

China / Hong Kong Company Guide

Tsit Wing International Holdings Ltd

Version 1 | Bloomberg: 2119 HK Equity | Reuters: 2119.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

12 Jul 2018

BUY (Initiate coverage)

Last Traded Price (12 Jul 2018): HK\$1.56 (HSI : 28,481)

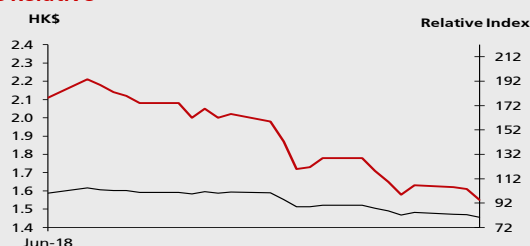
Price Target 12-mth: HK\$2.38 (53% upside)

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Price Relative



— Tsit Wing International Holdings Ltd (LHS) — Relative HSI (RHS)

Forecasts and Valuation

FY Dec (HK\$ m)	2017A	2018F	2019F	2020F
Turnover	955	1,073	1,186	1,318
EBITDA	124	153	171	190
Pre-tax Profit	64	119	145	163
Net Profit	46	88	109	122
Net Pft (Pre Ex) (core profit)	77	95	109	122
EPS (HK\$)	0.06	0.12	0.14	0.16
EPS Gth (%)	(27.1)	91.2	23.4	12.4
Core EPS Gth (%)	23.6	24.1	14.3	12.4
Diluted EPS (HK\$)	0.06	0.12	0.14	0.16
DPS (HK\$)	0.02	0.05	0.05	0.06
BV Per Share (HK\$)	0.28	0.67	0.78	0.89
PE (X)	25.7	13.5	10.9	9.7
Core PE (X)	15.5	12.5	10.9	9.7
P/Cash Flow (X)	44.3	13.1	10.9	9.9
P/Free CF (X)	104.5	17.8	14.1	12.6
EV/EBITDA (X)	10.9	7.1	6.0	5.1
Net Div Yield (%)	1.2	3.4	3.2	3.6
P/Book Value (X)	5.5	2.3	2.0	1.8
Net Debt/Equity (X)	0.6	CASH	CASH	CASH
ROAE (%)	18.7	24.3	19.8	19.4

Earnings Rev (%): New New New

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters, HKEX

Banking on a lifestyle addiction

- **Leading integrated B2B beverage solutions provider in Hong Kong, China and Macau**
- **Expect growth to be driven by rising demand of coffee and tea as well as drinks variety**
- **Initiate with Buy and TP at HK\$2.38/sh**

Leading integrated B2B beverage solutions provider. Tsit Wing is a one-stop coffee and tea solutions provider in Hong Kong, China and Macau. With dominant market shares in key channels in Hong Kong, the Company seeks to leverage on its knowledge and expertise to expand in China. We forecast sales to grow by 12.4% in 2018, mainly driven by higher volumes in both tea and milk as well as the foods business, driven by a combination of new and existing customers. We expect the Group to achieve earnings CAGR of 17% in FY17-20F. Initiate with a Buy rating and TP at HK\$2.38/sh, pegged to 17x FY19F PE, supported by a c.3.2% dividend yield. With the successful IPO listing, the Company successfully raised c.HK\$233.7m (inclusive of over-allotment option exercised). We expect the Company to turn net cash by end-FY18F (Dec'17: net gearing of 68%).

Ride on the coffee and tea culture. With increasing popularity of a coffee and HK milk tea culture, and rising stringent requirement in the supply chain by catering establishments, we expect the B2B beverage solutions market will face growing demand going forward. In addition, the Company has been proactive in launching innovative products with key customers. According to Frost & Sullivan, the coffee and black tea market in Hong Kong and the PRC are expected to grow at a compound annual growth rate (CAGR) of 4.2% and 11.0% to HK\$1,364m and RMB11.4bn respectively in 2017-21E, with a stronger growth trajectory from coffee.

Key catalyst drivers. This includes volume growth in coffee and tea category driven by old and new customers, and favourable raw material prices. Long term driver include potential development with strategic partners, NH Foods and Fraser & Neave.

Valuation:

We initiate coverage with a BUY rating, and TP at HK\$2.38/sh, pegged to 17x FY19F PE. This is equivalent to a 32% discount to F&B sector average.

Key Risks to Our View:

Key risks include raw material price volatility, and food safety concerns.

At A Glance

Issued Capital (m shrs)	761
Mkt Cap (HK\$m/US\$m)	1,187 / 151
Major Shareholders (%)	
Wong (Tat Tong)	63.8
Free Float (%)	36.2
3m Avg. Daily Vol. (US\$m)	7.0
ICB Industry: Consumer Goods / Food Producers	



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Investment summary

- Tsit Wing is a leading integrated B2B coffee and black tea solutions provider in Hong Kong, the PRC and Macau. In the B2B coffee and black tea solutions market, based on 2016 data, Tsit Wing is ranked first in Hong Kong (by revenue), fourth in the PRC (by revenue), and third in Macau (by revenue), according to Frost and Sullivan. It is also the largest importer of Sri Lankan teas in Hong Kong and third largest in the PRC by volume. Besides beverage solutions, Tsit Wing also imports frozen meat and frozen processed food and supplies these to its customers in Hong Kong and the PRC. In May '18, the Company successfully listed in the Hong Kong Stock Exchange with market capitalisation of HK\$1,504m and offer price at HK\$1.98/sh, with overall net proceeds reaching HK\$233.7m (inclusive of over-allotment option exercised).
- Tsit Wing's market coverage in Hong Kong is extensive, reaching c.60% of food outlets in Hong Kong, and has especially high coverage in fast food stores, Cha Chaan Tengs, and cafes of 77.6%/ 70.3%/ 78.7% respectively. The company has developed a stable and diverse group of customers, including reputable names such as franchised business of McDonald's, Café de Coral, Fairwood, The Spaghetti House, Yoshinoya, Tsui Wah, Tai Hing and 7-Eleven.
- Tsit Wing's strength lies in its ability to provide total beverage solutions to its customers, starting from market analysis and recipe design, through sourcing, production as well as after sales service of coffee machines. Coupled with its capability of producing customised tea and coffee products of consistent quality, we believe customers' stickiness is relatively high. We expect Tsit Wing to continue to benefit from rising demand for tea and coffee products in HK and the PRC, with the B2B market to be driven by greater emphasis on food safety and quality requirements from chain operators. Beverage solutions accounted for 74.5% of the company's total revenue, of which tea and coffee contributed 44.7% to total sales in 2017.
- The Hong Kong coffee and black tea market, despite already well developed, is expected to sustain a decent 4-year CAGR of 4.2% to achieve HK\$1,364m in 2021E, based on Frost and Sullivan. For the past three years, the Company's coffee production in Hong Kong has reached full capacity exceeding 100%, which the Company plans to build new production lines to meet demand. As the leading player, Tsit Wing should be well positioned to capture the growth, with room to further enhance its market share and deepen customer relationships through developing higher value-added SKUs. The Company will also expand its product offerings in milk, syrup, frozen meat and more to its existing customers.
- Market potential in PRC is even stronger, with the B2B coffee and black tea market expected to grow at a stronger 4-year CAGR of 11.0% to reach RMB11.4bn in 2021E. Leveraging on its position as one of the major players, Tsit Wing aims to expand its sales channels mainly in the Pearl River Delta and Yangtze River Delta. In particular, the company will focus on first and second tier cities such as Shanghai, Beijing, Hangzhou, Guangzhou, Shenzhen, and Dongguan through expanding its sales network and customer base. Besides this, Tsit Wing plans to set up its online platform via Tmall and JD, and potentially expand overseas.
- To diversify its product offerings, Tsit Wing expanded into frozen food in Hong Kong and the PRC in 2013 and frozen processed food in 2015 in Hong Kong, and 2016 in the PRC. Hong Kong and PRC frozen meats market is expected to grow at a CAGR of 6% and 7.8% in 2017-21E to HK\$8,356m and RMB290bn respectively, while frozen processed food is expected to stage a stronger CAGR of 11.6% and 16.8% over the same period to HK\$2,021m and RMB56bn in 2021E respectively. In July-2017, the company forged a strategic agreement with NH Foods to jointly develop food products in Hong Kong, Macau and the PRC, which should further enhance its product offerings as well as margins.
- We forecast earnings CAGR at 17% in 2017-20F, driven by (i) solid market growth; (ii) enhanced product offerings; and (iii) improving operating leverage. Without any listed peers in the HK, there is no direct comparable. As such, we benchmark Tsit Wing against its customers (restaurants) as well as Hong Kong/China food staples and other listed global B2B food solutions providers at a discount due to its focus on B2B. We initiate coverage with a Buy rating and TP at HK\$2.38/sh, pegged to 17x FY19F PE. This is supported by a dividend yield c.3.2%.

SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> Leading integrated B2B coffee and black tea solutions provider in Hong Kong, Macau and the PRC Strong beverage customising capability and established food products business supported by a worldwide sourcing network Stable and diversified customer base supported by multi-channel distribution network Ability to deliver tailor-made products in mass volume with strong track record of quality control 	<ul style="list-style-type: none"> Dependent on major suppliers. Its five largest suppliers account for 44.3% of total cost of sales in 2017. Of which, the largest supplier accounted for 22.8% of total cost of sales in 2017 Tsit Wing does not enter into long-term contracts with its customers, distributors and suppliers, which means any sudden disruption in their business could cause volatility in Tsit Wing's income
Opportunities	Threats
<ul style="list-style-type: none"> The increase in coffee and tea consumption in the PRC should benefit the Company. Based on Frost & Sullivan, B2B coffee and black tea market is expected to grow at a CAGR of 11.0% in 2017-21E Well-positioned to benefit from the steady growth in B2B coffee and tea consumption in Hong Kong, and Macau, supported by continual product upgrades Expansion of its frozen food business to leverage on its existing relationships with customers in coffee and tea segment 	<ul style="list-style-type: none"> Rising competition is likely in the B2B beverage solutions industry in the PRC Profitability is directly impacted by raw material price volatility in coffee and Sri-Lankan tea, as well as selling prices by its customer Any negative news on the brand could adversely impact sales

Source: DBS HK

Profile of Tsit Wing

Background

Tsit Wing is a leading integrated B2B beverage solutions provider in Hong Kong, Macau and the PRC, with a specialisation in coffee and black tea. With a history dating back 85 years ago, the company was listed on the SGX-ST in 2001, and later privatised in 2013.

In B2B revenue terms, Tsit Wing was **the largest B2B coffee and black tea solutions provider in Hong Kong**, ranked **fourth in PRC**, and **third in Macau** in 2016 according to Frost & Sullivan. Tsit Wing is also the largest importer of Sri Lankan tea in Hong Kong, and the third-largest in the PRC in terms of volume.

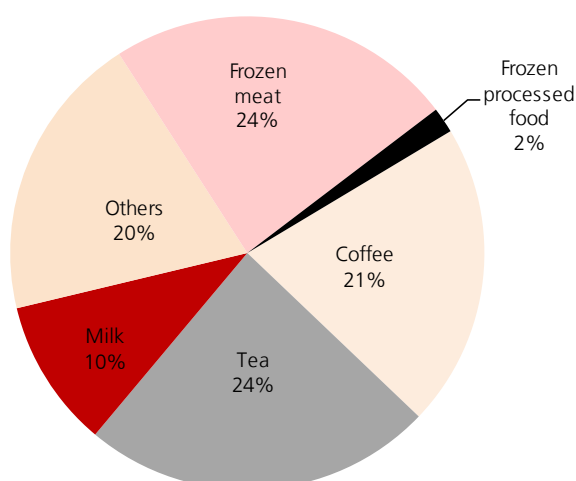
Besides roasted coffee and blended tea, Tsit Wing also offers complementary beverage solutions such as all-in-one packet mixes (coffee, tea, yuan yeung), milk, syrups, and coffee machines. The company is the distributor of Lipton yellow label tea in HK. It also exclusively imports French syrup brand 'Monin' and solely distributes Rex-Royal coffee machines in HK and Macau.

Tsit Wing boasts a multi-channel distribution network that reaches c.60% of the food outlets in Hong Kong. Its customer base includes reputable names such as franchised business of McDonald's in the PRC and Hong Kong, Yoshinoya, 7-Eleven, Café de Coral, Fairwood, Tsui Wah, Tai Hing, and Spaghetti House, among others.

Since 2013, Tsit Wing has further broadened its business scope to include frozen meat products. The company now supplies imported frozen meat as well as customised frozen processed food to its customers in HK and the PRC. In July 2017, the company entered a strategic cooperation with NH Foods, a leading food provider in Japan which has operations in 90 locations in 19 countries, to jointly develop food products in Hong Kong, Macau, and the PRC.

