

20 November 2018

China

## EQUITIES

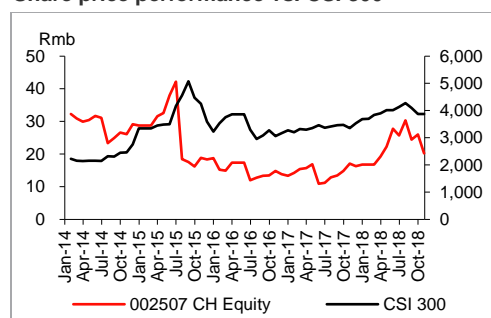
002507 CH	Not rated	
Stock price as of 16/11/2018 RMB	22.90	
GICS sector	Consumer staples	
Market cap	RMBm	18,076
Avg Value Traded (3m)	RMBm	237
12m high/low	RMB	30.78/16.00
PER FY19	x	23.1
P/BV FY 19	x	5.8

## Historical financials

YE Dec (US\$m)	2015A	2016A	2017A
Revenue	931	1,121	1,520
% growth	2.7	20.4	35.6
EBITDA	209	328	526
% growth	26.5	56.7	60.4
EPS	49.00	49.00	52.00
% growth	19.2	63.5	61.0
EBIT Margin	18.0	24.3	30.7

Source: Company data, FactSet, November 2018

## Share price performance vs. CSI 300



\*Relative to the market.

Source: Macquarie Research, November 2018

## Share Price Driver

Thematic
<b>Growth</b>
Value
Event

Source: Macquarie Research, November 2018

## Analysts

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## MacVisit: Fuling Zhacai

### No.1 pickled vegetables brand in China

## Key points

- ▶ Pricing power on the back of brand equity.
- ▶ Raw material price likely to increase; channel expansion is underway.
- ▶ Strong balance sheet to provide sufficient ammunition for M&A.

## Event

- We visited Fuling Zhacai's factory in Chongqing and talked with mgmt. during our recent consumer tour. The company develops, produces and sells pickled mustard, pickled mustard sauce and other appetizers under two brands, Wujiang and Huitong. Fuling's market share in 2017 reached 16.8%, more than twice that of the second largest company (Yuquan, 7.1%).

## Key findings

- **Pricing power on the back of brand equity.** From November 2018, Fuling Zhacai lifted CIF (cost, insurance and freight) price for some products by 10%, mainly for areas outside Guangdong to avoid transshipments. The company will provide rebates for some distributors to maintain a competitive margin before it is able to lift retail prices. On the back of its brand equity, the company was able to consecutively raise its CIF price YoY, resulting in a 4% and 16% ASP increase in 2016 and 2017 respectively. Currently, all of Fuling's products are sold at above Rmb2/package, while the retail price of mainstream pickled vegetables is at Rmb1.5-2/package.
- **Raw material price likely to increase; channel expansion is under way.** According to the company, mustard vegetables accounted for 45% of COGS, while packaging and worker force cost 22% and 10%, respectively. Recently, the purchase price of mustard vegetables for 2019 has been set at Rmb800/ton and above by the company, 14% higher than the floor price for 2018. Meanwhile, for pickled mustard products, Fuling Zhacai has started to expand into the restaurant channel, as it sees significant potential there along with the fast growth of delivery services. For Sichuan pickled vegetables and other appetizers, the penetration rate among its 1,200+ distributors was ~20% in 2017 and will improve in the future, according to the company.
- **Strong balance sheet to provide sufficient ammunition for M&A.** Thanks to its strong cash generative ability, the company recorded 61.6% net cash position as at end-3Q18. Post the acquisition of 100% of Huitong's equity in 2015, the company keeps sufficient ammunition for potential M&A, with focus on condiments area, such as soybean paste, according to mgmt.

## Financials, valuations, and risks

- Fuling Zhacai reported 9M18 revenue of RMB1,545m, up 26% YoY, with net profit up 72% YoY to RMB523m. 3Q18 revenue increased 11% to RMB482m, with net profit increasing 65% to RMB218m.
- The stock is trading at 23x FY19E PER, compared with the average 27x FY19E PER for domestic condiment peers, all based on Bloomberg consensus.

