

WH Group (288 HK) Defensive amid plight; maintain BUY

- Revenue growth momentum picked up in 2Q19 to 5.3% YoY vs -6.0% YoY in 1Q19; revenue growth of packaged meat and fresh meat segments was 3.4% YoY and 8.2% YoY in 2Q19
- 1H19 margins were lower, 2Q19 margin performance showed signs of turnaround
- Expect FY18-21E revenue CAGR to reach 6.26% and the Group's margins would benefit from the US-China hog price gap
- Maintain **BUY**; current TP represents 17.29x/13.49x 19E/20E P/E or 1.93x/1.72x 19E/20E P/B

Growth momentum accelerated in 2Q19. 1H19 revenue edged down by 0.4% YoY; revenue of packaged meat and hog production was down by 0.3% YoY and 17.1% YoY, while revenue of fresh pork segment increased by 0.2% YoY. China is the only geographical region that recorded revenue growth of 2.1% YoY in 1H19. However, overall revenue grew 5.3% YoY in 2Q19 vs. the 6.0% YoY decline in 1Q19. By product segment, 2Q19 revenue of packaged meat and fresh meat segments reversed the decline in 1Q19 and grew 3.4% YoY and 8.2% YoY; revenue decline in the hog production segment narrowed to 7.1% YoY in 2Q19 vs 27.0% YoY in 1Q19. 2Q19 revenue in China, the US and Europe all witnessed a turnaround.

Lower margins in 1H19, with signs of turnaround in 2Q19. GPM, OPM, and NPM (to owners of the Company) dropped from 20.3%, 7.8%, and 5.0% in 1H18 to 19.4%, 6.9%, and 4.2% in 1H19, respectively. In 1H19, packaged meat segment OPM declined slightly to 12.9% and hog production OPM deteriorated to -13.7%, while fresh pork OPM increased slightly to 2.2%. However, OPM and NPM (to owners of the Company) increased to 7.3% and 4.6% in 2Q19 from 6.5% and 3.7% in 1Q19; hog production's 2Q19 OPM saw significant jump to 67.2%. We believe efforts on product mix adjustments, reduction in operating expenses, and raising product prices have mitigated the impacts of rising costs and trade tensions between China and the US.

FY18-21E revenue CAGR to reach 6.3%. For FY18-21E, we expect the Group's revenue CAGR in packaged meat, fresh pork, and hog production to be 7.3%, 5.1%, and 7.5%. Revenue CAGRs in China, the US, and Europe would be 4.9%, 6.8%, and 9.0%, respectively, while GPM and NPM (to owners of the Company) would reach 22.6% and 5.6% in 2021E. We expect the Group would be able to mitigate the rising raw material costs and the challenging trade environment.

TP at HK\$ 8.8; maintain BUY. We maintain **BUY** since business performance improved in 2Q19 and the Group would be able to leverage its operations in China and the US. Our DCF-derived TP is HK\$ 8.8, which was lower than our previous TP as we have concerns over the uncertainty of the trade relation between China and the US and whether the Group's pricing increase would catch up with the rising raw material costs in China. Current TP represents 17.29x/13.49x 19E/20E P/E or 1.93x/1.72x 19E/20E P/B.

Risk factors: 1) Macroeconomic risk; 2) Regulatory/policy risk; 3) Risk of revenue and profit loss over trade war; 4) Product quality/safety risk; 4) Risk of changing consumer tastes; 5) Commodity price risk; 6) Foreign exchange risk; 7) Interest rate risk

Results and Valuation

FY ended Dec 31	2017A	2018A	2019E	2020E	2021E
Revenue (US\$ mn)	22,379	22,605	23,711	25,266	27,121
Chg (% YoY)	3.92	1.01	4.89	6.56	7.34
Net Profit (to owners of the Company)(US\$ mn)	1,133	922	955	1,224	1,506
Chg (% YoY)	9.36	(18.64)	3.59	28.18	23.00
Basic EPS (US\$)	0.0754	0.0643	0.0649	0.0832	0.1023
Chg (% YoY)	(0.53)	(14.72)	0.95	28.18	23.00
P/E (x)	11.28	13.23	13.10	10.22	8.31
BVPS (US\$)	0.5082	0.5278	0.5823	0.6534	0.7411
P/B (x)	1.67	1.61	1.46	1.30	1.15
DPS(HK\$)	0.27	0.20	0.20	0.26	0.32
Yield (%)	4.05	3.00	3.05	3.91	4.81
ROAA (%)	9.14	7.55	7.26	8.22	8.99
ROAE (%)	16.47	12.14	11.71	13.47	14.68

