

Nongfu Spring Co., LTD.(9633.HK)

World-class packaged drinking water enterprise;
dual-engine development enables diversified product varieties
Hong Kong | Soft Beverage Market | Initial Coverage Research Report

13 December 2021

Investment highlights

Nongfu Spring has been pursuing the “dual-engine” development of drinking water and beverages. On one hand, it meets the daily drinking needs of consumers and on the other hand, it satisfies the diverse and personalized drinking demands of consumers. Diversified product varieties enhancing flexible product mixes has enabled companies and distributors to achieve differentiating advantages in different markets and channels, to improve scale of business, distribution efficiency and profitability.

The world's second largest packaged drinking water company

Nongfu Spring's packaged drinking water products include natural drinking water and natural mineral water. The company is the second largest packaged drinking water company in the world in terms of sales volume. It is also the only company, among the top 5 PRC packaged drinking water companies, that uses solely natural water to produce packaged drinking water, pledging "Every drop of Nongfu Spring has its source". In 2020, the company's market share of packaged drinking water in China reached 20.9% (in terms of retail sales value), which is 1.5 times that of the second largest player. In 2018, 2019 and 2020, the revenue generated from packaged drinking water products accounted for 57.5%, 59.7% and 61% of the company's total revenue, respectively.

Profitability is comparable to the strongest companies in the soft beverage industry around the world

Nongfu Spring's gross margin of 59.1% in 2020 is well ahead of its peers, Tingyi Holding Corp.(33.2%) and Uni-President(34.4%); and is comparable to Coca-Cola(59.3%), the No. 1 soft drink company in the global soft beverage industry. Net profit levels were also much higher than the average in the soft beverage industry in China and also globally over the same period, reaching 17.6%, 20.6% and 23% in 2018, 2019 and 2020. High profitability levels are expected to remain stable in the long term.

Nationwide sales network with in-depth market penetration and Quality Distributor

Nongfu Spring's sales network is nationwide, accounting for approximately 11% of the 22 million retail points of sale in China, covering a wide area and not limited to first and second tier cities. The Company has partnered with local distributors who have extensive experience in the distribution of soft beverage products, leveraging their financial strength, professional teams and facilities to penetrate the local retail network. Besides, the "Nongfu Spring" branded refrigerators installed at nearly 500,000 retail points of sale have particularly enhanced the Company's brand display and share of shelf, thereby boosting sales volume. The Company's annual evaluation and screening of distributors has helped the distributors to improve their business capabilities, so that the overall quality and business capabilities of the cooperating distributors have gradually stabilized and matured.

Company valuation

Nongfu Spring is the leader in the soft beverage industry, with a significantly faster growth rate than the industry average in all its product categories. In addition, fruit juice, tea beverage and functional beverage products are bringing new development focus to the company. With reference to the average valuation of the company in the past year, we give the company a minus 1 standard deviation target P/E ratio of 63x for 2022, and estimate the company's EPS for 2021/2022/2023 to be RMB 0.7/0.8/1.0. The target price forecast for 2022 is HK\$64.59, which corresponds to PE ratio of 74.1x/ 63x/ 53.5x for 2021/2022/2023 respectively. The Company is given a “Buy” rating (initial coverage).

Risk factors

The recovery of COVID-19 might not be as expected and the price of raw materials might increase.

Buy (Initial)

CMP HKD 47.35
(Closing price as of 9 December)
Target HKD 64.59 (+36.41%)

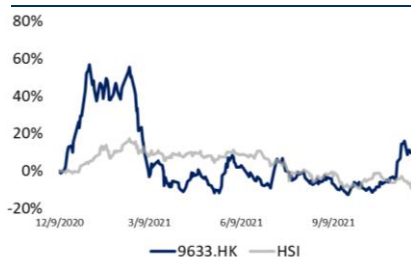
COMPANY DATA

O/S SHARES (MN) :5,034.6664
MARKET CAP (HKD MN) : 2,383.91
52- WK HI/LO (HKD) : 68.546/36.346

SHARE HOLDING PATTERN, %

Zhong Shanshan 66.82%

PRICE VS. HSI



Source: Wind, PSHK

KEY FINANCIALS

CNY mn	FY20	FY21E	FY22E	FY23E
Net Sales	22,877	31,373	35,007	39,234
Net Profit	5,277	8,043	9,455	11,130
EPS, CNY	0.47	0.72	0.84	0.99
P/E, x	84.9	54.3	46.2	39.2
BVPS, CNY	4.303	5.734	7.414	9.393
P/BV, x	34.4	25.8	20.0	15.8
DPS (HKD)	0.2	0.26	0.3	0.36
Div. Yield (%)	0.4	0.6	0.7	0.8

Source: PSHK Est.

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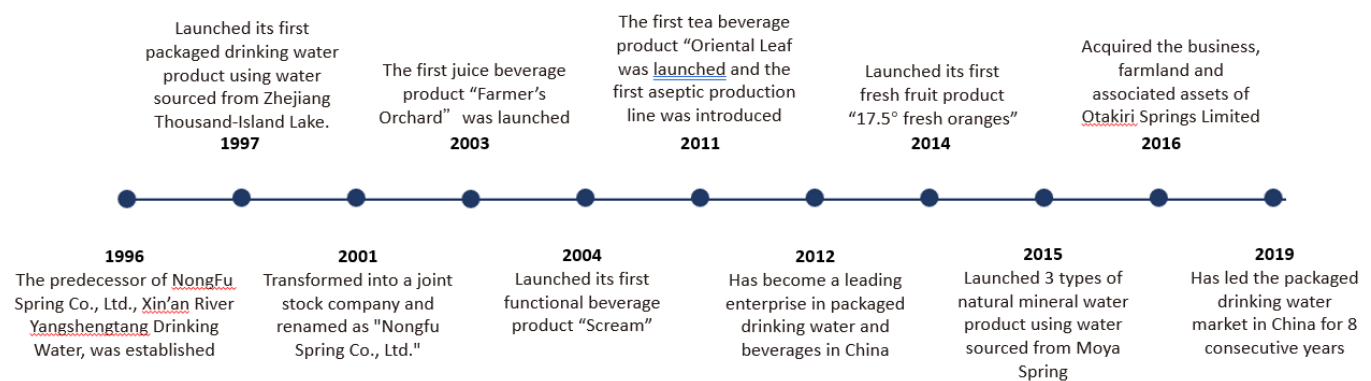
Company introduction