### Ownership (As of 3Q18)

- Chongqing Fuling State-owned asset investment management Group, 39.65%
- Hong Kong Securities Clearing Co. Ltd., 4.41%
- National Social Security Fund 406 portfolio, 4.31%
- Beijing Construction Co.,Ltd, 3.80%
- Zhou Binqun, 1.68%

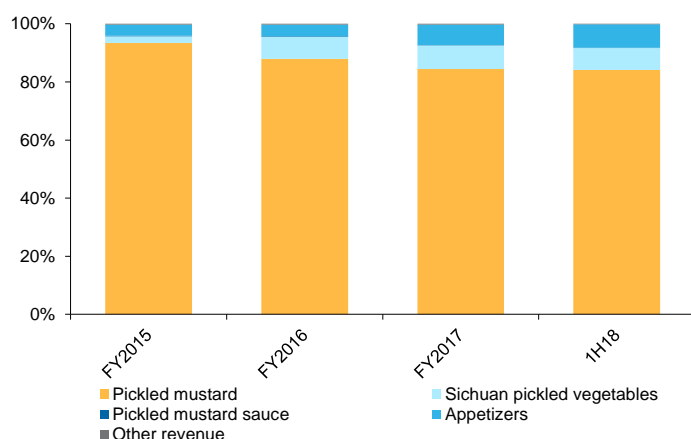
### Balance sheet data and refinancing (As of 3Q18)

- Cash and bank balance of Rmb1,438m
- Fixed asset and construction in process of Rmb878 m
- No short-term and long-term debt
- Net cash/equity ratio at 61.6%

### Latest results highlights (3Q18)

- Revenue grew by 11% to Rmb482m in 3Q18.
- Gross margin expanded by 10.9ppt to 57.3% in 3Q18.
- EBIT margin increased by 13.5ppt to 48.6%.
- Net profit increased by 65% to Rmb218m.

Fig 1 Revenue breakdown by product (Rmb m)



Source: Company data, November 2018

### History and corporate governance

- 1988, established as Chongqing Fuling Zhacai Group.
- 2008, restructured to Chongqing Fuling Zhacai Co., LTD
- 2010, listed on the Shenzhen Stock Exchange.
- 2015, acquired 100% equity of Huitong, who focused on production and sales of Sichuan pickled vegetables.

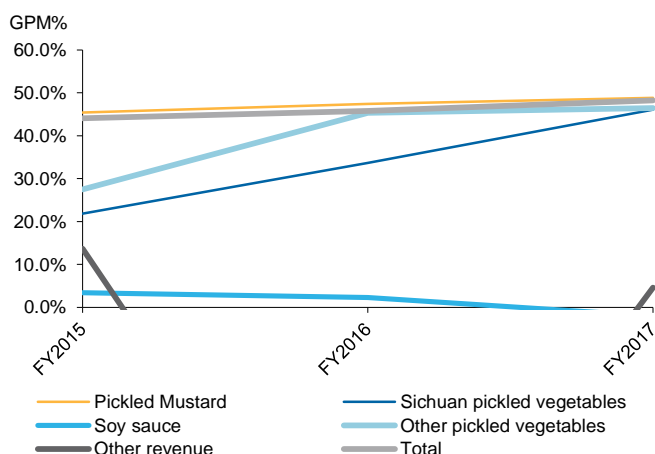
### Management and Directors background

- Mr. Zhou Binqun, aged 55, was appointed Chairman in May 2011. He is also Vice Chairman of China Condiments Association. He joined the company in 2000 and previously served as General Manager.
- Mr. Zhaoping, aged 52, was appointed the General Manager in May 2011. He joined the company in 2005 and served as Deputy General Manager during 2005-11.
- Mr. Yuan Guosheng, aged 39, serves as a director on the Board and is in charge of sales and marketing. He has been always engaged in the field of sales since he joined the company in 1998.

