

# WH Group (288 HK)

## NDR takeaways; China market is improving in 3Q19E

We hosted a NDR yesterday. Key interested areas of investors were profitability of various segments and policy. The improvement of China market performance in 3Q19E, driven by packaged meat segment, is better than our expectation.

- **China market is improving in 3Q19E.** (1) **Packaged meat:** It is the second largest segment of WH in terms of profit contribution (38% of segment profit in 1H19). 3Q19E OP/tonne has been improving notably compared to 1H19, led by 4% ASP hike in Jul and consumption of low-cost pork inventory. Cost pressure can be offset. The Shuanghui cooking sausage (双汇筷厨炒菜煎烤肠) launched in late Jun has been well received with average monthly sales volume of 800 tonne. (2) **Fresh pork:** Due to supply shortage, hog processing volume fell YoY and operating cost/head increased. However, we think OP/head can achieve above normal profitability range (RMB40-60/head) in 2H19E because WH started to sell low-cost pork inventory.
- **US market in 2H19 better than 1H19.** (1) **Hog production:** management reiterates the segment can achieve profitable growth in 2H19E and FY19E thanks to hedging done in 1H19. (2) **Fresh pork:** the business was still loss-making in Jul but turned around in Aug. We expect profitability in 3Q19E to improve from 2Q19. (3) **Packaged meat:** We expect that OP margin would continue to improve YoY in 2H19E as product mix enhancement carries on.
- **All eyes on trade talks in Oct.** Regarding the news saying China government would support enterprises to purchase certain volume of US pork without additional tariff, WH has not received any formal notices yet. According to CNBC, US Treasury Secretary Mnuchin said China and US officials would have trade talks in two weeks. Management believes the authorities may have updates on the exclusion of additional tariff after the trade talks.
- **China hog price to go up in coming two quarters.** Management expects the price hike to be led by YoY sharp decline of hog and sow balance and pork consumption peak season. WH is keeping to source cheap pork overseas as reserves. Given that US hog and pork carcass prices trade at 67% and 69% discount to China's, respectively, we expect US' export volume to China to keep going up, which should support US hog and pork 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)	12.0	12.6	10.9	10.0	9.8
P/B (x)	1.8	1.7	1.5	1.4	1.3
Yield (%)	3.8	2.8	4.1	4.5	4.6
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	+31%
Current Price	HK\$7.02

### China Staples Sector

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### Stock Data

Mkt Cap (HK\$ mn)	103,270
Avg 3 mths t/o (HK\$ mn)	310.63
52w High/Low (HK\$)	9.95/5.27
Total Issued Shares (mn)	14,664

Source: Bloomberg

### Shareholding Structure

Rise Grand	35.94%
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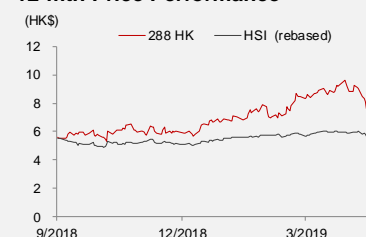
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	6.5%	6.3%
3-mth	-12.5%	-5.0%
6-mth	-16.9%	-7.7%