Pioneered in the domestic packaged drinking water market; succeeded in realizing a prospective strategy; becoming the representative brand in the soft beverage industry

The predecessor of NongFu Spring Co., Ltd., Xin'an River Yangshengtang Drinking Water, was established in September 1996 as the earliest packaged drinking water enterprise in China. In 1997, the company launched its first packaged drinking water product using water sourced from Zhejiang Thousand-Island Lake. Subsequently, it was transformed into a joint stock company and renamed as "Nongfu Spring Co., Ltd." in 2001. Various soft drink products have also been launched afterwards. With the insight of its experienced core management team, the Company caught the development trend of the industry and was able to make forward-looking plans to obtain water extraction and mining licenses for 10 high-quality water sources in China. In 2016, the Company acquired the business, farmland and associated assets of Otakiri Springs Limited, a bottled water production and sales company in New Zealand, to expand its overseas operations. After more than 20 years of development, Nongfu Spring has been established as a representative brand in the domestic soft beverage industry and become a leading enterprise in packaged drinking water and beverages in China. The company's distributor network covers more than 2.4 million retail points of sale and has a diversified product portfolio that includes packaged beverages, fruit juices, functional beverages and tea beverages, etc. According to a report by Frost & Sullivan, Nongfu Spring has led the packaged drinking water market in China for 8 consecutive years from 2012 to 2019. In terms of retail sales, the company also ranked among the top 3 in the domestic market for juice, functional beverages and tea beverages in 2019.

Farmer Shanquan dominated China's packaged drinking water market for eight consecutive years from 2012 to 2019, according to The Frost Sullivan report. In terms of retail sales, the company also ranks in the top three in terms of domestic market share in fruit juice drinks, functional beverages and tea beverages in 2019.

Figure 1: Company's Milestones



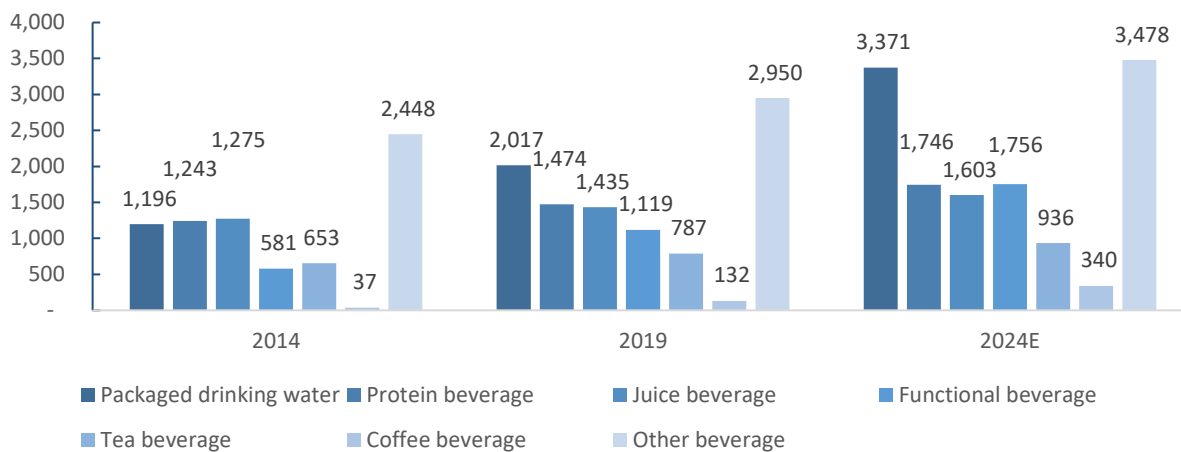
Source: Company, PSHK

Industry analysis

Increasing health consciousness and urbanization bring about the rapid growth of China's soft beverage market

China is amongst the world's largest soft beverage markets, with a market size of RMB 991.4 billion in terms of retail sales value in 2019. "Health" has undoubtedly been the trend in recent years. Consumers has become more health-conscious and tend to buy beverages that are either beneficial or burdenless to their health. Coupled with the growing consumption power of Chinese consumers driven by the acceleration of China's urbanization process, consumers have shifted their focus from price to quality in product consumption. While the process of urbanization has promoted diversification of sales channels, consumption frequency has also increased. Taking into account of all the aforesaid factors, the size of China's soft beverage market is expected to grow with a CAGR of 5.9% aligning with the applied CAGR in the period 2014-2019. Among all the sub-categories under China's soft beverage market, coffee beverage, functional beverage and packaged drinking water are the 3 sub-categories with the highest compound annual growth rate in market size. They are expected to grow at a CAGR of 20.8%, 9.4% and 10.8% respectively, from 2019 to 2024.

Figure 2: China's Soft Beverage Market Size by Category, 2014 - 2024E



Source: Company, PSHK

Figure 3: China's Soft Beverage Market Concentration, 2019

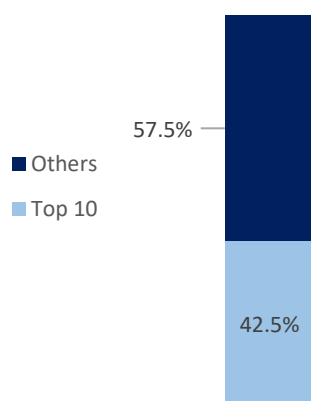
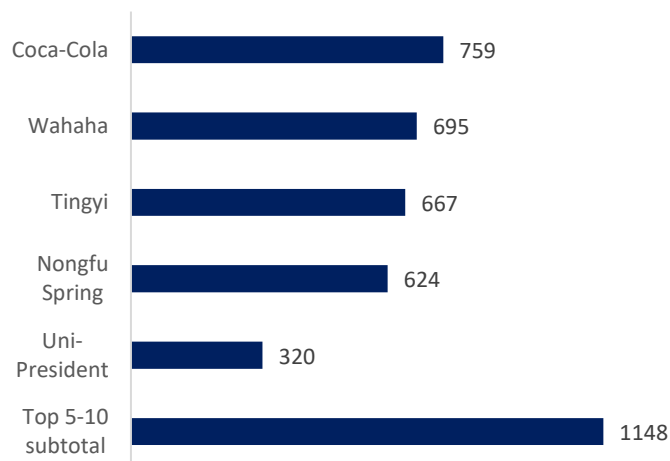


