

Vitasoy(345.HK)

Continuing expanding production capacity and channels in China market, double-digit growth is expected for the next three to five years

Hong Kong | Consumer | Company report

20 March 2019

Investment Summary

Revenue increased 22% to HK\$4448million, compared to 23% of last year's growth. As the main contributor to the company, revenue of Vitasoy China increased 33%, whereas Hong Kong Operation increased 4%. Vitasoy China experienced strong growth in recently years, we believe the reasons behind include the recognition of its soya milk and lemon tea products has been improved. At the same time, deepening of the sales channels in South China market, and the opening up of new markets.

According to the management team, compared to lemon tea products, more resources will be invested in the soya milk business, as the market base of the latter is small and thus the growth is relatively fast. Currently, the market size of soya milk in China is one tenth of the tea beverage market. The company relaunched its premium high nutrition VITASOY Health Plus range, which target high-end market and differentiated from the main competitors Yili and Mengniu. The company also intends to continue to develop in the middle and high-end market in the future.

In fact, in the more mature Hong Kong market, the annual intake of soy milk is 12 kilograms per person, which is only 1 kilogram in China, reflecting the huge room of development. Vitasoy currently owns and runs four production plants in China, and the production capacity has reached 100%. The company has kept upgrading the machinery every year to improve production efficiency. It also plans to build 20 new production lines in Dongguan, and expects to go into operation in 2021.

With the capacity expansion, improvements of channels and branding, we expect that the Vitasoy's China business and overall revenue to maintain mid-teens growth in the next three to five years, which will be mainly driven by sales volume. If raw material costs can maintain stable and the gross profit margin can also be further improved. At the same time, Hong Kong business is expected to maintain relatively stable growth due to its maturity.

Vitasoy currently ranks first in the soya milk market in Hong Kong, with a market share of 70% and lemon tea with 30%. In the first half of the fiscal year, its China business accounted for 67% of total revenue, this figure is expected to increase further in the future.

In the short term, considering the large base in the same period last year, we expect the growth of overall revenue and China business in the second half to be more moderate than the first half. According to the management team, the Chinese economy has been affected by the Sino-US trade war and the downside risks have increased, it has not seen a big impact on sales, and the company has no plans to increase the discount promotion.

We expect EPS of FY2019 will be RMB0.77, with target price HKD38.5, and target price-earnings ratio 44.7 times. (Closing price at 18 March 2019)

Accumulate (Initially)

CMP HKD35.95

(Closing price at 18 March 2019)

TARGET HKD38.5 (+7.1%)

COMPANY DATA

O/S SHARES (MN) :	1061
MARKET CAP (HKDMN) :	38164
52 - WK LO/HI (HKD):	19.52/35.85

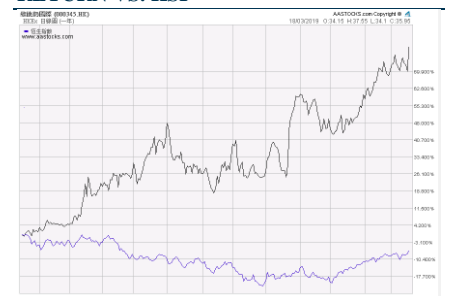
SHARE HOLDING PATTERN , %

Lo's family	28.96%
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PRICE PERFORMANCE , %

	1M	6M	1Y
Vitasoy	7.15	43.8	79.3
HSI	3.75	8.58	-6.68

RETURN VS. HSI



Source: Aastocks, Phillip Securities

KEY FINANCIALS

HKD mn	FY16	FY17	FY18E	FY19E
Net Sales	5,406	6,465	7,628	8,849
Net Profit	653	642	837	1,003
EPS, HKD	0.59	0.55	0.72	0.86
PER, x	61.06	64.78	49.95	41.70
BVPS, HKD	2.56	3.00	3.46	4.03
P/BV, x	14.04	11.97	10.39	8.93
ROE, %	24.29%	20.26%	22.81%	23.47%

Source: Company, Phillip Securities Est.