Source: Bloomberg

### 12-mth Price Performance



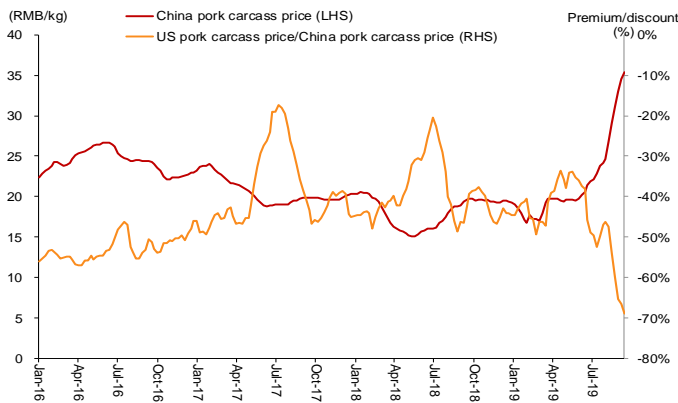
Source: Bloomberg

### Auditor: EY

### Related Reports

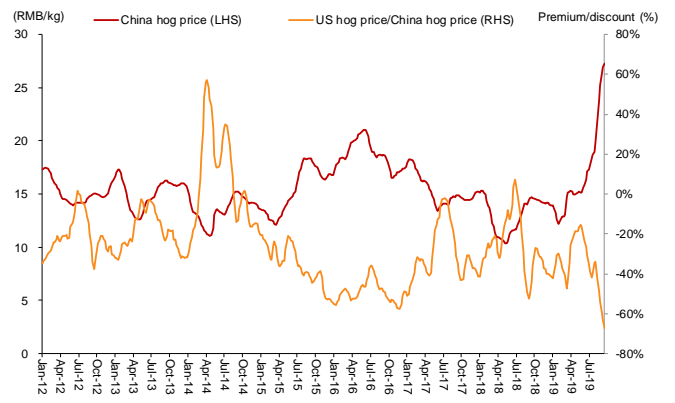
1. "WH Group – US hog futures rallied as trade tensions ease" – 14 Sep 2019
2. "WH Group – Expect a better 2H19" – 14 Aug 2019
3. "WH Group – 1H19 preview; expect a better 2H19" – 24 Jul 2019
4. "WH Group – US ham price up after Mexico dropped tariff" – 24 May 2019
5. "WH Group – 1Q19 net profit fell but earnings outlook still positive" – 30 Apr 2019