Figure 4: China's Soft Beverage Market Retail Sales Value of Top Ten Players, 2019 (RMB 10million)



Source: Company, PSHK

The competitive landscape of China's soft beverage market is relatively fragmented. The top 10 players took up only 42.5% of the total market share in 2019, in which the leading advantage of the top 4 participants, including Nongfu Spring, is more significant, with an aggregate market share of 27.7% .

The growth of Natural water and Natural mineral water tops the market

Packaged drinking water has been the largest category in China's soft beverage market, reaching a market size of RMB 201.7 billion in 2019. It can be broadly divided into 4 sub-categories, namely: 1. Purified drinking water; 2. Natural water; 3. Natural mineral water; 4. Other drinking water. As purified drinking water is generally defined as water that does not contain minerals or trace elements, and water sources are not strictly regulated, it is naturally the largest category of packaged drinking water, accounting for 60.4% of the overall retail sales of packaged drinking water in 2019. On the other hand, Natural water and Natural mineral water are 2 fastest-growing packaged drinking water categories in recent years, stimulated by people’s increasing health awareness and rising consumption power. They are expected to grow at a CAGR of 15.2% and 14.1% respectively, from 2019 to 2024, and reach a market size of 89.5Bn and 30Bn in 2024.

The packaged drinking water market in China is relatively concentrated. In terms of retail sales in 2019, the top 5 participants accounted for more than 50% of total market share, while the largest player, Nongfu Spring’s market share was over 50% ahead of the second largest player.

Figure 5: China’s Packaged Drinking Water Market Size by Category, 2014 - 2024E (RMB 10Mn)

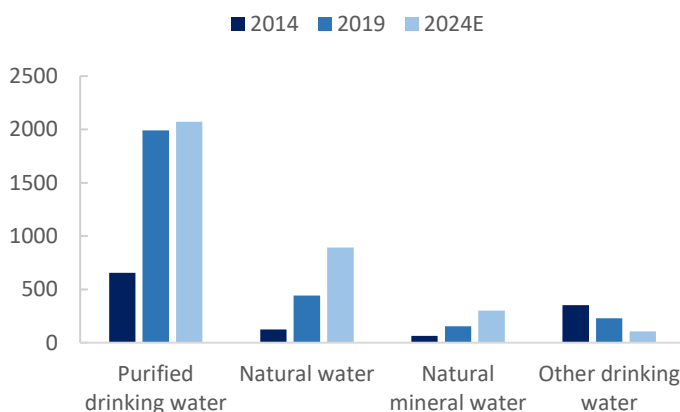
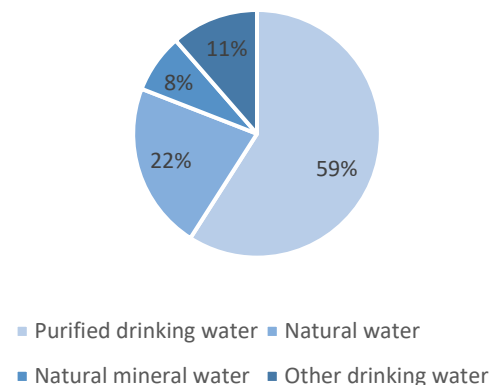


Figure 6: Category Share in China’s Packaged Drinking Water Market, 2019



Source: Company, PSHK

Sugar-free tea beverage, natural pure juice, and functional beverage as newly booming markets

The market size of the tea beverage market in China was RMB 78.7Bn in 2019. Tea beverages are divided into 2 main categories : sugar-free tea beverage and sugar-sweetened tea beverage. The market size of sugar-sweetened tea beverages has always been much larger than that of sugar-free tea beverages, with retail sales value accounting for nearly 95% of the aggregate retail sales value of all tea beverages in 2019. Nevertheless, given that people are adopting a more healthy consumption habit, the market size of sugar-free tea beverage is growing rapidly, and is expected to increase to 12.3% in 2024.

The market concentration of the tea beverage market in China is relatively high., with CR5 accounting for more than 85% of the overall market share.

Figure 7: China’s Tea Beverage Market Size by Category, 2014 - 2024E (RMB 10million)

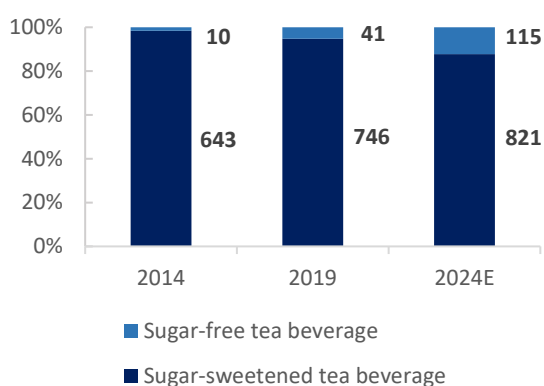
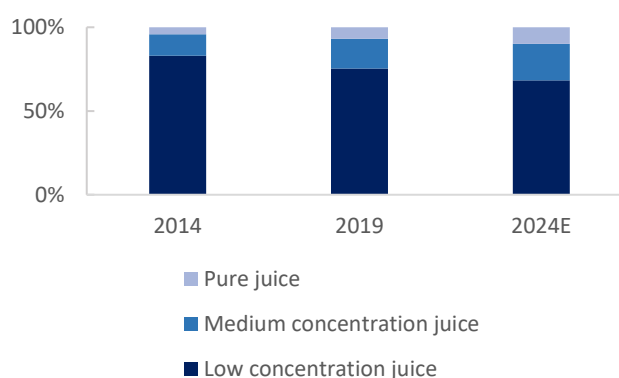


Figure 8: China’s Juice Beverage Market Size by Category, 2014 - 2024E (RMB 10million)



Source: Company, PSHK

Juice beverage market in China had a market size of RMB 143.5Bn in 2019. Low-concentration juice (Juice concentration: 5%-29%) has always been the mainstream. Yet, people tend to choose natural products nowadays owing to their rising disposable income and health awareness. This has sparked the growth of the retail sales of pure juice (Juice concentration:100%) and medium concentration juice (Juice concentration: 30%-99%). It is expected that the growth rate will further increase in the future, and the market size will reach 160Bn and 158Bn in 2024, respectively.