Source(s): Bloomberg, ABCI Securities estimates

Company Report Aug 22, 2019

Rating: **BUY**
TP: HK\$ 8.8

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Share price (HK\$)	6.67
52Wk H/L(HK\$)	9.95/5.11
Est. share price return	31.93%
Est. dividend yield	3.90%
Est. total return	35.83%
Previous Rating&TP	BUY; HK\$9.14
Previous report date	Apr 4, 2018

Source(s): Bloomberg, ABCI Securities

Key Data

Issued shares (mn)	14,710.62
Market cap (HK\$ mn)	98,119.84
3-mth ADT (HK\$ mn)	329.64

Major shareholders

	(%)
Heroic Zone	23.61
Wan Long	6.29
Mondrian Investment Partners	4.99

Source(s): Bloomberg, HKEX

% of total revenue

	FY19E
Packaged meat	54.08
Fresh Pork	40.23
Hog production	3.26

Source(s): ABCI Securities estimates

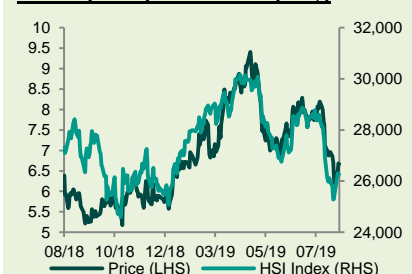
Sector Performance (%)

	Absolute	Relative*
1-mth	(15.03)	(6.36)
3-mth	(4.63)	0.83
6-mth	(8.98)	(1.11)

* Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year price performance(HK\$)



Source(s): Bloomberg, ABCI Securities

* All pricing and market data as of closing of Aug 21, 2019

** Gross and operating profits discussed in the report are before biological adjustment

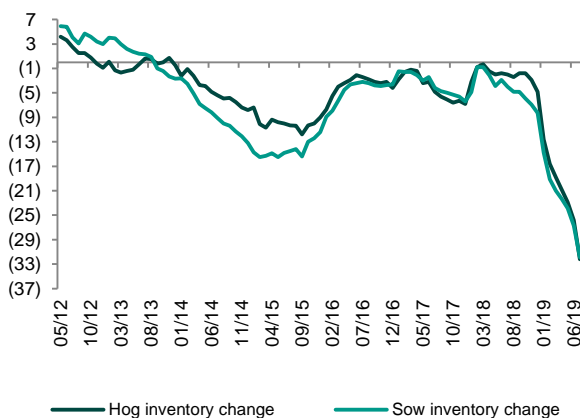
*** Net profits are after biological adjustment

US-China market – a brief discussion

US-China hog price gap is advantageous to the Group. Hog price in China and the US have been trending in opposite directions, as the African Swine Flu (ASF) situation in China has been limiting hog supply, while supply in the US has been increasing. Hog and sow inventories in China declined by 25.8% YoY and 26.7% YoY in Jun 2019, while hog inventory in the US increased by 3.64% YoY in 2Q19. As of the 1st week of Aug 2019, hog wholesale price in China reached RMB 19.21/kg, up 38.5% YTD or 45.0% YoY; piglet wholesale price in China reached RMB 44.19/kg, up 96.6% YTD or 75.4% YoY. The hog price in the US declined by 2.8% YoY in Jun 2019, reaching a price of US\$ 1.28/kg. We believe if the Group can continue to leverage on its upstream operation in the US and the US-China hog price gap, its margins would improve further.

