

# China Consumer Staples

## Marketing feedback – inflation & price hikes were key words that appeared in every meeting

- **We held a 5-day analyst marketing last week and met over 20 regional investors.** We feel that investors in general have remained very cautious on 2022E outlook in view of 1) a persistently elevated cost inflation; 2) uncertainty residing with the “dual control” policy and 3) any contagious impact to consumption if the property market is entering into a multi-year down-cycle. We see little pushbacks to [our stock calls](#). There were some discussions of whether there would be an inflection point to the current investment sentiment if China’s policy cycle were to normalize over 2022E. In our view, in this binary event, we still see grounds to stick with players high pricing power that protect margins until any developments emerge. Our top picks are CR Beer (291 HK, Buy) and Mengniu (2319 HK, Buy).
- **The sustainability and magnitude of recent price hikes for Beer and dairy players was discussed in almost every meeting.** CR Beer initiated a higher price for its Yongchuangtianya series in Sep and sees possibility of another potential price lift for its mid/ mass market products next year. Budweiser hedged its raw materials cost and yet the company initiated a 3-10% price hike for its core+ products. Mengniu sees easing raw milk cost pressure into 2H21 whereas Yili’s mix upgrade in 3Q further solidified market confidence to its corporate execution and its 0.5% margins expansion p.a. guidance.
- **Recent newsflow has not altered our constructive view.** There were some worries over recent [newsflow by the Economic Daily](#) concerning the pace of premiumization pursued dairy players. Takeaways from our **Expert Call** suggests that this likely serves as a reminder to keep mass-market dairy products affordable, while the current consumer trade-up trend is well supported by diversifying needs and demand to high nutrition products. Meanwhile, the enforcement of a whitelist shall remove the regulatory overhang to e-vapor producers in China. That said, a conservative policy stance on flavored cartridge (fruits and mint) remains a known unknown to Smoore and RLX. Compared to those in beer and dairy names, we see thinner incremental buying interest for e-vapors especially after considering preference from investors with ESG mandates. As a separate note, we are positive to [CR Beer’s entry to HSI](#) but expect limited positive reaction to share price given that the name is not particularly under-owned for now.
- **Valuation.** The MSCI China Consumer Staple index is trading at 23.2x 2022E P/E. We benchmark our TPs for Mengniu, Yili and Tsingtao to +1sd above the stocks’ 3-year averages, CRB at 3-year average, while we set those for Smoore and RLX at -1sd below, as we still attempt to price-in the perplexed sentiment post regulatory scrutiny.

Name	Ticker	Rating	Price	TP	Mkt Cap (US\$ mn)	P/E (x)		P/B (x)		ROE (%)	
			(LC)	(LC)		FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
CR Beer	291 HK	Buy	65.7	88.0	27,736	40.2	38.7	7.4	6.7	13.9	17.5
Mengniu	2319 HK	Buy	46.0	58.0	23,338	41.0	34.5	5.8	5.1	11.9	13.5
Smoore	6969 HK	Buy	40.9	51.4	31,548	38.5	27.1	13.5	10.4	41.7	45.8
Tsingtao	168 HK	Buy	66.0	86.0	16,312	27.2	22.5	3.3	3.0	12.2	13.6
Yili Ind.	600887 CH	Buy	40.2	50.0	38,353	27.1	23.4	7.5	6.7	27.7	30.5
RLX Tech	RLX US	Buy	4.5	6.9	7,069	18.3	13.1	16.8	9.8	39.7	42.0

Source: Company data, CMBIS estimates

### MARKET PERFORM (Maintain)

#### China Consumer Staples

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##### Investment thesis

A habitual consumption pattern, premiumization and an effective cost pass-through are structural drivers that F&B players offer to buffer relatively stable margins amid cost inflation.

