150	149	180	183
Hog production	(147)	83	(108)	18	(19)
Others	(71)	(148)	(141)	(162)	(170)
Segment profit margin	4.7%	7.1%	4.0%	7.0%	7.0%

Source: Company data, CMBIS estimates

Figure 19: Major assumptions for China market

(US\$mn)	FY18	FY19	FY20E	FY21E	FY22E
Packaged meat segment					
External revenue	3,458	3,615	4,160	4,327	4,502
growth %	4.4%	4.5%	15.1%	4.0%	4.0%
Sales volume (mn metric tons)	1.60	1.60	1.60	1.62	1.63
growth %	1.1%	0.0%	0.0%	1.0%	1.0%
ASP (Rmb/ton)	14,303	15,673	18,180	18,726	19,287
growth %	1.3%	9.6%	16.0%	3.0%	3.0%
OP margin %	20.6%	18.6%	21.2%	21.6%	22.0%
Fresh pork segment					
External revenue	3,584	4,725	5,343	5,210	5,535
growth %	-7.8%	31.8%	13.1%	-2.5%	6.3%
Hog processed (mn heads)	16.31	13.20	7.92	11.88	14.85
growth %	14.3%	-19.0%	-40.0%	50.0%	25.0%
OP/head (Rmb)	72.7	137.8	135.0	60.0	50.0
Hog production segment					
External revenue	8	2	1	2	2
growth %	-27.3%	-75.0%	-40.5%	35.0%	30.0%
Hog produced (mn heads)	0.29	0.13	0.07	0.10	0.13
growth %	-6.1%	-54.9%	-50.0%	50.0%	30.0%
OP/head (Rmb)	113.0	-683.8	-1200.0	400.0	300.0
Total external revenue	7,328	8,756	10,120	10,216	10,785
Packaged meat	3,458	3,615	4,160	4,327	4,502
Fresh pork	3,584	4,725	5,343	5,210	5,535
Hog production	8	2	1	2	2
Others	278	414	616	678	746
Segment profit	922	957	1,081	1,108	1,178
growth %	75.6%	3.8%	12.9%	2.5%	6.4%
Packaged meat	712	673	882	935	990
Fresh pork	179	262	153	102	106
Hog production	5	(13)	(11)	6	6
Others	26	35	57	66	76
Segment profit margin	12.6%	10.9%	10.7%	10.8%	10.9%

Source: Company data, CMBIS estimates

Figure 20: Major assumptions for Europe market

(US\$m)	FY18	FY19	FY20E	FY21E	FY22E
Packaged meat segment					
External revenue	916	902	1,020	1,154	1,260
growth %	39.2%	-1.5%	13.1%	13.1%	9.1%
Sales volume (mn metric tons)	0.28	0.28	0.29	0.31	0.32
growth %	17.9%	-1.5%	5.0%	5.0%	5.0%
ASP (EUR/ton)	2,738	2,895	3,040	3,131	3,225
growth %	13.2%	5.7%	5.0%	3.0%	3.0%
OP margin	5.5%	6.0%	6.6%	7.2%	9.3%
Fresh pork segment					
External revenue	762	886	1,139	1,283	1,392
growth %	12.6%	16.3%	28.6%	12.6%	8.6%
Hog processed (mn heads)	5.83	6.08	6.69	7.36	7.87
growth %	14.6%	4.4%	10.0%	10.0%	7.0%
OP/head (EUR)	2.8	-1.3	-2.0	2.0	2.0
Hog production segment					
External revenue	61	58	89	148	156
growth %	19.6%	-4.9%	53.9%	65.6%	5.8%
Hog produced (mn heads)	4.17	3.99	3.83	3.95	4.07
growth %	18.0%	-4.3%	-4.0%	3.0%	3.0%
OP/head (EUR)	5.9	21.7	34.0	28.0	20.0
Total external revenue					
	2,095	2,188	2,601	2,956	3,214
Packaged meat	916	902	1,020	1,154	1,260
Fresh pork	762	886	1,139	1,283	1,392
Hog production	61	58	89	148	156
Others	356	342	352	372	405
Segment profit					
	113	142	203	239	246
growth %	-16.3%	25.7%	43.2%	17.8%	2.8%
Packaged meat	50	54	68	84	117
Fresh pork	19	(9)	(15)	18	19
Hog production	29	97	149	132	98
Others	15	0	2	7	12
Segment profit margin					
	5.4%	6.5%	7.8%	8.1%	7.7%