**Figure 1: The discount of US pork carcass price to China's widened to 69% on 15 Sep 2019**



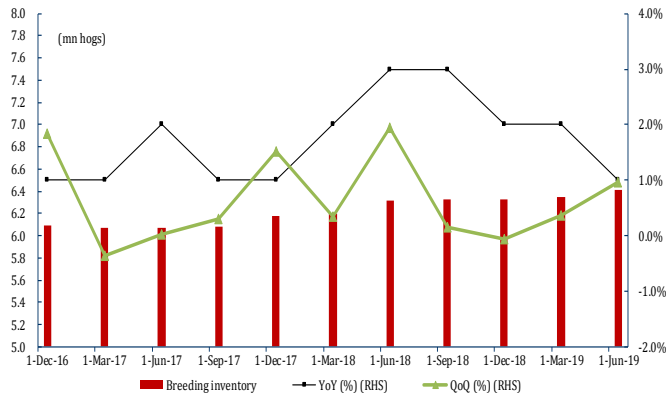
Source: Bloomberg, CMBIS

**Figure 2: The discount of US hog price to China's widened to 67% on 18 Sep 2019**



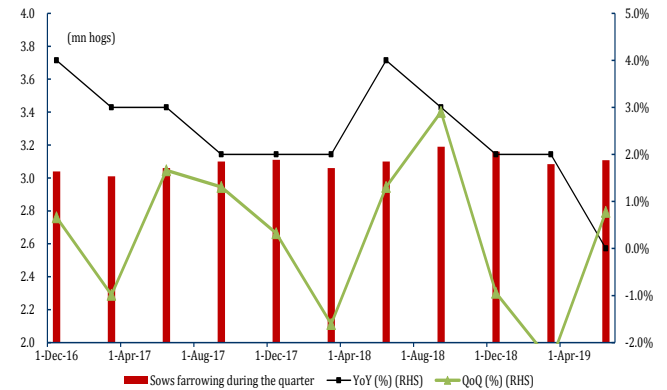
Source: Bloomberg, CMBIS

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



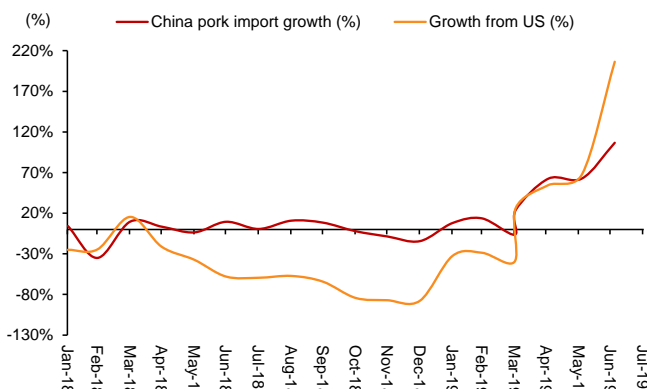
Source: USDA, CMBIS

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



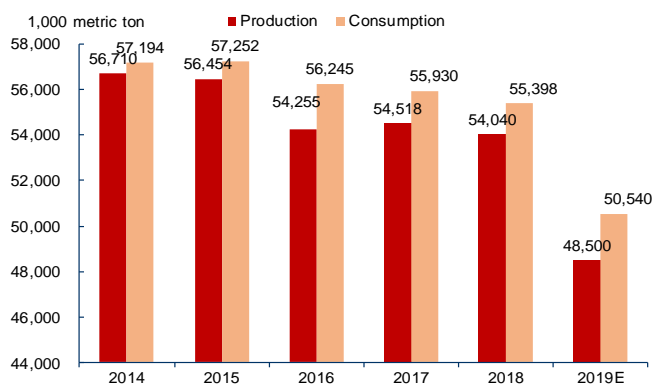
Source: USDA, CMBIS

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



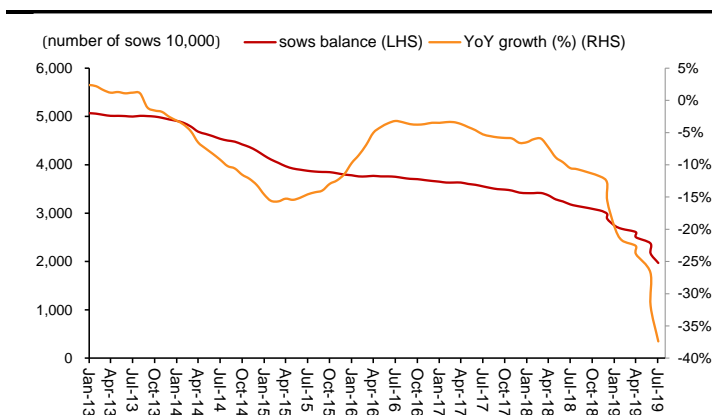
Source: WIND, CMBIS

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

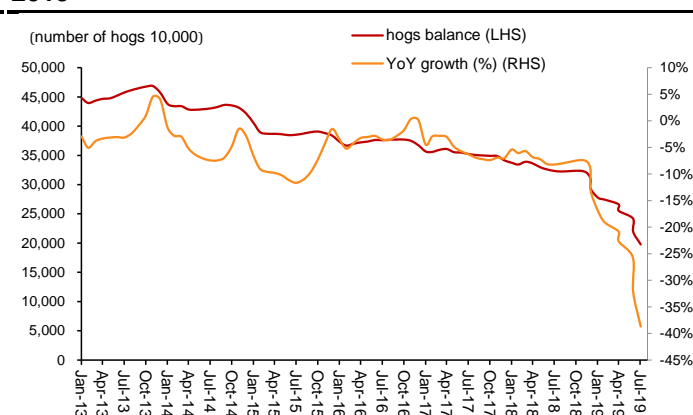


Source: USDA

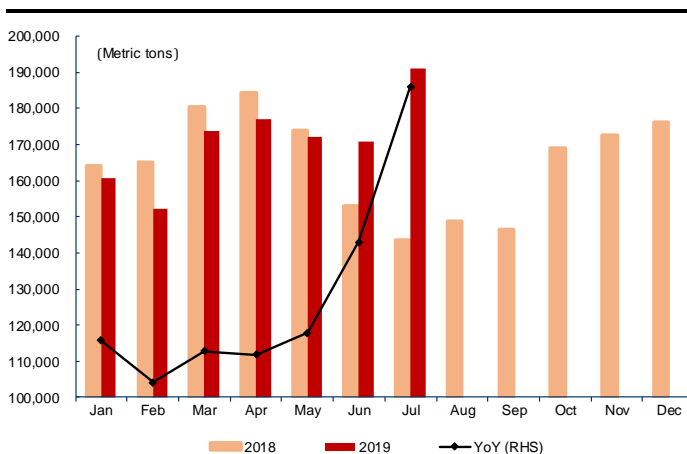
**Figure 7: Sows balance in China fell 37% YoY in Aug 2019** **Figure 8: Hogs balance in China fell 39% YoY in Aug 2019**