##### CR Beer (291 HK, Buy)

Target Price (HK\$)	88.0
Up/Downside	+34.0%
Current Price (HK\$)	65.7
Mkt Cap (HK\$ mn)	200,652
52w High/Low (HK\$)	46.0/78.6

Source: Bloomberg, CMBIS

##### Mengniu (2319 HK, Buy)

Target Price (HK\$)	58.0
Up/Downside	+26.1%
Current Price (HK\$)	46.0
Mkt Cap (HK\$ mn)	195,874
52w High/Low (HK\$)	36.3/53.9

Source: Bloomberg, CMBIS

##### Smoore (6969 HK, Buy)

Target Price (HK\$)	51.4
Up/Downside	+25.7%
Current Price (HK\$)	40.9
Mkt Cap (HK\$ mn)	224,165
52w High/Low (HK\$)	31.2/90.0

Source: Bloomberg, CMBIS

##### Yili Industrial (600887 CH, Buy)

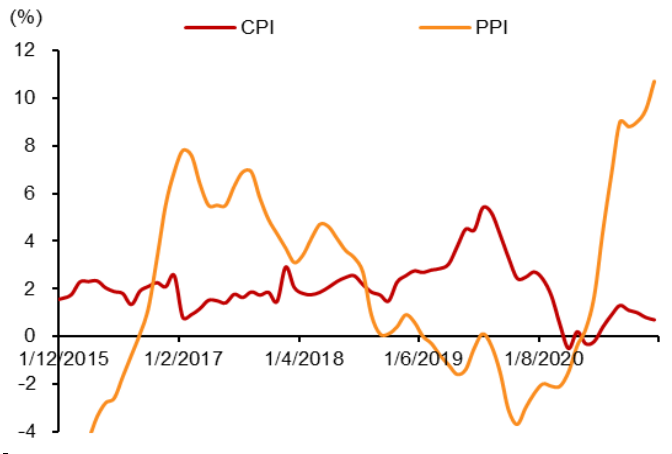
Target Price (RMB)	50.0
Up/Downside	+24.4%
Current Price (RMB)	40.2
Mkt Cap (RMB mn)	261,534
52w High/Low (RMB)	30.9/51.9

Source: Bloomberg, CMBIS

##### Related Reports

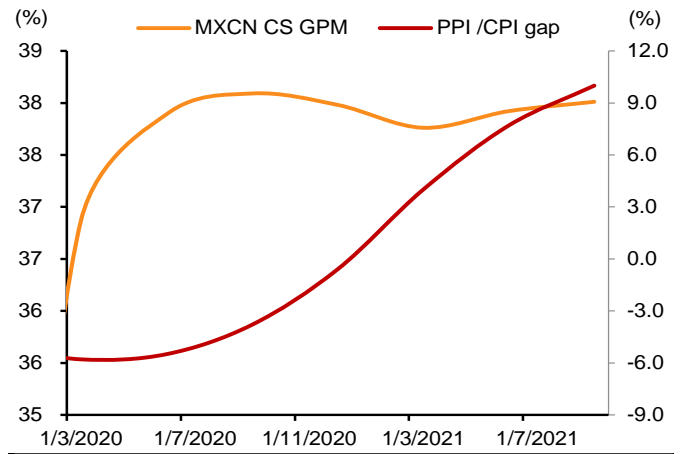
1. [“Structural merits look prominent amid transitional headwind and any stagflation expectation”](#) – 2 Nov 2021