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Business Overview

About the company

The VITASOY story began in 1940. Its founder, Dr K.S. Lo wanted to help the people of Hong Kong during the war by bringing them a nutritious, protein-rich soymilk drink at an affordable price. In 1979, it launched the ready-to-drink lemon tea. In 1994, it was listed on the Hong Kong Stock Exchange.

MILESTONES

1940	launched VITASOY as a nutritious, high-protein soy milk drink in Hong Kong
1975	the first Hong Kong company to introduce the revolutionary Tetra Pak packaging system
1979	launched the world`s first ready-to-drink lemon tea
1987	opened a new HK\$100 million facility in Hong Kong
1994	listed on the Hong Kong Stock Exchange, opened Shenzhen manufacturing plant
2016	divested certain assets of North American operation. Vitasoy USA continues its sales and distribution of Asian import beverage business in North America.

China`s business is currently based in South China

At present, the Vitasoy business is mainly concentrated in the South China market, accounting for more than 60% of the revenue of China business. Soya milk business in China faces competition mainly from the two dairy giants Yili and Mengniu, while lemon tea business faces competition mainly from Taiwanese brands such as Uni-President and Tingyi.

According to the management team, Vitasoy ranked the third in dairy and soya milk beverage market in Guangdong province in 2018, with a market share of 12%. Yili and Mengniu ranked the first and second, with market share of 28% and 17% respectively. The market share of Vitasoy in Hubei is 9%, whereas that of Yili and Mengniu is 32% and 27% respectively. Vitasoy ranked the 5th in Shanghai with market share of 2.4%. The top four are Bright Dairy, Mengniu, Yili and Coconut Palm, with market share of 42%, 16%, 13% and 2.4% respectively.

For the tea beverage market including lemon tea, Guangdong province is still the best performing market for Vitasoy. It ranked second with market share of 22%. Tingyi ranked the first with market share of 37%. In Shanghai, Vitasoy ranked the

fifth with market share of 8.6%. Uni-President ranked the first with market share of 24%. In Hubei, Vitasoy ranked the sixth with market share of 4%. Uni-President ranked the first with market share of 30%.

Interim results review

Revenue of 1H increased 22% to HK\$4448million, compared to 23% of last year's growth. As the main contributor to the company, revenue of Vitasoy China increased 33%, whereas Hong Kong Operation increased 4%. Gross profit margin increased by 1ppt y.o.y. to 54%. The performance was driven by high growth in sales volume, favourable material costs and continuous improvements in manufacturing efficiency.

According to the management team, the cost of soybean as one of the key raw materials, will be locked in half a year to one year ago by contract. The company does not import soybeans from the United States, so the Sino-US trade war does not have any impacts on the cost. Soybeans used in China market are mainly sourced in China, for Hong Kong and Singapore markets are purchased from Canada, and for Australia are sourced locally.

Total operation expenses increased 26% y.o.y. in 1H as the company increased investment in brand equity programs, and higher staff-related and logistic expenses. Marketing, selling and distribution expenses increased 32%. Profit attributable to equity shareholders was HK\$518million, representing an increase of 30% y.o.y.

Vitasoy China achieved 42% growth in profit. The performance was driven by high growth in sales volume, favourable material costs and continuous improvements in manufacturing efficiency. The appreciation of average Renminbi when comparing to previous interim period had a positive impact on results when reported in HKD.

The company re-launched its premium high nutrition VITASOY Health Plus range. For VITA, it continued to drive expansion of Lemon Tea product across regions and channels. All regions grew strongly, including Guangdong province, and so did all main trading channels. E-commerce operations also continued to grow.

For Hong Kong Operation, revenue increased with broad based growth across all product lines and main channels, across on-the-go and home occasions, with e-commerce registering particularly strong growth from its small base. It has accelerated investments in both core brands VITASOY and VITA, and continued its 2-year internal investment programme in manufacturing and logistic infrastructure. This program is expected to increase spending during second half of this financial year and next financial year.

