WH Group (288 HK)

The new HSI constituent riding on improving fundamentals

- 1H17 results show steady margin improvement despite slower growth in 2Q17
- Geographical segments showed varying signs of improvement
- Working capital management was efficient, but leverage slightly increased
- Maintain **BUY;** upgrade TP on strong fundamentals and inclusion as an HSI constituent stock; current TP represents 16.27x/15.21x FY17E/18E P/E and 2.58x/2.44x FY17E/FY18E P/B

1H17 saw steady growth; better margins in 2Q17. The Group's topline growth reached 1.96% YoY in 1H17. The slower growth of 0.79% YoY in 2Q17 was attributable to the revenue decline in fresh pork (-3.73% YoY) and hog production (-29.68% YoY). However, the packaged meat segment saw a revenue growth of 6.34% YoY in 2Q17 mainly on accelerating growth in the U.S. market. Overall OPM for the quarter increased to 9.05%, while the OPM of packaged meat, fresh pork, and hog production segments increased to 12.89%, 5.31%, and 33.03%.

Different markets, different dynamics. Revenue of the China segment was down 10.53% YoY in 1H17, but OPM of the packaged meat and fresh pork segments in the region improved to 21.68% and 2.97% in 2Q17, reflecting lower cost pressure that may extend into 2H17. The U.S. market topline grew by 8.92% YoY in 1H17, which was affected by the lower growth of 7.28% YoY in 2Q17, and the region's 1H17 OPM improved to 7.35%. The European market saw a revenue growth of 13.46% YoY in 1H17, mainly supported by the fresh pork and hog production segments; the region's 1H17 OPM also improved to 9.33%, which was mainly supported by the hog production segment.

Working capital management remained efficient, but leverage slightly increased. Inventory turnover days were stable at 38. Payable turnover days increased to 18, and the receivable turnover days increased slightly to 14, resulting in a shorter CCC of 34 days (37 days in 1H16). The Group' net debt reduced to US$ 2,800mn by end-1H17 vs. US$ 3,227mn by end-1H16, but increased compared to US$ 1,688mn by end-FY16. Total debt/equity ratio increased to 51.06% by end-1H17 from 45.57% by end-FY16. .

Further improvement can be expected. The 1H17 results indicated possible turnaround in the U.S. and European markets, and the China market would continue to improve on lower cost pressure. For 2016-19E, we expect the Group's revenue, GP, and NP (to owners of the company) would expand at 6.23%, 5.24%, and 5.27% CAGRs. GPM and NPM (to owners of the company) would remain steady in 2017E-19E.

Maintain BUY; upgrade TP to HK$ 9.14. We upgrade the Group's TP on improving fundamentals in 1H17 and the recent inclusion as an HSI constituent stock - a move that would increase institutional holdings of the Group's shares. Current TP represents 16.27x/15.21x FY17E/18E P/E and 2.58x/2.44x FY17E/FY18E P/B. Maintain **BUY**.

Risk factors: 1) Macroeconomic risk; 2) Regulatory/policy risk; 3) Product quality/safety risk; 4) Risk of changing consumer tastes; 5) Commodity price risk; 6) Foreign exchange risk; 7) Interest rate risk; 8) Dilution of ROE resulted from deleveraging

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (US$ mn)	**21,209**	**21,534**	**22,541**	**23,841**	**25,816**
Chg (%,YoY)	*(4.65)*	*1.53*	*4.68*	*5.76*	*8.28*
Net Profit (US$ mn)	**786**	**1,036**	**1,060**	**1,133**	**1,209**
Chg (%,YoY)	*2.61*	*31.81*	*2.29*	*6.92*	*6.67*
Basic EPS (US$)	**0.0575**	**0.0758**	**0.0723**	**0.0773**	**0.0825**
Chg (% YoY)	*(10.71)*	*31.83*	*(4.58)*	*6.92*	*6.67*
P/E (x)	*18.56*	*14.08*	*14.75*	*13.80*	*12.93*
BVPS (US$)	0.3934	0.4312	0.4556	0.4818	0.5094
P/B (x)	*2.71*	*2.47*	*2.34*	*2.21*	*2.09*
DPS(HK$)	0.13	0.26	0.18	0.19	0.21
Yield (%)	*1.51*	*3.14*	*2.18*	*2.34*	*2.57*
ROAA (%)	6.86	8.87	9.84	9.91	10.19
ROAE (%)	14.43	17.15	16.31	16.50	16.65