### Latest results highlights (FY17)

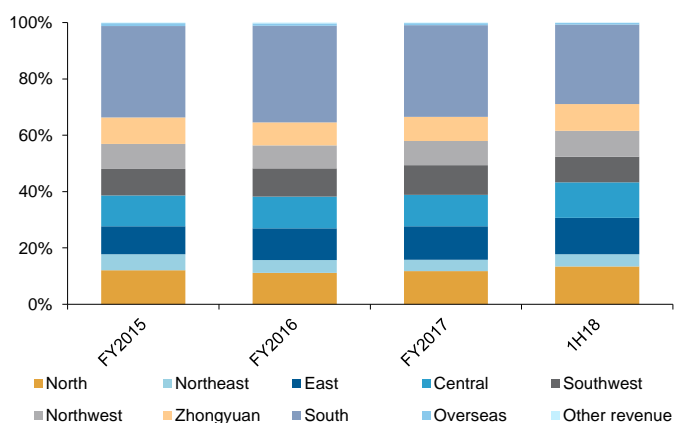
- Revenue grew by 36% to Rmb1,520mn in FY17.
- Gross margin expanded by 2.4ppt to 48.2% from 45.8% in FY16.
- EBIT margin was lifted by 6.4ppt to 30.7% from 24.3% in FY16.
- Net profit increased by 61% to Rmb414m.

