

China Consumer Staples

Easing raw material pressure underpins cost savings

The lukewarm May-23 CPI print may not be a positive read to near-term economic growth. On the flip side, decelerating PPI growth looks to be favourable to food & beverage producers. Of note, major raw material prices (agricultural/ packaging) represent approximately half of F&B producers' COGS, and the formers have come down on average by 11% since 4Q22. Anecdotal evidence shows that a widened CPI-PPI gap has consistently led to better cost savings, and among all sectors F&B producers ranked top 3 sensitive to the gap. Into results season, we think these are non-negligible events to underpin production cost savings, and hence key driver to sustain earnings growth amid the weak consumption sentiment. Considering the strong pricing power for breweries, we are hopeful of seeing both to engineer a meaningful GPM expansion for 1H23. We remain top-buyer of **CR Beer (291 HK, BUY)** and **Tsingtao (168 HK, BUY)**.

- **A CPI-PPI gap widening...** China CPI rose 0.2% YoY in May after rising 0.1% YoY in April, when PPI further declined 4.6% YoY in May after dropping 3.6% YoY in April. In particular, food inflation mildly rose as food CPI picked up 1% YoY in May after rising 0.4% in April. While the soft data prints could have triggered concerns over the magnitude of price upgrades and hence margins expansion among F&B names, however, we argue that 1) selective quasi-staples like beer/ soft drinks remain upbeat in their premiumization progress, 2) input cost (or PPI) is likely to extend its deceleration and that leaves room for margins expansion even when average price is stagnant. Our economist forecasts that CPI growth is likely to hit 0.8% in 2023 with a 2.3% decline in PPI.
- **... leads to more apparent cost savings.** Examining historical data enables us to substantiate the positive correlation between CPI-PPI gap and GPM for F&B producers. For instance, the causal relationship was particularly obvious over the years of 2009-2010 and 2015-17, when GPM expanded subsequent to a sharpening CPI-PPI gap.
- **F&B producers are among the most sensitive to input cost change.** Another study of ours which drew data between 2003-2022 pointed out that F&B is one of sectors that shares high GPM sensitivity to change in input costs, right behind home appliances, and utilities.
- **COGS breakdown.** Surveying data of the last four years, barley and wheat accounted for 17-22% of COGS for breweries, while raw milk accounted for 45-55% of COGS for dairy player. Breweries also bear a high packaging cost from glass and aluminium that contributed to 40-50% of their COGS, whereas that for dairy producers were 15-20%. As a general note, our sensitivity analysis indicates that a 10% raw material cost change will lead to 2-4ppt change in GPM.

Valuation Table

Name	Ticker	Rating	TP		Mkt Cap	PER (x)		PBR (x)		Div yield (%)		ROE (%)	
			(LC)	(LC)		FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
CR Beer	291 HK	BUY	76.9	53.5	22,212	30.8	26.6	5.2	4.6	1.1	1.3	17.0	17.4
Tsingtao Beer	168 HK	BUY	92.9	72.4	16,381	20.5	17.8	3.3	3.0	2.7	3.1	16.0	17.2
Budweiser APAC	1876 HK	HOLD	26.6	21.7	36,694	29.0	26.9	3.2	3.0	0.0	0.0	11.0	11.2
Mengniu	2319 HK	BUY	40.0	31.5	15,901	18.3	15.7	2.6	2.3	1.4	1.6	14.0	14.6
Yili	600887 CH	BUY	44.0	29.1	25,838	17.0	15.1	3.3	3.2	4.5	5.1	19.7	21.1
China Feihe	6186 HK	HOLD	5.9	4.6	5,373	7.5	6.7	1.4	1.3	5.9	6.7	18.6	18.7
Nongfu Spring	9633 HK	BUY	58.0	43.9	63,186	46.9	41.6	17.3	16.0	1.6	1.8	37.0	38.4
Smooore	6969 HK	BUY	12.0	8.7	6,740	14.3	20.9	2.1	2.0	1.2	0.8	14.8	9.4
Hongjiu Fruits	6689 HK	BUY	43.5	18.8	3,406	3.6	2.6	0.9	0.7	-	-	25.7	26.0
Pagoda	2411 HK	BUY	7.7	5.6	1,141	17.2	13.2	2.3	2.1	1.0	1.3	13.5	15.9
Moutai	600519 CH	BUY	2440.0	1744.0	306,064	30.1	26.5	9.2	7.7	1.4	1.6	30.5	29.0

