

WH Group (288 HK)

Maintain Buy on undemanding valuation

We hosted an investor meeting with management recently. We estimate 1H20E NP to increase by ~45% to US\$670mn (47% of our FY20E est.). Looking into 2H20E, while we are positive on softening hog price in China market, we think recent rebound of new cases of COVID-19 in US could delay market recovery. That said, market cap of WH's Shuanghui equity interests is greater than WH's market cap, implying Smithfield is free. Maintain Buy on undemanding valuation.

- **China market OP growth to accelerate in 2Q20E.** (1) **Packaged meat:** Sales volume resumes growth in 2Q20E after a drop in 1Q20 due to temporary shutdown of plants. Raw materials costs declined QoQ as pork price dropped QoQ in 2Q20. We expect OP to grow strongly YoY with a high OP/tonne. (2) **Fresh pork:** Hog processing volume continues to decline significantly due to ASF but the Company increased import volume of frozen pork to keep fresh pork sales volume stable. OP/head lowered from exceptional high level in 1Q20 to relatively high level in 2Q20E as pork price softened in QoQ in 2Q20.
- **US market OP growth could be flat YoY.** (1) **Packaged meat:** We expect YoY decline of OP in 2Q20E would be similar to 1Q20 because food service channel was hit by COVID-19 and extra expenses (US\$40-50mn) from responsibility bonus payment and epidemic prevention cost. (2) **Fresh pork:** The price spread between pork and hog prices surged in Apr and May as pork supplies reduced due to temporary factories shutdown in downstream. We expect 2Q20E OP would be higher than 1Q20. (3) **Hog production:** Hog price slumped because of temporary factories shutdown. Thanks to hedging, we think segment loss would not be significant.
- **2H20E outlook.** (1) **China market to benefit from softening hog price:** Management forecasts hog price to soften in 2H20E given that sow balance has been improving MoM (Figure 13). Profit margin of packaged meat could further improve in 2H20E. (2) **US market depends on COVID-19:** The recent rebound of COVID-19 new cases has delayed the recovery by keeping food service demand low. Based on current futures prices and hedging position, management expects hog production segment could be profitable in 3Q20E but loss-making in 4Q20E. Currently US pork price is 77% below Chinese pork price. Smithfield would continue to export a lot of pork to China.
- **Valuation.** Our SOTP-based TP of HK\$9.50 represents 13.0x FY20E P/E. **Catalyst:** US economy reopening. **Risks:** uncertainties from COVID-19 outbreak, US hog market in severe oversupply.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (US\$ mn)	22,605	24,103	25,148	25,930	26,912
Net profit (US\$ mn)	1,047	1,380	1,415	1,436	1,556
Adj. net profit (US\$ mn)	1,046	1,378	1,415	1,436	1,556
Adj. EPS (US\$)	0.071	0.094	0.102	0.107	0.114
YoY growth (%)	(4.9)	31.5	2.6	1.5	8.3
Consensus EPS (US\$)	na	na	0.096	0.102	0.135
Adj. P/E (x)	12.6	9.6	9.4	9.3	8.5
P/B (x)	1.7	1.5	1.4	1.3	1.2
Yield (%)	2.8	4.5	4.6	4.6	5.0
Adj. ROAE (%)	13.8	16.8	15.6	14.5	14.4

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$9.50
(Previous TP)	HK\$9.50)
Up/Downside	+35%
Current Price	HK\$7.05

China Staples Sector

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Stock Data

Mkt Cap (HK\$ mn)	103,844
Avg 3 mths t/o (HK\$ mn)	356.36
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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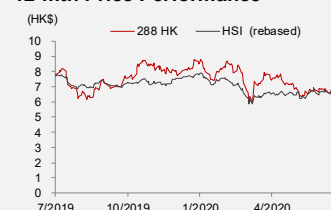
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	5.3%	0.7%
3-mth	-6.8%	-13.6%
6-mth	-17.0%	-9.5%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: EY

Related Reports

1. "WH Group – 1Q20 results on track " – 29 Apr 2020
2. "WH Group – FY19 results beat; 1Q20E NP growth still good " – 25 Mar 2020
3. "WH Group – 4Q19 momentum continued and a positive 2020 " – 13 Jan 2020
4. "WH Group – 3Q19 NP +79%, China's packaged meat and fresh pork margins could continue in 4Q19E " – 29 Oct 2019
5. "WH Group – NDR takeaways; China market is improving in 3Q19E " – 25 Sep 2019