Fig 2 Gross margin by product



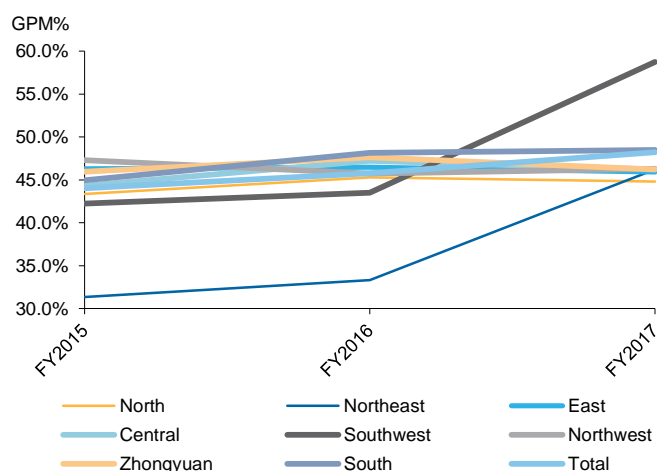
Source: Company data, November 2018

**Fig 3 Revenue breakdown by region (Rmb m)**



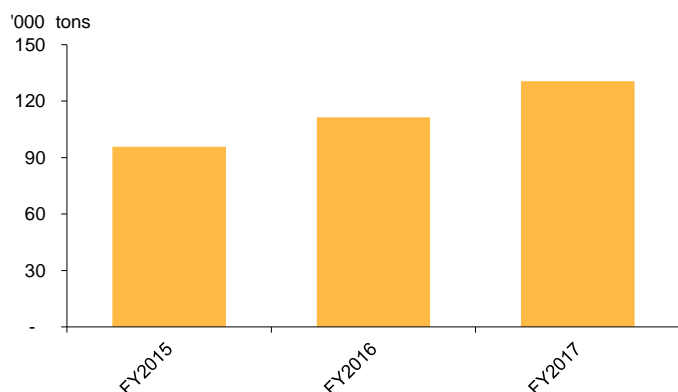
Source: Company data, November 2018

**Fig 4 Gross margin by region (%)**



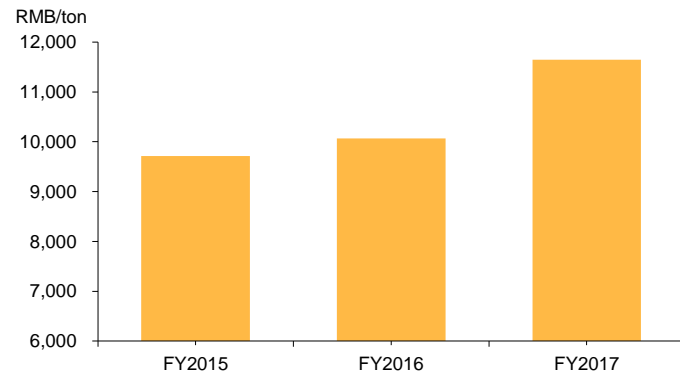
Source: Company data, November 2018

**Fig 5 Sales volume ('000 tons)**



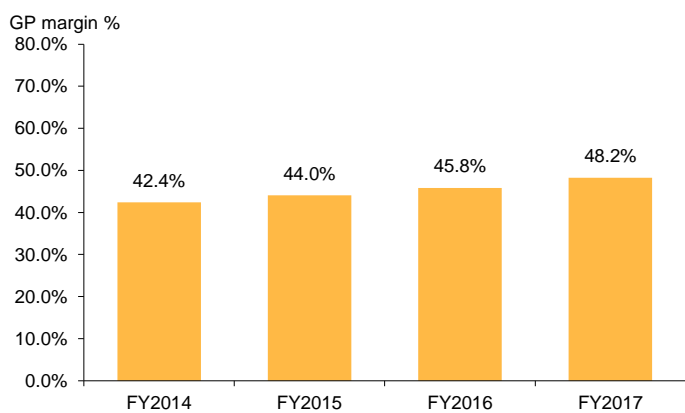
Source: Company data, November 2018

**Fig 6 Average selling price (RMB/ton)**



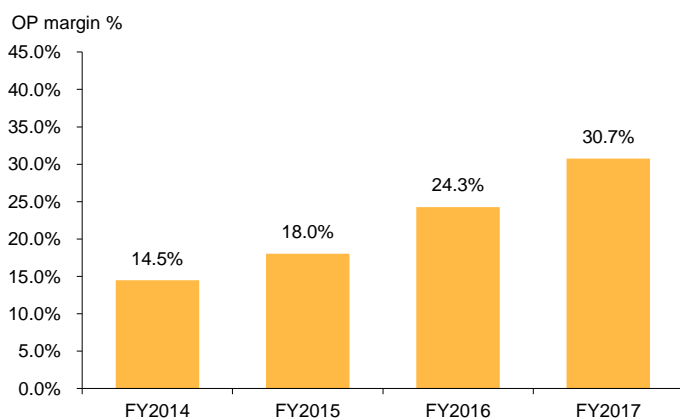
Source: Company data, November 2018

**Fig 7 Gross margin trend (%)**



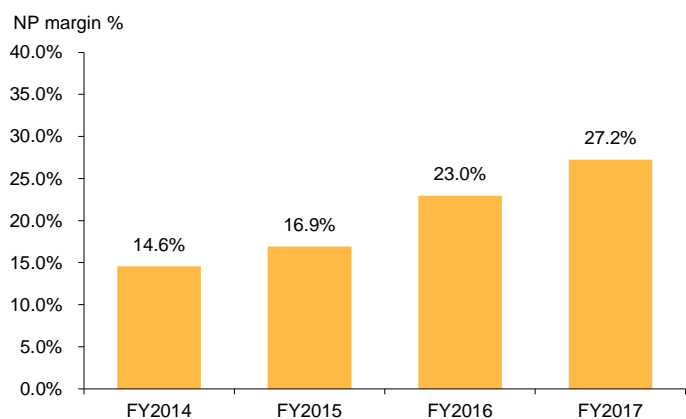
Source: Company data, November 2018

**Fig 8 Operating margin trend (%)**



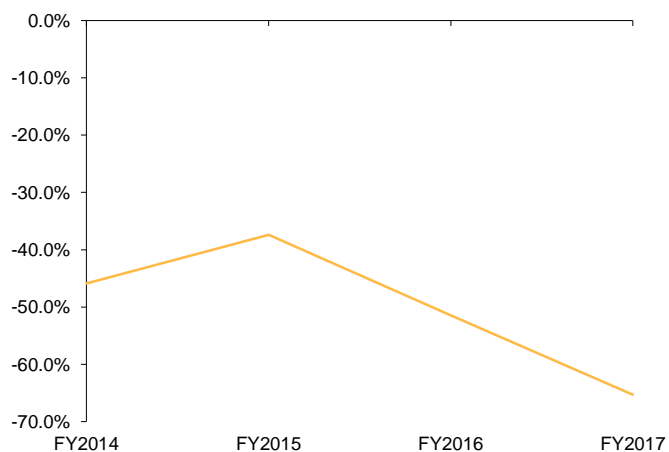
Source: Company data, November 2018

**Fig 9 Net profit margin trend (%)**



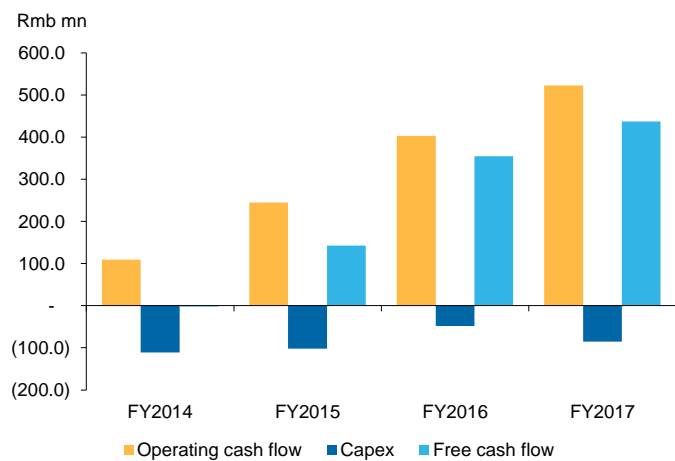
Source: Company data, November 2018

**Fig 10 Net debt to equity ratio (%)**



Source: Company data, November 2018

**Fig 11 Free cash flow (Rmb m)**



Source: Company data, November 2018

## Fuling Zhacai (002507 CH, not rated)

Interim Results					Annual Results						
		2H16A	1H17A	2H17A	1H18A		2014A	2015A	2016A	2017A	
<b>Revenue</b>	m	514	793	727	1,064	<b>Revenue</b>	m	906	931	1,121	1,520
<b>Gross profit</b>	m	223	373	360	585	<b>Gross profit</b>	m	384	410	513	733
Cost of goods sold	m	290	420	367	478	Cost of goods sold	m	522	521	608	787
<b>EBITDA</b>	m	170	224	302	385	<b>EBITDA</b>	m	165	209	328	526
Depreciation	m	28	28	29	28	Depreciation	m	32	39	53	56
Amortisation	m	2	1	2	1	Amortisation	m	2	2	3	3
<b>EBIT</b>	m	142	196	272	356	<b>EBIT</b>	m	131	168	272	467
Net interest income	m	3	0	2	1	Net interest income	m	13	7	4	2
Forex gain/loss	m	0	0	0	0	Forex gain/loss	m	0	0	0	0
Other pre-tax profit	m	-30	6	13	-1	Other pre-tax profit	m	12	9	30	18
<b>Pre-Tax Profit</b>	m	168	202	286	356	<b>Pre-Tax Profit</b>	m	156	185	306	488
Tax expenses	m	(27)	(30)	(44)	(51)	Tax expenses	m	(24)	(27)	(49)	(74)
<b>Net profit</b>	m	141	172	242	305	<b>Net profit</b>	m	132	157	257	414
Minority interest	m	0	0	0	0	Minority interest	m	0	0	0	0
<b>Reported Earnings</b>	m	141	172	242	305	<b>Reported Earnings</b>	m	132	157	257	414
<b>Reported Earnings</b>	m	141	172	242	305	<b>Reported Earnings</b>	m	132	157	257	414
EPS (rep)	¢	27	22	30	39	EPS (rep)	¢	66	49	49	52