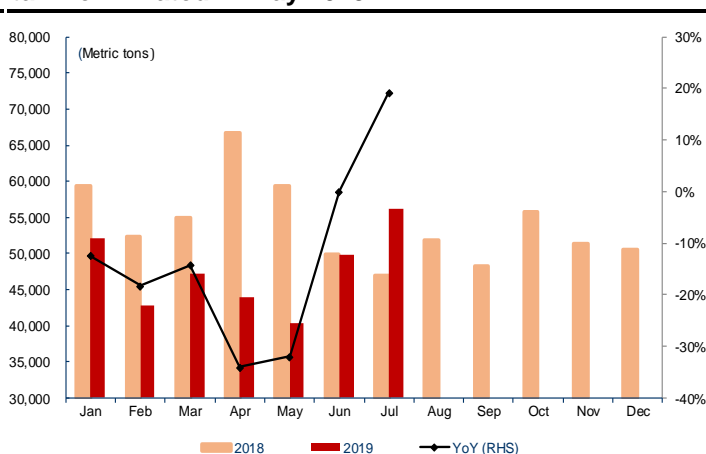
Source: WIND, CMBIS



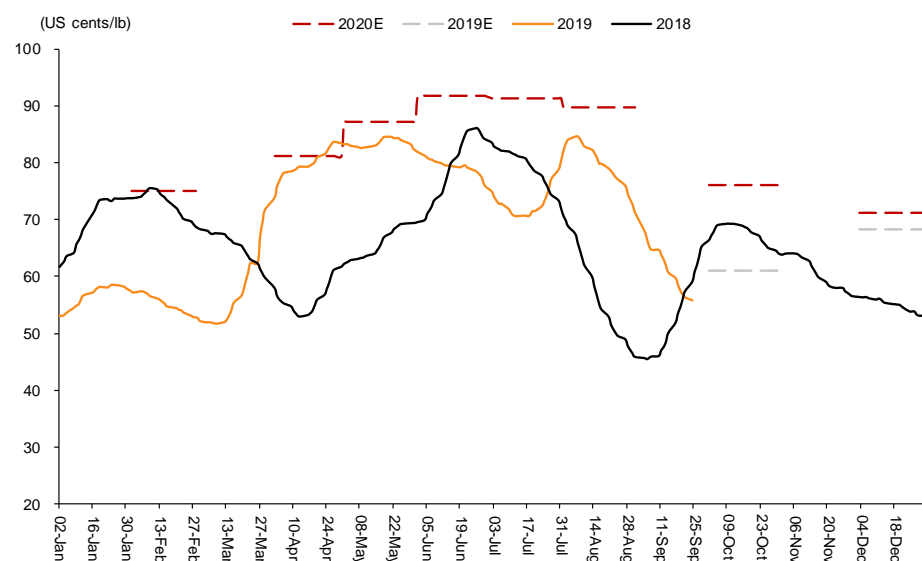
Source: WIND, CMBIS

**Figure 9: US total pork export volume is accelerating**

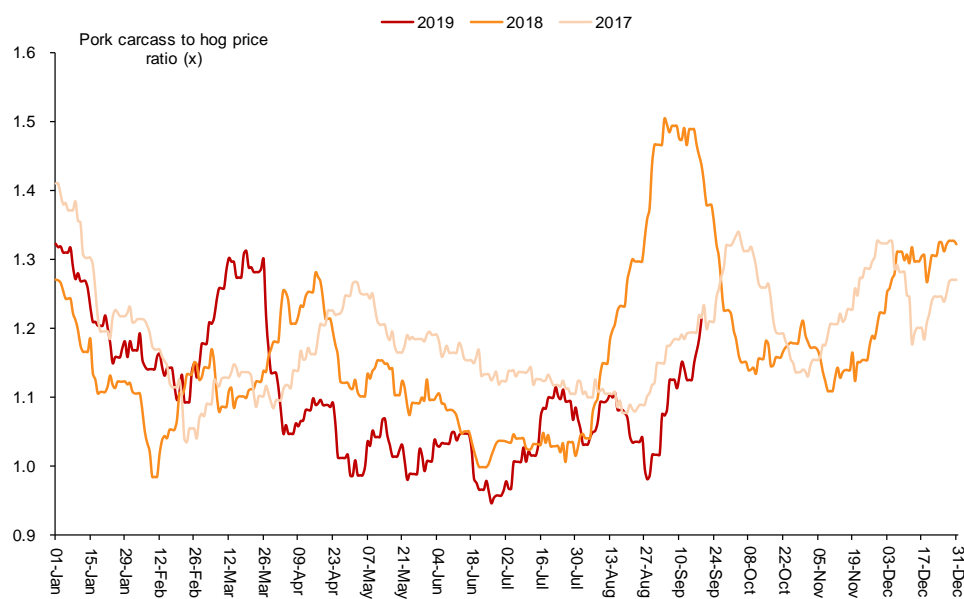
Source: US meat export federation

**Figure 10: US pork export volume to Mexico, its largest