**Figure 1: China PPI and CPI inflations**



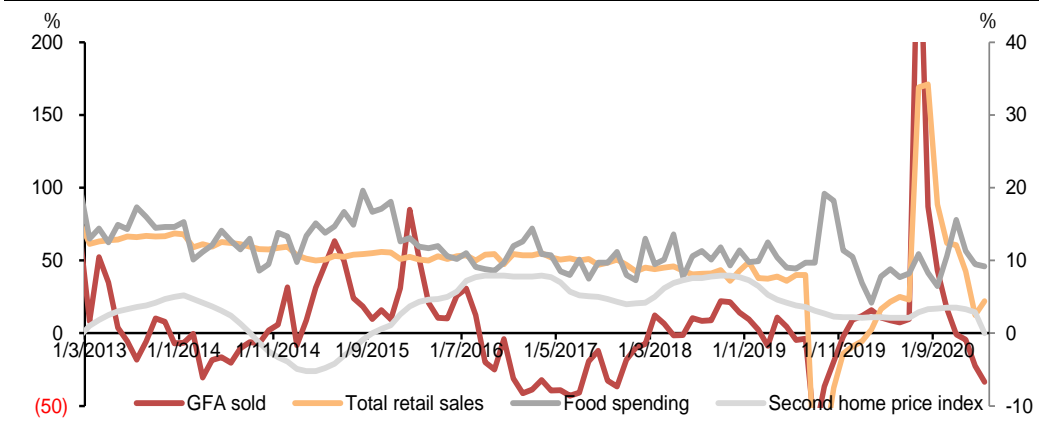
Source: Wind, CMBIS

**Figure 2: Strong margins buffer amid cost inflation**



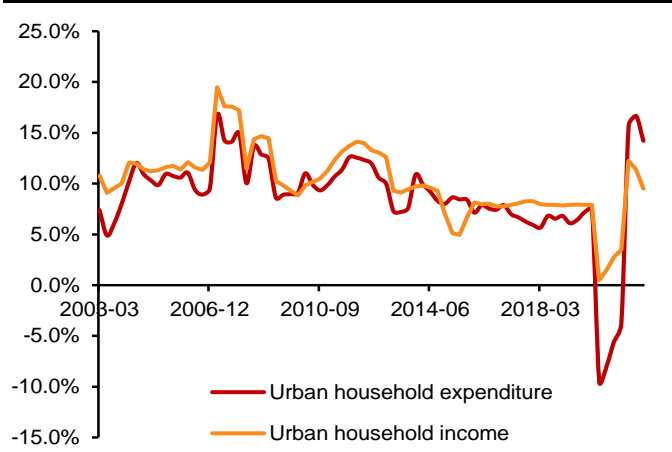
Source: Bloomberg, CMBIS

**Figure 3: Food spending offered a relatively resilience compared to China total retail sales, GFA sold and home price changes**



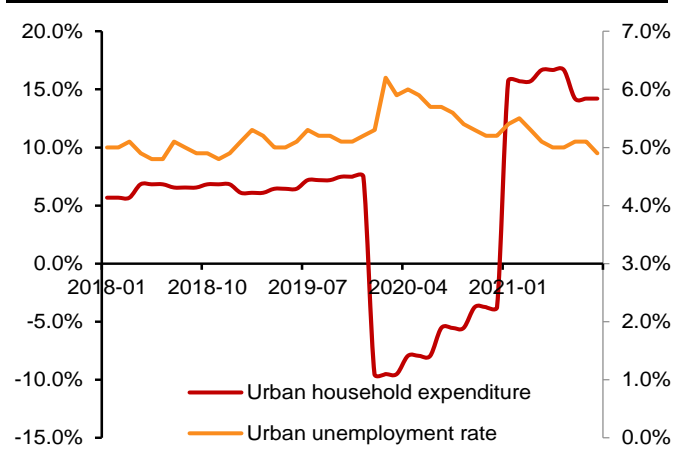
Source: Wind, CMBIS

**Figure 4: Urban household income vs expenditure**



Source: Wind, CMBIS

**Figure 5: Household expense vs unemployment**



Source: Wind, CMBIS

## Key investment thesis of our stock picks

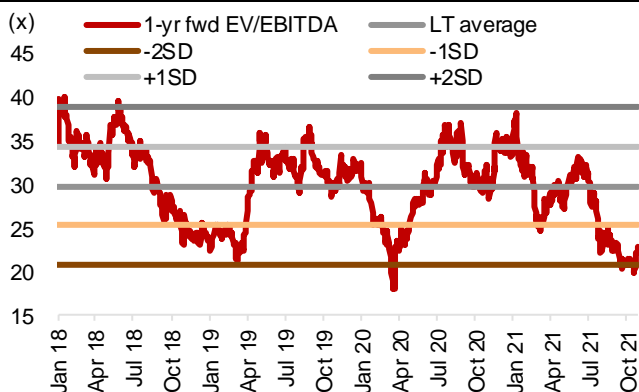
**CRB (291 HK, Buy, TP HK\$88.0).** Despite an anticipated 3Q consumption disruption and a seasonally slower 4Q, CRB remains a high-quality name to stand tall thanks to its undisrupted premiumization trajectory, underpinned by a ~2% sub-premium price hike and a ~5% from a higher premium mix, respectively. We envisage these should also mitigate any cost inflation (4-5%) to be materialized over 2H21.