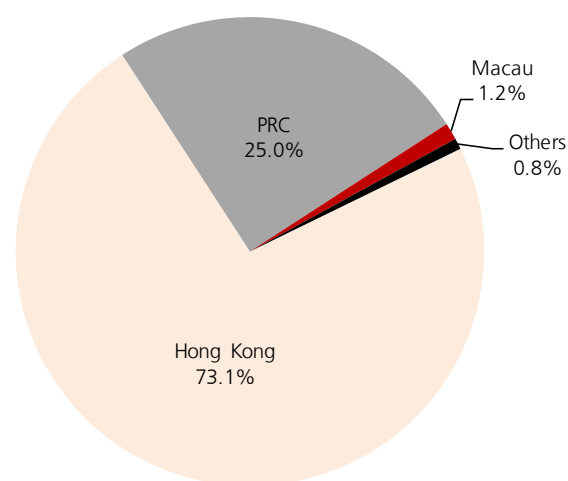
By product, beverage solutions (coffee, tea, milk & others) represented 74.5% of the company's 2017 sales, with a relatively diversified split between tea, coffee, milk and others. Food products (frozen meat & frozen processed food), a newer business segment for Tsit Wing, accounted for 25.5%. Geographically, Hong Kong remains Tsit Wing's largest market representing c.73% of its total 2017 revenue with the balance coming from PRC, Macau, and others.

Revenue breakdown by product segment (2017)



Source: Company data

Revenue breakdown by region (2017)



Source: Company data

Tsit Wing International Holdings Ltd

Business segments

Tsit Wing offers a variety of beverage solutions, including roasted coffee, blended tea, all-in-one packet mixes and other beverage solutions items such as Lipton yellow label tea, and coffee machines. In the past few years, the company has expanded its product offerings to include frozen meat and frozen processed food. Previously, the company was also involved in ice-cream and prune businesses but those were disposed of in 2015 and 2016 respectively.

Beverage solutions (74.5% of 2017 sales)

Coffee. Aside from a small volume of green coffee beans which are sold directly to customers without processing, most are sold as roasted coffee beans, ground coffee powder, and drip coffee bags produced in Tsit Wing's production plants. In addition, by offering a one-stop service to consumers, the company also provides coffee machines, which comes with 24-hour round-the-clock servicing, as well as designing details of the preparation techniques.

Coffee products



Source: Company data

Tea. Tea products are blended tea processed in Tsit Wing's production plants. The company works with its customers to develop customised recipes to produce tailor-made tea products. Tsit Wing's expertise in the Hong Kong-style milk tea, a traditional tea typically consumed in Cha Chaan Tengs in Hong Kong, is also getting increasingly popular in other food outlets as well as in the PRC.

Tea products



Source: Company data

All-in-one. All-in-one beverage mix comprise of coffee powder, tea and yuan yeung products. These are primarily sold through retail stores such as supermarkets and convenience stores.

All-in-one beverage mix



Source: Company data

Other beverage solution products. Aside from processing coffee beans and tea for customers, Tsit Wing also provides other beverage related products such as milk, sugar and syrup. The company is a distributor for Lipton yellow label tea in Hong Kong. It is also the sole authorised agent of Monin products, a French luxury syrup brand, as well as the sole distributor of Rex-Royal coffee machines, in Hong Kong and Macau. Such products are complimentary to its core portfolio.

Other beverage solutions



Source: Company data

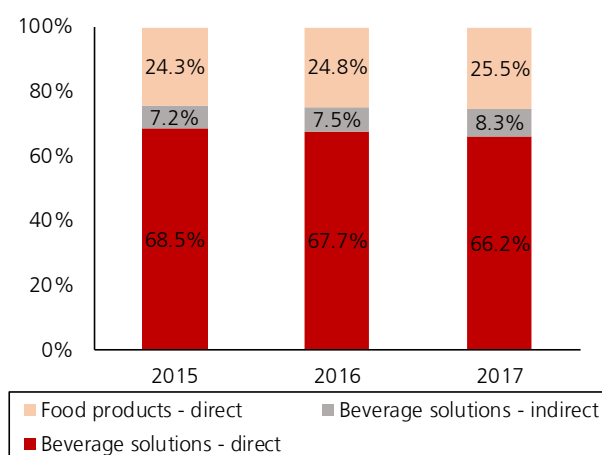
Food products (25.5% of 2017 sales)

Frozen meats. To broaden its product portfolio, Tsit Wing has expanded into the frozen meat category since 2013 via acquisition. The company imports frozen beef, pork, lamb and poultry from Brazil, New Zealand, Japan, the US, Thailand etc. to its wholesale customers who eventually sell those to fast food restaurants and Cha Chaan Tengs.

Frozen processed food. To improve profitability, Tsit Wing has diversified its meat portfolio to include frozen processed food, which is of higher value-added. The company has its own OEM brand, "Papa Chef," which offers a variety of frozen processed food products such as roasted chicken, skewers, hash brown, breaded pork and seafood. The company aims to expand this business through its partnership with Japan's NH Foods in Hong Kong, the PRC and Macau.

Distribution network

Tsit Wing sells its products mainly through direct sales, which accounted for 91.7% of FY17 sales respectively. Direct sales accounted for 88.8% of FY17 beverage solution sales, while all of its food products (frozen meat and frozen processed foods) are sold through direct sales.

Sales breakdown by distribution

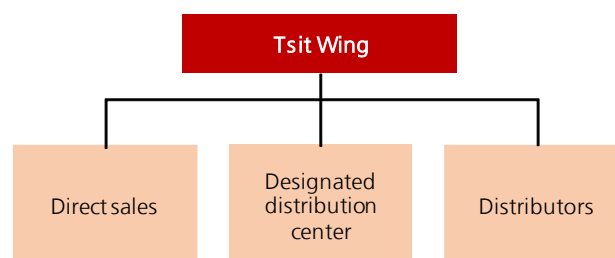
Source: Company data

Direct sales

Tsit Wing has a well-established sales network in Hong Kong directly dealing with customers, which is grouped under six divisions—Hong Kong, Kowloon and New Territories, as well as Hotels and Institutions, Fast Moving Consumer Goods (FMCG), and import and export divisions. Hong Kong Island, Kowloon and New Territories are responsible for catering sales to fast food chains and other food outlets, while Hotel and Institution and FMCG oversee their respective sectors.

In the PRC, the company has been focusing its efforts in first tier and second tier cities in Eastern and Southern China, particularly in Beijing, Shanghai, Guangzhou, Zhuhai, Dongguan, Hangzhou and Shenzhen, with regional sales and distribution offices being set up in respective cities.

Besides the core markets, Tsit Wing also exports to Taiwan and other overseas countries including Canada, Australia, the United States, Malaysia and Philippines through distributors.

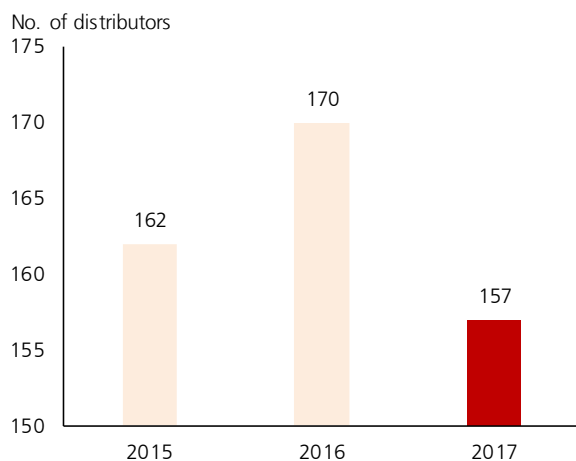
Sales by channels

Source: Company data

Distributors

As of 2017, Tsit Wing has a total of 157 distributors, a reduction from 170 distributors in Dec'16, as the company shifted more FMCG sales to direct sales, and increased efforts to target larger players, as well as natural attrition.

Number of distributors



Source: Company data

While businesses in Macau and the PRC are relatively less mature, the company has secured contracts with hotels, fast food chains, including McDonald's outlets in the PRC and domestic airlines.

Production facilities

Tsit Wing processes its own coffee, blended tea, and all-in-one products (coffee, tea and yuan yeung) in its own production facilities in Hong Kong and Dongguan.

Hong Kong - Hong Kong's production plant houses 2 roasted coffee production lines, and 2 blended tea production lines, which operate c.10 hours per day and 5.5 days a week. The facility is at near/full capacity for coffee and tea products. In 2017, coffee and tea utilisation rate reached 101% and 86% respectively.

Dongguan - The newer Dongguan plant, on the other hand, has 2 roasted coffee production lines, 2 blended tea production lines, and 4 all-in-one beverage production lines. Utilisation rates for coffee, tea, and all-in-one were 83%, 53% and 42% respectively in 2017.

In the future, Tsit Wing plans to shift some of its Hong Kong's production to its Dongguan facility. This should help level off the utilisation rate differences in these facilities and hence help to improve overall cost efficiency.

Production capacity

Description	Approximate gross floor area (sq ft)
Hong Kong	
- 2 roasted coffee production lines	23,086
- 2 blended tea production line	
24 production staff as of 2017	
Dongguan	51,600
- 2 roasted coffee production lines	
- 2 blended tea production lines	
- 4 all-in-one beverage production lines	
93 production staffs as of 2017	

Source: Company data

Tsit Wing also leases 17 warehouses in Hong Kong, including five temperature controlled warehouses for its food business as of 2017.

Production capacity

	#	2015	2016	2017
Hong Kong				
Coffee				
Designed production capacity (lbs)	#	4,464,706	4,464,706	4,464,706
Actual production volume (lbs)	#	4,458,835	4,630,628	4,489,144
Utilisation rate (%)	#	100%	104%	101%
Tea				
Designed production capacity (lbs)	#	3,970,588	3,970,588	3,970,588
Actual production volume (lbs)	#	3,829,797	3,579,843	3,432,554
Utilisation rate (%)	#	96%	90%	86%
Dongguan				
Coffee				
Designed production capacity (lbs)	#	2,807,470	2,807,470	2,807,470
Actual production volume (lbs)	#	1,937,769	1,956,274	2,334,879
Utilisation rate (%)	#	69%	70%	83%
Tea				
Designed production capacity (lbs)	#	2,028,604	3,955,774	6,011,872
Actual production volume (lbs)	#	1,739,927	2,481,254	3,183,282
Utilisation rate (%)	#	86%	63%	53%
All-in-one				
Designed production capacity (lbs)	#	9,324,201	9,324,201	9,324,201
Actual production volume (lbs)	#	3,735,102	3,406,916	3,915,983
Utilisation rate (%)	#	40%	37%	42%

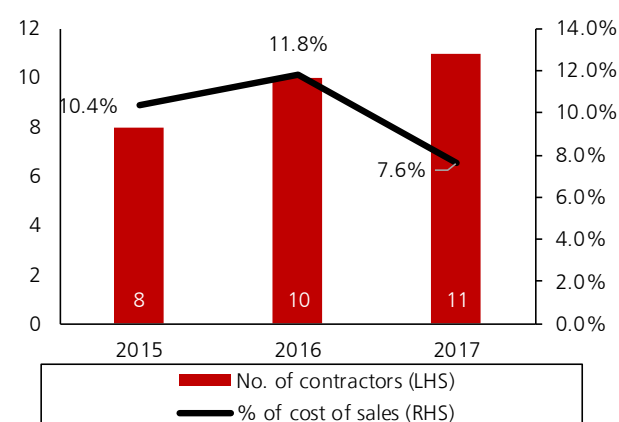
Source: Company data

OEM contractors

Tsit Wing also engages with OEM contractors based in Lithuania, Czech Republic and Thailand for certain SKUs. This includes milk products for beverage solutions, and some frozen processed foods. As of 2017, the company has 11 OEM contractors, with most having more than two years of business relationships with the company.

Typically, Tsit Wing enters into master OEM agreements with their contractors with a term ranging from one to three years on cost and freight terms, where the OEM contractor will cover all costs, except insurance, to deliver the products to the port of destination. Purchases from OEM contractors amounted to 7.6% of total cost of sales in FY17.