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Aug 30, 2017

Rating: BUY

TP: HK$ 9.14

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Share price (HK$)	8.29
52Wk H/L(HK$)	8.45/5.66
Est. share price return	10.25%
Est. dividend yield	3.14%
Est. total return	13.39%
Previous Rating&TP	BUY; HK$7.68
Previous report date	May 5, 2017

Source(s): Bloomberg, ABCI Securities

Key Data	
Issued shares (mn)	14,652.87
Market cap (HK$ mn)	121,032.69
3-mth ADT (HK$ mn)	290.81

Major shareholders	(%)
Rise Grand	36.00
Wan Long	18.58
Teeroy Limited	6.88

Source(s): Bloomberg, HKEX

% of total revenue	FY17E
Packaged meat	51.07
Fresh Pork	43.02
Hog production	3.85

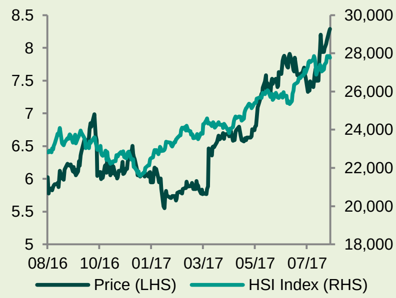
Source(s): ABCI Securities estimates

Sector Performance (%)

	Absolute	Relative*
1-mth	9.40	4.91
3-mth	14.72	3.32
6-mth	40.11	18.73

* 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 30, 2017

Exhibit 1: ASP and volume growth assumptions

(YoY %)	FY15A	FY16A	FY17E	FY18E	FY19E
ASP					
Packaged meat	(4.08)	(2.35)	2.98	2.16	2.80
Fresh pork	(10.77)	(0.34)	(4.79)	1.42	2.33
Hog production	56.35	(15.29)	(5.25)	(11.28)	(8.31)
Volume					
Packaged meat	(1.36)	0.89	2.45	3.95	6.55
Fresh pork	2.82	7.20	9.87	4.40	5.03
Hog production	7.87	0.64	(4.59)	4.30	3.38

Source(s): The Group, ABCI Securities estimates

Exhibit 2: Quarterly OPM* of segments

(%)	1Q16	2Q16	1Q17	2Q17
By product segment				
Packaged meat	15.34	13.44	11.94	12.89
China	24.45	21.31	18.80	21.68
U.S.	11.69	10.14	9.64	9.81
Others	7.46	5.88	4.62	3.11
Fresh pork	5.14	3.27	5.25	5.31
China	1.30	2.28	2.08	2.97
U.S.	9.94	4.84	8.43	7.39
Others	(0.88)	(2.94)	(0.67)	1.19
Hog production	(46.63)	21.94	7.83	33.03
China	300.00	300.00	266.67	200.00
U.S.	(55.26)	9.86	(10.46)	(5.32)
Others	(112.50)	(11.11)	110.00	191.67
By geo segment				
China	10.73	10.53	9.01	11.63
US	6.61	7.04	7.29	7.41
Others	2.61	3.66	7.27	11.08

* Before biological fair value adjustments
Source(s): The Group, ABCI Securities

Exhibit 3: Quarterly revenue and OP* growth

(YoY %)	1Q17	2Q17
Revenue	3.16	0.79
By product segment		
Packaged meat	0.45	6.34
Fresh pork	6.55	(3.73)
Hog production	1.84	(29.68)
By geo segment		
China	(9.40)	(11.66)
U.S.	10.61	7.28
Others	12.42	14.37
Operating profit	2.20	12.59
By product segment		
Packaged meat	(21.79)	1.97
Fresh pork	8.85	56.41
Hog production	(117.11)	5.88
By geo segment		
China	(23.92)	(2.44)
US	21.88	12.80
Others	212.50	246.15

* Before biological fair value adjustments
Source(s): The Group, ABCI Securities

Consolidated income statement (2015A-2019E)