Juice beverage market in China is relatively fragmented, with CR5 being only 25.1%.

Functional beverage market in China had a market size of RMB 111.9Bn in 2019. The sector mainly covers energy beverage, sports beverage, and nutritional beverage, with energy beverage being the largest segment, accounted for over 70% of total market share in 2019. Such 3 subcategories under China’s functional beverage market are expected to grow at a CAGR of 9.7%, 9.6% and 7.6% respectively, from 2019 to 2024. The overall market size of China’s functional beverage market is expected to reach 175.4Bn in 2024.

The functional beverage market in China is relatively concentrated. CR5 was 56.7% in 2019.

Company products

Dual-engine development enables diversification of products

Nongfu Spring is more than a brand that sells water. The company has been pursuing the “dual-engine” development of drinking water and beverages. On one hand, it meets the daily drinking needs of consumers and on the other hand, it satisfies the diverse and personalized drinking demands of consumers. Diversified product varieties enhancing flexible product mixes has enabled companies and distributors to achieve differentiating advantages in different markets and channels, to improve scale of business, distribution efficiency and profitability.

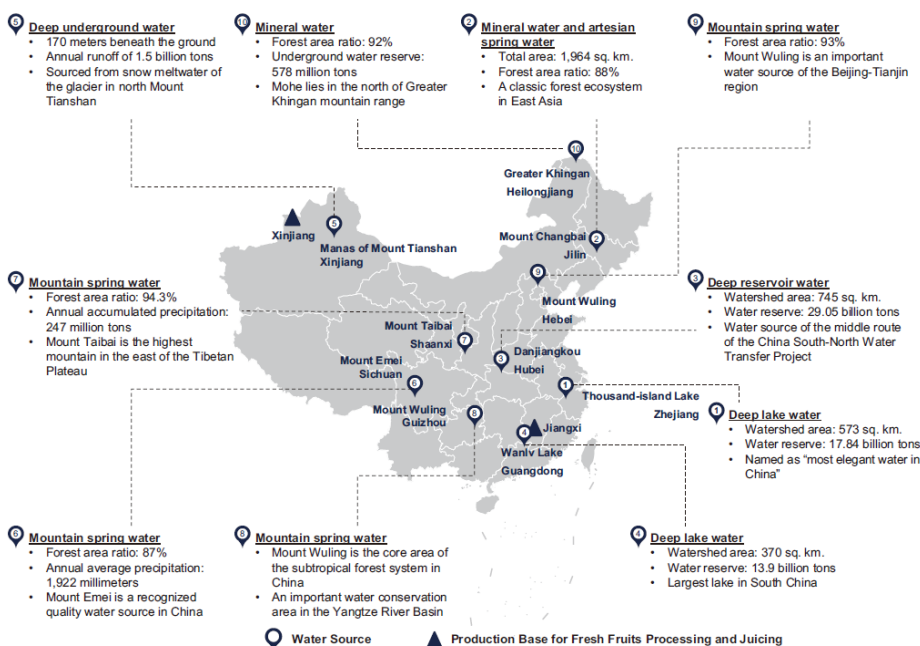
The world's second largest packaged drinking water company

Nongfu Spring’s packaged drinking water products include natural drinking water and natural mineral water. The company is the second largest packaged drinking water company in the world in terms of sales volume. It is also the only company, among the top 5 PRC packaged drinking water companies, that uses solely natural water to produce packaged drinking water, pledging “Every drop of Nongfu Spring has its source”. In 2020, the company's market share of packaged drinking water in China reached 20.9% (in terms of retail sales value), which is 1.5 times that of the second largest player. In 2018, 2019 and 2020, the revenue generated from packaged drinking water products accounted for 57.5%, 59.7% and 61% of the company's total revenue, respectively.

Strategically take the lead in developing water sources

Being the pioneer in discovering and utilizing China's top 10 natural high-quality water sources is one of the keys to the company's success. The water sources chosen by the company have undergone rigorous water quality monitoring, water replenishment inspections, and water feasibility assessments to ensure the long-term supply capacity and stability of packaged drinking water products. The 10 water sources obtained by the company are located in different regions of China which cover the entire national market supply, realizing economies of scale. Besides, by establishing production bases near the water sources, this prospective planning has enabled the company to effectively shorten the transportation radius, better control the logistics costs, and improve profitability.

Figure 9: China’s Top Ten Quality Water Sources



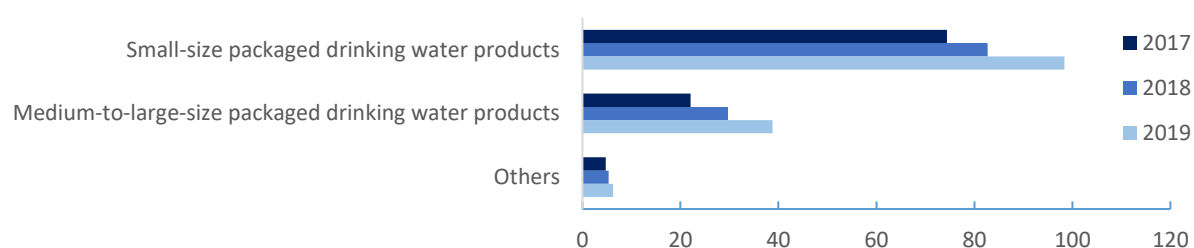
Source: Company, PSHK

Concern over the quality of tap water promotes the demand of household-consumption water