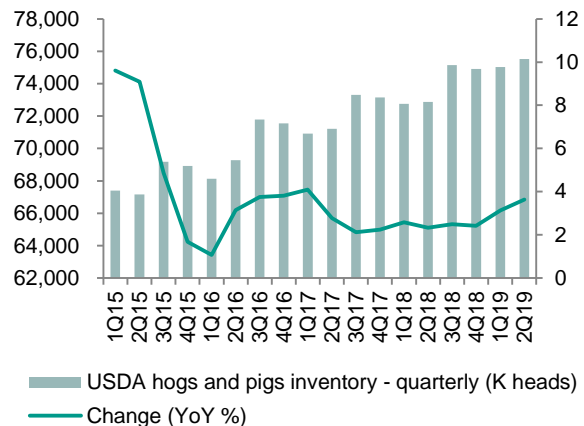
China is still importing pork from the US. According to USDA, China's imports of US pork and variety meat have been trending up in 1H19. For pork, import volume in Jun 2019 rose by 234.7% YoY (Jun 2018: -41.4% YoY) and 6M19 import volume increased by 37.3% YoY (6M18: -14.1% YoY). For variety meat, import volume in Jun 2019 increased by 49.5% YoY (Jun 2018: -33.7% YoY) and 6M19 import volume increased by 10.5% YoY (Jun 2018: -25.9% YoY). Despite additional tariffs have been imposed on pork and related products amid the ongoing Sino-US trade talk, the straining supply of hog in China and the price gap between the two countries are driving up US export to China. We expect the low hog inventory and the rising hog price would mean more reliance on import for China in the medium term, which would benefit the Group.

Exhibit 1: Hog & sow inventory in China (YoY %)



Source(s): MOA, ABCI Securities

Exhibit 2: Hog inventory in the US



Source(s): USDA, Bloomberg, ABCI Securities

Exhibit 3: Hog wholesale price in China (RMB/kg)



Source(s): MOA, ABCI Securities

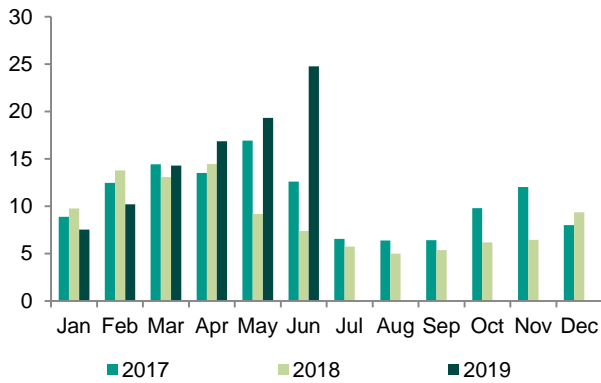
Exhibit 4: Hog prices received by farmers (barrows, gilts, and sows) in the US (US\$/kg)



Source(s): USDA, Bloomberg, ABCI Securities

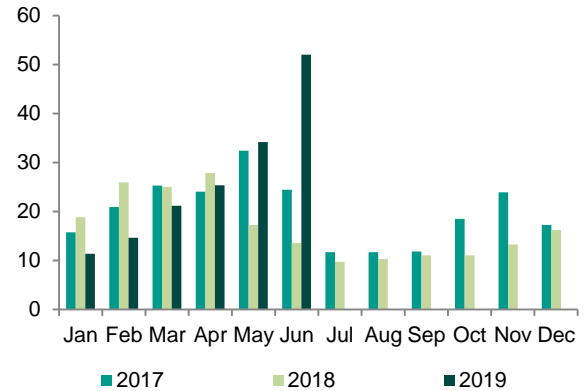


Exhibit 5: US pork export volume to China (k metric tonne)



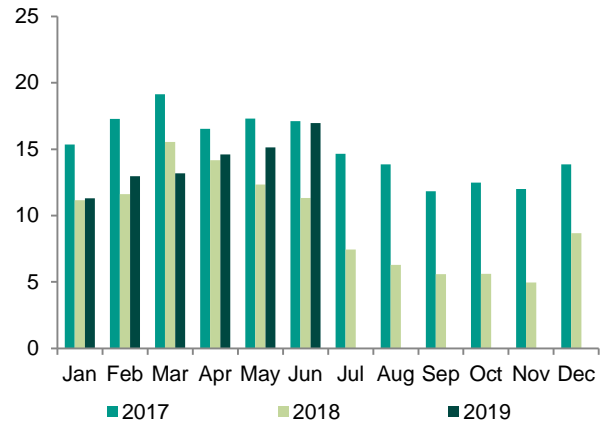
Source(s): USDA, Bloomberg, ABCI Securities

Exhibit 6: US pork export value to China (US\$ mn)