OEM distributors



Source: Company data

History of Tsit Wing

History of Tsit Wing

Year	Event
1932	Establishment of the Group, primarily engaged in the business trading principally as a wholesaler in the supply of coffee and tea products
1956	Incorporation of Tsit Wing Hong Kong Company Limited
1963	Acquisition of Tsit Wing's owned factory in Beech Street, Kowloon for coffee roasting and packaging
1980	Acquisition of properties in Kwai Tak Industrial Centre in Kwai Chung, New Territories, Hong Kong for production and as head's office
1982	Adoption of computerized coffee processing plants and machineries from the United States
2000	Incorporation of Tsit Wing
2001	Tsit Wing was listed on the main board of Singapore Stock Exchange Aggregate consideration for the listing was SGD0.29 per share or SGD46.4m. In terms of PE valuation on listing: (i) total consideration/2000 earnings of SGD6.942m was 6.68x, while P/NTA stood at 1.70x
2008	Zhuhai Tsit Wing Food Co. Ltd was designated as the Beijing Olympic Games' Official Coffee and black tea supplier
2009	Establishment of Dongguan production and service center
2013	Tsit Wing was privatised and delisted from SGX-ST. Aggregate consideration for the privatisation was SGD0.3075 per share or SGD65.5m. In terms of PE valuation on privatisation: (i) total consideration/2012 earnings of HK\$22.5m was 18x (Trailing PE at 16.6x) ; while P/NTA stood at 1.3x Incorporation of Whole Sun for the business and assets of Oriole Properties Limited, which marked the commencement of frozen food business
2015	Expanded food market business to importing frozen processed food
2017	Strategic cooperation agreement with NH Foods

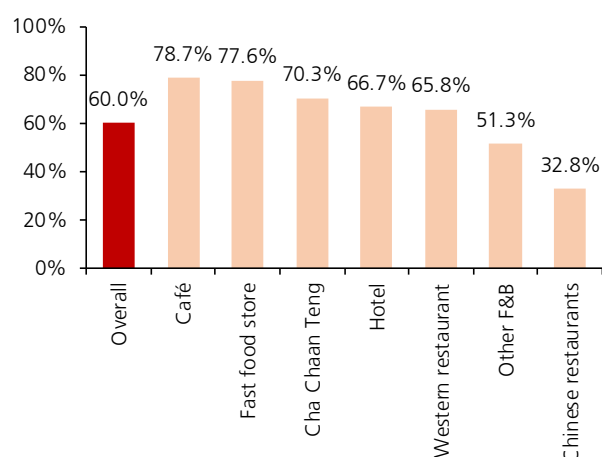
Source: Company, DBS

Competitor strength

(1) Strong heritage with longstanding relationships with reputable customers

With 85 years of operating history, Tsit Wing is a leading integrated B2B coffee and black tea solutions provider in Hong Kong, Macau and the PRC. In Hong Kong, the company's market coverage is extensive, reaching c.60% of food outlets in total, and covering over 70% of fast-food stores, Cha Chaan Tengs and cafés. The company has developed a stable and diverse group of customers, including reputable names such as franchised businesses of McDonald's in the PRC and HK, Café de Coral, Fairwood, The Spaghetti House, Yoshinoya, Tsui Wah, Tai Hing, and 7-Eleven.

Tsit Wing's market coverage by type of F&B serving establishments in Hong Kong

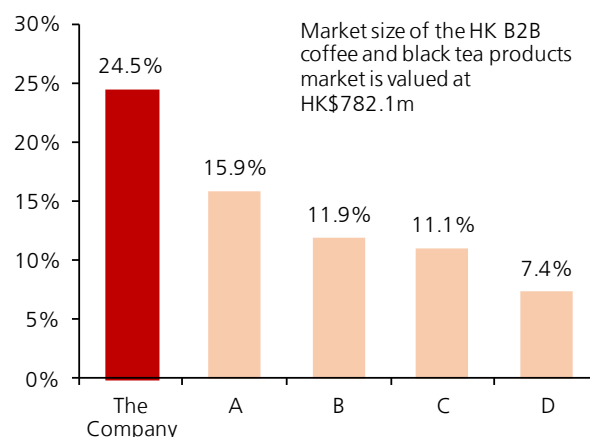


Source: Frost & Sullivan

(2) Strong market shares

Tsit Wing is ranked number 1 in the B2B coffee and black tea beverage solutions market, accounting for 24.5% of total market share (by B2B revenue) in Hong Kong. Combining the top 4 players (including Tsit Wing), total market share is concentrated at 70.8% in terms of revenue. There is increasing demand for one-stop services but requirements for suppliers are also stringent, hence the B2B beverage solutions market should stay favourable to the top players.

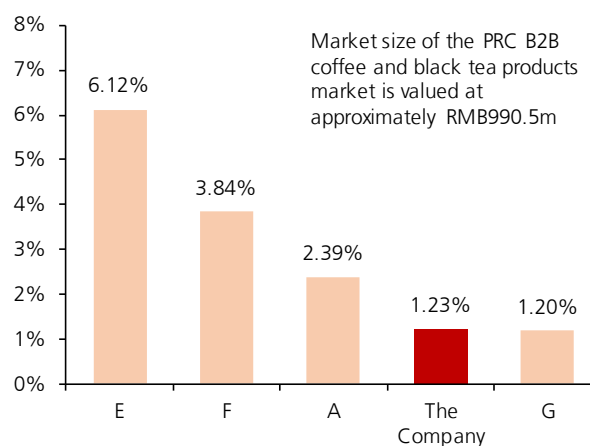
Market share of top 5 players in terms of revenue in the Hong Kong B2B coffee and black tea products market (2016)



Source: Frost & Sullivan

In PRC, Tsit Wing had a market share of 1.23% in terms of revenue, and ranked number 4th in 2016. The top five players command a total market share of 14.8%, which suggests China market is highly fragmented. On the other hand, the company is also the third largest importer of Sri Lankan tea in the PRC. Sri-Lanka was the largest black tea exporting country by export value and the second largest by export volume in 2016. Tsit Wing's imported 69.2 tons in 2016, and accounts for 9.2% of the imported black tea market in the PRC.

Market share of top 5 players in terms of revenue in the Greater China B2B coffee and black tea products market (2016)

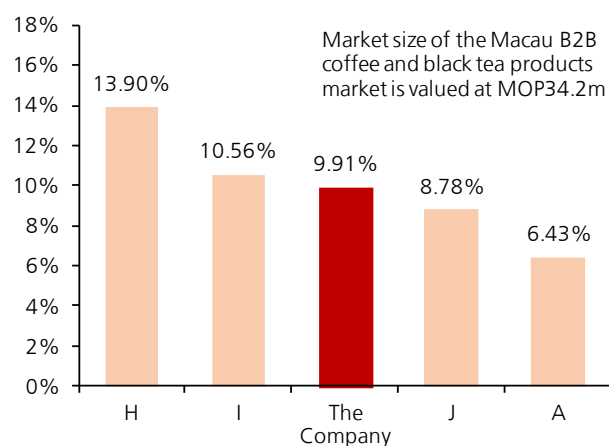


Source: Frost & Sullivan

Tsit Wing International Holdings Ltd

In Macau, Tsit Wing ranks number 3 in terms of operating revenue, representing 9.91% of the total market in 2016.

Market share of top 5 players in terms of operating revenue in the Macau B2B coffee and black tea products market (2016)



Source: Frost & Sullivan

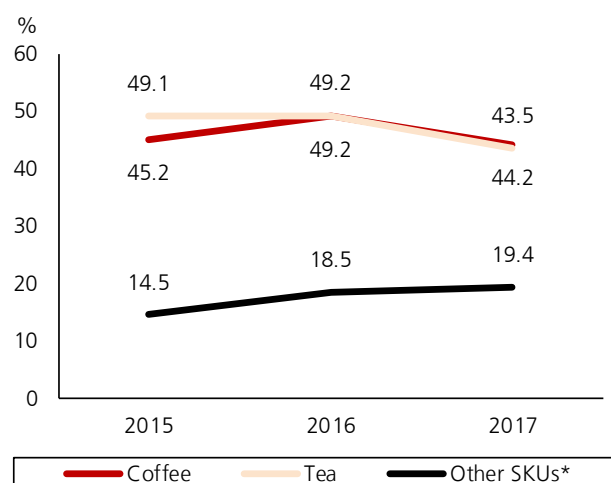
(3) One-stop service for customers

Tsit Wing provides a one-stop service for commercial customers with solutions covering the entire concept to market process, ranging from market analysis, recipe development, sourcing, production, all the way to marketing and after sales services, which includes customer training and equipment maintenance.

The company constantly develops new beverage concepts, and helps design seasonal and new beverage items for its customers. Besides catering for customers on developing unique recipes on coffee and black tea, the company also provides coffee machines and design procedural techniques to fast food chains and Cha Chaan Tengs to serve fresh brewed coffee and espresso drinks.

Providing these value-added solutions has helped to enhance customer stickiness, as illustrated by its long working relationship with customers, as well as benefiting margins. Sales of coffee and tea products, which accounts for 64.6% of total gross profit in 2017, commanded margins of above 40% in 2015-2017.

Gross margin by product segment



Source: Company data

*milk, other beverage solutions, frozen meat, frozen processed food

(4) Customisation, consistency in mass volume

We believe one key competitive advantage that Tsit Wing has is its ability to provide tailor made products with strong consistency and in mass volume. This, coupled with its stringent quality assurance, are important attributes for chain food and beverage providers which are enforcing stricter food quality requirements nowadays.

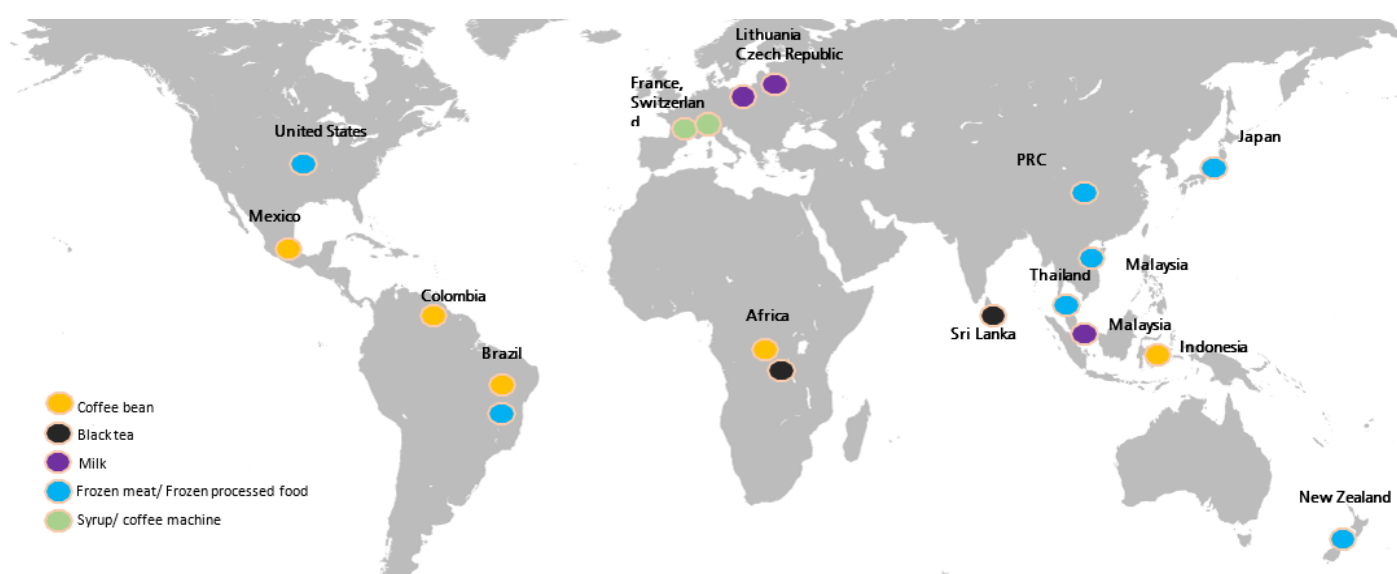
Tsit Wing's production process is of high automation with limited offline manual procedures, i.e. less exposure to human errors with production staff representing only 23% of its total workforce of 506. The company has a comprehensive traceability system, and offers scientific tests and online monitoring to ensure product quality consistency. The company has also adopted an integrated business intelligence system to support production planning, supply chain management, and business analysis. With such data, this enables more up-to-date market information for sales personnel to engage in more effective cross-selling opportunities.

(5) Strong sourcing capabilities

Tsit Wing has a comprehensive global sourcing network, including many globally renowned ones with internationally accredited quality certifications such as HACCP, ISO 9001:2008, ISO 14001:2004 and ISO 22000:2005, and an average of over ten years of procurement experience with its major suppliers. The company sources coffee and tea from Brazil, Colombia and Sri Lanka; it is the largest Sri Lankan tea importer in HK (by volume) and among the largest in the PRC (by volume). Its ability to secure exclusive

rights with strategic partners such as Monin are also illustrations of its strong sourcing capability.

The company has a close collaboration with its suppliers, and thus enables it to obtain better market information, leading to advantages in forecasting market prices and acquiring supply at more competitive pricings.

Worldwide sourcing network

Source: Company, DBS HK

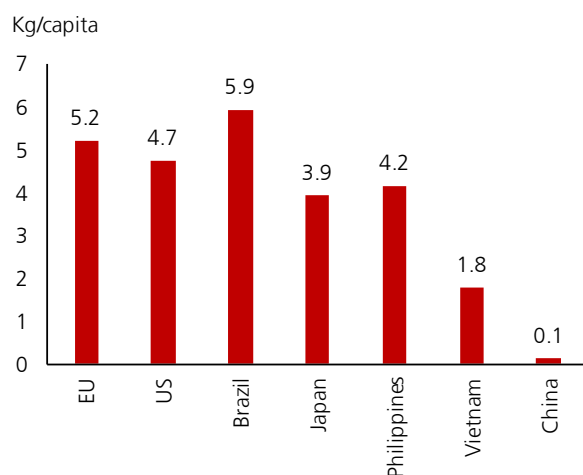
Growth strategies – Go wide, go deep

The key growth drivers would include rising consumer preferences towards coffee and HK's milk tea culture, an increase in coffee and tea offerings at food and beverage chains as well as the growing number of boutique coffee shops, special tea lounges for handcrafted beverages, and lastly, increasingly stringent requirements in the supply chain placed by catering establishments, favouring established B2B players.