Nongfu Spring has introduced different sizes of packaged drinking water: from the original small-size packaged products (380ml to 750ml) to the medium-to-large-size packaged products (1.5L to 19L) launched in 2016 to meet various consumption needs. The demand for household-use drinking water has increased significantly in recent years as consumers have become more health-conscious and doubt about the quality of tap water. As a result, the revenue of medium-to-large-size packaged products suitable for household consumption increased from 2.21Bn in 2017 to 3.88Bn in 2019, with a CAGR of 33%, far higher than the 15% growth rate of small-sized products. The proportion of medium-to-large-size products in the total revenue also increased from 12.6% to 16.2%. The recent outbreak of COVID-19 has further promoted the penetration rate of household-use water, and it is expected that the growth will remain strong.

In addition, the Company has launched several packaged drinking water products targeting different consumer segments and scenarios during 2015-2019, including a premium line of natural mineral water in glass bottles, natural mineral water with sports bottle caps, natural mineral water with lithium to repair the nervous system, and sterile natural water for infants and young children. Such products help to explore a new customer base, thus, providing new growth points for the company.

Figure 10: Revenues of the Company's Packaged Drinking Water Products by Package Size, 2017 to 2019 (RMB 10million)



Source: Company, PSHK

Figure 11: Packaged Drinking Water Products Targeting Different Scenarios

	Natural mineral water (glass bottled)	Natural mineral water (with functional sports bottle cap)	Drinking natural water (suitable for infants and young children)	Natural mineral water (containing lithium)
Product image				
Launch Year	2015	2015	2015	2019
Targeting scenario and selling point	It is positioned as a high-end product for conference or banquet purpose	Suitable for drinking while working out, driving, and doing other outdoor activities with the bottle designed to support uncapping with one hand and avoid leakage	The amount of its microbiological content meets the requirement of commercial sterilization and the minerals content is suitable for infants and young children	It contains lithium that can boost recovery of human nervous system, which is suitable for middle-aged and elderly people
Volume	350ml/750ml	535ml/400ml	1L	535ml

Source: Company, PSHK

Multi-category beverage products to multi-brand development





Nongfu Spring's beverage products accounted for approximately 40% of total revenue. The Company's beverage products have been launched in a variety of categories, including juice, tea beverage, functional beverage, coffee, soda, flavored beverages and plant-based yogurt products, etc. Being attentive to market trends and consumers' changing demands for beverages, Nongfu Spring adopts a multi-brand development strategy, whereby each beverage brand has its own unique market position, expanding the Company's sales scale.

Breakthrough launch of NFC juice products

Nongfu Spring's juice beverage products cover a full range of low concentration juice, medium concentration juice and not-from-concentrate (NFC) juice products.

The company has made a breakthrough solving the technical problems about raw materials, freshness and aseptic filling and successfully introduced the NFC juice series. The products have better taste and are more nutritious than the concentrated juice currently available in the market. The Company's fresh fruit processing and juicing bases in Xinjiang Uyghur Autonomous Region and Jiangxi Province, providing fruit raw materials for the production of NFC juice products.

Figure 12: The Company's Juice Beverage Brands

Brand	Juice Concentration	Launch Year	Volume	Suggested Retail Price
	30%	2003	500ml-1.8L	¥ 4- ¥ 10
	50%	2019	250ml-1.25L	¥ 3- ¥ 10
	12%	2008	445ml	¥ 3/ ¥ 5
	NFC Juice	2016	300ml/900ml	¥ 8/ ¥ 21.5
	NFC Juice	2016	330ml/950ml	¥ 13.9/ ¥ 29.9

Source: Company, PSHK

Prospective strategic vision creates the No.1 brand of sugar-free tea

Nongfu Spring's 2 tea beverage series, "Teaπ" and "Oriental Leaf", are produced through an advanced aseptic cold filling process that preserves the original color, aroma and taste of fresh tea leaves. "Oriental Leaf", a sugar-free tea product strategically launched by the company, became the No. 1 brand in the sugar-free tea category with a market share of 3% in 2019.

Figure 13: The Company's "Oriental Leaf" Tea Beverage Series



Source: Company, PSHK

A variety of flavors and nutritional formulas to meet consumer needs

The company's functional beverage products target customers who pursue a healthy lifestyle. The "Scream" series consists of 3 types of products, namely the fiber type, poly-peptide type and plant type, with different nutritional values and flavors to meet the health needs of different consumers. The six flavors in the "Victory Vitamin Water" series correspond to six different nutritional formulas.

New products on-line to seize the soft beverage market share

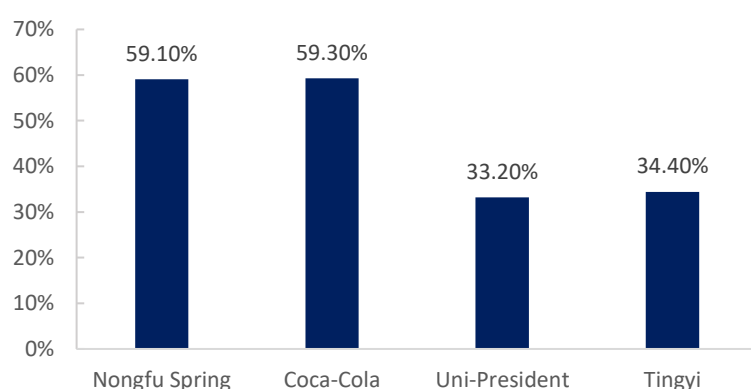
In addition to the above products, coffee beverage, soda water beverage, sparkling flavored beverage and plant-based yogurt products were launched in 2019 which further supported the Company to capture market share in the soft beverage market.