Figure 1: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	25,148	25,930	26,912	25,916	26,710	27,188	-3%	-3%	-1%
Gross Profit	5,278	5,282	5,434	5,419	5,624	5,784	-3%	-6%	-6%
Operating Profit	2,250	2,303	2,461	2,302	2,356	2,390	-2%	-2%	3%
Net profit	1,411	1,429	1,548	1,513	1,610	1,699	-7%	-11%	-8%
Gross Margin	21.0%	20.4%	20.2%	20.9%	21.1%	21.3%	+0.1ppt	-0.7ppt	-1.1ppt
Operating Margin	8.9%	8.9%	9.1%	8.9%	8.8%	8.8%	flat	+0.1ppt	+0.3ppt
Net Margin	5.6%	5.5%	5.8%	5.8%	6.0%	6.2%	-0.2ppt	-0.5ppt	-0.4ppt

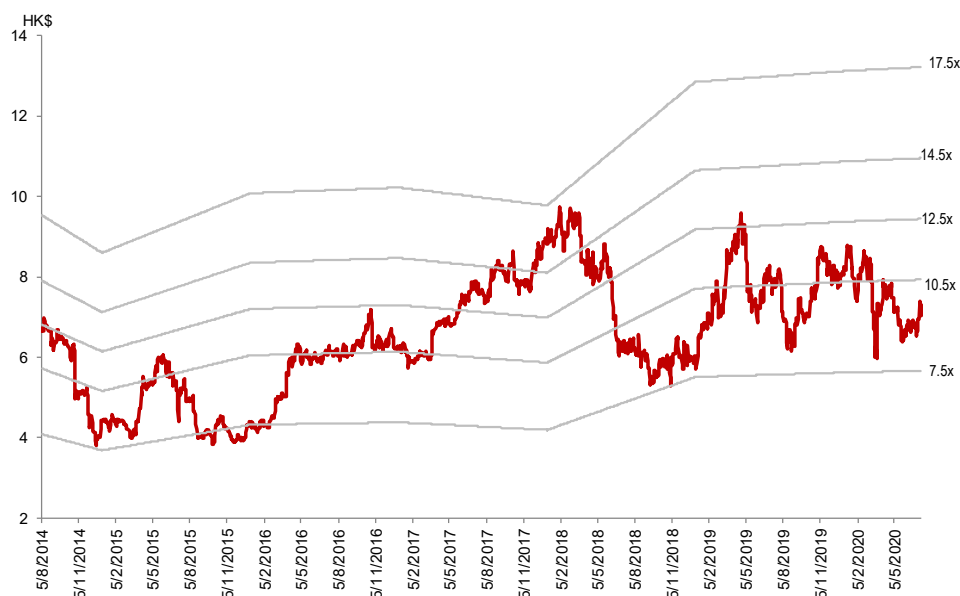
Source: Bloomberg, CMBIS estimates

Figure 2: SOTP-based valuation

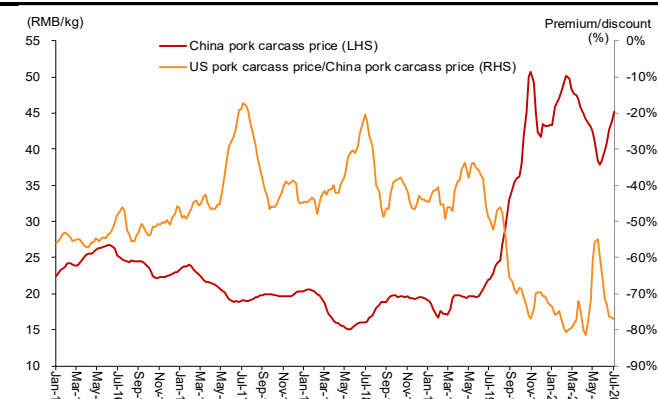
Segment	FY20 P/E	FY20E net profit (US\$mn)	Valuation (US\$mn)	Remarks
US & Europe businesses	10.0	840.3	8,403	10x FY20E P/E
China business	16.6	574.2	9,532	30% discount on HK listed peers' average 23.7x FY20E P/E
Total			17,935	
Value per share (HK\$)			9.5	
Implied FY20E P/E			13.0	

