

WH Group (288 HK) FY17 performance supports further growth

- Growth momentum extended in FY17 as revenue growth increased to 3.9%
- Margin improved in FY17; GPM and NPM (to owners of the Company) rose to 20.61% and 5.06%
- Impact from Sino-US trade war would have minimal impact on the Group
- Maintain **BUY**; current TP represents 13.40x/11.91x 18E/19E P/E, or 2.19x/2.08x 18E/19E P/B

Growth momentum picked up in FY17. Revenue growth improved from 1.5% YoY in FY16 to 3.9% YoY in FY17, mainly due to the 6.4% YoY increase in packaged meat segment. Regionally, revenue from the US and Europe rose 7.4% YoY and 17.4% YoY while that from China declined by 4.2% YoY.

Margin improvement extended to FY17. GPM and OPM went up slightly to 20.61% (FY16: 20.21%) and 8.32% (FY16: 8.30%) in FY17. Improved OPM was mainly driven by hog production segment, whose OPM turned positive in FY17. SG&A/sales ratio rose to 12.3% in FY17 from 11.8% in FY16, hence offsetting part of the gain in OP. Lower effective tax rate at 12.1% helped boost NPM (to owners of the Company) to 5.06% in FY17.

Negative impact from Sino-US trade war should be minimal. MOF announced that China will impose additional tariff on a list of products exported from the US. In particular, pork and related products would receive a 25% tariff. In 2017, US exported 173k tons of pork to China, of which 131k tons or 75.9% was accounted by Smithfield. By our calculation, pork export to China took up 16.8% of Smithfield total pork export worldwide, or less than 1% of external sales volume of its US fresh pork segment. Moreover, even with the 25% tariff increase, price of the US pork import would remain competitive against that of the domestic pork. In fact, the price gap between the US and domestic hog has widened to more than 1USD/kg with the China and US hog price being US\$2.3/kg and US\$1.2kg in 2017. Based on the above data, we estimate the entire China pork export business contributed to 0.7-1% of the Group's FY17 total revenue.

Maintain BUY with TP at HK\$ 9.14. We expect the Group's total revenue growth would pick up to 6.48% YoY in FY18E, supported by 6.71% YoY and 6.39% YoY growth in the packaged meat and fresh meat segment; GPM/NPM would steadily improve to 21.17%/5.38% in FY18E, supported by cost control measures and stable hog prices. Maintain **BUY**. Our DCF-derived TP of HK\$ 9.14 represents 13.40x/11.91x 18E/19E P/E, or 2.19x/2.08x 18E/19E P/B.

Risk factors: 1) Macroeconomic risk; 2) Regulatory/policy risk; 3) Risk of revenue 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	2016A	2017A	2018E	2019E	2020E
Revenue (US\$ mn)	21,534	22,379	23,828	25,404	27,377
Chg (% YoY)	1.53	3.92	6.48	6.61	7.77
Net Profit (US\$ mn)	1,036	1,133	1,281	1,441	1,699
Chg (% YoY)	31.81	9.36	13.09	12.48	17.88
Basic EPS (US\$)	0.0758	0.0779	0.0873	0.0982	0.1158
Chg (% YoY)	31.83	2.77	12.08	12.48	17.88
P/E (x)	14.12	13.74	12.26	10.90	9.24
BVPS (US\$)	0.4312	0.5082	0.5335	0.5630	0.5977
P/B (x)	2.48	2.11	2.01	1.90	1.79
DPS(HK\$)	0.26	0.27	0.27	0.31	0.36
Yield (%)	3.11	3.23	3.26	3.67	4.33
ROAA (%)	8.87	9.14	10.50	11.64	12.85
ROAE (%)	17.15	16.47	16.78	17.91	19.95

Source(s): Bloomberg, ABCI Securities estimates

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

*** Net profits are after biological adjustment

Company Report

Apr 4, 2018

Rating: BUY

TP: HK\$ 9.14

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Share price (HK\$)	8.36
52Wk H/L(HK\$)	9.9/6.64
Est. share price return	9.33%
Est. dividend yield	3.11%
Est. total return	12.44%
Previous Rating&TP	BUY; HK\$9.14
Previous report date	Nov 20, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

Issued shares (mn)	14,674.68
Market cap (HK\$ mn)	123,414.06
3-mth ADT (HK\$ mn)	359.71