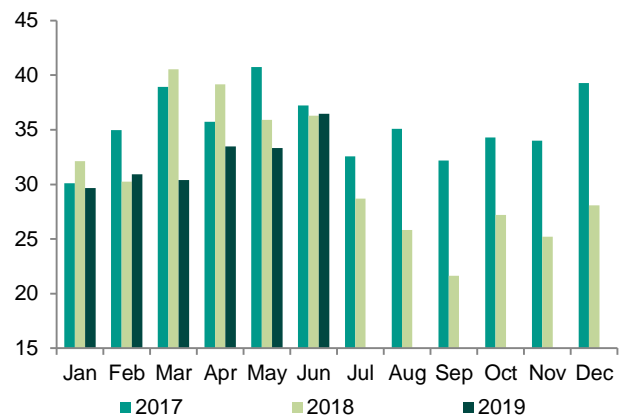
Source(s): USDA, Bloomberg, ABCI Securities

Exhibit 7: US pork variety meat export volume to China (k metric tonne)



Source(s): USDA, Bloomberg, ABCI Securities

Exhibit 8: US pork variety meat export value to China (US\$ mn)



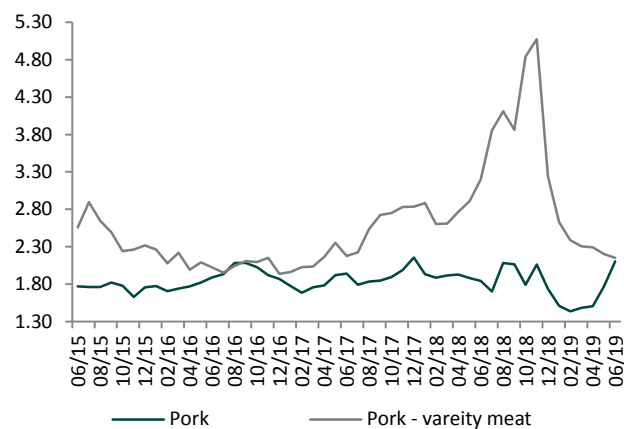
Source(s): USDA, Bloomberg, ABCI Securities

Exhibit 9: Pork wholesale price in China (RMB/kg)



Source(s): MOA, ABCI Securities

Exhibit 10: ASP of pork and variety meat exported from US to China (US\$/kg)



Source(s): USDA, Bloomberg, ABCI Securities

Quarterly performance breakdown

Exhibit 11: Quarterly figures of WH Group (US\$ mn)								
	1Q18	2Q18	1Q19	2Q19	1Q18	2Q18	1Q19	2Q19
	Revenue				OP ⁽¹⁾			
Total	5,620	5,549	5,282	5,845	379	488	341	424
By product								
Packaged meat	2,980	2,921	2,866	3,020	362	426	397	364
Fresh pork	2,305	2,284	2,129	2,471	56	37	148	(45)
Hog production	200	197	146	183	(13)	35	(168)	123
Others	135	147	141	171	(26)	(10)	(36)	(18)
By geo								
China	1,878	1,791	1,764	1,981	214	260	223	202
US	3,292	3,265	3,093	3,353	141	189	110	184
Others	450	493	425	511	24	39	8	38

Notes: 1) Data are measured prior to biological adjustment

Source(s): The Group, ABCI Securities

Exhibit 12: Quarterly performance of WH Group												
	1Q18	2Q18	1Q19	2Q19	1Q18	2Q18	1Q19	2Q19	1Q18	2Q18	1Q19	2Q19
	Revenue growth (YoY %)				Operating profit growth ⁽¹⁾ (YoY %)				OP Margins ⁽¹⁾ (%)			
Total	5.66	3.93	(6.01)	5.33	(9.33)	1.04	(10.03)	(13.11)	6.74	8.79	6.46	7.25
By product												
Packaged meat	10.17	3.69	(3.83)	3.39	12.07	17.36	9.67	(14.55)	12.15	14.58	13.85	12.05
Fresh pork	(1.66)	(0.52)	(7.64)	8.19	(54.47)	(69.67)	164.29	(221.62)	2.43	1.62	6.95	(1.82)
Hog production	20.48	80.73	(27.00)	(7.11)	(200.00)	(2.78)	1,192.31	251.43	(6.50)	17.77	(115.07)	67.21
By Geo												
China	6.46	4.19	(6.07)	10.61	34.59	30.12	4.21	(22.38)	11.40	14.53	12.64	10.20
US	2.52	1.59	(6.04)	2.70	(39.74)	(20.45)	(21.99)	(2.81)	4.28	5.80	3.56	5.49
Others	30.81	21.43	(5.56)	3.65	(4.00)	(13.33)	(66.67)	(2.56)	5.33	7.91	1.88	7.44