	Price (RMB)	Issue shares (mn)	Value (HK\$mn)	
Market cap of WH			103,844	
Mkt value of Shaunhui stakes	49.16	3,319.3	133,477	based on 73.41% equity stakes and 10 Jul closing price
Implied Smithfield value			(29,634)	

Source: Company data, Bloomberg, CMBIS estimates

Figure 3: P/E band

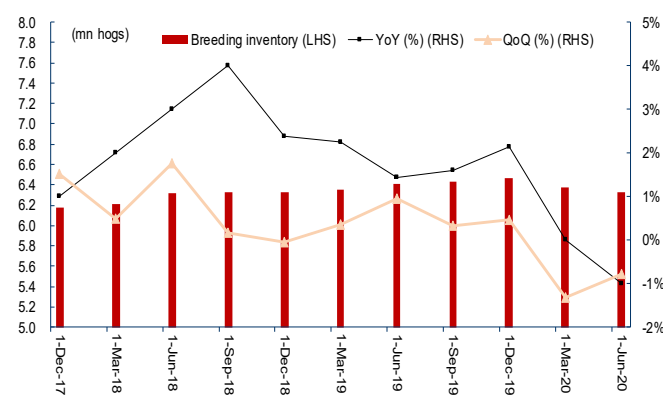
Source: Bloomberg, Company data, CMBIS estimates

Figure 4: The discount of US pork carcass price to China's was 77% on 5 Jul 2020


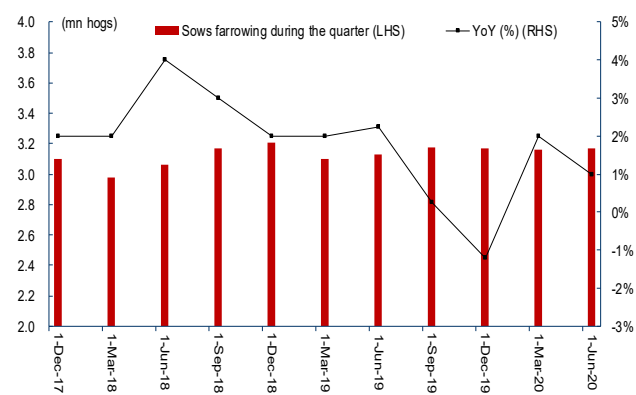
Source: Bloomberg, CMBIS

Figure 5: The discount of US hog price to China's was 81% on 8 Jul 2020

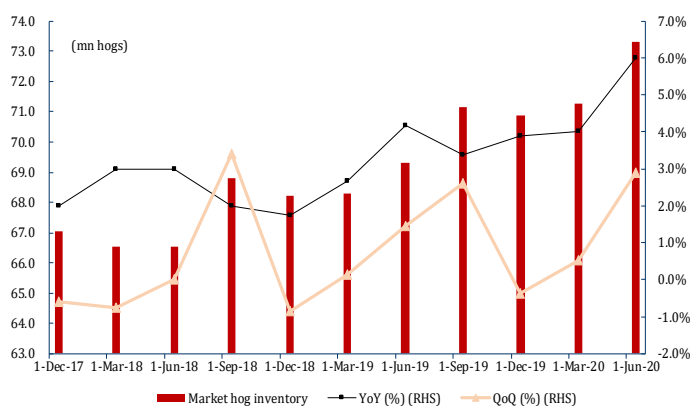

Source: Bloomberg, CMBIS

Figure 6: Growth of US breeding hog inventory was down 1% in the quarter ended 1 Jun 2020