Major shareholders

	(%)
Rise Grand	36.00
Wan Long	18.59
Teeroy Limited	6.88

Source(s): Bloomberg, HKEX

% of total revenue

	FY18E
Packaged meat	52.7
Fresh Pork	42.5
Hog production	2.4

Source(s): ABCI Securities estimates

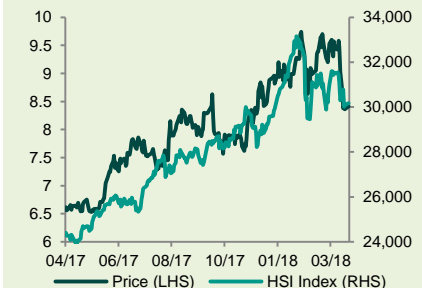
Sector Performance (%)

	Absolute	Relative*
1-mth	(11.29)	(10.16)
3-mth	(8.59)	(7.76)
6-mth	1.45	(6.39)

* 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 on Apr 3, 2018

**Exhibit 1: Smithfield's pork export to China**

	2017
China's pork import (10k tons)	121.7
China's pork import from the US (10k tons)	17.3
Smithfield's pork export (10k tons)	77.9
Smithfield's pork export to China /US pork export to China (%)	75.9
Smithfield's pork export to China (10k tons)	13.1
Smithfield's pork export to China/ Total Smithfield pork export (%)	16.8
Smithfield's pork export to China/China's total imported pork (%)	10.8

Source(s): Bloomberg, China Customs, the Group, USDA, ABCI Securities calculation

Exhibit 2: Smithfield's pork export analysis in 2017

	South Korea	Japan	Mexico	China
US export of pork (10k tons)	23.8	55.8	82.1	17.3
Smithfield's pork export to destination/US pork export to destination (%)	51.2	25.8	25.7	75.9
Smithfield's pork export to destination (10k tons)	12.2	14.4	21.1	13.1
Destination's weight of total Smithfield's export (%)	15.7	18.5	27.1	16.8

Source(s): Bloomberg, China Customs, the Group, USDA, ABCI Securities calculation

Consolidated income statement (2016A-2020E)

FY ends at Dec 31 (US\$ mn, except per share data)	2016A	2017A	2018E	2019E	2020E
Revenue	21,534	22,379	23,828	25,404	27,377
- Packaged meat	11,074	11,777	12,567	13,489	14,559
- Fresh pork	9,178	9,526	10,134	10,872	11,724
- Hog production	844	572	574	466	477
- Others	438	504	552	577	616
COGS	(17,327)	(18,061)	(18,832)	(19,983)	(21,412)
Gross profit	4,207	4,318	4,997	5,421	5,965
Distribution and selling expenses	(1,794)	(1,930)	(2,069)	(2,175)	(2,368)
Admin expenses	(748)	(823)	(841)	(896)	(966)
Biological adjustment	170	318	(50)	(55)	18
Others	18	(206)	75	66	77
Operating profit	1,853	1,677	2,112	2,361	2,727
- Packaged meat	1,475	1,435	1,653	1,854	1,926
- Fresh pork	545	547	450	548	556
- Hog production	(40)	56	113	137	124
- Others	(192)	(177)	(104)	(178)	120
Net finance cost	(183)	(198)	(142)	(105)	(91)
Share of profits from JV and associates	33	22	27	31	36
Pretax profit	1,703	1,501	1,996	2,287	2,671
Tax	(465)	(182)	(394)	(473)	(540)
Net profit	1,238	1,319	1,603	1,814	2,132
- Profit attributable to shareholders	1,036	1,133	1,281	1,441	1,699
- Minority interest	202	186	338	382	449
EPS					
- Basic (US\$ cent)	7.58	7.79	8.73	9.82	11.58
- Diluted (US\$ cent)	7.25	7.76	8.60	9.68	11.41
DPS (HK\$ cent)	26.00	27.00	27.28	30.69	36.17

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2016A-2020E)