(1) Low coffee and tea consumption per capita offers opportunity for growth in China

Despite the rising popularity towards coffee, China still lags behind significantly in terms of coffee consumption at only 0.1kg/capita per year, based on our estimates. This is extremely low when compared to global peers as well as tea consumption per capita in China. Assuming 10g of coffee per cup, we estimate the average Chinese consumes only 0.04 cup per day versus 1.43 cups in the EU per day.

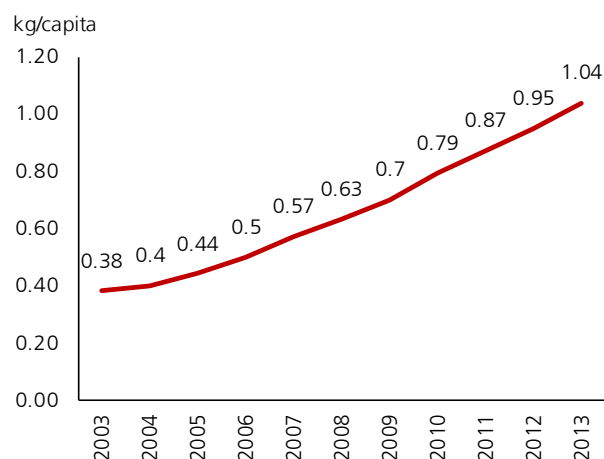
2016 coffee consumption per capita - China



Source: USDA, DBS HK

As China has a stronger tea drinking culture, tea consumption is higher at 1.04 kg/capita per year, based on FAOSTAT (2013). Black tea, the specialty of Tsit Wing, commands a market share of c.7.8% among all the tea categories in China.

Tea consumption per capita - China

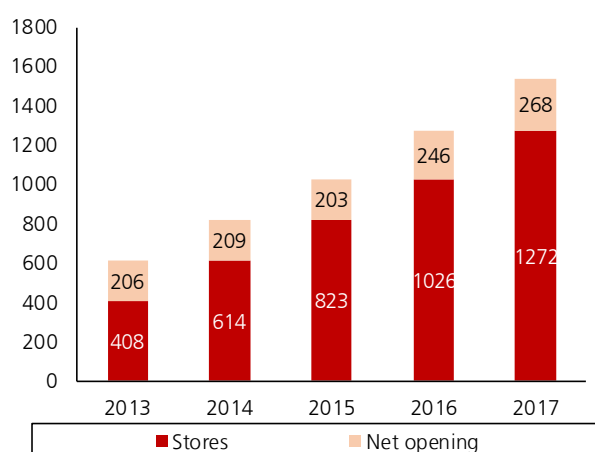


Source: FAOSTAT

(2) Explosion of the coffee chain phenomena in PRC

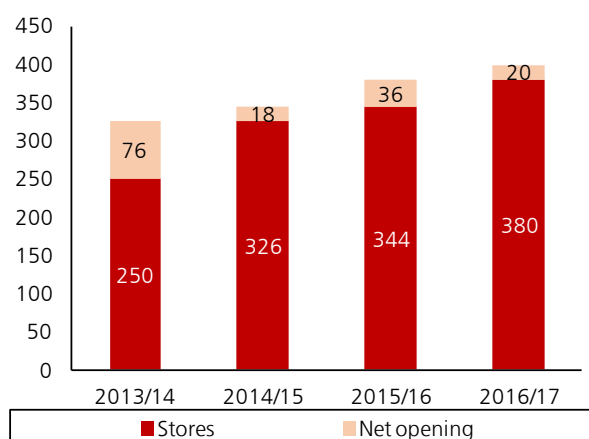
While instant coffee accounts for bulk of the coffee consumption, the rise in coffee culture is best illustrated by the explosive growth of foreign coffee chains in China. Starbucks has identified China as one of its key growth drivers, and targets to open 5,000 outlets by 2021, implying more than one new store per day and a CAGR of 34% in 2017-21E. Costa Coffee, which has been fully controlled by Whitbread since Oct 17, targets to open up to 700 stores by 2020 (>400 stores as of FY16/17), suggesting CAGR of 21% in 2017-20E.

Starbucks store opening in China (Company operated stores)



Source: Starbucks company data

Costa Coffee's store plan in China



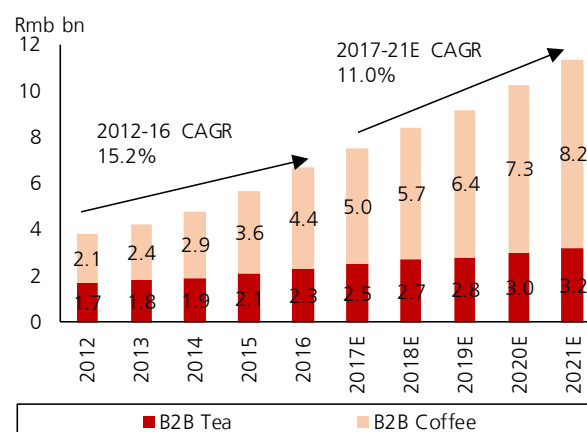
Source: Whitbread Company data

Already one of the leading B2B players, Tsit Wing currently caters to more than 800 hotels, fast food chains and food establishments, as well as 7 domestic airlines (out of 24 domestic airlines) in the PRC.

The company intends to strengthen its market positioning in first and second tier cities in eastern and southern China, such as Shanghai, Beijing, Hangzhou, Guangzhou, Shenzhen, and Dongguan through expanding its sales team and sales offices in China. Tsit Wing can also leverage on its existing strong customer relationships in Hong Kong to expand into the PRC.

In 2012-16, the B2B coffee market size in China doubled with the surge in popularity in coffee products, and achieved a CAGR of 20.3% to RMB4.4bn. The B2B coffee market is expected to grow at a CAGR of 13.2% to RMB8.2bn in 2017-21E. Combining black tea and coffee products in China, the market size is expected to grow at a CAGR of 11% in 2017-21E to RMB11.4bn.

B2B coffee and black tea market size in China (2012-2021E)



Source: Frost & Sullivan

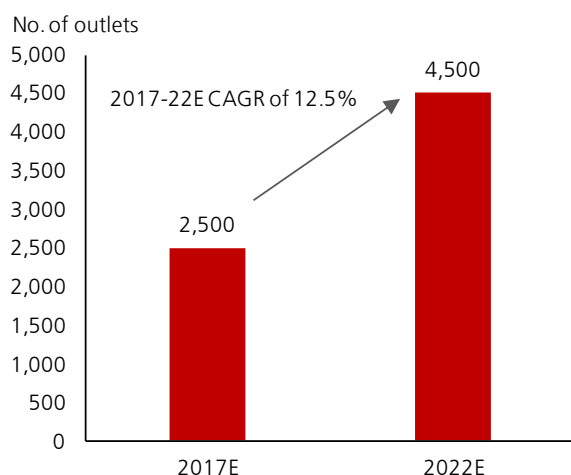
Tsit Wing International Holdings Ltd

(3) Riding on key customer's growth in China

We expect Tsit Wing to continue to ride on the strong growth of its customers in China. Case in point being the franchised business of McDonald's, one of Tsit Wing's key customers, which is expected to accelerate its expansion plan in China following the recent conclusion of a strategic cooperation deal with property developers such as Country Garden and Evergrande Group.

In August 2017, McDonald's unveiled plans with its strategic partners, CITIC Limited, CITIC Capital Partners and The Carlyle Group, to expand its store count from 2,500 to 4,500 by the end of 2022E, meaning the pace of store openings will double from 250 p.a. in 2017 to 500 p.a. during 2018-2022E. McDonald's aims to increase its portfolio significantly in tier 3-4 cities, which will account for 45% of its store portfolio in China. The accelerated expansion should benefit Tsit Wing, who has been supplying to McDonald's in China for more than 10 years.

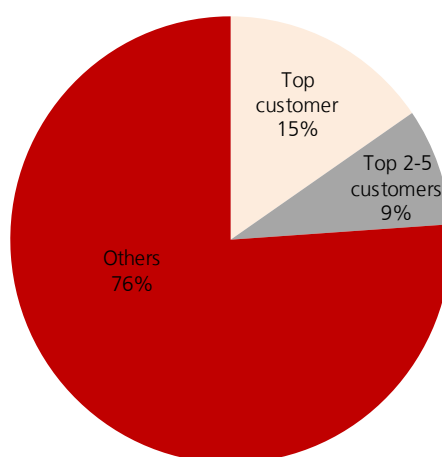
McDonald's store count expansion plan in China



Source: McDonald's presentation

Tsit Wing's top 5 largest customers accounted for 23.9% of 2017 sales respectively. Of which, its largest customer, accounted for 15.4% of 2017 sales. Tsit Wing's top 5 largest customers include fast food chains, restaurants, a food and beverage distributor, and a food processing company, which hold long relationships with the company for 3-10 years. The established and stable relationships suggest strong trust and credibility between Tsit Wing and its customers.

Revenue breakdown by customers (2017)

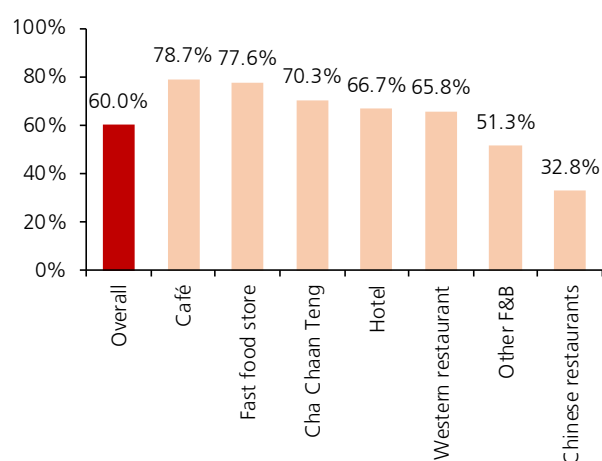


Source: Company data

(4) Further strengthen position in the coffee and black tea market in Hong Kong

According to a survey conducted by Frost & Sullivan, Tsit Wing is the most well-recognised top quality coffee and black tea brand among restaurants in Hong Kong. In fact, the company supplies to 9 out of 11 major fast food chains, and 34 of the 240 hotels in Hong Kong. This roughly translates to c.60% of the food outlets in Hong Kong.

Tsit Wing's market coverage by type of F&B establishments



Source: Frost & Sullivan

With strong global sourcing capabilities, as well as established relationships with customers, there are opportunities for Tsit Wing to expand further in the premium coffee and tea segment to better ride on the changing consumer trends, such as the organic certified SKUs or promotion of sustainability trends. Tsit Wing also works closely with its customers to offer seasonal coffee and specialty beverages.

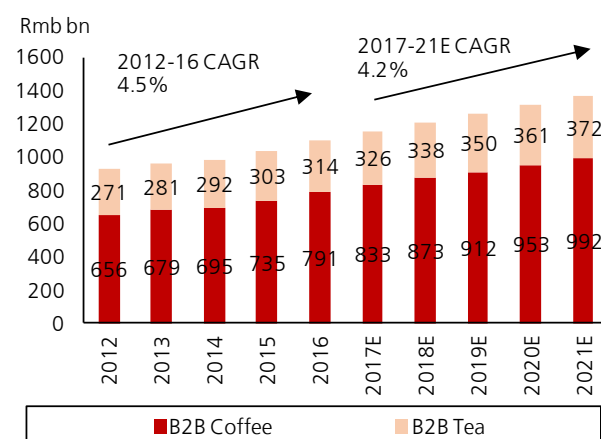
Innovative beverage offerings by customers

Customers	Beverage offerings
McDonald's - McCafe	Matcha x OREO - A New Twist - includes Matcha Chocolate OREO Cookies Drink, Iced Matcha Chocolate OREO Cookies Drink
Yoshinoya	Tea Set Special - Iced Matcha Tea Red Bean Drink / Iced Milk Tea Red Bean Drink
7-Eleven	Daily Café - Coffee offerings
Café de Coral	Tea & coffee
Spaghetti House	Offerings include handcrafted coffee, special drinks, freshly brewed coffee

Source: Company data, DBS HK

The Hong Kong B2B coffee and black tea products market has expanded at a CAGR of 4.5% in 2012-16, and is expected to continue with a CAGR of 4.2% in 2017-21E.