export destination, has recovered since 20% tariff eliminated in May 2019**

Source: US meat export federation

**Figure 11: 2020E US hog futures prices are trading above 2019 hog price**


Source: Bloomberg

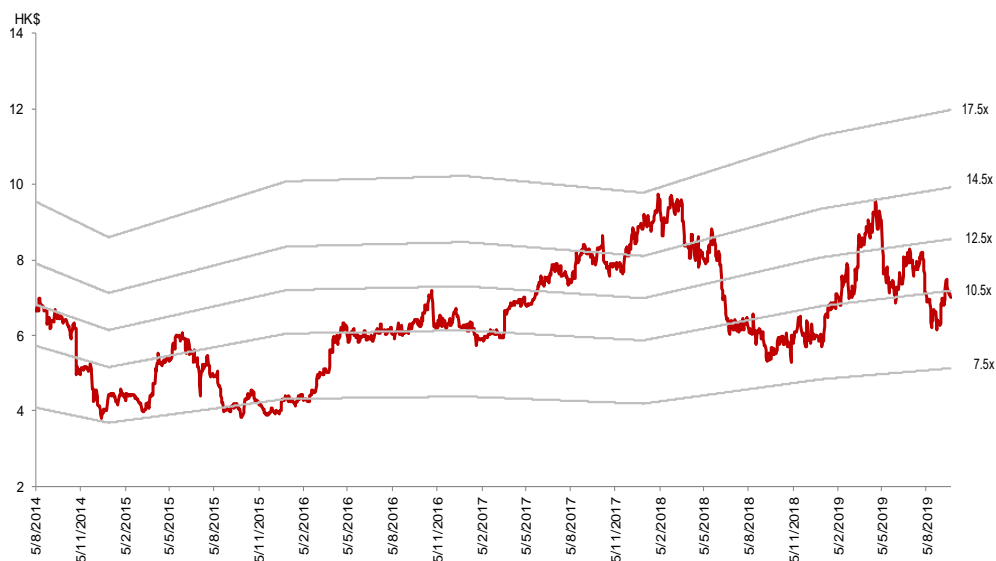
**Figure 12: US fresh pork margin could recover in Sep 2019**