FY ends at Dec 31 (US\$ mn)	2016A	2017A	2018E	2019E	2020E
Cash and cash equivalent	1,139	1,371	1,094	829	950
Trade and bills receivable	793	989	978	1,082	1,159
Inventory	1,678	1,905	1,880	2,097	2,174
ST Biological assets	933	990	1,328	1,715	2,304
Others	305	418	432	407	475
Total current assets	4,848	5,673	5,712	6,130	7,062
PP&E	4,529	5,037	5,080	5,310	5,559
LT Biological assets	186	181	271	335	447
Goodwill	1,784	1,838	1,838	1,838	1,838
Intangible assets	1,681	1,742	1,622	1,592	1,563
Interest in JV and associates	181	295	314	334	356
Others	402	492	442	340	481
Total non-current assets	8,763	9,585	9,567	9,750	10,243
Total assets	13,611	15,258	15,280	15,880	17,305
Trade and bills payable	854	1,076	768	1,195	902
ST borrowings	1,011	901	722	630	553
Others	1,458	1,522	1,785	1,694	2,095
Total current liabilities	3,323	3,499	3,274	3,519	3,551
LT Borrowings	1,867	2,297	1,333	1,163	1,022
Others	1,383	1,240	1,729	1,439	2,014
Total non-current liabilities	3,250	3,537	3,061	2,602	3,036
Shareholders' equity	6,316	7,445	7,829	8,262	8,771
Minority interest	722	777	1,115	1,497	1,946
Total equity	7,038	8,222	8,944	9,759	10,717
Total liabilities and equity	13,611	15,258	15,280	15,880	17,305

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2016A-2020E)

FY ends at Dec 31 (US\$ mn)	2016A	2017E	2018E	2019E	2020E
Pretax profit	1,703	1,501	1,996	2,287	2,671
Depreciation and amortization	372	337	306	346	358
Change in working capital	30	(202)	(386)	(366)	(703)
Others	(255)	(124)	(332)	(418)	(497)
Cash flow from operating activities	1,850	1,512	1,584	1,849	1,829
Capex	(451)	(563)	(818)	(759)	(789)
Others	310	(221)	846	(408)	24
Cash flow from investing activities	(141)	(784)	28	(1,168)	(765)
Change in borrowings	(1,036)	320	(1,144)	(261)	(218)
Others	(382)	(500)	(667)	(670)	(729)
Cash flow from financing activities	(255)	(411)	0	0	0
Net change in cash	(1,673)	(591)	(1,811)	(931)	(947)
ForEx effect	(1,036)	320	(1,144)	(261)	(218)
Cash at the end of FY	(637)	(911)	(667)	(670)	(729)

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2016A-2020E)

FY ends at Dec 31	2016A	2017A	2018E	2019E	2020E
Growth (YoY %)					
Revenue	1.53	3.92	6.48	6.61	7.77
- Packaged meat	(1.48)	6.35	6.71	7.33	7.93
- Fresh pork	6.83	3.79	6.39	7.28	7.84
- Hog production	(14.75)	(32.23)	0.34	(18.76)	2.36
Gross profit	0.69	3.40	5.72	6.10	7.35
Operating profit	14.84	4.08	13.48	11.81	15.47
Net profit (to owners of the company)	31.81	9.36	13.09	12.48	17.88
Profitability ratios (%)					
GPM	20.21	20.61	21.17	21.55	21.85
OPM	8.30	8.32	8.86	9.30	9.96
- Packaged meat	13.32	12.18	13.15	13.75	13.23
- Fresh pork	5.94	5.74	4.44	5.04	4.74
- Hog production	(4.74)	9.79	19.76	29.38	25.97
EBITDA margin	10.39	10.49	9.28	9.72	9.96
NPM (to owners of the company)	4.81	5.06	5.38	5.67	6.21
Revenue contribution (%)					
Packaged meat	51.4	52.6	52.7	53.1	53.2
Fresh pork	42.6	42.6	42.5	42.8	42.8
Hog production	3.9	2.6	2.4	1.8	1.7
Return ratios (%)					
ROAA	8.87	9.14	10.50	11.64	12.85
ROAE	17.15	16.47	16.78	17.91	19.95
ROIC	12.55	16.76	25.79	29.52	34.71
Liquidity ratio (x)					
Current ratio	1.46	1.62	1.74	1.74	1.99
Quick ratio	0.67	0.79	0.76	0.66	0.73
Cash ratio	0.36	0.41	0.35	0.24	0.28
Cash conversion cycle (days)					
Days of outstanding receivable	13	14	15	15	15
Days of inventory on hand	36	37	37	36	36
Days of outstanding payable	18	19	18	18	18
CCC	32	32	34	33	33
Leverage ratios (%)					
Total debt/Equity	45.6	28.7	23.0	18.4	14.7
Total debt/Total assets	21.1	21.0	13.4	11.3	9.1

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

Source(s): Company, ABCI Securities estimates



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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ 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	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 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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