B2B coffee and black tea market size in Hong Kong (2012-2021E)



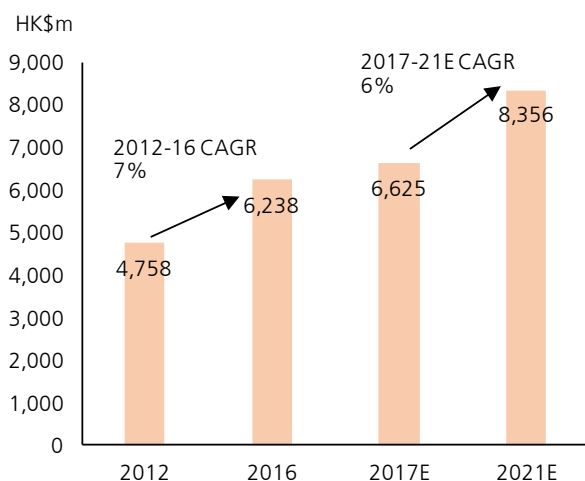
Source: Frost & Sullivan

(5) Diversification in product offerings

Leveraging on its relationship with customers, Tsit Wing has expanded its offerings into frozen meat and frozen processed food. There is increasing demand for frozen food amongst consumers due to (i) convenience in transportation and storage, (ii) stronger demand for imported meat given better value-to-quality proposition; and (iii) stricter standards and requirements over food safety.

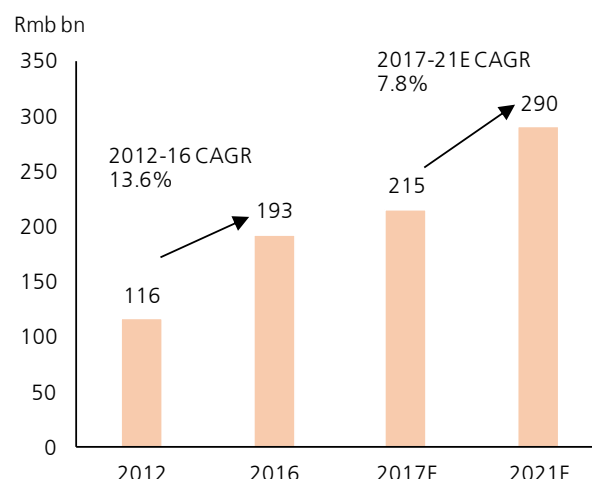
In July 2017, Tsit Wing entered into a strategic cooperation agreement with NH Foods, to jointly develop the food products market including frozen, fresh, pre-cooked processed meat & seafood products, in Hong Kong, Macau and the PRC. NH Foods, a specialist in meat products, is a leading food provider with operations in 19 countries and regions.

In Hong Kong, the frozen meat products market grew at a CAGR of 7% in 2012-16. It is expected to grow at a steady CAGR of 6% in 2017-21E to HK\$8,356m, according to Frost & Sullivan.

Frozen meat market size in Hong Kong

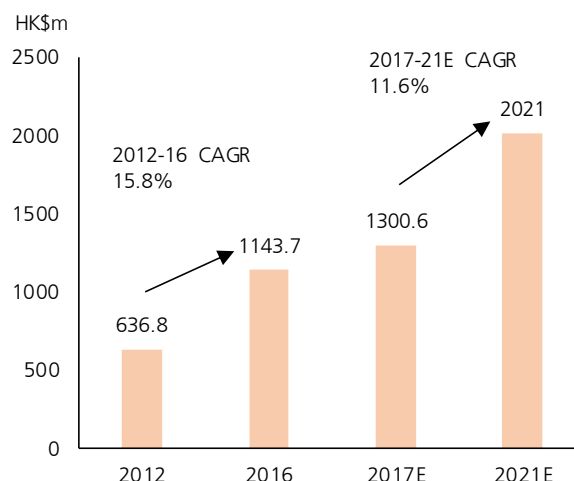
Source: Frost & Sullivan

Compared with HK, the PRC's frozen meat market is highly fragmented with stronger growth opportunities. There is increasing support to build vertically integrated chains to improve food safety management, which means there is a growing trend towards stricter management and greater degree of standardisation going forward. The PRC frozen meat market grew at a CAGR of 13.6% in 2012-16, and is expected to sustain a steady CAGR of 7.8% in 2017-21E to RMB290.3bn.

Frozen meat market size in the PRC

Source: Frost & Sullivan

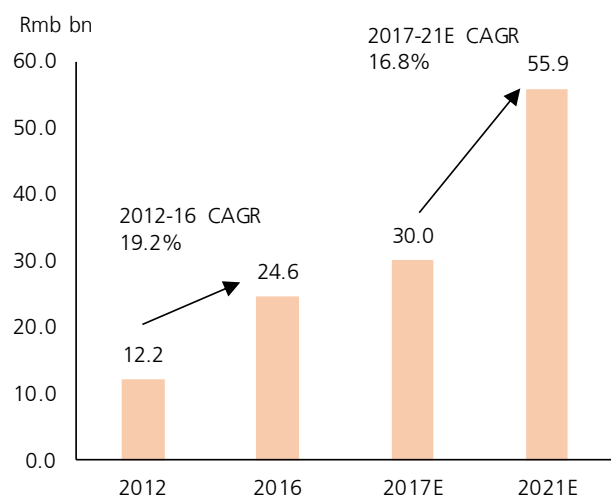
Meanwhile, frozen processed food is expected to experience stronger growth than frozen meat, as consumers increasingly demand convenience and value-added products. In 2012-16, the frozen processed food product market grew at a CAGR of 15.8% in HK, and is expected to maintain double digit growth at 11.6% in 2017-21E to reach HK\$2,021m.

Frozen processed meat market size in Hong Kong

Source: Frost & Sullivan

In the PRC, the frozen processed food market has grown at a CAGR of 19.2% in 2012-16, and is expected to sustain strong CAGR of 16.8% in 2017-21E to RMB55.9bn.

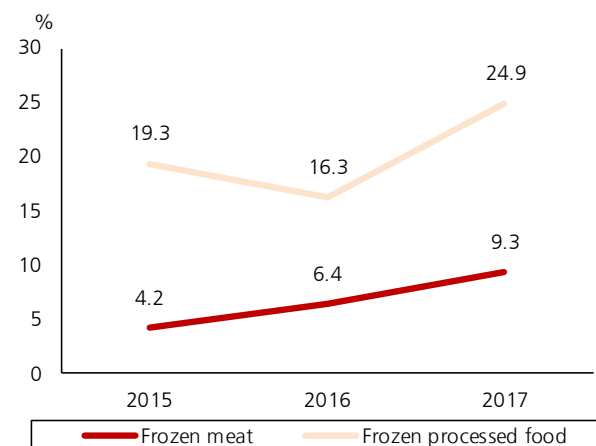
Frozen processed food market size in the PRC



Source: Frost & Sullivan

As frozen processed food commands stronger gross margin than frozen meat, the faster growth in this segment should help enhance product mix, and hence margins.

Tsit Wing - frozen meat vs. frozen processed food gross margin (%)



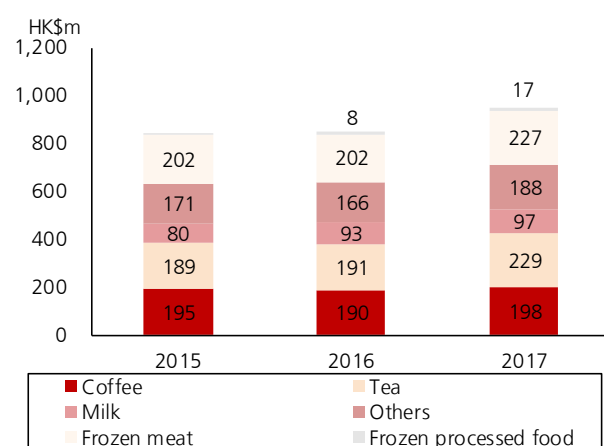
Source: Company

Financial analysis

Revenue. In 2016, revenue rose by 1.4% y-o-y, with growth seen in both product segments. Beverage solution segment rose 1% due to an increase in milk sales volume on higher promotion activities in Hong Kong and the PRC. This was partly offset by the decrease in the tea sales volume in the PRC, and by the decrease in the average selling price of milk products. Food product sales grew 3.5% y-o-y, driven by sales volume.

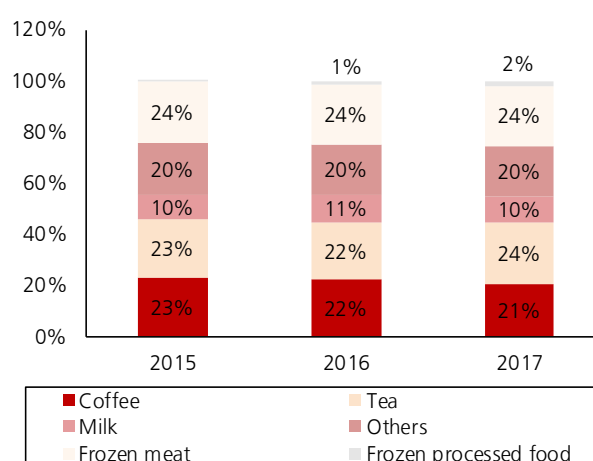
In 2017, revenue rose 12.3% y-o-y to HK\$954.6m, driven by beverage solution sales (+11.3% y-o-y) and frozen product sales (+15.5% y-o-y). Tea, in particular, saw strong volume growth from both key customers and new customer growth, as well as ASP increase (+5% y-o-y). In frozen product, frozen meat sales grew 12.1% on rising demand for US and New Zealand products.

Revenue by product segment



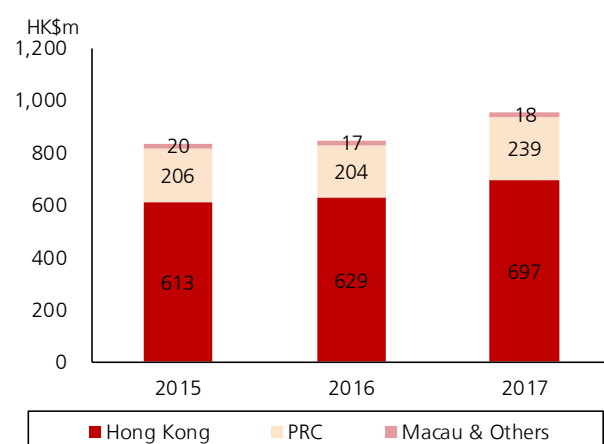
Source: Company data

Revenue breakdown by product segment (%)



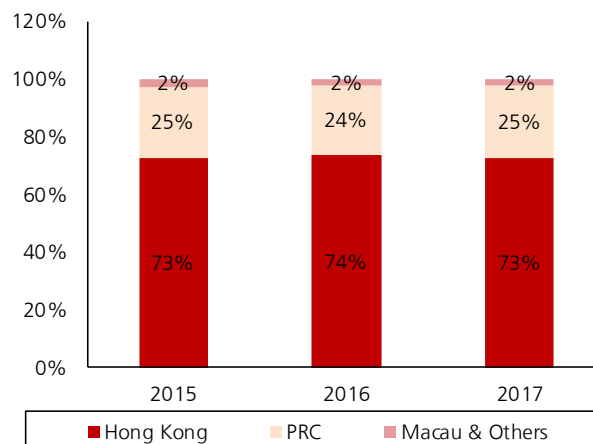
Source: Company data

Revenue by region



Source: Company data

Revenue breakdown by region (%)

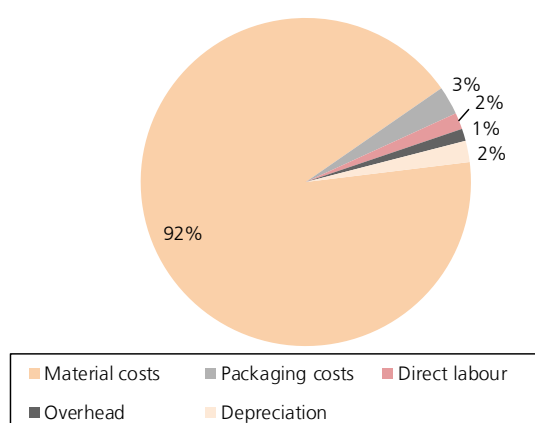


Source: Company data

Gross profit

Tsit Wing's cost of goods sold (COGS) comprises of mainly material costs, which accounted for 92% of 2017 COGS. Packaging, labour, overhead and depreciation costs accounted for the remaining 8% of COGS.

Breakdown of costs by expenses (2017)



Source: Company data

How to set pricing. The company sets its pricing based on a percentage of gross margin, which is determined by product costs (raw material and packaging materials), overheads, commodity prices, relative pricing with competing products, production capacity, bargaining power, and the cost of after-sale services for coffee machines. On a case by case basis, the company may offer volume discounts to customers.

For one of its five largest customers, the company enters into a fixed price agreement nine months in advance for the sale of coffee products for the coming 3-12 months, using coffee bean future pricing on the New York Board of Trade as a reference.