Notes: 1) Data are measured prior to biological adjustment;

Source(s): The Group, ABCI Securities

Financial Statements

Consolidated income statement (2017A-2021E)

FY ends at Dec 31 (US\$ mn, except per share data)	2017A	2018A	2019E	2020E	2021E	1H18A	1H19A
Revenue	22,379	22,605	23,711	25,266	27,121	11,169	11,127
- Packaged meat	11,777	12,147	12,822	13,785	15,012	5,901	5,886
- Fresh pork	9,526	9,136	9,538	10,030	10,601	4,589	4,600
- Hog production	572	688	774	834	854	397	329
- Others	504	634	577	616	654	282	312
COGS	(18,061)	(17,907)	(19,007)	(19,980)	(21,041)	(8,828)	(8,665)
Gross profit	4,318	4,698	4,704	5,286	6,080	2,341	2,462
Distribution and selling expenses	(1,930)	(2,139)	(2,251)	(2,419)	(2,612)	(1,035)	(1,017)
Admin expenses	(823)	(732)	(764)	(811)	(867)	(376)	(381)
Biological adjustment	318	(339)	(32)	35	(57)	(139)	(174)
Others	(206)	3	12	18	16	18	(10)
Operating profit	1,677	1,491	1,669	2,108	2,560	809	880
- Packaged meat	1,435	1,547	1,651	1,737	1,912	788	761
- Fresh pork	547	246	288	364	429	93	103
- Hog production	56	(113)	(53)	(45)	(41)	22	(45)
- Others	(177)	(30)	(154)	53	260	(36)	(54)
Net finance cost	(198)	(115)	(197)	(235)	(240)	(55)	(70)
Share of profits from JV and associates	22	35	43	51	59	21	6
Pretax profit	1,501	1,411	1,516	1,925	2,378	775	816
Tax	(182)	(258)	(314)	(389)	(486)	(158)	(146)
Net profit	1,319	1,153	1,202	1,536	1,892	617	670
- Profit attributable to shareholders	1,133	922	955	1,224	1,506	514	569
- Minority interest	186	243	253	324	399	103	101
EPS							
- Basic (US cent)	7.54	6.43	6.49	8.32	10.23	3.50	3.87
- Diluted (US cent)	7.76	6.19	6.36	8.15	10.02	3.47	3.85
DPS (HK cent)	27.00	20.00	20.36	26.10	32.10	5.00	5.00

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2017A-2021E)

FY ends at Dec 31 (US\$ mn)	2017A	2018A	2019E	2020E	2021E	1H18A
Bank balance and cash	1,371	525	1,256	1,845	2,674	358
Trade and bills receivable	989	1,135	923	1,109	1,158	1,012
Inventory	1,905	2,022	2,891	2,063	3,027	2,605
ST Biological assets	990	947	1,686	2,912	3,114	1,088
Others	418	838	331	278	525	990
Total current assets	5,673	5,467	7,087	8,207	10,499	6,053
PP&E	5,037	5,300	6,054	6,546	7,095	5,427
LT Biological assets	181	147	302	501	525	148
Goodwill	1,838	1,847	1,847	1,847	1,847	1,961
Intangible assets	1,742	1,734	1,592	1,563	1,533	1,723
Interest in JV and associates	295	352	377	404	433	277
Others	492	451	540	507	562	864
Total non-current assets	9,585	9,831	10,711	11,367	11,996	10,400
Total assets	15,258	15,298	17,798	19,574	22,494	16,453
Trade and bills payable	1,076	977	1,296	830	1,575	749
ST borrowings	901	860	1,431	1,604	1,840	1,316
Others	1,522	1,491	1,799	1,717	1,680	1,519
Total current liabilities	3,499	3,328	4,527	4,151	5,095	3,584
LT Borrowings	2,297	2,259	2,643	2,963	3,399	2,192
Others	1,240	1,293	1,138	1,599	1,451	1,687
Total non-current liabilities	3,537	3,552	3,781	4,562	4,850	3,879
Shareholders' equity	7,445	7,746	8,566	9,612	10,902	8,287
Minority interest	777	672	925	1,249	1,647	703
Total equity	8,222	8,418	9,491	10,861	12,549	8,990
Total liabilities and equity	15,258	15,298	17,798	19,574	22,494	16,453

