

Health & Happiness (H&H) International (1112.HK)

A number of new SKUs to be launched on the coming Nov. 11, further develop offline business to combat with uncertainty of cross-border e-commerce policy

China | Consumer | Company report

29 October 2018

Investment Summary

- Interim income as of the end of June this year increased by 28.8% y.o.y to RMB 4.573 billion, and the adjusted EBITDA increased by 16.2% to RMB 1.249 billion. As the top-line growth in 1H exceeded expectations, the management team has raised the ANC(adult nutrition and care) and BNC(baby nutrition and care) business revenue growth guidelines. ANC's revenue growth guideline has been increased from 20% to over 30%, and EBITDA has remained at around 30%, milk powder in the BNC business has been increased from 15 to 20% to slightly above 20%, and the probiotics has been increased from 20 to 30% to about 30%, which is lower than the actual growth of 64% in 1H, mainly due to the one-off capture of the shortage of goods at the end of last year, as well as the base factor. BNC's EBITDA is expected to remain around 20%.

- The management team said that recent operational data was in line with expectations, and has not yet seen the impact of the trade war between China and USA on China's retailing market. We believe that the one-off factors of restocking by distributors during the launch of new registered infant formula, and the backorders placed in the fourth quarter of 2017, will not occur in 2H. We also take into account of the large base effect, and expect that the revenue growth of BNC business will slow down from 1H. However, the growth trend of ANC business is expected to continue, as considering the company will launch a number of new SKUs. The management revealed that around 8 to 9 new SKUs will be launched in 2H of the year, including oral-intake hyaluronic acid and collagen jelly which will be launched during the upcoming Nov. 11.

-The cross-border e-commerce(CBEC) positive list may be launched by the end of this year in China, that will imply that Swisse non-vitamin SKUs of ANC business cannot be sold through this channel. However, we question about whether it can be launched on time, as the details of the policy remain to be clarified. In fact, the market is currently brewing noises about launching a negative list. At the same time, E-commerce Law will be implemented from next year. It requires anyone who engages in purchasing abroad, must obtain licenses and fulfill its tax obligation, purchasing in person or micro shops will be under regulated. We believe that the market of purchasing from abroad is too big to be fully regulated. For H&H, it already has large e-commerce partners including Tmall, JD.com, VIP.come and NetEase Kaola.com. It also has physical stores. We believe the negative impacts of the new law on the company is limited in medium to long term.

The company intends to further expand its offline business. It plans to increase the number of stores from the current 7,000 to more than 9,000 by the end of the year. 50% of the newly added stores will be maternal stores, and there will be synergies with the BNC business. Due to the uncertainty of the policy in the online business, and the increase in the penetration rate of 3rd to 4th-tier cities, the management team expects the share of the offline business to increase in the future.

Buy (Initially)

CMP HKD39.95

(Closing price at 25 October 2018)

TARGET HKD49.55 (+24.04%)

COMPANY DATA

O/S SHARES (MN) :	640.196
MARKET CAP (HKDBN) :	25.576
52 - WK HI/LO (HKD):	36.1/64.5

SHARE HOLDING PATTERN , %

Biostime Pharmaceuticals (China) Limited	67.77
--	-------

PRICE PERFORMANCE , %

	1 個月	3 個月	1 年
H&H	-15.45	-31.53	1.52
恒生指數	-10.15	-13.58	-11.69

RETURN VS. HSI



Source: Aastocks, Phillip Securities

KEY FINANCIALS

RMB mn	FY16	FY17	FY18E	FY19E
Net Sales	6506	8095	10137	11598
Net Profit	954	933	1183	1539
EPS, RMB	1.52	1.48	1.85	2.40
PER, x	23.35	24.10	19.23	14.79
BVPS, RMB	5.10	6.66	8.43	10.83
P/BV, x	6.97	5.34	4.22	3.28
ROE, %	32.91%	22.04%	21.93%	22.19%

Source: Company, Phillip Securities Est.