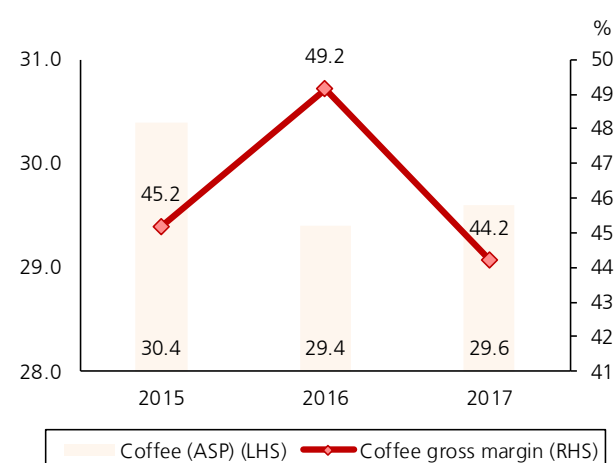
Coffee: To manage costs, coffee bean prices are generally managed through an inventory management system. For Arabica coffee beans, the company maintains three months of inventory at the warehouse, and 3-6 months on way shipment. This represents 6-9 months of inventory. As for Robusta coffee, the company maintains 1.5 months of supply. Aside from this, the company also negotiates and fixes different contracts with coffee suppliers to further manage procurement costs.

Based on our sensitivity analysis, a 5% change in average coffee procurement prices with no adjustment in ASP, would have a c.5% impact on 2018 earnings. In the past,

Tsit Wing had engaged in some hedging activities when appropriate, which helped to mitigate some of the impact.

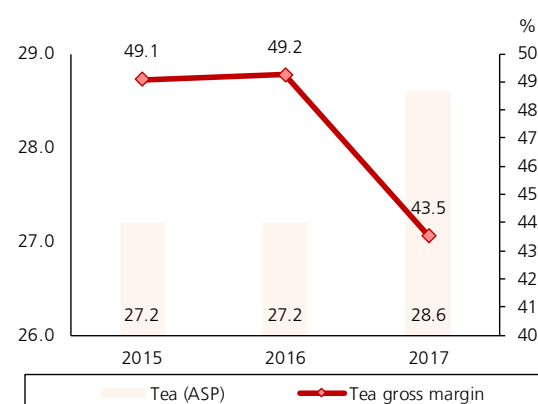
Tea. For tea, Tsit Wing deals mainly with suppliers who bid in auctions for tea. Given its long-standing relationships with suppliers and huge volume requirements, Tsit Wing can procure tea at a discount. Our sensitivity analysis indicates that a 5% change in average tea procurement prices with no adjustment in ASP, would result in a c.6% impact on 2018 earnings.

Coffee ASP vs. gross margin (%)



Source: Company data

Tea ASP vs. gross margin



Source: Company data

Cost of sales

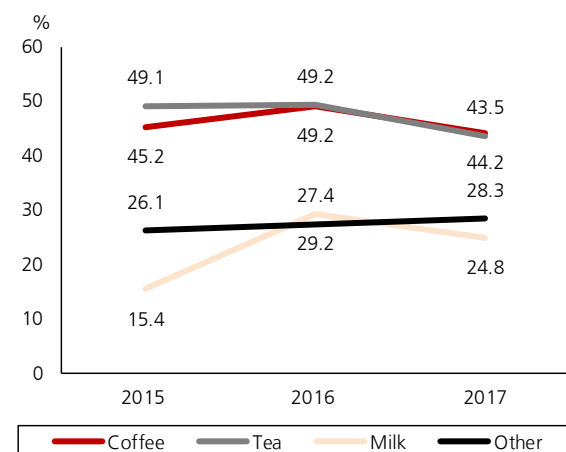
	2015		2016		2017	
	HK\$m	%	HK\$m	%	HK\$m	%
Material costs	547.8	93%	528.9	92%	613.6	92%
Packaging costs	14.4	2%	15.0	3%	18.7	3%
Direct labour	8.6	1%	9.7	2%	10.8	2%
Overhead	6.3	1%	6.6	1%	8.0	1%
Depreciation	14.6	2%	15.5	3%	13.9	2%
	591.7	100%	575.6	100%	665.0	100%

Source: Company data

In 2016, gross profit increased by 11.2% y-o-y to HK\$274.1m, driven by lower coffee bean and milk procurement prices which declined 11.5% and 12.9% respectively. As a result, gross profit margins on coffee and milk beverages expanded by 4.0ppts and 13.9ppts to 49.2% and 29.2% respectively. Overall gross margin expanded 2.9ppts to 32.3%.

In 2017, gross profit increased by 6.0% y-o-y to HK\$290m with gross profit margin contracted 1.9ppts to 30.3%, dragged by a rebound in raw material costs in beverages. Coffee and processed tea average procurement prices rose by 11% and 16% to HK\$10.3/lb and HK\$13.5/lb respectively in 2017.

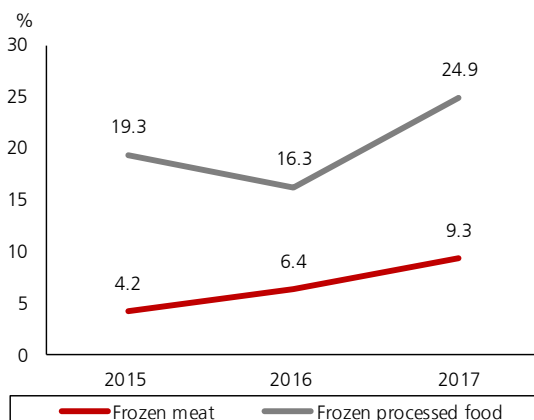
Gross margin by product segment – Beverage solutions



Source: Company data

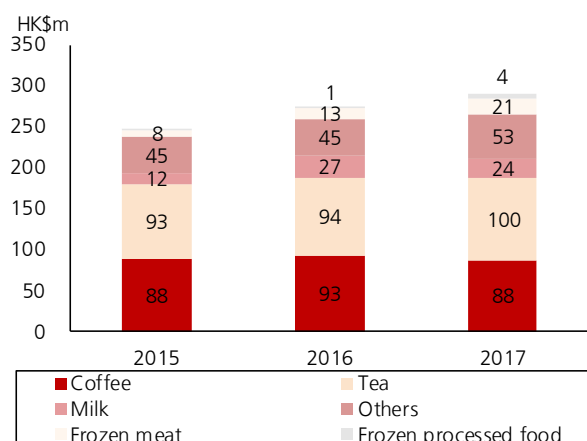
*Other SKUs include groceries and others, FMCG and instant beverage mix, Monin Products, and coffee and tea machines.

Gross margin by product segment – Food

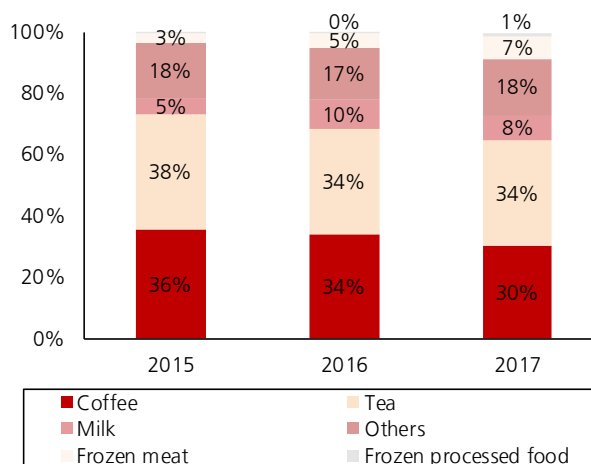


Source: Company data

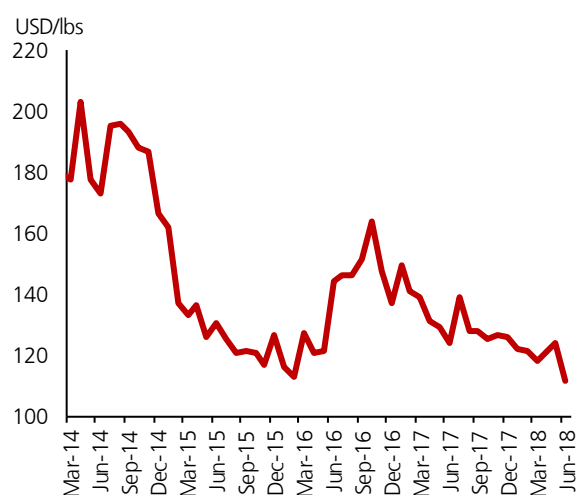
Gross profit by product segment



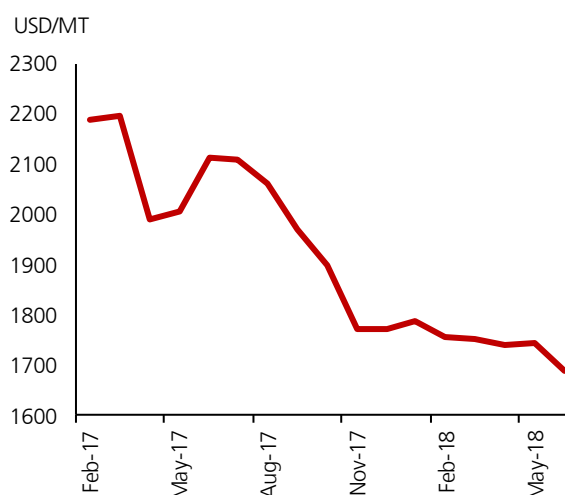
Gross profit breakdown by product segment (%)



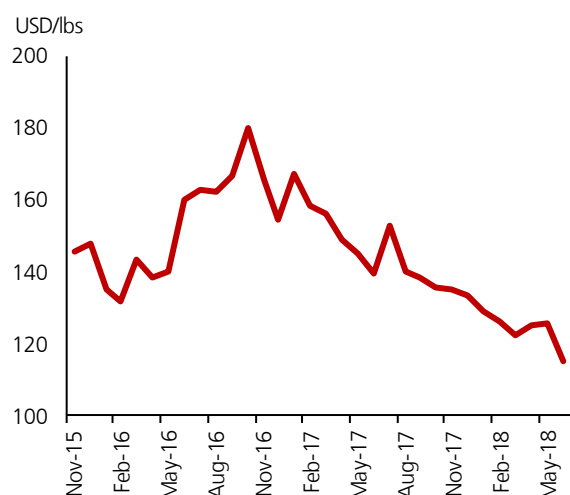
Arabica coffee prices



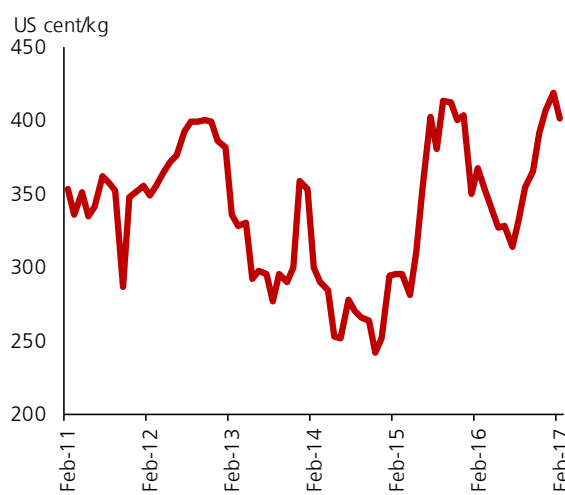
Robusta coffee prices



Green coffee prices



Black tea prices (Kenya)



Source: Company data

Net profit

Attributable net profit from continuing operations increased by 31.7% to HK\$63.2m in 2016. Adjusting for non-recurrent income (compensation from settled litigation), costs and charges, net profit grew 20.6% y-o-y to HK\$62.0m.

In 2017, net profit declined 27% to HK\$46m due to consultancy fee and professional expenses. However, stripping out one-offs, net profit grew 23.6% y-o-y to HK\$77m with stronger sales volume, particularly from tea.

Adjusted net profit

For the year end 31 December (HK\$m)	2015	2016	2017	2018F	2019F
Profit for the year/ period from continuing operations	48	63	46	88	109
Adjusted for:					
Consultancy fee for land use	6	6	6	-	-
Legal fee incurred for settled trademark litigation	4	3	-	-	-
Compensation from settled litigation	(10)	(16)	-	-	-
Others	3	6	25	7	-
Adjusted core profit	51	62	77	95	109

Source: Company data, DBS HK

Net gearing ratio

Net gearing ratio expanded from 46% in Dec'15 to 68% in Dec'17. Over the same period, total cash declined by HK\$59.9m to HK\$45.6m, while total debt rose by HK\$175m to HK\$192m. Equity attributable to owners of the Parent declined by 23.3% on the distribution of dividend to ultimate holding company of HK\$122.9m.

