

Prince Frog International (1259 HK)

Share Price: HKD2.82

MCap (USD): 367M

Hong Kong

Target Price: HKD3.82(+35%)

ADTV (USD): 6M

Consumer Staples

BUY

(Unchanged)

Still positive, undervalued: BUY

- Maintain BUY with lower TP of HKD3.82 (from HKD4.72). Valuation multiple intact at 9x FY14F PER. Lower our FY13F-15F earnings by 14-21% on higher A&P assumptions.
- Despite the stock's rally yesterday, we remain positive. Trading at only 5.4x FY14F PER (ex-cash) on improving fundamentals appears unjustified. Could be potential M&A target while PF also indicated may consider strategic investors. FCF yield at 8%/12% FY14/15x appears attractive.
- Positive sales feedback due to sponsorship of TV reality show and movie *"Where are you going? Dad"*. Launch of season 3 of cartoon animation was delayed to Nov 13, but this also bodes well for the FY14F sales outlook, in our view.

What's New

We visited Prince Frog (PF)'s factory and sales channels before the blackout. Construction of phase 2 of the factory is progressing smoothly and operations (ie. oral care) should begin by end-FY14F.

We observed that PF has continued to expand its presence across the Walmart chain in China, despite experiencing temporary supply shortages. We also found PF's products are now entering RT-mart (Eastern China), CP Lotus, Century Lianhua, Carrefour, etc. Our random customer surveys also revealed rising brand awareness.

CFO Ms Hong Fong will now manage the day-to-day business for the entire company after relinquishing the company secretary role to Investor Relation Director Ms. Sandra Huang.

A membership system may be launched to more effectively collect distributors' and end-customers' data in future, as its upcoming ERP system can only track up to distributors' level.

What's Our View

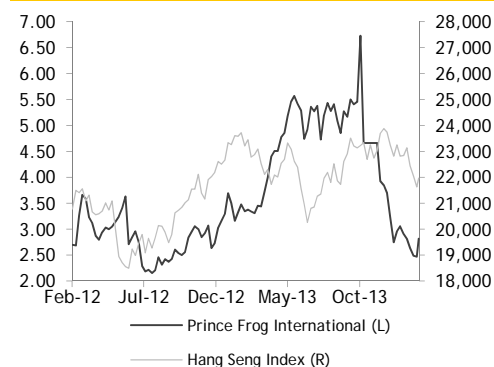
We lower our FY13-15 earnings forecasts by 14%-21% after raising our A&P cost assumptions given the committed brand building initiatives. We now forecast 23.9% net profit CAGR over FY14-15F.

FYE 31 Dec (CNY m)	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue	1,269.2	1,572.1	1,888.5	2,430.7	3,078.6
EBITDA	227.3	306.5	359.2	481.7	636.0
Core net profit	192.7	242.9	263.2	348.1	458.0
Core EPS (CNY)	0.21	0.24	0.26	0.34	0.45
Core EPS growth (%)	9.8	12.7	9.1	32.3	31.6
Net DPS (CNY)	0.04	0.05	0.05	0.07	0.09
Core P/E (x)	10.4	9.2	8.5	6.4	4.9
P/BV (x)	2.0	1.9	1.6	1.3	1.1
Net dividend yield (%)	1.9	2.2	2.4	3.1	4.1
ROAE (%)	35.2	23.0	20.8	23.1	25.0
ROAA (%)	27.5	20.6	19.0	21.1	23.1
EV/EBITDA (x)	5.9	5.7	4.7	3.3	2.2
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

Key Data

52w high/low (HKD)	6.73/2.40
Free float (%)	52.0
Issued shares (m)	1,010
Market capitalization	HKD2.8B
Major shareholders:	
-LI ZHEN HUI	34%
-XIE JIN LING	14%
-Neuberger Berman LLC	6%

Share Price Performance



	1 Mth	3 Mth	12 Mth
Absolute(%)	(3.1)	(39.5)	(15.8)
Relative to country (%)	0.8	(36.4)	(11.0)

Maybank vs Market

	Positive	Neutral	Negative
Market Recs	2	1	0
	Maybank Consensus		% +/-
Target Price (HKD)	3.82	4.75	(19.5)
2013 PATMI(CNYm)	263	278	(5.5)
2014 PATMI(CNYm)	348	343	1.5

Source: FactSet; Maybank

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We stand by the company

We remain positive on PF's growth prospects given solid execution in expanding its sales network and enhancing its brand name. Our multiple visits to its headquarters and random store visits also point to a consistent operational improvement. For example, we saw some manufacturing processes have been upgraded and are now automated/semi-automated, and construction on its new factory (phase 2) is underway.

While we did not visit its entire POS network, we believe its rising shelf-space presence in tier-1 cities such as Beijing and Shanghai can be indirect proof that the sales team is working hard to achieve the revenue targets. Earlier, we had also spoken to Nanchang Honglilai, one of PF's top five customers. Overall, we believe our findings support PF's sales data. PF sold around CNY30m worth of products to Honglilai in 2012. The number largely matches the disclosure given that the top five customers accounted for 14% of its sales (or CNY220m) during the year. Honglilai distributes PF's products through more than 500 POS. The implied per store annual retail sales value of CNY100,000 appears reasonable to us.

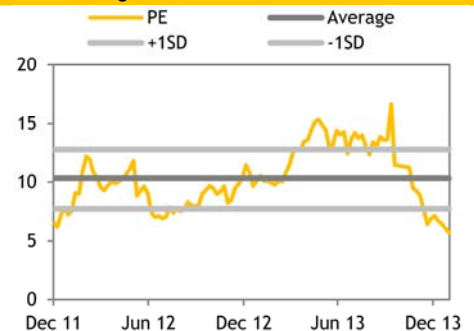
We understand the company is collecting its sales network coverage details for disclosure purposes in future so as to better clarify investors' concerns. We believe the company may consider adopting a self-reporting membership system so that it can more effectively collect the end-user buying habits and information, and check the efficiency of each POS. We are positive on this initiative despite it still being at the "ideas" stage. Meanwhile, management is also considering arranging reverse roadshows for investors to visit its distributors and some POS in future.