Competitive landscape

Profitability is comparable to the strongest companies in the soft beverage industry around the world

Nongfu Spring's gross margin of 59.1% in 2020 is well ahead of its peers, Tingyi Holding Corp. and Uni-President; and is comparable to Coca-Cola, the No. 1 soft drink company in the global soft beverage industry. Net profit levels were also much higher than the average in the soft beverage industry in China and also globally over the same period, reaching 17.6%, 20.6% and 23% in 2018, 2019 and 2020. High profitability levels are expected to remain stable in the long term.

Figure 14: Gross Profit Margins of Leading Companies in The Global Soft Beverage Market, 2020



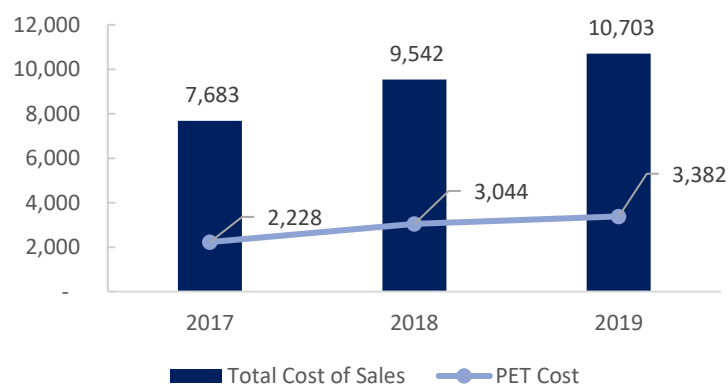
Source: Bloomberg, PSHK

Centralized procurement of raw materials to secure reserves at more competitive prices

As the cost of water is charged as resource tax, it is not significantly apportioned to individual bottles. Therefore, Nongfu Spring's gross profit margin is mainly affected by the cost of the raw material PET which accounts for approximately 30% of the Company's total cost of sales.

In order to reduce the impact on the Company's operations and profitability due to fluctuations in the prices and supply of raw materials, the Company maintains close cooperation with its raw material suppliers and centralizes its procurement in order to obtain more competitive purchase prices. The Company's PET purchase price is usually 5% lower than the national average price and will increase its reserves when the PET purchase price decreases to ensure the stability of raw material supply.

Figure 15: PET cost to total cost of sales of the Company, 2017 - 2019 (RMB 10million)



Source: Company, PSHK

Sound R&D leads the company to prevail in the industry and to expand its market share

Nongfu Spring attaches great importance to invest in R&D, and through continuous research and development of new products, the company is leading the industry and expanding its market share. The company's R&D team currently consists of 106 technical staff, mainly responsible for application research, including the development of new beverage formulations, packaging design and process research. Among the R&D team, 62 team members hold a master's degree or higher qualification. At the same time, the technical support obtained through cooperation with relevant research institutes and universities has further strengthened Nongfu Spring's R&D capabilities. For example, basic research on beverages has been entrusted to the Yang Sheng Tang Institute of Natural Medicine. In 2011, the company took the lead in introducing the first aseptic production line for domestic beverage enterprises; successfully solved the problem of oxidation and discoloration of pure tea beverages and launched the first sugar-free tea beverage in transparent bottles in China; and developed the longest lasting preservative-free juice on the market.

World-leading production equipment + Highly stringent closed-loop enterprise quality management system

Nongfu Spring's production capability cannot be overlooked. The company has a highly stringent closed-loop corporate quality management system and world-leading production facilities. Its three main production bases has benefited from its efficient logistics network.

The company has established a closed-loop corporate quality management system covering the entire process, from quality control of raw material procurement, manufacturing process optimization, to storage and sales assurance. In order to regulate the quality of raw material suppliers, the company has standardized the admission criteria of raw material and packaging material suppliers, set up regular assessment and evaluation system. The production system of Nongfu Spring is also certified by the 3 main ISO quality management systems, while the storage, transportation and sales are monitored by the company's product assurance team and information traceability system. To date, the company has 12 production sites with 144 automated drinking water and beverage production lines, 7 fresh fruit juice production lines and 3 fresh fruit production lines. Among them, 17 drinking water production lines are capable of filling 81,000 bottles per hour and 14 beverage production lines are capable of achieving the Log6 aseptic standard. In addition, the company's 3 production bases, located in Qiandao Lake, Changbai Mountain, and Danjiangkou, are connected to dedicated railroad lines to ensure the efficiency and scope of transportation.

Brand preservation; high penetration

According to the "2020 Asia Brand Footprint Report" released by Kantar Worldpanel, Nongfu Spring is the No. 7 local FMCG brand in China, with 408 million consumer engagements and a year-on-year growth rate of 9.9%, the highest growth rate among the top 10 brands on the list. By category, according to Chnbrand's China Brand Power Index report, Nongfu Spring has been the No. 1 packaged water brand for 5 consecutive years since 2017, and its tea, juice and functional beverage sub-categories have also been ranked among the top 5 in the industry for years. Most of the company's beverage products have been able to maintain brand vitality for more than a decade.

Figure 16: Ranking of Domestic FMCG Brands in the "2020 Asia Brand Footprint Report"

Ranking	Brand	Consumer engagements (million)	Penetration rate(%)	Growth rate of consumer engagements (%)
1	Yili (伊利)	1,297	91.6	1.0
2	Mengniu Dairy (蒙牛)	1,081	89.1	1.7
3	Tingyi (康師傅)	826	81.0	-3.5
4	Haitian (海天)	566	75.7	8.1
5	Shuanghui (雙匯)	430	60.7	-2.8
6	Want Want (旺旺)	426	64.1	-6.5
7	Nongfu Spring (農夫山泉)	408	63.2	9.9
8	Liby (立白)	382	65.6	-1.4
9	Bright Food (光明)	367	37.4	-6.3
10	Xin Xiang Yin (心相印)	362	59.7	2.4

Source: "2020 Asia Brand Footprint Report" by Kantar Worldpanel, PSHK

Professional and healthy image built through in-depth and story-based brand advertising

Nongfu Spring has successfully established a "healthy and natural" image and conveyed the brand spirit through numerous simple and memorable classic advertising slogans. Among them, the most familiar slogans of the company are "Nongfu Spring tastes a bit sweet" and "We are not manufactures of water. We are porters of nature". Under the theme of "Nature's Porters", the company has also launched a series of micro-films, telling short stories about the daily work of employees and the beautiful scenery of the Changbai Mountain water source, to demonstrate and promote the company's sense of corporate responsibility and the quality of water sources.