Research Analyst
Tracy Ku (2277 6516)
tracyku@phillip.com.hk

-We expect that the price increase of ANC business in 1H will help GPM to expand y.o.y., while OPM will decline, as this year was positioned as investment year. We expect it will continue to increase spending on marketing activities, including online and offline platforms for its new infant formula. It will also improve the high debt situation caused by the acquisition of Swiss, we expect financial expenses to fall year by year, which will help to improve the net profit margin. We give Buy Rating, forecast P/E ratio 23.9 times, the corresponding target price HKD49.55. (current price as of October 25, 2018)

Business Overview

H&H Group has two core business including baby nutrition and care, and premium quality vitamins and supplements. It owns several brands including Biostime, Swisse, Health Times, Dodie and ect.

One of the company`s main priorities during the first half of the year was the progressive transfer of Swisse distribution rights from PGT to the company`s full ownership in Hong Kong, Singapore, Italy, Netherlands and the United Kingdom. The transfer of of HK market was completed in February 2018, while the transfer in other territories was completed by the end of June 2018.

In mid-June 2018, the company optimized its capital structure with a new 3-year term loan facility that refinanced an existing senior secured term loan facility with significantly improved terms and conditions. The company enhanced its net leverage ratio and further develop the financial resources with strong cash flow generated during the first half of this year.

Table: Company History

Year	Milestone
1999	Biostime established
2002	Import children`s probiotics into China with Lallemand
2008	Launch Biostime super premium IMF
2010	Listed on Hong Kong Stock Exchange
2015	Aquired Swisse Wellness Group (PGT partnership in place), aquired U.S. organic baby food brand- Health Times
2016	Acquired Dodie
2017	Rename of H&H Group, bought back Swisse Wellness PGT territories to complete global ownership, launch Dodie in China market, launch Biostime Organic IMF in France

Source: Company, Phillip Securities

Last financial year`s performance review

In 1H, the revenue of BNC increased 33.2% y.o.y., which accounts for 60.7% of total income. The revenue increase includes one-off factors of restocking by distributors during the launch of new registered infant formula, and the backorders of probiotic supplements placed in the fourth quarter of 2017. The revenue of other pediatric products increased by 51.3%. The growth was mainly led by the incremental sales from Dodie branded diapers.

The GPM of BNC segment decreased by 0.6ppt y.o.y to 68.4%. The lowered GPM was mainly caused by the increased cost of packaging materials and the increased cost of IMF ingredients resulting from the upgraded formula in IMF products.

The revenue for the ANC segment increased by 29.3% y.o.y on a currency-adjusted basis. The company has increased price points on its top-selling SKUs, the average price increase was 10 to 15%. The management team has no plan to adjust the price in 2H. According to it, the market has responded the price hike positively. Although there were some push backs in Australia, sales in the Chinese market has continued to rise.

The GPM for the ANC sector increased by 5.6ppt to 65.5%, which help to driven the overall GPM to rebound by 2ppt to 67.2%. The increase in GPM for ANC was mainly a result of the company`s initiatives taken including sales price increase for top selling SKUs, reduction of discounts and bonus stocks to customers, as well as enhancement of inventory management efficiencies.

The adjusted EBITDA margin decreased by 3ppt to 27.3%, mainly due to the selling and distribution costs as a percentage to revenue increased by 3.6ppt to 33.8% resulting from the ramped-up investments in advertising and marketing activities. According to the management, it considered the expenses critical especially the current year is the first year the Chinese new IMF registration rules became effective, and at the same time with the distribution rights of marketing and selling of Swisse products in a number of key markets have been transferred from PGT to the company.

medium- to-long-term development plan of this year for ANC and BNC

-ANC:

The Chinese market accounts for 35% of ANC`s business, with CBEC accounting for 92% and offline for only 8%. The company will launch a pregnancy and infant range and adult probiotics range under the Swisse brand in 2H. These products will rolled-out in-store and online in Australia and New Zealand, as well as across Chinese CBEC channels. Furthermore, Swisse`s high-selling Calcium+Vitamin D product- the first Australian-made VHMS product approved by the CFDA through new filing process, will also be launch soon.

The State Council has recently announced 22 cities as pilot zones for comprehensive CBEC, in addition to the original 15 cities. We believe that this implies that Chinese government intention to further develop CBEC as an important channel meeting domestic consumption demand.