Source: Company data, BBG, CMBIGM estimates

MARKET PERFORM (Maintain)

China Consumer

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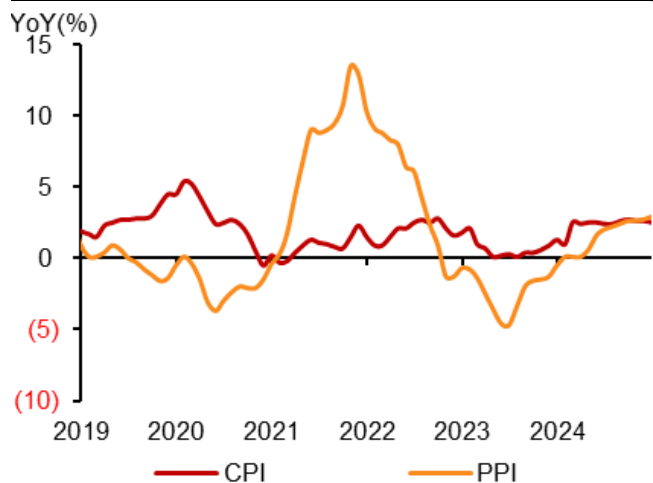
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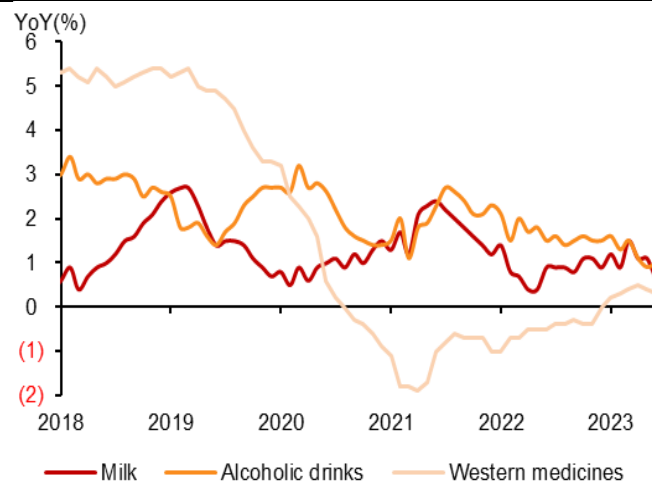
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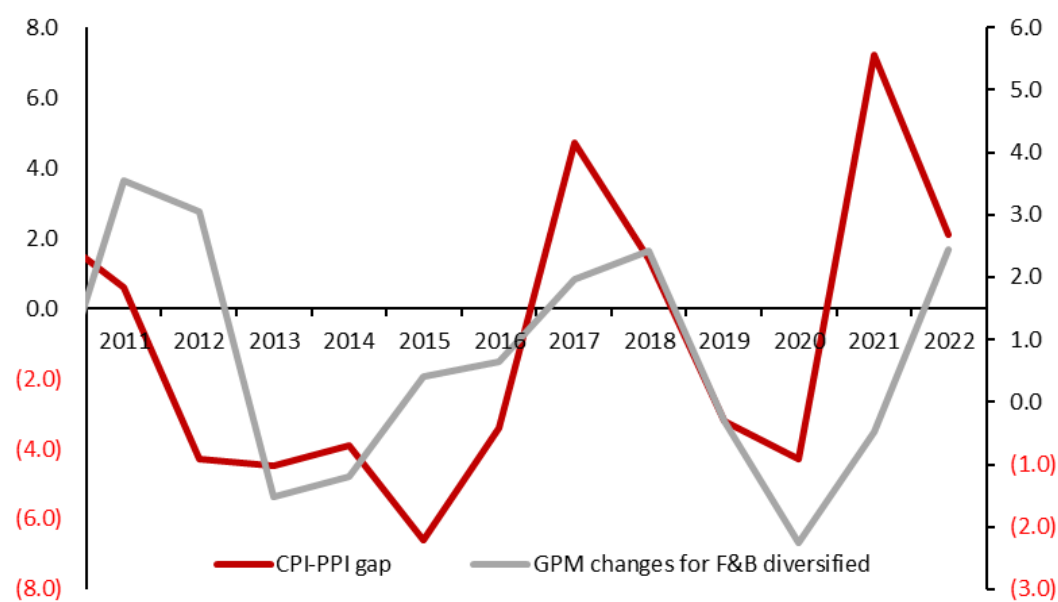
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Figure 1: China PPI and CPI growth gap