Gearing ratio (Dec'15-Dec'17)

For the year end 31 December (HK\$m)	2015	2016	2017
Borrowings	174.8	173.9	191.6
Less: cash and cash equivalents	59.9	48.1	45.6
Net debt	114.9	125.8	145.9
Equity attributable to owners of the Parent	247.4	279.3	214.2
Net gearing ratio	46%	45%	68%

Source: Company data

Cash flow

In 2017, net cash from operating activities declined by 77% to HK\$26.8m. Aside from higher base from FY16, the decline was largely due to higher working capital requirement. Inventories increased by HK\$45.3m on higher tea storage in light of expected increase in tea prices. Trade receivables also grew with the expansion of frozen food business. Net cash used in investing activities amounted to HK\$26.6m, which mainly included purchases of property, plant and equipment (HK\$15.4m).

Summary cash flow statements (2015-2017)

For the year end 31 December (HK\$m)	2015	2016	2017
Net cash flows generated from operating activities	82.7	118.7	26.8
Net cash flows used in investing activities	(20.0)	(112.0)	(26.6)
Net cash generated from/(used in) financing activities	(88.2)	(17.7)	(3.7)
Net increase/ (decrease) in cash and cash equivalents	(25.4)	(10.9)	(3.5)
Cash and cash equivalents at beginning of the year	86.9	59.9	48.1
Effects of foreign exchange rate changes, net	(1.5)	(0.9)	1.0
Cash and cash equivalents at the end of the year	59.9	48.1	45.6

Source: Company data

Tsit Wing International Holdings Ltd

Valuation

Specialising in B2B beverage solutions, Tsit Wing's direct peers are mostly unlisted companies. This includes privately held B2B players such as Dehong Hogood Coffee Co., Jascabee, and the HK-based Hiang Kie Coffee Group, as well as specialty coffee chains such as Starbucks Coffee, UBC Coffee, Costa Coffee (Whitbread), C Straits Café, among others.

There are not many coffee or tea players listed in HK. Tenfu Group (6868.HK), while having similar revenue size, focuses on Chinese tea (vs Tsit Wing's focus on black tea) and the retail market (vs Tsit Wing's B2B focus).

Given lack of any direct listed comparable, we have opted to take reference to a list of overseas listed B2B food service providers, which serves as a better comparable to Tsit Wing in terms of business model and supply chain. While Tsit Wing is significantly smaller in scale, this should be largely compensated by its market dominance in the Hong Kong market and growth potential in the B2B beverage solution

business in the PRC. This group of companies' trade at an average PE of 19x.

When compared to other HK-listed F&B players, Tsit Wing earnings growth of 17% (FY17-20 CAGR) and ROE of 19% (FY19F) are similar to sector average of 19% and 16% respectively. Hence, despite its smaller size, partly due to its focus in the B2B market, we applied a discount of 32% to the sector average of 25x FY19F PE

Tsit Wing also generates steady cash flow. As such, a discounted-cashflow valuation methodology serves as a good valuation barometer. Based on a WACC of 8.4% and terminal growth rate of 2.0%, our DCF valuation values Tsit Wing at HK\$1,983m.

As such, we value Tsit Wing at HK\$2.38/sh, pegged to 17x FY19F PE.

Peers valuation

Company Name	Code	Price Local\$	Target Price Local\$	Mkt Cap US\$m	Fiscal Yr	PE 18F x	PE 19F x	Yield 18F %	Yield 19F %	P/Bk 18F x	P/Bk 19F x	ROE 18F %	ROE 19F %
B2B food service provider													
Us Foods Holding	USFD US	38.78	n.a.	8,376	Dec	18.8	16.4	0.0	0.0	2.7	2.4	14.8	15.0
Sysco	SYU US	69.4	n.a.	36,157	Jun	23.1	19.9	2.0	2.1	15.1	12.5	63.8	70.1
Performance Food Group	PFGC US	36.9	n.a.	3,847	Jun	23.0	19.2	0.0	0.0	3.4	2.8	17.0	16.2
International QSRs													
Starbucks	SBUX US	50.14	n.a.	69,193	Sep	20.8	18.8	2.5	2.8	13.1	11.4	79.5	148.7
Mcdonalds	MCD US	158.62	n.a.	124,545	Dec	20.7	19.2	2.6	2.8	n.a.	n.a.	(143.9)	(81.1)
Yum China Holdings	YUMC US	36.3	n.a.	14,015	Dec	22.6	20.6	1.2	1.3	4.4	3.8	21.1	20.1
Restaurants/ F&B related													
Tsui Wah Holdings#	1314 HK	0.98	n.a.	177	Mar	14.0	9.8	5.1	6.1	0.9	0.8	n.a.	n.a.
Fulum Group Holdings#	1443 HK	0.67	n.a.	111	Mar	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Cafe De Coral Hdg.*#	341 HK	18.78	24.00	1,407	Mar	19.0	n.a.	4.5	0.0	3.0	n.a.	16.1	0.0
Fairwood Holdings#	52 HK	29.35	n.a.	482	Mar	14.0	12.7	4.9	5.0	4.7	4.6	34.5	36.5
Farmer Brothers	FARM US	30.25	n.a.	512	Jun	n.a.	42.2	n.a.	n.a.	2.5	2.4	(11.4)	4.6

Source: Thomson Reuters, DBS HK

Peers valuation

Company Name	Code	Price HK\$	Mkt Cap HK\$m	Fiscal Yr	PE 18F x	PE 19F x	Yield 18F %	Yield 19F %	P/Bk 18F x	P/Bk 19F x	EV/EBITDA 18F x	EV/EBITDA 19F x	ROE 18F %	ROE 19F %
Brewery Sector														
Tsingtao Brewery 'H'	168 HK	42.4	57,282	Dec	30.3	26.0	1.5	1.8	2.6	2.5	12.8	11.5	9.2	10.1
China Resources Beer Holdings*	291 HK	36.6	118,737	Dec	51.8	40.0	0.8	1.0	5.1	4.7	21.8	18.0	10.2	12.2
MC Wt. average					44.8	35.5	1.0	1.3	4.3	4.0	18.8	15.9	9.9	11.5
Dairy Sector														
China Mengniu Dairy*	2319 HK	25.4	99,755	Dec	26.9	23.9	0.9	1.0	3.3	3.0	17.5	15.3	13.1	13.2
China Modern Dairy Holdings*	1117 HK	1.32	8,093	Dec	n.a.	n.a.	0.0	0.0	1.0	1.1	13.4	11.3	(5.5)	(4.4)
H & H Intl. Hdg.	1112 HK	53.75	34,388	Dec	23.2	18.9	0.6	1.6	5.0	4.0	12.8	11.1	25.4	25.1
Yashili International Holdings	1230 HK	1.58	7,498	Dec	267.3	60.8	0.1	0.4	1.2	1.1	43.2	28.5	0.3	1.9
MC Wt. average^^					34.1	21.7	0.7	1.0	3.2	2.8	15.6	13.2	13.5	13.7
Instant Noodle & Beverage and Others														
Tingyi Cymn.Isle.Hldg.*	322 HK	17.96	100,895	Dec	35.6	31.0	1.4	1.6	4.4	4.1	11.3	11.1	12.7	13.6
Want Want China Holdings*#	151 HK	7.01	87,270	Mar	21.7	20.7	3.1	3.2	4.9	4.6	13.6	12.9	23.2	22.9
Tsit Wing International Holdings*	2119 HK	1.56	1,187	Dec	14.6	10.9	3.4	3.2	2.3	2.0	7.4	6.0	22.4	19.8
Uni-President China Hdg.*	220 HK	9.19	39,695	Dec	30.4	27.2	2.3	2.6	2.5	2.5	11.4	10.3	8.5	9.2
Vitasoy Intl.Hdg.*#	345 HK	26.3	27,853	Mar	40.5	35.4	1.6	1.8	8.6	7.8	22.2	19.5	22.4	23.1
China Foods*	506 HK	4.01	11,217	Dec	28.6	25.4	1.2	1.3	2.4	2.4	9.6	9.6	8.7	9.5
Dali Foods Group Co.	3799 HK	6.69	91,614	Dec	19.8	16.9	3.3	3.9	5.1	4.5	12.1	10.4	26.8	28.2
Yihai Intl.Hldg.	1579 HK	17.1	17,902	Dec	36.3	29.7	0.9	1.0	7.8	6.3	17.1	12.9	26.2	24.6
Nissin Foods*	1475 HK	4.41	4,738	Dec	20.7	18.0	1.9	2.2	1.3	1.3	4.7	3.3	6.5	7.2
Zhou Hei Ya Intl.Hdg.	1458 HK	6.09	14,513	Dec	15.9	14.4	1.9	2.2	2.6	2.3	11.6	10.3	18.8	19.2
MC Wt. average					27.6	24.4	2.3	2.6	4.8	4.3	12.9	11.8	19.2	19.8
Pork Sector														
WH Group*	288 HK	6.13	89,961	Dec	10.4	9.6	2.9	3.1	1.4	1.3	6.0	5.6	14.0	13.9
COFCO Meat Holdings*	1610 HK	1.14	4,448	Dec	4.7	3.6	0.0	0.0	0.6	0.5	4.7	3.8	14.7	16.6
MC Wt. average					9.0	8.2	2.4	2.6	1.2	1.1	5.3	4.9	12.5	12.4
HK-listed simple average					42.4	25.8	1.7	2.0	3.9	3.5	15.8	13.2	16.1	16.6
HK-listed MC Wt. average^^					31.3	25.1	1.8	2.1	4.1	3.7	14.2	12.5	15.9	16.6

FY18: FY19;FY19:FY20

Source: Thomson Reuters, * DBS HK

^^ Excluding China Modern Dairy

CRITICAL FACTORS TO WATCH

Critical Factors

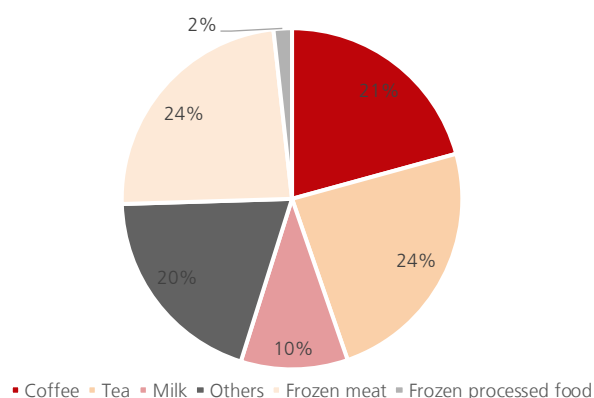
Coffee volume growth. Beverage solutions account for 75% and 65% of FY17 sales and gross profit respectively. Of which, coffee sales and gross profit accounted for c.21% and 30% of total. Driven by new customer orders and rising coffee and tea drinking culture in Hong Kong and China, we expect Tsit Wing's coffee volume to deliver a CAGR of 6% in FY17-20E.

Tea volume growth. Tea FY17 sales and gross profit account for 24% and 34% respectively. Driven by new customer orders (Muji in China) and rising coffee and tea drinking culture in Hong Kong and China, we expect Tsit Wing's tea volume to deliver a CAGR of 7% in FY17-20E.

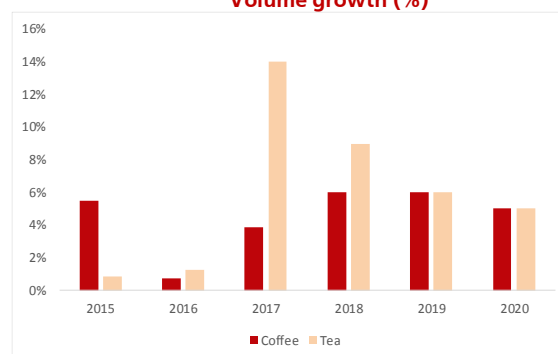
Raw material price volatility. Tsit Wing's cost of goods sold is comprised of mainly material costs (92%), with the remainder as packaging, labour, overhead and depreciation costs. Of which, we expect coffee bean and tea account for bulk of the purchases. Based on our sensitivity analysis, 5% change in procurement cost in coffee and tea would impact earnings by 5%/6% respectively in FY18F. We expect overall margin to expand by 1.1ppt to 31.4% in FY18F on lower tea prices, partly diluted to by expanding frozen food business sales.

Use of proceeds. The Company successfully listed on 11th of May and raised HK\$233.7m of net proceeds, inclusive of over-allotment of 15% of offer shares. The Company has plans to build its own proprietary milk tea machine to supply to its B2B customers, to be launched in 2019. Second, the Company has successfully garnered two strategic shareholders such as NH Food and F&N, which could offer more expansionary plans in the future.