Figure 17: The Company's Classic Advertising Slogans

Brand	Slogan
Nongfu Spring	"Nongfu Spring tastes a bit sweet"
	"We are not manufactures of water. We are porters of nature"
	"The quality of the water source defines the quality of life"
Tea π	"Tea π, Be My Own Style"
Oriental Leaf	"Traditional Chinese tea, marvelous Oriental Leaf"
Scream	"Scream rather than heartbeat"
Victory Vitamin Water	"Replenish Vitamin Anytime and Anywhere"
Water Soluble C100	"Meet the Daily Requirement of Vitamin C"
Farmer's Orchard	"Farmer's Orchard, shake before drink"

Source: Company, PSHK

Diversified marketing methods to reach consumers in all aspects

The company has integrated online and offline marketing through advertising, bottle campaigns, variety show title sponsorships, product placement in movies and TV programs, celebrity endorsements, sports event sponsorships, social media marketing, and cross-industry cooperation. For example, the company changed the packaging of the "Victory Vitamin Water" and cooperated with programs such as The Rap of China and Idol Producer, which gave the product a new vitality and resulted in a CAGR of over 47% from 2017 to 2019. Many of Nongfu Spring's online and offline advertising campaigns have become classic marketing cases.

Figure 18: Idol Producer Program Endorsement



Source: Online Photo, PSHK

Nationwide sales network with in-depth market penetration and Quality Distributor

Nongfu Spring's sales network is nationwide, accounting for approximately 11% of the 22 million retail points of sale in China, covering a wide area and not limited to first and second tier cities. The Company has partnered with local distributors who have extensive experience in the distribution of soft beverage products, leveraging their financial strength, professional teams and facilities to penetrate the local retail network. In addition to selling Nongfu Spring's products in designated channels, distributors can also sell the Company's products in online stores or assign secondary distributors, if authorized by the Company, so that the Company can better expand the number of retail points of sale. Besides, the "Nongfu Spring" branded refrigerators installed at nearly 500,000 retail points of sale have particularly enhanced the Company's brand display and shelf space, thereby boosting sales volume. In order to control business risks and improve the operation level of their partner distributors, the Company utilizes the NCP system to conduct big data analysis to manage and guide distributors' inventory and product sales at the retail points of sale in real time. At the same time, the Company's annual evaluation and screening of distributors has helped the distributors to improve their business capabilities, so that the overall quality and business capabilities of the cooperating distributors have gradually stabilized and matured.

Direct business model helps the company consolidate its market position

Nongfu Spring has not only deployed its sales network in the form of distributor partnerships, but also has about 250 direct customers. The Company's direct customers are generally large customers, such as national or regional supermarkets, convenience store chains, e-commerce platforms, restaurants, airlines and group customers. By establishing business relationships with these customers, the Company can effectively increase product exposure, adjust its marketing strategy and control the direction of product development to strengthen its market position.

Developing new channels to expand the sales network

The soft beverage market has always been dominated by traditional channels (small grocery stores and non-chain convenience store) and modern channels (shopping malls, supermarkets and convenience store chains). About 80% of Nongfu Spring's revenue also comes from traditional and modern channels. However, emerging sales channels such as e-commerce channels are on the rise, with e-commerce channels alone growing at a much higher rate of 12.5% than traditional channels, and retail sales are expected to reach RMB 110Bn by 2024. On this basis, Nongfu Spring is actively expanding new retail channels represented by vending machines, with around 63,000 smart retail equipment installed in nearly 300 cities nationwide, providing consumers with an instant and convenient channel to purchase beverages and further expanding the company's retail points of sale.

Revenue Forecasts and Risk Factors

Revenue forecast

We forecast total revenue to be \$31.4 billion, \$35.0 billion and \$39.2 billion from 2021 to 2023, respectively. 1) Packaged water business: Medium-to-large-size packaged water products will continue to expand due to the increasing demand for household-consumption water, driving revenue growth at a CAGR of 15.9% from 2020 to 2023. 2) Tea beverage business: the Company tops the sugar-free beverage market which is the development trend thus expects to bring about new growth point. The revenue is expected to reach \$4,451 million in 2023, with a CAGR of 13% from 2020 to 2023; 3) Functional beverage business: the functional beverage market is one of the highest growth segments, and the Company's business will benefit from the overall growth of this market, with a CAGR of 24.1% from 2020 to 2023; 4) Juice beverage business: the Company will continue to focus on the development of NFC juice and is expected to gradually realize economies of scale, narrowing the raw material cost. The revenue is expected to grow at a high rate of 39.5% CAGR from 2020 to 2023.

Revenue	2019	2020	2021E	2022E	2023E
Packaged drinking water	14,346	13,966	17,655	19,586	21,727
Tea beverage	3,138	3,088	3,737	4,079	4,451
Functional beverage	3,779	2,792	4,492	4,898	5,340
Juice beverage	2,311	1,977	3,520	4,345	5,362
Others	447	1,054	1,969	2,100	2,354
Total	24,021	22,877	31,373	35,007	39,234

Company valuation

Nongfu Spring is the leader in the soft beverage industry, with a significantly faster growth rate than the industry average in all its product categories. In addition, fruit juice, tea beverage and functional beverage products are bringing new development focus to the company. With reference to the average valuation of the company in the past year, we give the company a minus 1 standard deviation target P/E ratio of 63x for 2022, and estimate the company's EPS for 2021/2022/2023 to be RMB 0.7/0.8/1.0. The target price forecast for 2022 is HK\$64.59, which corresponds to PE ratio of 74.1x/ 63x/ 53.5x for 2021/2022/2023 respectively. The Company is given a "Buy" rating (initial coverage).