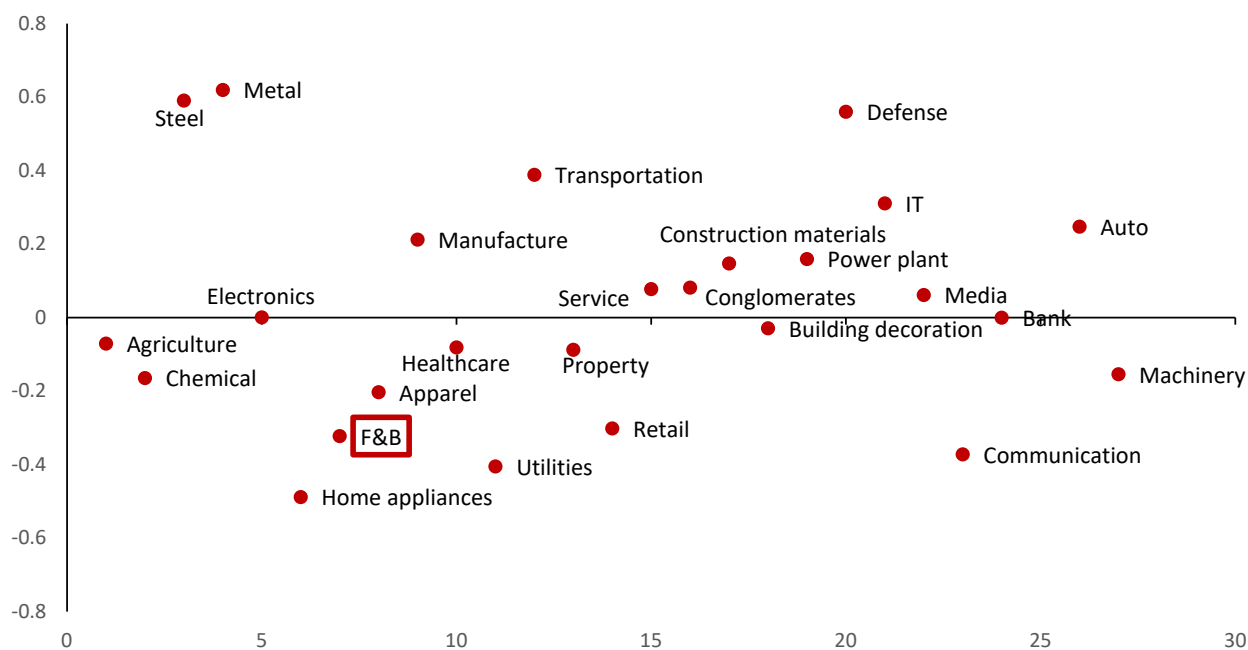
Source: Wind, CMBIGM

Figure 2: CPI growth for major milk and alcohol

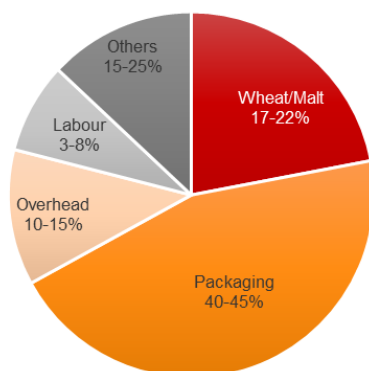
Source: Wind, CMBIGM

Figure 3: PPI-CPI gap and F&B sector GPM exhibited a strong correlation

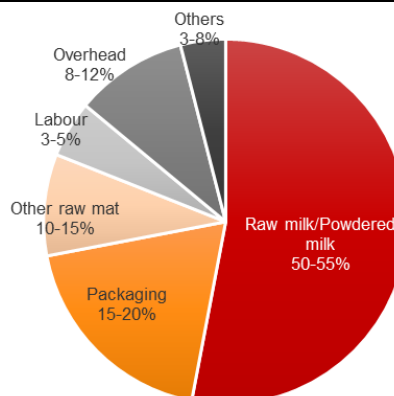
Source: Wind, CMBIGM

Figure 4: GPM of F&B companies is one of the most sensitive to input price change