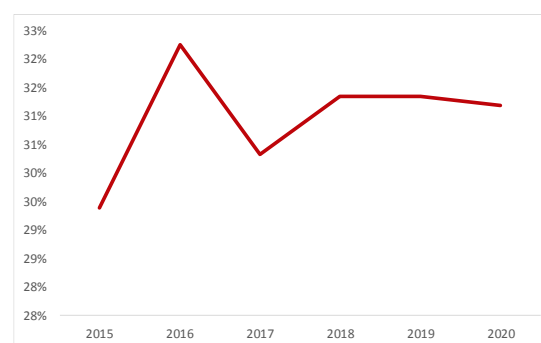
Sales breakdown (%)



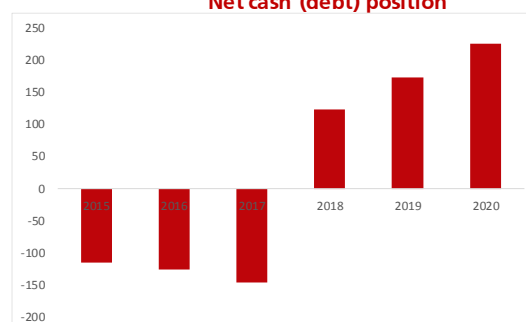
Volume growth (%)



Gross profit margin (%)



Net cash (debt) position



Source: Company, DBS HK

Balance Sheet:

Low spending needed. The Company listed on May 11th 2018, at HK\$1.98/sh with a market capitalization of c.HK\$1,505m, with net proceeds of HK\$233.7m (inclusive of over-allotment option exercised or 15% of offer shares). The Company expects to spend HK\$23.8m including (i) HK\$12.4m on plant and machinery such as coffee machines to be leased to customers, (ii) HK\$2.1m on furniture and fixtures and (iii) HK\$2.3m on delivery trucks and executive cars. The Company has committed to payout not less than 35% of net profit. We estimate the Company to turn net cash by end-FY18F, helped by funds raised from public listing. (Dec'17: net gearing: 68.1%)

Share Price Drivers:

New customer intake to drive volume growth. Tsit Wing is dependent on new customers to drive volume growth in the coffee and black tea business in Hong Kong and China.

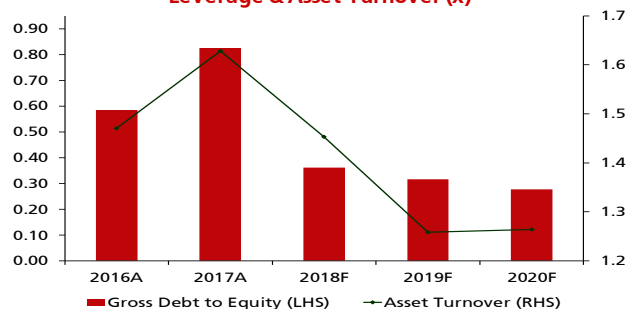
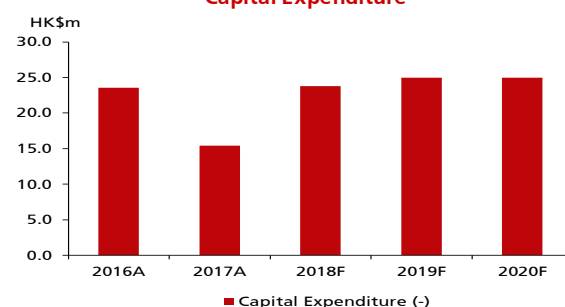
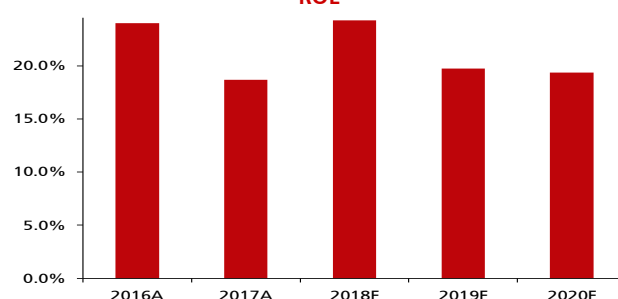
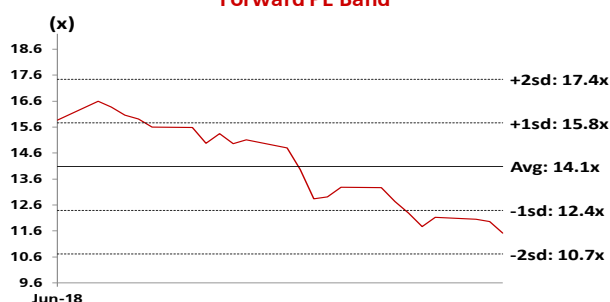
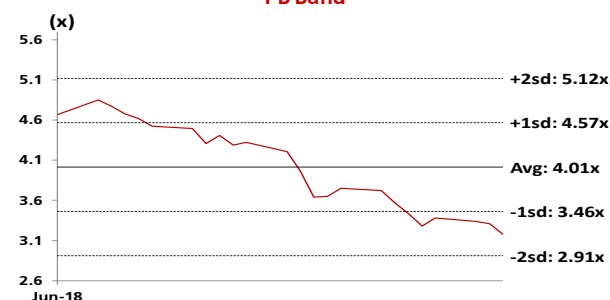
Favourable raw material price. With favourable raw material prices such as coffee and black tea, we expect this should drive margin expansion.

Key Risks:

Key risks include supply and customer concentration risks, raw material price volatility, pricing pressure and food safety concerns.

Company Background:

Tsit Wing is a leading integrated B2B beverage solutions provider in Hong Kong, Macau and the PRC, with a specialization in coffee and black tea. With a history dating back 85 years ago, the company was listed on the SGX-ST in 2001, and later privatized in 2013.

Leverage & Asset Turnover (x)**Capital Expenditure****ROE****Forward PE Band****PB Band**

Source: Company, DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2015A	2016A	2017A	2018F	2019F	2020F
Revenues (HK\$ m)						
Beverage Solutions	619	635	639	711	781	837
Food products	263	203	211	243	291	350
Total	838	850	955	1,073	1,186	1,318

Source: Company, DBS HK

Income Statement (HK\$ m)

FY Dec	2015A	2016A	2017A	2018F	2019F	2020F
Revenue	838	850	955	1,073	1,186	1,318
Cost of Goods Sold	(592)	(576)	(665)	(736)	(814)	(907)
Gross Profit	246	274	290	336	372	411
Other Opg (Exp)/Inc	(179)	(190)	(191)	(205)	(223)	(244)
Operating Profit	68	84	99	131	149	167
Other Non Opg (Exp)/Inc	0	0	0	0	0	0
Associates & JV Inc	0	0	0	0	0	0
Net Interest (Exp)/Inc	(5)	(4)	(4)	(6)	(4)	(4)
Dividend Income	0	0	0	0	0	0
Exceptional Gain/(Loss)	(3)	1	(31)	(7)	0	0
Pre-tax Profit	59	82	64	119	145	163
Tax	(13)	(17)	(16)	(30)	(36)	(41)
Minority Interest	1	(1)	(2)	(1)	0	0
Preference Dividend	0	0	0	0	0	0
Net Profit	48	63	46	88	109	122
Net Profit before Except.	51	62	77	95	109	122
EBITDA	95	112	124	153	171	190
Growth						
Revenue Gth (%)	N/A	1.4	12.3	12.4	10.6	11.1
EBITDA Gth (%)	N/A	17.9	10.2	23.6	11.9	10.9
Opg Profit Gth (%)	N/A	24.6	17.1	33.0	13.6	12.1
Net Profit Gth (%)	N/A	31.7	(27.1)	91.2	23.4	12.4
Margins & Ratio						
Gross Margins (%)	29.4	32.3	30.3	31.4	31.3	31.2
Opg Profit Margin (%)	8.1	9.9	10.4	12.3	12.6	12.7
Net Profit Margin (%)	5.7	7.4	4.8	8.2	9.2	9.3
ROAE (%)	N/A	24.0	18.7	24.3	19.8	19.4
ROA (%)	N/A	10.9	7.9	11.9	11.5	11.7
ROCE (%)	N/A	14.4	16.5	17.1	14.6	14.8
Div Payout Ratio (%)	0.0	0.0	31.5	46.3	35.0	35.0
Net Interest Cover (x)	13.9	21.1	24.0	23.5	34.7	38.8

Source: Company, DBS HK

Interim Income Statement (HK\$ m)

FY Dec	1H2016	2H2016	1H2017	2H2017
Revenue	407	443	458	497
Cost of Goods Sold	(275)	(301)	(317)	(348)
Gross Profit	132	142	141	149
Other Oper. (Exp)/Inc	(91)	(98)	(89)	(102)
Operating Profit	41	44	52	47
Other Non Opg (Exp)/Inc	0	0	0	0
Associates & JV Inc	0	0	0	0
Net Interest (Exp)/Inc	(2)	(2)	(2)	(2)
Exceptional Gain/(Loss)	10	(9)	(9)	(21)
Pre-tax Profit	49	33	41	23
Tax	(10)	(7)	(8)	(7)
Minority Interest	0	(1)	(1)	(1)
Net Profit	39	25	32	14
Net profit bef Except.	28	34	41	36

Growth

Revenue Gth (%)	N/A	N/A	12.5	12.2
Opg Profit Gth (%)	N/A	N/A	28.2	6.8
Net Profit Gth (%)	N/A	N/A	(17.3)	(42.5)

Margins

Gross Margins (%)	32.4	32.1	30.8	29.9
Opg Profit Margins (%)	10.0	9.9	11.4	9.4
Net Profit Margins (%)	9.5	5.6	7.0	2.9

Source: Company, DBS HK

Balance Sheet (HK\$ m)

FY Dec	2015A	2016A	2017A	2018F	2019F	2020F
Net Fixed Assets	124	111	108	110	113	116
Invt in Associates & JVs	0	0	0	0	0	0
Other LT Assets	57	40	39	38	38	37
Cash & ST Invt	60	48	46	316	365	418
Inventory	164	147	195	216	239	266
Debtors	135	129	170	191	212	235
Other Current Assets	25	116	23	23	23	23
Total Assets	565	591	581	895	991	1,096
ST Debt	115	131	139	139	139	139
Creditors	114	112	151	167	185	206
Other Current Liab	6	3	2	2	2	2
LT Debt	59	43	53	53	53	53
Other LT Liabilities	5	5	5	5	5	5
Shareholder's Equity	247	279	214	511	589	674
Minority Interests	17	18	18	18	18	18
Total Cap. & Liab.	565	591	581	895	991	1,096
Non-Cash Wkg. Capital	203	277	235	261	287	317
Net Cash/(Debt)	(115)	(126)	(146)	124	173	226
Debtors Turn (avg days)	6.2	6.6	5.6	5.6	5.6	5.6
Creditors Turn (avg days)	7.9	8.3	7.3	7.3	7.3	7.3
Inventory Turn (avg days)	50.5	98.6	94.0	102.0	102.1	101.8
Asset Turnover (x)	NM	1.5	1.6	1.5	1.3	1.3
Current Ratio (x)	1.6	1.8	1.5	2.4	2.6	2.7
Quick Ratio (x)	0.8	0.7	0.7	1.6	1.8	1.9
Net Debt/Equity (X)	0.4	0.4	0.6	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	0.5	0.5	0.7	(0.2)	(0.3)	(0.3)
Capex to Debt (%)	12.9	13.6	8.1	12.4	13.1	13.1
Z-Score (X)	NA	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (HK\$ m)

FY Dec	2015A	2016A	2017A	2018F	2019F	2020F
Pre-Tax Profit	59	82	64	119	145	163
Dep. & Amort.	27	28	25	22	22	23
Tax Paid	(17)	(20)	(20)	(30)	(36)	(41)
Assoc. & JV Inc/(loss)	0	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0	0
Chg in Wkg.Cap.	(1)	18	(48)	(26)	(26)	(30)
Other Operating CF	13	11	5	6	4	4
Net Operating CF	83	119	27	90	109	119
Capital Exp.(net)	(23)	(24)	(15)	(24)	(25)	(25)
Other Invts.(net)	(45)	(48)	(7)	0	0	0
Invts in Assoc. & JV	0	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0	0
Other Investing CF	48	(41)	(4)	0	0	0
Net Investing CF	(20)	(112)	(27)	(24)	(25)	(25)
Div Paid	(28)	(13)	(15)	(25)	(31)	(38)
Chg in Gross Debt	(55)	(1)	17	0	0	0
Capital Issues	0	0	0	234	0	0
Other Financing CF	(6)	(5)	(5)	(6)	(4)	(3)
Net Financing CF	(90)	(19)	(3)	204	(35)	(41)
Currency Adjustments	0	0	0	0	0	0
Chg in Cash	(27)	(12)	(2)	270	49	53
Opg CFPS (HK\$)	0.11	0.13	0.10	0.15	0.18	0.20
Free CFPS (HK\$)	0.08	0.13	0.01	0.09	0.11	0.12

Source: Company, DBS HK

Appendix – Other products distribution



Source: Company data

Appendix – Own brand (Supreme, Instant Coffee, Tsit Wing Tea, TARZA)



Source: Company data

DBS HK recommendations are based on Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 12 Jul 2018 19:00:57 (HKT)

Dissemination Date: 12 Jul 2018 19:38:53 (HKT)

Sources for all charts and tables are DBS HK unless otherwise specified.

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