FY ends at Dec 31 (US$ mn, except per share data)	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Revenue	**21,209**	**21,534**	**22,541**	**23,841**	**25,816**	**10,453**	**10,658**
- Packaged meat	11,240	11,074	11,683	12,406	13,588	5,342	5,522
- Fresh pork	8,591	9,178	9,601	10,165	10,925	4,585	4,640
- Hog production	990	844	763	706	669	318	275
- Others	388	438	495	563	633	208	221
COGS	(17,129)	(17,327)	(18,108)	(19,074)	(20,696)	(8,417)	(8,621)
Gross profit	**4,080**	**4,207**	**4,433**	**4,767**	**5,119**	**2,036**	**2,037**
Distribution and selling expenses	(1,783)	(1,794)	(1,857)	(1,968)	(2,131)	(854)	(919)
Admin expenses	(740)	(748)	(795)	(842)	(912)	(339)	(357)
Biological adjustment	(63)	170	113	(51)	(50)	135	244
Others	13	18	53	75	67	14	36
Operating profit	**1,507**	**1,853**	**1,947**	**1,980**	**2,093**	**992**	**1,041**
- Packaged meat	1,499	1,475	1,495	1,632	1,779	769	686
- Fresh pork	226	545	456	451	551	191	245
- Hog production	54	(40)	36	13	4	(42)	49
- Others	(222)	(192)	(40)	(115)	(240)	(80)	(79)
Net finance cost	(219)	(183)	(183)	(112)	(98)	(96)	(140)
Share of profits from JV and associates	14	33	37	43	51	17	10
Pretax profit	**1,302**	**1,703**	**1,800**	**1,911**	**2,046**	**913**	**911**
Tax	(307)	(465)	(458)	(494)	(525)	(261)	(274)
Net profit	**995**	**1,238**	**1,342**	**1,417**	**1,521**	**652**	**653**
- Profit attributable to shareholders	786	1,036	1,060	1,133	1,209	551	557
- Minority interest	209	202	283	299	320	101	80
EPS							
- Basic (US$ cent)	5.75	7.58	7.23	7.73	8.25	4.03	4.07
- Diluted (US$ cent)	5.50	7.25	7.17	7.66	8.17	3.85	3.89
DPS (HK$ cent)	**12.5**	**26.00**	**18.05**	**19.42**	**21.30**	**5.00**	**5.00**

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2015A-2019E)

FY ends at Dec 31 (US$ mn)	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Cash and cash equivalent	1,137	1,139	848	1,816	1,533	515	551
Trade and bills receivable	725	793	673	943	772	791	887
Inventory	1,748	1,678	1,806	1,875	2,148	1,750	1,808
ST Biological assets	865	933	1,180	1,240	1,361	1,016	1,046
Others	738	305	212	331	235	897	574
Total current assets	**5,213**	**4,848**	**4,720**	**6,204**	**6,048**	**4,969**	**4,866**
PP&E	4,674	4,529	4,514	4,520	4,555	4,644	4,808
LT Biological assets	200	186	255	267	286	191	189
Goodwill	1,801	1,784	1,784	1,784	1,784	1,797	1,823
Intangible assets	1,715	1,681	1,653	1,622	1,592	1,703	1,730
Interest in JV and associates	185	181	195	210	226	182	203
Others	513	402	544	328	428	387	425
Total non-current assets	**9,088**	**8,763**	**8,945**	**8,731**	**8,871**	**8,904**	**9,178**
Total assets	**14,301**	**13,611**	**13,665**	**14,935**	**14,919**	**13,873**	**14,044**
Trade and bills payable	812	854	902	975	1,063	491	615
ST borrowings	606	1,011	775	675	586	1,412	1,131
Others	1,441	1,458	1,555	1,664	1,794	1,388	1,347
Total current liabilities	**2,859**	**3,323**	**3,231**	**3,314**	**3,443**	**3,291**	**3,093**
LT Borrowings	3,308	1,867	1,430	1,246	1,083	2,338	2,263
Others	1,431	1,383	1,323	2,013	1,307	1,351	1,388
Total non-current liabilities	**4,739**	**3,250**	**2,753**	**3,259**	**2,390**	**3,689**	**3,651**
Shareholders' equity	5,763	6,316	6,676	7,059	7,463	6,086	6,647
Minority interest	940	722	1,005	1,303	1,624	807	65
Total equity	**6,703**	**7,038**	**7,680**	**8,362**	**9,086**	**6,893**	**6,712**
Total liabilities and equity	**14,301**	**13,611**	**13,665**	**14,935**	**14,919**	**13,873**	**13,456**

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2015A-2019E)