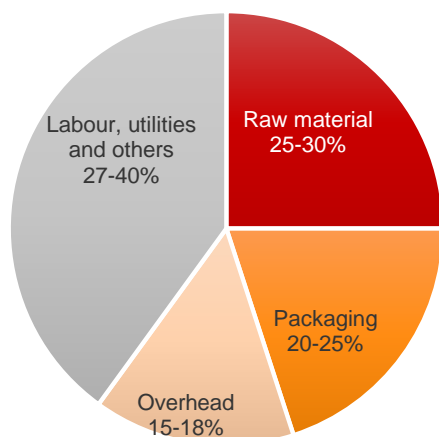
Source: Wind, CMBIGM

Figure 5: COGS breakdown - beer producers


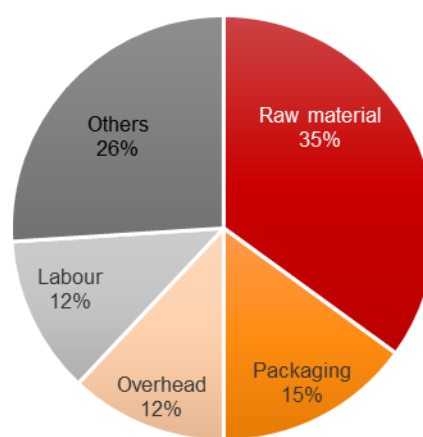
Source: Company data, CMBIGM estimates

Figure 6: COGS breakdown – dairy producers


Source: Company data, CMBIGM estimates

Figure 7: COGS breakdown – soft drinks producers

Source: Company data, CMBIGM estimates

Figure 8: COGS breakdown – instant noodle producers

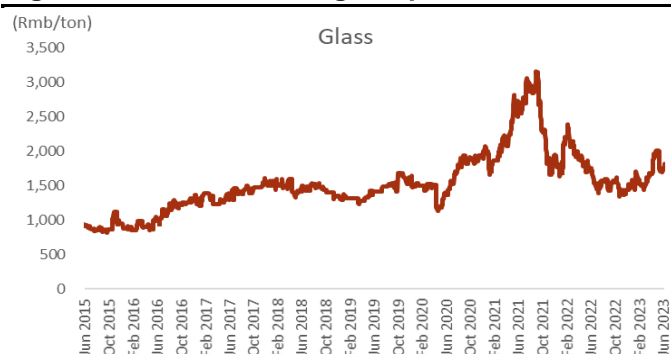
Source: Company data, CMBIGM estimates

Figure 9: GPM sensitivity analysis to raw material cost change

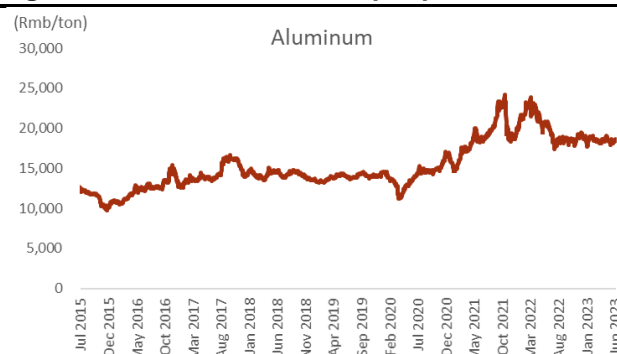
(RMB mn)	Assumed % change	CRB	Tsingtao	Budweiser (USD mn)	Mengniu	Yili	Feihe	Nongfu	UPC	Tingyi	Nissin (HKD mn)
Revenue (2023E)		39,071	35,852	7,463	100,354	133,919	22,937	37,914	30,551	84,710	4,325
Gross profit		15,305	10,869	3,970	35,728	43,387	14,433	22,192	9,398	25,855	1,458
GPM		39.2%	30.3%	53.2%	35.6%	32.4%	62.9%	58.5%	30.8%	30.5%	33.7%
Packaging & raw mat cost change	-10%	1,321	1,286	236	3,878	5,432	680	804	659	2,737	143
GPM impact		3.4%	3.6%	3.2%	3.9%	4.1%	3.0%	2.1%	2.2%	3.2%	3.3%