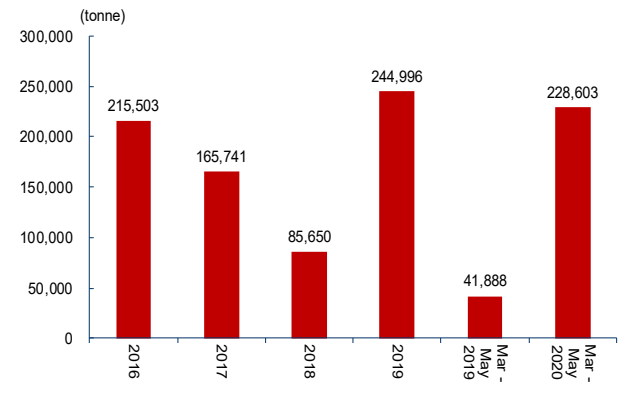
Source: USDA, CMBIS

Figure 7: Number of sows farrowing during the quarter ended 1 Jun 2020 up 1%


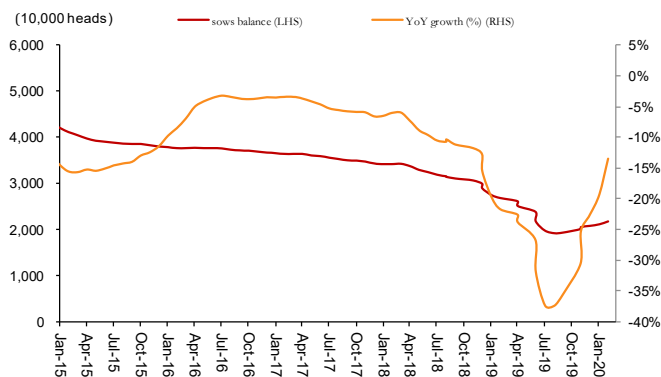
Source: USDA, CMBIS

Figure 8: Growth of US market hog inventory was 6% in the quarter ended 1 Jun 2020 due to epidemic


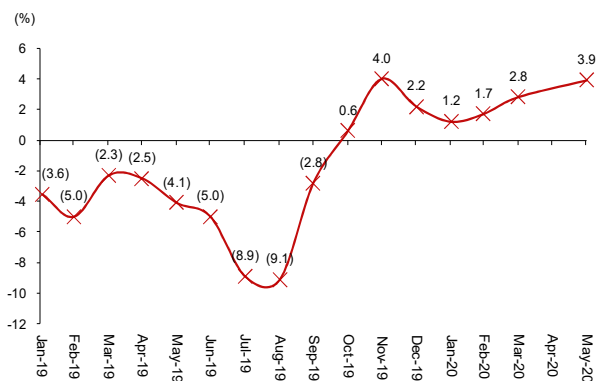
Source: USDA, CMBIS

Figure 9: China's pork import volume from US between Mar and May 2020 almost reached 2019 level