EPS (adj)	¢	27	22	30	39	EPS (adj)	¢	66	49	49	52
EPS grow th yoy (adj)	%	29	0	11	77	EPS grow th yoy (adj)	%	(6)	19	63	61
						PE (rep)	x	44	38	27	32
						PE (adj)	x	44	38	27	32
EBITDA margin	%	33.1	28.3	41.6	36.2	Total DPS	¢	10.0	20.0	10.0	15.0
EBIT margin	%	27.6	24.7	37.3	33.5	Payout ratio	%	15.2	40.8	20.4	28.8
Revenue grow th	%	13	31	42	34	Weighted average shares	m	200	324	526	789
EBIT grow th	%	109	51	91	82						
		2014A	2015A	2016A	2017A						
<b>Profit and Loss Ratios</b>						<b>Cash Flow Analysis</b>					
<b>Revenue growth</b>	%	7.1	2.7	20.4	35.6	<b>Net income</b>	m	132	157	257	414
EBITDA grow th	%	(4.5)	26.5	56.7	60.4	Depreciation & Amortisation	m	34	42	56	59
EBIT Grow th	%	(6.1)	27.8	62.2	71.9	Other non-cash adjustments	m	(3)	21	5	(49)
Gross profit margin	%	42.4	44.0	45.8	48.2	Changes in non-cash capital	m	(54)	25	85	98
<b>EBITDA margin</b>	%	18.3	22.5	29.3	34.6	<b>Operating cash flow</b>	m	109	245	403	523
EBIT margin	%	14.5	18.0	24.3	30.7	Acquisitions	m	0	0	0	0
Net profit margin	%	14.6	16.9	23.0	27.2	Capex	m	(111)	(102)	(48)	(85)
Payout ratio	%	15.2	40.8	20.4	28.8	Asset sales	m	8	0	0	0
						Other	m	(103)	(163)	(274)	(515)
<b>Balance Sheet Ratios</b>						<b>Investing cash flow</b>	m	(206)	(265)	(322)	(600)
ROE	%	12	13	17	24	Dividends	m	(31)	(21)	(66)	(53)
ROA	%	10	10	14	19	Equity raised	m	0	0	0	0
Net debt/equity	x	(0.5)	(0.4)	(0.5)	(0.65)	Debt movements	m	0	(117)	0	0
						Other	m	0	35	(3)	1
						<b>Financing cash flow</b>	m	(31)	(103)	(69)	(51)
						Forex	m	(0)	0	0	0
						<b>Net change in cash/debt</b>	m	(128)	(124)	12	(129)
						<b>Free cash flow</b>	m	(2)	142	354	437
						<b>Balance Sheet</b>					
						Cash		523	514	806	1,259
						Receivables		4	3	1	2
						Inventories		142	175	172	248
						Investments		0	0	0	0
						Fixed asset	█	560	761	750	778
						Intangible asset		93	130	127	118
						Other assets	█	52	77	76	80
						Total assets	█	1,372	1,660	1,932	2,484
						Payables	█	96	123	139	232
						Short term debt		0	0	0	0
						Long term debt		0	0	0	0
						Other liabilities	█	136	162	227	324
						Total liabilities	█	232	285	366	556
						Share capital		202	329	526	789
						Surplus reserves		62	78	104	144
						Undistributed profits		365	486	652	973
						Other	█	511	482	284	21
						Total S/H equity		1,140	1,375	1,566	1,928
						Total liab & S/H equity		1,372	1,660	1,932	2,484