- BNC:

BNC business mainly focuses on high-end market. According to the management team, it intends to develop new business including goat milk powder. For channels, it will continue to further expand the existing channels. Currently, 2nd, 3rd and 4th-tier cities account for 90% of total infant powder revenue.

In 1H of the year, ASP of infant powder was around RMB300, higher than the

industry average. Due to the small base and rapid growth, the overall market is expected to maintain a steady growth of 14 to 16% this year and next, but will slow down from 2019 to 2020.

As competition between major companies in the infant formula market is expected to remain fierce in 2H, the management team plans to invest in branding and channels, while continues to drive creative marketing campaigns. Recently, Dodie brand has got a new brand ambassador to boost its brand exposure in online and offline markets.

Market share

The IMF market remained competitive during 1H as major players stepped up their investments in branding and channel initiatives following the commencement of the China Food and Drug Administration's new registration rules on 1 January 2018. The Group's super premium and premium IMF series grew 27.9% compared to the same period of last year, due to ongoing consumption trade-up, as well as continuous and effective investments in marketing and channel initiatives.

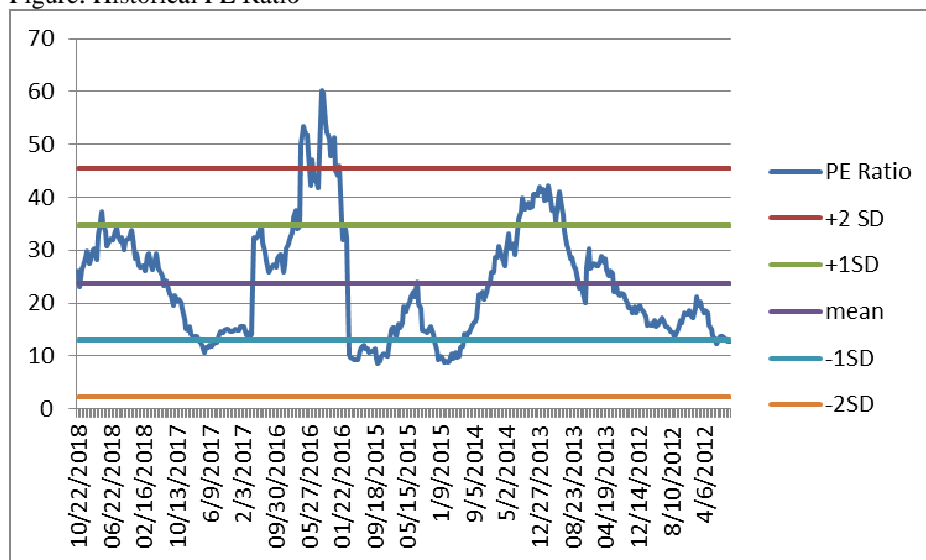
According to Nielsen, an independent market research company, the market share of the company's premium and super premium series under Biostime and Healthy Times increased to 5.7% for the twelve months ended 30 June 2018, while the share of the Group's mid-tier Adimil branded IMF products weakened compared to the same period of last year. Consequently, the company's overall market share increased to 5.9% in the first half of 2018, from 5.5% for the twelve months ended 30 June 2017.

According to research statistics by IRI, an independent market research company, Swisse further strengthened its leading position in the Australian VHMS market, with a market share of 18.6%* for the twelve months ended 30 June 2018. It also has a leading position in the Chinese online VHMS market.

Investment Thesis & Valuation

We give Buy Rating, forecast P/E ratio 23.9 times, the corresponding target price HKD49.55. Potential investment risks include revenue growth and channel expansion not meeting expectation, CBEC policy changes and the competition of infant milk powder market deteriorating (current price as of October 25, 2018)