FY ends at Dec 31 (US$ mn)	2015A	2016E	2017E	2018E	2019E	1H16	1H17
Pretax profit	1,302	1,703	1,800	1,911	2,046	913	911
Depreciation and amortization	391	372	453	484	520	190	191
Change in working capital	191	30	(85)	(317)	84	(619)	(758)
Others	(271)	(255)	(410)	(465)	(501)	(130)	(290)
Cash flow from operating activities	**1,613**	**1,850**	**1,759**	**1,612**	**2,148**	**354**	**54**
Capex	(629)	(451)	(551)	(667)	(757)	(208)	(174)
Others	115	310	(17)	(47)	(26)	(141)	(370)
Cash flow from investing activities	**(514)**	**(141)**	**(568)**	**(714)**	**(783)**	**(349)**	**(544)**
Change in borrowings	(744)	(1,036)	(673)	(284)	(251)	(194)	516
Others	(157)	(637)	(529)	(484)	(498)	(456)	(658)
Cash flow from financing activities	**(901)**	**(1,673)**	**(1,203)**	**(768)**	**(749)**	**(650)**	**(142)**
Net change in cash	**198**	**36**	**(11)**	**130**	**616**	**(645)**	**(632)**
ForEx effect	(31)	(38)	1	(11)	(39)	(15)	38
Cash at the end of FY	**1,125**	**1,123**	**1,113**	**1,232**	**1,808**	**465**	**529**

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2015A-2019E)

FY ends at Dec 31	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Growth (YoY %)							
Revenue	(4.65)	1.53	4.68	5.76	8.28	2.43	1.96
- Packaged meat	(5.39)	(1.48)	5.50	6.19	9.53	0.66	3.37
- Fresh pork	(8.26)	6.83	4.60	5.88	7.48	9.93	1.20
- Hog production	68.65	(14.75)	(9.60)	(7.46)	(5.21)	(41.54)	(13.52)
Gross profit	(5.96)	0.69	4.78	6.21	8.48	1.76	0.84
Operating profit	(2.91)	11.87	6.07	2.31	5.71	13.00	8.40
Net profit (to owners of the company)	2.61	31.81	2.29	6.92	6.67	81.85	1.09
Profitability ratios (%)							
GPM	19.54	20.21	20.13	19.79	19.65	19.59	20.47
OPM	7.34	8.30	8.64	8.31	8.11	8.02	8.45
- Packaged meat	13.34	13.32	12.80	13.15	13.09	14.40	12.42
- Fresh pork	2.63	5.94	4.75	4.44	5.04	4.17	5.28
- Hog production	5.45	(4.74)	4.73	1.81	0.60	(13.21)	17.82
EBITDA margin	9.64	10.39	8.60	8.32	8.12	10.29	10.72
NPM (to owners of the company)	3.71	4.81	4.70	4.75	4.68	5.27	5.23
Revenue contribution (%)							
Packaged meat	53.00	51.43	51.83	52.04	52.64	51.10	51.81
Fresh pork	40.51	42.62	42.59	42.64	42.32	43.86	43.54
Hog production	4.67	3.92	3.38	2.96	2.59	3.04	2.58
Return ratios (%)							
ROAA	6.86	8.87	9.84	9.91	10.19	7.91	7.98
ROAE	14.43	17.15	16.31	16.50	16.65	18.60	17.19
ROIC	9.69	12.55	17.64	25.35	28.25	10.44	10.93
Liquidity ratio (x)							
Current ratio	1.82	1.46	1.46	1.87	1.76	1.51	1.57
Quick ratio	0.91	0.67	0.54	0.93	0.74	0.67	0.65
Cash ratio	0.40	0.36	0.27	0.56	0.45	0.16	0.19
Cash conversion cycle (days)							
Days of outstanding receivable	13	13	12	12	12	13	14
Days of inventory on hand	39	36	35	35	35	38	38
Days of outstanding payable	18	18	18	18	18	14	18
CCC	35	32	30	30	30	37	34
Leverage ratios (%)							
Total debt/Equity	67.92	45.57	28.71	22.97	18.37	61.62	51.06
Total debt/Total assets	27.37	21.14	16.13	12.86	11.19	27.03	24.17

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

Source(s): Company, ABCI Securities estimates

Disclosures

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Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate
Hold	Market return – 6% ≤ Stock return < Market return rate
Sell	Stock return < Market return – 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months
Market return: 5-year average market return rate
Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	2.6 ≤180 day volatility/180 day benchmark index volatility
High	1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 ≤180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index. Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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