All figures in CNY unless noted.

Source: Company data, Wind, Bloomberg, November 2018

## Important disclosures:

## Recommendation definitions

**Macquarie - Australia/New Zealand**

Outperform – return >3% in excess of benchmark return  
Neutral – return within 3% of benchmark return  
Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield, which is currently around 9%.

**Macquarie – Asia/Europe**

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

**Mazi Macquarie – South Africa**

Outperform – expected return >+10%  
Neutral – expected return from -10% to +10%  
Underperform – expected return <-10%

**Macquarie - Canada**

Outperform – return >5% in excess of benchmark return  
Neutral – return within 5% of benchmark return  
Underperform – return >5% below benchmark return

**Macquarie - USA**

Outperform (Buy) – return >5% in excess of Russell 3000 index return  
Neutral (Hold) – return within 5% of Russell 3000 index return  
Underperform (Sell) – return >5% below Russell 3000 index return

## Volatility index definition\*

This is calculated from the volatility of historical price movements.

**Very high-highest risk** – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

**High** – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

**Medium** – stock should be expected to move up or down at least 30–40% in a year.

**Low-medium** – stock should be expected to move up or down at least 25–30% in a year.

**Low** – stock should be expected to move up or down at least 15–25% in a year.

\* Applicable to Asia/Australian/NZ/Canada stocks only

**Recommendations** – 12 months

**Note:** Quant recommendations may differ from Fundamental Analyst recommendations

## Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense  
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

**EPS** = adjusted net profit / epowa\*

**ROA** = adjusted ebit / average total assets

**ROA Banks/Insurance** = adjusted net profit / average total assets

**ROE** = adjusted net profit / average shareholders funds

**Gross cashflow** = adjusted net profit + depreciation

\*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

## Recommendation proportions – For quarter ending 30 September 2018

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	51.56%	59.51%	45.05%	46.88%	67.86%	46.70%	(for global coverage by Macquarie, 3.70% of stocks followed are investment banking clients)
Neutral	33.20%	28.92%	37.36%	47.70%	25.00%	42.73%	(for global coverage by Macquarie, 2.04% of stocks followed are investment banking clients)
Underperform	15.23%	11.57%	17.58%	5.42%	7.14%	10.57%	(for global coverage by Macquarie, 0.47% of stocks followed are investment banking clients)

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