Source: Bloomberg

**Figure 13: 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	12x FY19E P/E
China business	17.6	500.2	8,804	30% discount on HK listed peers' average 25.1x FY19 P/E
<b>Total</b>			<b>17,382</b>	
Value per share (HK\$)			9.2	
Implied FY19 P/E			14.3	

Source: Company data, Bloomberg, CMBIS estimates

**Figure 14: P/E band**

Source: Bloomberg, Company data, CMBIS estimates

**Figure 15: Major assumptions for US market**

(US\$mn)	FY17	FY18	FY19E	FY20E	FY21E
<b>Packaged meat segment</b>					
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%
<b>Fresh pork segment</b>					
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
<b>Hog production segment</b>					
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
<b>Total external revenue</b>	<b>13,278</b>	<b>13,182</b>	<b>13,505</b>	<b>13,998</b>	<b>13,724</b>
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
<b>Segment profit</b>	<b>923</b>	<b>615</b>	<b>974</b>	<b>1,202</b>	<b>1,084</b>
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)
<b>Segment profit margin</b>	<b>7.0%</b>	<b>4.7%</b>	<b>7.2%</b>	<b>8.6%</b>	<b>7.9%</b>

Source: Company data, CMBIS estimates

**Figure 16: Major assumptions for China market**

(US\$mn)	FY17	FY18	FY19E	FY20E	FY21E
<b>Packaged meat segment</b>					
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%
<b>Fresh pork segment</b>					
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
<b>Hog production segment</b>					
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
<b>Total external revenue</b>					
	<b>7,446</b>	<b>7,328</b>	<b>7,301</b>	<b>7,545</b>	<b>7,556</b>
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
<b>Segment profit</b>					
	<b>525</b>	<b>922</b>	<b>783</b>	<b>662</b>	<b>832</b>
growth %	<b>-36.2%</b>	<b>75.6%</b>	<b>-15.1%</b>	<b>-15.4%</b>	<b>25.6%</b>
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
<b>Segment profit margin</b>					
	<b>7.1%</b>	<b>12.6%</b>	<b>10.7%</b>	<b>8.8%</b>	<b>11.0%</b>

Source: Company data, CMBIS estimates

**Figure 17: Major assumptions for Europe market**

(US\$m)	FY17	FY18	FY19E	FY20E	FY21E
<b>Packaged meat segment</b>					
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%
<b>Fresh pork segment</b>					
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
<b>Hog production segment</b>					
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
<b>Total external revenue</b>	<b>1,655</b>	<b>2,095</b>	<b>2,411</b>	<b>2,696</b>	<b>2,988</b>
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
<b>Segment profit</b>	<b>135</b>	<b>113</b>	<b>145</b>	<b>184</b>	<b>190</b>
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
<b>Segment profit margin</b>	<b>8.2%</b>	<b>5.4%</b>	<b>6.0%</b>	<b>6.8%</b>	<b>6.4%</b>