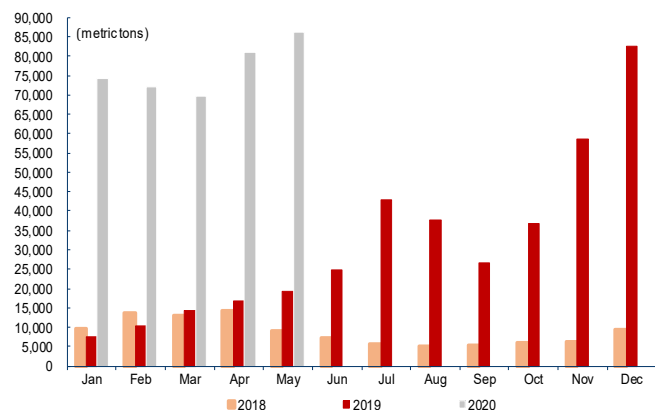
Source: WIND, CMBIS

Figure 10: Sows balance decline in China narrowed to 13.5% YoY in Mar 2020


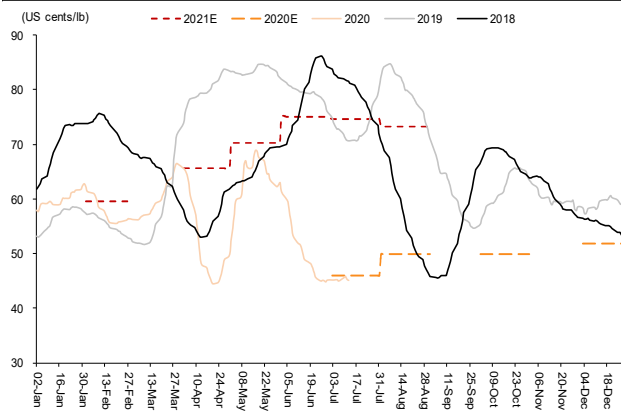
Source: WIND, CMBIS

Figure 11: Sow balance MoM growth accelerated to 3.9% in May 2020


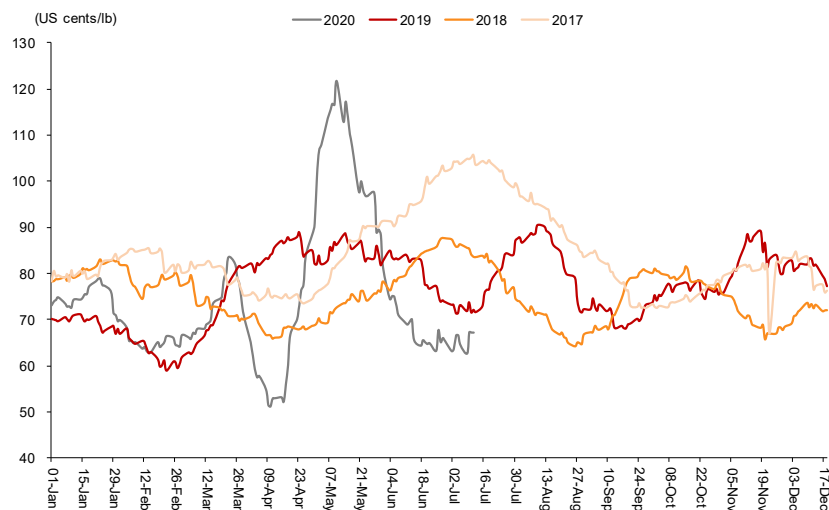
Source: WIND, CMBIS

Figure 12: US pork export volume to China kept going up in 2020


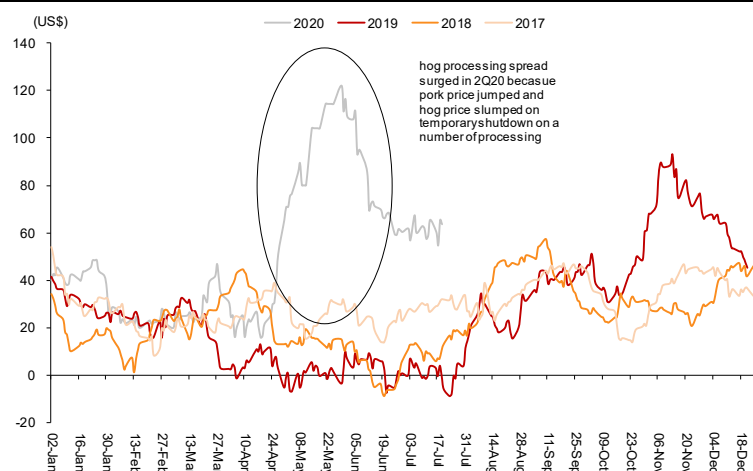
Source: US meat export federation

Figure 13: US hog spot price and futures prices have softened since epidemic


Source: Bloomberg, CMBIS estimates

Figure 14: US pork price chart


Source: Bloomberg, CMBIS

Figure 15: US pork packers margins has expanded since epidemic

Source: Bloomberg, CMBIS

Figure 17: Major assumptions for US market

(US\$m)	FY18	FY19	FY20E	FY21E	FY22E
Packaged meat segment					
External revenue	7,773	7,814	7,888	7,887	8,045
growth %	-0.4%	0.5%	0.9%	0.0%	2.0%
Sales volume (mn metric tons)	1.46	1.45	1.44	1.45	1.47
growth %	0.9%	-0.5%	-1.0%	1.0%	1.0%
ASP (US\$/ton)	5,324	5,378	5,485	5,431	5,485
growth %	-1.3%	1.0%	2.0%	-1.0%	1.0%
OP margin	10.1%	10.8%	11.1%	11.6%	12.0%
Fresh pork segment					
External revenue	4,790	4,467	5,275	5,092	5,071
growth %	-3.4%	-6.7%	18.1%	-3.5%	-0.4%
Hog processed (mn heads)	33.95	34.51	35.20	35.91	36.63
growth %	-1.4%	1.7%	2.0%	2.0%	2.0%
OP/head (US\$)	1.4	4.3	8.0	7.0	7.0
Hog production segment					
External revenue	619	877	1,029	986	976
growth %	21.4%	41.7%	17.3%	-4.1%	-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	2.0	(1.0)
Total external revenue	13,182	13,158	14,192	13,965	14,092
Packaged meat	7,773	7,814	7,888	7,887	8,045
Fresh pork	4,790	4,467	5,275	5,092	5,071
Hog production	619	877	1,029	986	976
Segment profit	615	932	1,110	1,040	1,032
growth %	-33.4%	51.5%	19.1%	-6.3%	-0.8%
Packaged meat	785	847	876	915	966
Fresh pork	48	150	282	251	256
Hog production	(147)	83	108	37	(19)
Others	(71)	(148)	(155)	(163)	(171)
Segment profit margin	4.7%	7.1%	7.8%	7.4%	7.3%