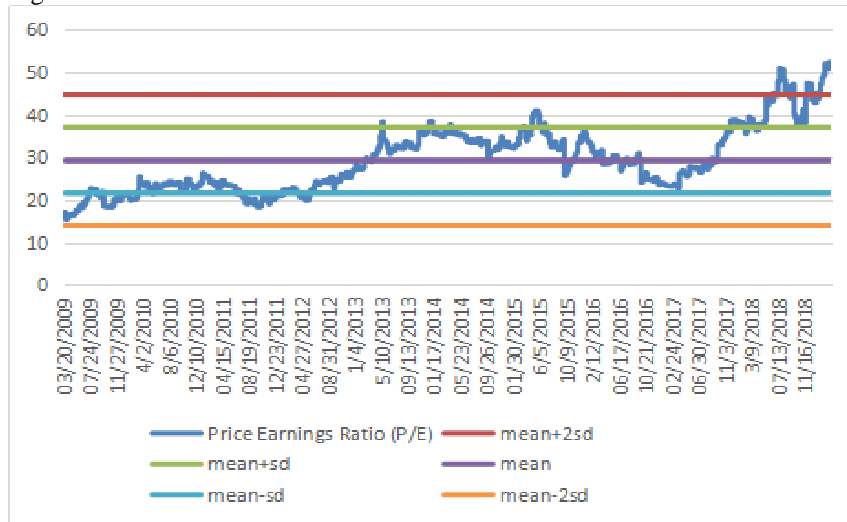
For other markets, revenue in Australia and New Zealand accelerated to 9% in local currency, and 5% in HKD, due to the appreciation of Australian dollar.

According to the management team, it expects strong but more moderate growth in 2H. China is expected to continue to be fastest growing market, behind a balanced combination of per capita consumption increase in the established markets and geographical expansion.

Valuation and Risk

We expect EPS of FY2019 will be RMB0.77, with target price HKD38.5, and target price-earnings ratio 44.7 times . Potential risks include China market expansion missing expectations, raw material prices fluctuate significantly, and market competition has deteriorated.(Closing price at 18 March 2019)

Figure: Historical P/E ratios



Source: Bloomberg, Phillip Securities

Financials

FYE	FY2015	FY2016	FY2017	FY2018E	FY2019E
Valuation Ratios					
Price to Earnings (P/E)	70.63	61.06	64.78	49.95	41.70
Price to Book (P/B)	15.54	14.04	11.97	10.39	8.93
Per Share Data (HKD)					
EPS	0.51	0.59	0.55	0.72	0.86
Book Value Per Share	2.31	2.56	3.00	3.46	4.03
Dividend Per Share	0.303	0.351	0.352	0.432	0.517
Growth (%)					
Revenue	9.90%	-2.63%	19.58%	18.00%	16.00%
Operating Income	14.00%	40.55%	-3.04%	27.59%	19.79%
Net Profit	38.30%	15.58%	-1.72%	30.42%	19.79%
Margins (%)					
Gross Profit Margin	50.90%	53.15%	52.90%	54.00%	54.50%
Operating Profit Margin	10.87%	15.69%	12.72%	13.75%	14.20%
Net Profit Margin	10.18%	12.08%	9.93%	10.98%	11.34%
Key Ratios					
ROE (%)	23.44%	24.29%	20.26%	22.81%	23.47%
ROA (%)	30.49%	27.96%	24.14%	27.17%	27.96%
Income Statement (HKD,Mn)					
Revenue	5,552	5,406	6,465	7,628	8,849
- Cost of Goods Sold	-2,726	-2,533	-3,045	-3,509	-4,026
Gross Income	2,826	2,873	3,420	4,119	4,823
-SD&A expenses	-2,222	-2,025	-2,598	-3,070	-3,566
Operating Income	603	848	822	1,049	1,257
Pretax Income	599	844	803	1,047	1,254
Net Profit	565	653	642	837	1,003

Source: Company, Phillip Securities (HK) Research Estimates
(Financial figures as at 18 March 2019)

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 ± 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

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