

# China Consumer

## 2Q earnings risks look well-contained with refreshed expectation; top picks: CRB/ Smoore

The rollout of pro-growth policy and the re-opening of Shanghai, in our view, set stage for consumption sentiment to flip. We are aware that 2Q earnings risks could be the major hurdles that make the recovery path bumpy. That said, recent accelerated consensus earnings downgrade has nevertheless started to reset market expectations, on top of the 3-month long de-ratings. With an improved risk-reward, we recommend investors to look past the weak 2Q and position for a sequentially higher 2H. In our view, beer stocks are at the forefront to benefit from a more buoyant economy and hence the highest sensitivity to re-openings. Separately, with regulatory reform coming to its end, we think e-cig names are poised for a recovery starting from 4Q22 onwards. We now rate **CRB (291 HK, BUY)** and **Smoore (6969 HK, BUY)** as our sector top picks.

### Our latest subsector views

- **Beer:** Shanghai/ Beijing lockdown has been a swing factor that might drag 2Q shipment and even the pace of restocking for the upcoming peak season. Our channel check suggests that, for CRB, 4M22 shipment still hovered at HSD growth and that in May was flattish YoY. A ~7% price hike has effectively mitigated raw material cost pressure and likely to result in a stable 1H GPM.
- **Dairy:** Mengniu 4M22 sales still pointed to a HSD growth and that of May was positive, in our view. Sales for low-temp SKUs struggled with logistics bottleneck (esp cold-chained related) while that of high-end SKUs decelerated on a high base. Operation deleverage could weigh on margins but more disciplined SG&A expenses could hopefully mitigate. Overall, we expect both Mengniu/ Yili to deliver positive top line growth for 2Q but likely at a sequentially slower pace.
- **Soft drinks:** We expect Nongfu to see a more meaningful impact from pandemic this year, driven by both disruptions to sales and deliveries. Tea continued to sell well but functional drinks saw a more rapid decline, and this could put 1H top line growth to single-digits (from double digits in 1Q22). Separately, the rising PET and delivery costs are likely to erode profit margins.
- **E-cig:** Dust is settling with the new regulation but sales during the transition period (Mar-Sep) should look dismal given a passive destocking for fruit-flavoured cartridge, which will see bans starting from October onwards. Smoore has tendered its new SKUs for approval and the company is optimistic that they will be able to go live in 4Q and thus bring hope for a meaningful recovery in 2023E. Consider also the debut of disposable vapes, in our view, a turn-around story is subtly emerging. For RLX, we forecast 2Q revenue to be RMB2.2bn with sequentially improving GPM on lower provision.
- **IMF:** A low birth rate remains the major sector headwind. We forecast Feihe to deliver a strong 2H come-back if the current restructuring goes as management plans. We still forecast GPM to hover 68-70% with 28-30% net profits margins for 2022E.
- **Duty-free:** 2Q likely be a dismal quarter for offline travelling but we are hopeful of seeing online transactions to help mitigate. Despite that, margins are likely to hold up thanks to more disciplined promotion efforts.

### MARKET PERFORM (Maintain)

#### China Consumer

##### Joseph Wong

(852) 3900 0838

josephwong@cmbi.com.hk

##### Zheng Xiaohui

zhengxiaohui@cmbi.com.hk

#### Investment thesis

A habitual consumption pattern, an ongoing premiumization trajectory and an effective cost pass-through are structural merits that F&B players offer as margins buffer amid cost inflation.

#### Related Reports

1. [Looking past the weak 2Q: earnings risk diminishing as consensus is subtly edging down; upgrade to BUY](#) – 8 Jun 2022
2. [Overseas order and the new disposable vape to sustain growth throughout 2022E](#) – Jun 2 2022
3. [1Q below consensus: 3Q to be a key quarter for transition](#) – 24 May 2022

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## CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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