**Mengniu (2319 HK, Buy, TP HK\$58.0).** Our 5.9% 2H EBIT margins stemmed from an effective cost control that was well proven in 1H. This efficiency gain should also suffice to mitigate the risks to our RMB2bn net profits assumption brought by the transitory raw milk price hike - we expect it to peak out and taper from 17% YoY in 1H to 5-6% YoY in 2H21E, resulting a ~36% 2H gross margins (2H19: 36.3%).

**Yili Industrial (600887 CH, Buy, TP RMB50.0).** Our incorporation of a 7.8% 2H EBIT margins is benchmarked to the level of 2H19, based on a similar rationale we assumed for Mengniu. The 15% raw milk price hike over 1H has resulted in a 0.6pp gross margins dilution to Yili, and we expect the impact to proportionately diminish if the hike maintains at 5% over 2H. We assume a 33.5% 2H gross margin.

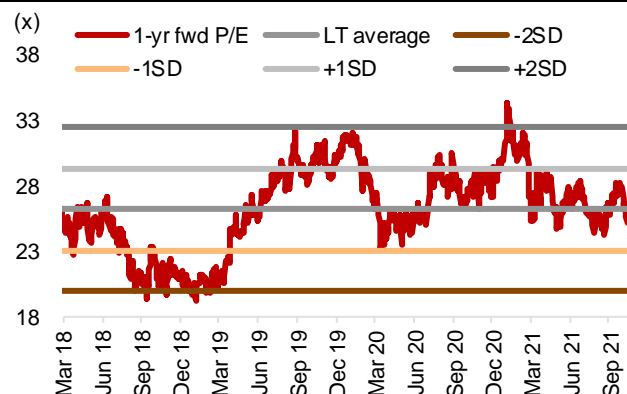
**Smoores (6969 HK, Buy, TP HK\$51.4).** Regulatory scrutiny is a well-known overhang to Smoores. That said, it also serves as a double-edged sword by lifting up the entry barrier to new entrants, upkeeping a high pricing discipline and projecting a more visible competitive landscape.

**Figure 6: CRB - 12M forward EV/EBITDA**



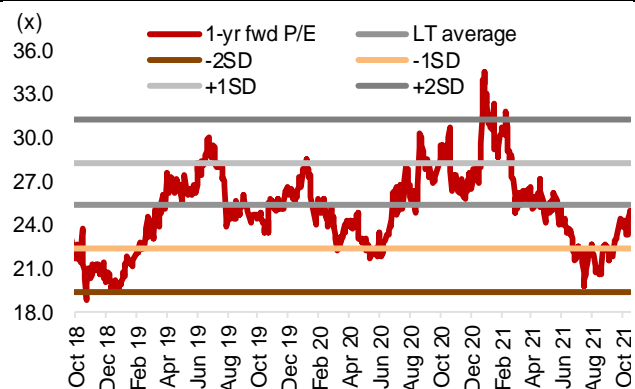
Source: Bloomberg, CMBIS

**Figure 7: Mengniu - 12M forward P/E band**



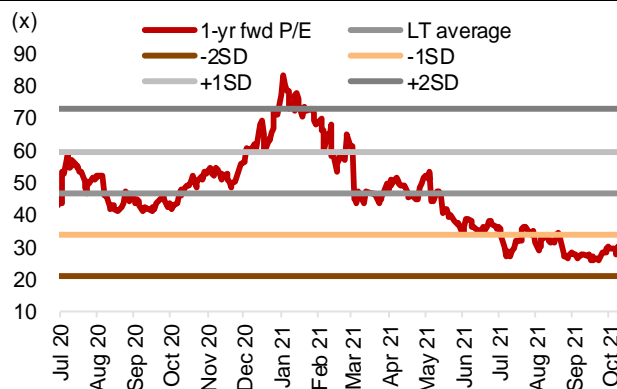
Source: Company data, CMBIS

**Figure 8: Yili - 12M forward P/E band**



Source: Bloomberg, CMBIS

**Figure 9: Smoores - 12M forward P/E band**



Source: Bloomberg, CMBIS

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