Company	Ticker	CMP	Mkt Cap.	P/E			P/B		
				TTM	2020	2021	TTM	2020	2021
		(Base Currency)	('mn HKD)						
Nongfu Spring Co., Ltd.	9633 HK Equity	47.35	532,520.17	66.69	64.02	56.76	24.64	21.03	16.48
Coca-Cola Co	KO US Equity	55.21	1,852,400.00	23.38	24.05	22.57	10.71	10.94	9.95
Monster Beverage Corporation	MNST US Equity	88.37	366,917.12	35.02	34.36	30.28	7.53	7.66	6.99
Tingyi (Cayman Islands) Holding Corp.	322 HK Equity	15.22	85,703.40	18.75	18.44	16.34	3.62	3.29	3.30
Uni-President China Holdings Ltd.	220 HK Equity	7.86	33,949.97	19.63	18.71	16.45	2.11	2.01	1.99
Nayuki Holdings Limited	2150 HK Equity	9.03	15,487.59	-	7350.11	50.69	-	3.60	3.44

Source: Bloomberg, PSHK



Source: Wind, PSHK

Risk factors

The recovery of COVID-19 might not be as expected and the price of raw materials might increase.

* The analyst has a financial interest in the listed corporation covered in this report.

Financial data
Consolidated Statement of Profit or Loss

Dec Y/E, RMB mn	FY19	FY20	FY21E	FY22E	FY23E
Revenue	24,021	22,877	31,373	35,007	39,234
COGS	(10,710)	(9,369)	(12,609)	(13,737)	(14,979)
Gross Profit	13,311	13,508	18,765	21,270	24,255
S&D expense	(5,816)	(5,511)	(7,226)	(7,818)	(8,536)
Admin. expense	(1,383)	(1,324)	(1,788)	(2,030)	(2,276)
Other gains and losses	403	392	867	1,054	1,241
Operating Profit	6,515	7,065	10,617	12,475	14,684
Finance costs	(16)	(79)	(34)	(34)	(39)
Profit before tax	6,499	6,986	10,583	12,441	14,645
Income tax	(1,545)	(1,709)	(2,540)	(2,986)	(3,515)
Profit for the year	4,954	5,277	8,043	9,455	11,130
Non-controlling interests	(6)	-	-	-	-
Net profit	4,948	5,277	8,043	9,455	11,130

Key Financial Data

Dec Y/E	FY19	FY20	FY21E	FY22E	FY23E
Valuation Ratio					
P/E ratio, x	30.8	84.9	54.3	46.2	39.2
Dividend Yield, %		0.4%	0.5%	0.6%	0.8%
Per share data (RMB)					
EPS		0.47	0.72	0.84	0.99
BVPS	2.745	1.377	1.835	2.373	3.006
DPS (HKD)		0.20	0.26	0.30	0.36
Growth & Margin					
Growth					
Revenue Growth	17.3%	-4.8%	37.1%	11.6%	12.1%
Gross Profit Growth	21.9%	1.5%	38.9%	13.3%	14.0%
Operating Profit Growth	31.4%	6.7%	44.3%	16.6%	16.9%
Net Profit Growth	37.2%	6.5%	52.4%	17.6%	17.7%
Margin					
Gross Profit Margin	55%	59%	60%	61%	62%
Operating Profit Margin	31%	35%	37%	38%	40%
Net Profit Margin	21%	23%	26%	27%	28%
Key Ratios					
ROE	40.8%	41.6%	44.5%	40.0%	36.8%
ROA	27.9%	20.4%	25.8%	24.8%	24.0%

Consolidated Statement of Financial Position

Dec Y/E, RMB mn	FY19	FY20	FY21E	FY22E	FY23E
Non Current Asset					
PPE	12,314	12,592	13,571	14,083	14,586
Right-of-use assets	656	695	747	798	847
Intangible assets	60	58	62	64	64
Others	394	324	324	324	324
Total Non Current Assets	13,424	13,668	14,703	15,268	15,821
Current Asset					
Inventory	1,762	1,805	1,952	2,291	2,498
Trade and bills receivables	306	358	430	504	593
Bank balance and cash	1,083	9,119	13,211	19,108	26,503
Others	1,221	910	910	910	910
Total Current Assets	4,372	12,192	16,502	22,812	30,503
Total Assets	17,796	25,860	31,205	38,081	46,325
Non Current Liabilities					
Lease liabilities	30	41	30	70	97
Deferred income tax liabilities	443	501	501	501	501
Total Non-current Liabilities	473	542	531	571	599
Current Liabilities					
Trade and bills payables	791	882	1,130	1,242	1,313
Contract liabilities	2,078	2,247	2,430	2,627	2,841
Others	4,572	6,696	6,474	6,949	7,757
Total Current Liabilities	7,441	9,825	10,034	10,818	11,911
Equity					
Equity attributable to owners of the parent	9,882	15,492	20,641	26,692	33,815
Non-controlling interests	-	-	-	-	-
Total equity	9,882	15,492	20,641	26,692	33,815
Total Liabilities and Equity	17,796	25,859	31,205	38,081	46,325

Consolidated Statement of Cash Flow

Dec Y/E, RMB mn	FY19	FY20	FY21E	FY22E	FY23E
CFO	7,472	8,430	10,694	12,031	13,976
Interest received	256	69	192	153	148
Income taxes paid	(1,511)	(1,386)	(2,540)	(2,986)	(3,515)
Cash generated from operations	8,727	9,747	13,042	14,864	17,343
CFI	643	(4,657)	(3,042)	(2,757)	(2,859)
Capital expense	(2,870)	(2,139)	(3,042)	(2,757)	(2,859)
Others	3,513	(2,518)	-	-	-
CFE	(8,697)	1,716	(3,560)	(3,377)	(3,722)
Dividends paid	(9,618)	(7,980)	(2,896)	(3,404)	(4,007)
Others	921	9,696	(664)	27	285
Net Change in Cash	(582)	5,488	4,093	5,897	7,395
Foreign exchange	1	(215)	-	-	-
Cash and CE at Y/E	783	6,056	10,149	16,046	23,441

Current Price as of 9th December 2021

Source: PSHK Est.

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

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