Source: Company data, CMBIS estimates



## Financial Summary

### Income statement

YE 31 Dec (US\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>22,379</b>	<b>22,605</b>	<b>23,217</b>	<b>24,240</b>	<b>24,268</b>
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)
<b>Gross profit</b>	<b>4,613</b>	<b>4,502</b>	<b>4,811</b>	<b>5,142</b>	<b>5,008</b>
Other income and gains	113	98	86	88	95
SG&A expenses	(2,753)	(2,871)	(2,917)	(3,104)	(2,918)
<b>Operating profit</b>	<b>1,973</b>	<b>1,729</b>	<b>1,980</b>	<b>2,126</b>	<b>2,184</b>
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)
<b>Net profit</b>	<b>1,127</b>	<b>1,047</b>	<b>1,215</b>	<b>1,317</b>	<b>1,347</b>
<b>Adj. net profit</b>	<b>1,090</b>	<b>1,046</b>	<b>1,215</b>	<b>1,317</b>	<b>1,347</b>

### Cash flow summary

YE 31 Dec (US\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Profit before tax</b>	<b>1,501</b>	<b>1,411</b>	<b>1,795</b>	<b>1,964</b>	<b>2,025</b>
Depreciation and amortization	394	441	469	501	514
Change in working capital	(321)	(570)	(341)	(65)	(2)
Others	(62)	(27)	(359)	(372)	(428)
<b>Net cash from operating</b>	<b>1,512</b>	<b>1,255</b>	<b>1,564</b>	<b>2,028</b>	<b>2,109</b>
Capex & investments	(530)	(811)	(800)	(600)	(600)
Interest received	12	6	17	15	20
Others	(266)	(412)	(58)	(57)	(56)
<b>Net cash from investing</b>	<b>(784)</b>	<b>(1,217)</b>	<b>(841)</b>	<b>(642)</b>	<b>(636)</b>
Change of borrowings	64	4	0	(200)	(300)
Dividend paid	(668)	(795)	(447)	(728)	(790)
Others	13	1	0	0	0
<b>Net cash from financing</b>	<b>(591)</b>	<b>(790)</b>	<b>(447)</b>	<b>(928)</b>	<b>(1,090)</b>
<b>Net change in cash</b>	<b>137</b>	<b>(752)</b>	<b>276</b>	<b>458</b>	<b>383</b>
Cash at the beginning	1,123	1,279	484	760	1,218
Exchange difference	19	(43)	0	0	0
<b>Cash at the end</b>	<b>1,279</b>	<b>484</b>	<b>760</b>	<b>1,218</b>	<b>1,601</b>
Bank and cash balance	1,371	525	801	1,259	1,642
Bank overdraft	(92)	(41)	(41)	(41)	(41)

### Balance sheet

YE 31 Dec (US\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>9,592</b>	<b>9,838</b>	<b>10,191</b>	<b>10,313</b>	<b>10,425</b>
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
<b>Current assets</b>	<b>5,666</b>	<b>5,460</b>	<b>6,145</b>	<b>6,757</b>	<b>7,129</b>
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
<b>Current liabilities</b>	<b>3,499</b>	<b>3,328</b>	<b>3,472</b>	<b>3,566</b>	<b>3,565</b>
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
<b>Non-current liabilities</b>	<b>3,537</b>	<b>3,552</b>	<b>3,470</b>	<b>3,300</b>	<b>3,001</b>
Borrowings	2,297	2,259	2,159	1,959	1,659
Deferred revenue	601	695	713	743	744
Others	639	598	598	598	598
<b>Minority Interest</b>	<b>777</b>	<b>672</b>	<b>808</b>	<b>847</b>	<b>888</b>
<b>Total net assets</b>	<b>8,222</b>	<b>8,418</b>	<b>9,394</b>	<b>10,203</b>	<b>10,989</b>
<b>Shareholders' equity</b>	<b>7,445</b>	<b>7,746</b>	<b>8,586</b>	<b>9,356</b>	<b>10,110</b>

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
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
<b>P&amp;L ratios (%)</b>					
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
<b>Balance sheet ratios</b>					
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
<b>Returns (%)</b>					
Adj. ROAE	15.8	13.8	14.9	14.7	13.8
Adj. ROAA	8.8	8.2	9.0	9.2	9.2
<b>Per share data</b>					
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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