Source: Company data, CMBIS estimates

Figure 18: Major assumptions for China market

(US\$m)	FY18	FY19	FY20E	FY21E	FY22E
Packaged meat segment					
External revenue	3,458	3,615	4,016	4,056	4,097
growth %	4.4%	4.5%	11.1%	1.0%	1.0%
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	17,553	17,553	17,553
growth %	1.3%	9.6%	12.0%	0.0%	0.0%
OP margin %	20.6%	18.6%	18.0%	20.5%	21.5%
Fresh pork segment					
External revenue	3,584	4,725	3,796	4,556	5,125
growth %	-7.8%	31.8%	-19.7%	20.0%	12.5%
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	110.0	60.0	50.0
Hog production segment					
External revenue	8	2	1	2	2
growth %	-27.3%	-75.0%	-40.5%	35.0%	20.0%
Hog produced (mn heads)	0.29	0.13	0.07	0.10	0.12
growth %	-6.1%	-54.9%	-50.0%	50.0%	20.0%
OP/head (Rmb)	113.0	-683.8	-1200.0	400.0	300.0
Total external revenue	7,328	8,756	8,368	9,224	9,895
Packaged meat	3,458	3,615	4,016	4,056	4,097
Fresh pork	3,584	4,725	3,796	4,556	5,125
Hog production	8	2	1	2	2
Others	278	414	554	610	671
Segment profit	922	957	887	998	1,061
growth %	75.6%	3.8%	-7.3%	12.6%	6.3%
Packaged meat	712	673	723	832	881
Fresh pork	179	262	124	102	106
Hog production	5	(13)	(11)	6	5
Others	26	35	51	59	69
Segment profit margin	12.6%	10.9%	10.6%	10.8%	10.7%

Source: Company data, CMBIS estimates

Figure 19: Major assumptions for Europe market

(US\$mn)	FY18	FY19	FY20E	FY21E	FY22E
Packaged meat segment					
External revenue	916	902	1,013	1,089	1,167
growth %	39.2%	-1.5%	12.3%	7.5%	7.2%
Sales volume (mn metric tons)	0.29	0.28	0.29	0.31	0.32
growth %	18.0%	-2.0%	5.0%	5.0%	5.0%
ASP (EUR/ton)	3,818	3,627	3,736	3,848	3,964
growth %	23.0%	-5.0%	3.0%	3.0%	3.0%
OP margin	5.5%	6.0%	6.2%	6.8%	7.3%
Fresh pork segment					
External revenue	762	886	1,136	1,180	1,251
growth %	12.6%	16.3%	28.3%	3.9%	6.0%
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)	3.9	-1.7	-2.0	4.0	4.0
Hog production segment					
External revenue	61	58	68	66	64
growth %	19.6%	-4.9%	17.1%	-2.7%	-3.0%
Hog produced (mn heads)	4.17	3.99	4.11	4.24	4.36
growth %	18.0%	-4.3%	3.0%	3.0%	3.0%
OP/head (EUR)	8.2	27.2	33.0	22.0	18.0
Total external revenue	2,095	2,188	2,588	2,741	2,924
Packaged meat	916	902	1,013	1,089	1,167
Fresh pork	762	886	1,136	1,180	1,251
Hog production	61	58	68	66	64
Others	356	342	371	406	442
Segment profit	113	142	187	198	198
growth %	-16.3%	25.7%	32.0%	5.9%	0.0%
Packaged meat	50	54	63	74	85
Fresh pork	19	(9)	(12)	27	29
Hog production	29	97	125	85	71
Others	15	0	11	12	13
Segment profit margin	5.4%	6.5%	7.2%	7.2%	6.8%