Figure: Historical PE Ratio



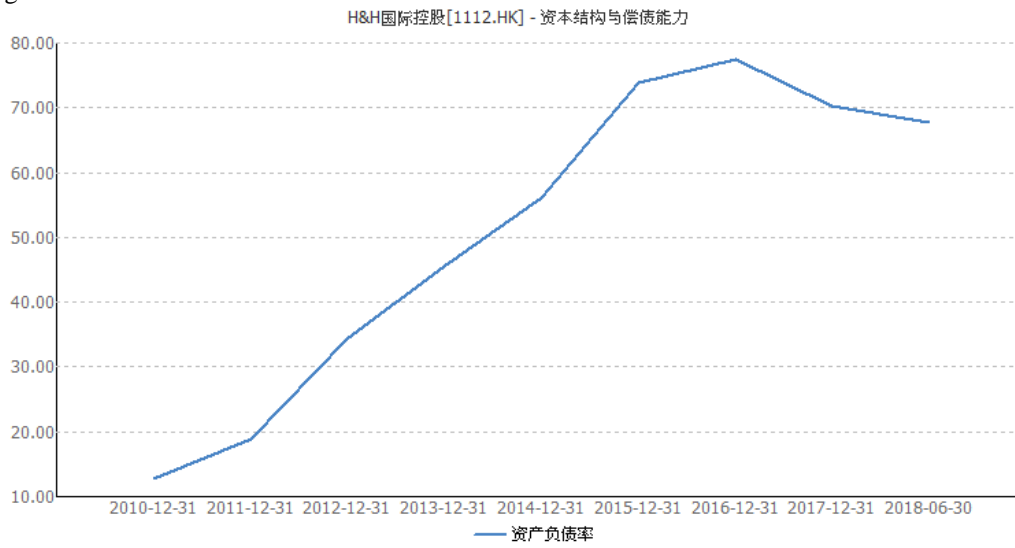
Source: Bloomberg, Phillip Securities

Figure: Peers Comparison

	Company	Market Value(HKD,mn)	PE Ratio
1112.HK	H&H	28889.79	23.54
2319.HK	Mengniu Dairy	106030.07	31.89
0288.HK	WH Group	96312.58	9.97
3799.HK	Dali Foods	87706.45	17.94
0151.HK	WantWant China	80014.96	18.22
0322.HK	Tingyi	75513.74	23.24
0220.HK	U-Presid China	39275.99	28.66
0345.HK	Vitasoy	29965.25	45.29
1579.HK	Yihai	22350.20	44.48
0506.HK	China Foods	11248.42	7.89

Source: Wind, Phillip Securities

Figure: Total liabilities/total assets ratio



Source: Wind, Phillip Securities

Figure: Finance cost (RMB,Mn)



Source: Wind, Phillip Securities

Financials

FYE	2015	2016	2017	2018E	2019E
Valuation Ratios					
Price to Earnings (P/E)	86.58	23.35	24.10	19.23	14.79
Price to Book (P/B)	6.03	6.97	5.34	4.22	3.28
Per Share Data (RMB)					
EPS	0.41	1.52	1.48	1.85	2.40
Book Value Per Share	5.90	5.10	6.66	8.43	10.83
Growth (%)					
Revenue	NA	35.01%	24.44%	25.22%	14.41%
Operating Income	NA	193.07%	-3.32%	17.92%	21.62%
Net Profit	NA	259.59%	-11.74%	27.44%	30.07%
Margins (%)					
Gross Profit Margin	61.94%	62.39%	65.04%	67.04%	67.54%
Operating Profit Margin	13.63%	29.59%	22.99%	21.65%	23.01%
Net Profit Margin	6.07%	16.17%	11.47%	11.67%	13.27%
Key Ratios					
ROE (%)	8.12%	32.91%	22.04%	21.93%	22.19%
ROA (%)	2.11%	7.41%	6.57%	6.54%	6.62%
Income Statement (RMBB,)					
Revenue	4819	6506	8095	10137	11598
-Cost of Goods Sold	-1834	-2447	-2830	-3341	-3765
Gross Income	2985	4059	5266	6796	7833
-SG&A expenses	-2257	-2309	-3198	-4308	-4871
Operating Income	657	1925	1861	2194	2669
Pretax Income	503	1457	1369	1744	2269
- Minority Interest	42	98	-4	0	0
Net Profit	251	954	933	1183	1539

Source: Company, Phillip Securities (HK) Research Estimates

Exchange rate (0.8899) is one year HKD/CNY forward contract price on 25h October from Wind

(Financial figures as at 25h October 2018)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2018 Phillip Securities (Hong Kong) Limited

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website: www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005