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2017A-2021E)

FY ends at Dec 31 (US\$ mn)	2017A	2018A	2019E	2020E	2021E	1H18A	1H19A
Pretax profit	1,501	1,411	1,516	1,925	2,378	775	816
Depreciation and amortization	389	437	331	342	344	216	221
Change in working capital	(321)	(570)	(608)	(1,155)	(736)	(754)	(966)
Others	(57)	(23)	(262)	(359)	(434)	(103)	328
Cash flow from operating activities	1,512	1,255	976	753	1,552	134	399
Capex	(563)	(811)	(979)	(1,033)	(1,120)	(326)	(272)
Others	(221)	(406)	274	850	311	(161)	(268)
Cash flow from investing activities	(784)	(1,217)	(705)	(184)	(808)	(487)	(540)
Change in borrowings	64	4	955	493	672	184	389
Others	(655)	(794)	(478)	(492)	(602)	(549)	(390)
Cash flow from financing activities	(591)	(790)	477	0	70	(365)	(1)
Net change in cash	137	(752)	748	570	813	(718)	(142)
ForEx effect	19	(43)	(14)	(7)	(27)	(27)	(1)
Cash at the end of FY	1,279	484	1,218	1,780	2,567	534	341

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2017A-2021E)

FY ends at Dec 31	2017A	2018A	2019E	2020E	2021E	1H18A	1H19A
Growth (YoY %)							
Revenue	3.92	1.01	4.89	6.56	7.34	4.79	(0.38)
- Packaged meat	6.35	3.14	5.56	7.51	8.90	6.86	(0.25)
- Fresh pork	3.79	(4.09)	4.40	5.16	5.69	(1.10)	0.24
- Hog production	(32.23)	20.28	12.46	7.76	2.44	44.36	(17.13)
Gross profit	3.40	1.90	4.82	5.47	4.85	5.06	0.70
Operating profit	4.08	(11.34)	4.97	21.73	21.42	(7.54)	(13.66)
Net profit (to owners of the company)	9.36	(18.64)	3.59	28.18	23.00	(7.72)	10.70
Profitability ratios (%)							
GPM	20.61	19.92	19.97	20.78	22.62	20.27	19.41
OPM	8.32	7.30	7.30	8.34	9.44	7.76	6.88
- Packaged meat	12.18	12.74	12.87	12.60	12.74	13.35	12.93
- Fresh pork	5.74	2.69	3.02	3.63	4.05	2.03	2.24
- Hog production	9.79	(16.42)	(6.82)	(5.38)	(4.77)	5.54	(13.68)
EBITDA margin	10.49	9.32	7.30	8.07	9.85	9.95	9.27
NPM (to owners of the company)	5.06	4.08	4.03	4.84	5.55	4.99	4.16
Revenue contribution (%)							
Packaged meat	52.63	53.74	54.08	54.56	55.35	52.83	52.90
Fresh pork	42.57	40.42	40.23	39.70	39.09	41.09	41.34
Hog production	2.56	3.04	3.26	3.30	3.15	3.55	2.96
Return ratios (%)							
ROAA	9.14	7.55	7.26	8.22	8.99	6.85	7.17
ROAE	16.47	12.14	11.71	13.47	14.68	13.76	14.20
Liquidity ratio (x)							
Current ratio	1.62	1.64	1.57	1.98	2.06	1.58	1.69
Quick ratio	0.79	0.75	0.55	0.78	0.86	0.66	0.66
Cash ratio	0.41	0.17	0.29	0.46	0.54	0.22	0.11
Cash conversion cycle (days)							
Days of outstanding receivable	14	17	16	15	15	16	18
Days of inventory on hand	37	40	47	45	44	40	47
Days of outstanding payable	19	21	21	20	20	22	19
CCC	32	36	42	39	39	35	46
Leverage ratios (%)							
Total debt/Equity	42.96	40.27	42.93	42.05	41.75	44.96	42.33
Total debt/Total assets	20.96	20.39	22.89	23.33	23.29	22.81	21.32

* Excluding measures relating to NP (to owners of the Company), all other measures are pre-bio. adj.

Source(s): Company, ABCI Securities estimates



Disclosures

Analyst Certification

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate (10%)
Hold	- Market return (-10%) \leq Stock return < Market return rate (10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2005 (HSI total return index 2005-17 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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