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (US\$ mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	22,605	24,103	25,148	25,930	26,912
China	7,328	8,756	8,368	9,224	9,895
US	13,182	13,158	14,192	13,965	14,092
EUR	2,095	2,188	2,588	2,741	2,924
Cost of sales	(18,103)	(19,209)	(20,051)	(20,645)	(21,400)
Gross profit	4,502	4,894	5,097	5,284	5,511
Other income and gains	98	59	63	73	82
SG&A expenses	(2,871)	(2,870)	(2,909)	(3,055)	(3,132)
Operating profit	1,729	2,083	2,250	2,303	2,461
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	2,082	2,138	2,319
Income tax	(293)	(336)	(423)	(434)	(470)
Non-controlling interests	(210)	(230)	(244)	(268)	(293)
Net profit	1,047	1,380	1,415	1,436	1,556
Adj. net profit	1,046	1,378	1,415	1,436	1,556

Cash flow summary

YE 31 Dec (US\$ mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before tax	1,411	2,052	2,082	2,138	2,319
Depreciation and amortization	441	581	597	609	621
Change in working capital	(570)	(930)	229	85	(42)
Others	(27)	(240)	(764)	(461)	(503)
Net cash from operating	1,255	1,463	2,144	2,371	2,394
Capex & investments	(811)	(680)	(600)	(600)	(600)
Interest received	6	6	15	25	34
Others	(412)	(122)	0	0	0
Net cash from investing	(1,217)	(796)	(585)	(575)	(566)
Change of borrowings	4	3	127	(400)	(400)
Dividend paid	(795)	(464)	(721)	(772)	(794)
Others	1	(132)	0	0	0
Net cash from financing	(790)	(593)	(594)	(1,172)	(1,194)
Net change in cash	(752)	74	965	624	634
Cash at the beginning	1,279	484	552	1,517	2,141
Exchange difference	(43)	(6)	0	0	0
Cash at the end	484	552	1,517	2,141	2,775
Bank and cash balance	525	552	1,517	2,141	2,775
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	7,564	8,179	8,974
Cash and pledged deposits	579	593	1,558	2,182	2,816
Inventory	2,022	2,903	2,727	2,668	2,765
Trade receivables	1,135	1,047	1,092	1,126	1,169
Others	1,724	2,164	2,186	2,202	2,223
Current liabilities	3,328	3,869	4,095	4,180	4,289
Borrowings	860	905	1,010	1,010	1,010
Trade payables	977	1,074	1,121	1,154	1,197
Other payables	1,430	1,686	1,760	1,812	1,878
Others	61	204	204	204	204
Non-current liabilities	3,552	3,961	3,681	3,306	2,936
Borrowings	2,259	2,187	2,209	1,809	1,409
Deferred revenue	695	1,114	812	837	867
Others	598	660	660	660	660
Minority Interest	672	768	886	991	1,107
Total net assets	8,418	9,452	10,391	11,323	12,378
Shareholders' equity	7,746	8,684	9,505	10,332	11,270

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
China	32.4	36.3	33.3	35.6	36.8
US	58.3	54.6	56.4	53.9	52.4
EUR	9.3	9.1	10.3	10.6	10.9
P&L ratios (%)					
Gross profit margin	19.9	20.3	20.3	20.4	20.5
Operating profit margin	7.6	8.6	8.9	8.9	9.1
Net profit margin	4.6	5.7	5.6	5.5	5.8
Adj. net profit margin	4.6	5.7	5.6	5.5	5.8
Payout ratio	35.8	43.0	43.0	43.0	43.0
Balance sheet ratios					
Current ratio (x)	1.6	1.7	1.8	2.0	2.1
Receivables turnover days	17	17	16	16	16
Payables turnover days	21	19	20	20	20
Inventory turnover days	40	47	51	48	46
Asset turnover (x)	1.5	1.4	1.4	1.4	1.4
Net gearing ratio (%)	30	30	16	6	(3)
Returns (%)					
Adj. ROAE	13.8	16.8	15.6	14.5	14.4
Adj. ROAA	8.2	9.9	9.4	9.2	9.6
Per share data					
Adj. EPS (US\$)	0.071	0.094	0.096	0.098	0.106
DPS (HK\$)	0.20	0.32	0.32	0.33	0.35
BVPS (US\$)	0.53	0.59	0.65	0.70	0.77

Source: Company data, CMBIS estimates

Disclosures & Disclaimers

Analyst Certification

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CMBIS Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIS

OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

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