Source: Wind, Company data, CMBIGM estimates

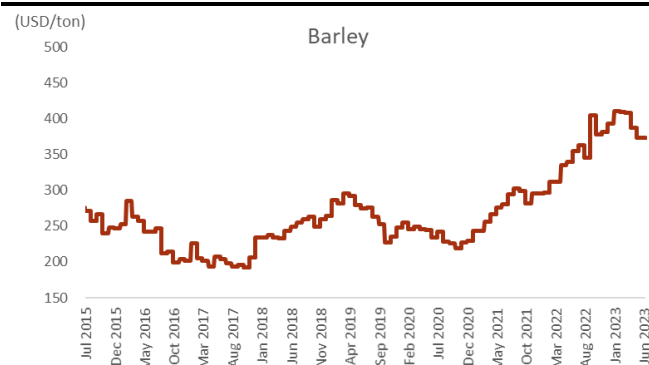
Note: UPC, Tingyi and Nissin estimates are taken from Bloomberg consensus.

Figure 10: China float flat glass price

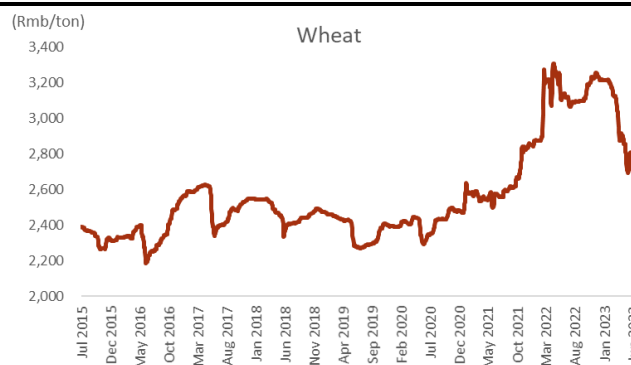
Source: WIND, CMBIGM

Figure 11: China aluminium spot price

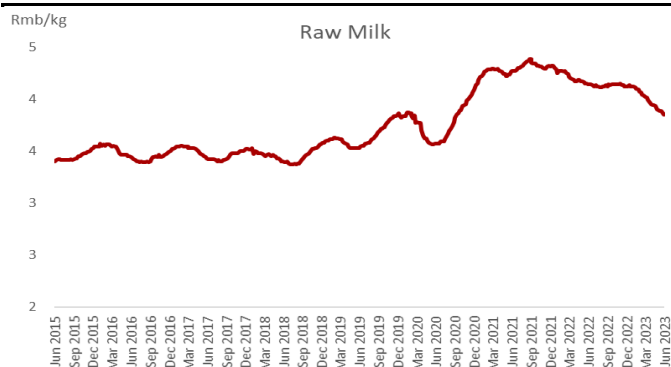
Source: WIND, CMBIGM

Figure 12: China average barley price

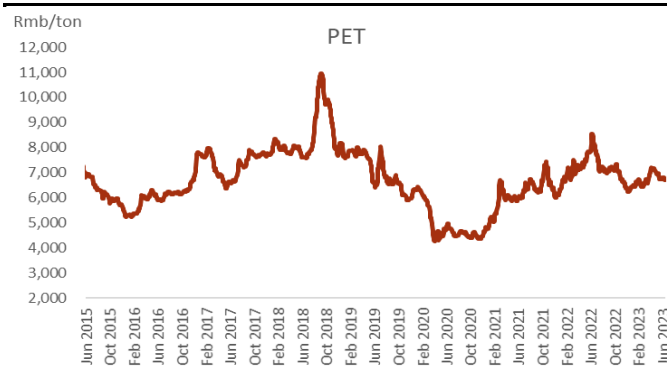
Source: WIND, CMBIGM

Figure 13: China average wheat price

Source: WIND, CMBIGM

Figure 14: China raw milk price

Source: WIND, CMBIGM

Figure 15: China PET price

Source: WIND, CMBIGM

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