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (US\$ mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	22,605	24,103	25,440	26,795	27,751
China	7,328	8,756	10,120	10,216	10,785
US	13,182	13,158	12,720	13,622	13,752
EUR	2,095	2,188	2,601	2,956	3,214
Cost of sales	(18,103)	(19,209)	(20,365)	(21,385)	(22,197)
Gross profit	4,502	4,894	5,075	5,410	5,554
Other income and gains	98	59	81	90	100
SG&A expenses	(2,871)	(2,870)	(3,282)	(3,126)	(3,089)
Operating profit	1,729	2,083	1,874	2,374	2,565
Finance cost	(115)	(144)	(126)	(125)	(104)
Other expenses	(74)	(63)	(63)	(63)	(63)
Other gains/(losses)	(21)	53	0	0	0
Share of profit of associate	8	4	4	4	5
Share of profit of JV	23	13	17	19	20
Profit before tax	1,550	1,946	1,705	2,210	2,423
Income tax	(293)	(336)	(345)	(448)	(491)
Non-controlling interests	(210)	(230)	(253)	(281)	(306)
Net profit	1,047	1,380	1,108	1,480	1,625
Adj. net profit	1,046	1,378	1,108	1,480	1,625

Cash flow summary

YE 31 Dec (US\$ mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before tax	1,411	2,052	1,705	2,210	2,423
Depreciation and amortization	441	581	597	609	621
Change in working capital	(570)	(930)	213	56	(40)
Others	(27)	(240)	(676)	(456)	(523)
Net cash from operating	1,255	1,463	1,840	2,419	2,480
Capex & investments	(811)	(680)	127	(400)	(400)
Interest received	6	6	(720)	(640)	(813)
Others	(412)	(122)	0	0	0
Net cash from investing	(1,217)	(796)	(593)	(1,040)	(1,213)
Change of borrowings	4	3	127	(400)	(400)
Dividend paid	(795)	(464)	(720)	(640)	(813)
Proceeds from	9	31	0	0	0
Others	(8)	(163)	0	0	0
Financing cash flow	(790)	(593)	(593)	(1,040)	(1,213)
Net change in cash	(752)	74	659	802	700
Cash at the beginning	1,279	484	552	1,211	2,013
Exchange difference	(43)	(6)	0	0	0
Cash at the end	484	552	1,211	2,013	2,712
Bank and cash balance	525	552	1,211	2,013	2,712
Bank overdraft	(41)	0	0	0	0

Balance sheet

YE 31 Dec (US\$ mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	9,838	10,575	10,603	10,631	10,629
PPE	5,300	5,406	5,552	5,686	5,808
Goodwill	3,581	3,667	3,658	3,649	3,640
JV/associates	352	347	368	391	416
Others	605	509	509	519	509
Current assets	5,460	6,707	7,319	8,201	9,068
Cash and pledged deposits	579	593	1,252	2,054	2,753
Inventory	2,022	2,903	2,770	2,763	2,868
Trade receivables	1,135	1,047	1,105	1,164	1,205
Others	1,724	2,164	2,192	2,221	2,241
Current liabilities	3,328	3,869	4,140	4,287	4,403
Borrowings	860	905	1,010	1,010	1,010
Trade payables	977	1,074	1,139	1,196	1,241
Other payables	1,430	1,686	1,787	1,877	1,948
Others	61	204	204	204	204
Non-current liabilities	3,552	3,961	3,690	3,332	2,962
Borrowings	2,259	2,187	2,209	1,809	1,409
Deferred revenue	695	1,114	821	863	893
Others	598	660	660	660	660
Minority Interest	672	768	893	1,010	1,140
Total net assets	8,418	9,452	10,092	11,213	12,331
Shareholders' equity	7,746	8,684	9,199	10,203	11,192

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
China	32.4	36.3	39.8	38.1	38.9
US	58.3	54.6	50.0	50.8	49.6
EUR	9.3	9.1	10.2	11.0	11.6
P&L ratios (%)					
Gross profit margin	19.9	20.3	20.0	20.2	20.0
Operating profit margin	7.6	8.6	7.4	8.9	9.2
Net profit margin	4.6	5.7	4.4	5.5	5.9
Adj. net profit margin	4.6	5.7	4.4	5.5	5.9
Payout ratio	35.8	43.0	43.0	43.0	43.0
Balance sheet ratios					
Current ratio (x)	1.6	1.7	1.8	1.9	2.1
Receivables turnover days	17	17	15	15	16
Payables turnover days	21	19	20	20	20
Inventory turnover days	40	47	51	47	46
Asset turnover (x)	1.5	1.4	1.4	1.4	1.4
Net gearing ratio (%)	30	30	21	8	(2)
Returns (%)					
Adj. ROAE	13.8	16.8	12.4	15.3	15.2
Adj. ROAA	8.2	9.9	7.7	9.6	10.0
Per share data					
Adj. EPS (US\$)	0.071	0.094	0.075	0.101	0.110
DPS (HK\$)	0.20	0.32	0.25	0.34	0.37
BVPS (US\$)	0.53	0.59	0.62	0.69	0.76

Source: Company data, CMBIS estimates

Disclosures & Disclaimers

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