Figure 1: The construction progress of the new production plant (top photo: early 2013, bottom photo: early 2014)



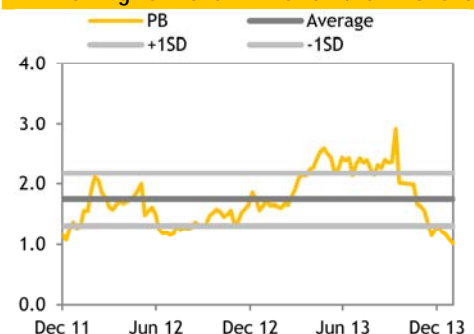
Source: Kim Eng Securities visits (2013, 2014)

12m rolling forward PER and +/-STD chart



Source: Bloomberg, Maybank Kim Eng

12m rolling forward PBR and +/-STD chart



Source: Bloomberg, Maybank Kim Eng

12m rolling forward PBR band



Source: Bloomberg, Maybank Kim Eng

Corporate strategy outlook

We believe PF's top priority is to focus on the children segment (aged 3-12) and therefore will slow the pace of expansion of its "E.inb" brand. Currently, the company has 290 SKUs within its product portfolio which it aims to streamline to 200. Of note, most of the SKUs to be phased out are within the "E.inb" brand as it had originally launched 70-80 SKUs under six series to test the market feedback.

Among its branded children's products, management is confident in the growth of its skincare, body and hair-care products. However, the company is even more bullish on its children's oral-care products given market competition is less intense and penetration rates are low for this segment. In contrast, management notes the difficult operating environment for the diapers business as it competes in the price-sensitive low to mid-end market.

Earnings forecast changes

We now forecast 23.9% net profit CAGR over FY13-15F. The major discrepancy between our old forecast and new projection is due to higher A&P assumptions, as the company did more in-store and on-street promotions to compensate for the delayed launch of season three of its TV cartoon animation.

Figure 2: Snapshots at RT-mart, Lianhua, CP Lotus, Walmart and Carrefour in Shanghai



Source: Maybank Kim Eng visit

Figure 3: Our sales assumptions

Sales (CNY'000)	2010A	2011A	2012A	2013F	2014F	2015F
Prince Frog						
Children care products						
- Skin care products	359,011	556,718	723,177	976,289	1,269,176	1,624,545
YoY changes (%)	40.45	55.07	29.90	35.00%	30.00%	28.00%
- Body and hair care products	100,747	193,434	335,415	486,352	656,575	866,679
YoY changes (%)	38.16	92.00	73.40	45.00%	35.00%	32.00%
- Oral care products	55,694	108,492	134,421	141,143	176,428	211,714
YoY changes (%)	39.72	94.80	23.90	5.00%	25.00%	20.00%
- Diaper products	20,199	58,577	83,941	125,911	163,685	204,606
YoY changes (%)	130.35	190.00	43.30	50.00%	30.00%	25.00%
Adult care products						
- Oral care products	43,238	50,113	48,710	49,684	50,181	50,683
YoY changes (%)	(21.97)	15.90	(2.80)	2.00%	1.00%	1.00%
Shuangfeijian						
Household hygiene products						
- Insecticide products	165,350	170,807	127,602	-	-	-
YoY changes (%)	70.29	3.30	(25.29)	-	-	-
Shenhuxi						
Household hygiene products						
- Air freshener products	14,689	15,423	14,178	-	-	-
YoY changes (%)	19.19	5.00	(8.08)	-	-	-
Others						
OEM and others	79,063	116,223	103,969	109,167	114,626	120,357
YoY changes (%)	(4.04)	47.00	(10.54)	5.00%	5.00%	5.00%
Total	837,991	1,269,167	1,571,413	1,888,546	2,430,670	3,078,584
YoY changes (%)	34.21	51.45	23.81	20.18%	28.71%	26.66%

Source: Company data, Maybank Kim Eng

Figure 4: Our gross margin assumptions for different segments

Gross margin (%)	2010A	2011A	2012A	2013F	2014F	2015F
Prince Frog						
- Skin care	42.50	50.20	54.70	56.00	58.00	60.00
- Body and hair care	46.80	47.10	50.30	50.00	50.00	50.00
- Oral care	54.40	53.40	29.10	20.00	23.00	25.00
- Diaper	40.00	35.40	19.30	20.00	20.00	22.00
- Adult oral care	39.20	30.00	24.00	19.00	19.00	19.00
Shuangfeijian	28.00	28.80	23.90	-	-	-
Shenhuxi	29.40	18.00	21.00	-	-	-
Others	21.90	24.40	25.90	26.00	26.00	26.00
Gross margin	38.50	42.37	45.90	46.66	48.43	50.25

Source: Company data, Maybank Kim Eng estimates

Figure 5: Our SG&A-to-sales ratio assumptions

% to sales	2010A	2011A	2012A	2013F	2014F	2015F
Advertising expenses	5.19	8.30	10.00	12.00	12.50	13.00
Marketing & promotion	4.64	4.80	6.00	7.30	7.50	7.80
Transportation	3.23	3.70	4.20	4.25	4.30	4.32
Staff costs	1.69	2.20	2.50	2.40	2.50	2.50

Source: Company data, Maybank Kim Eng estimates

FYE 31 Dec (CNY m)	FY11A	FY12A	FY13E	FY14E	FY15E
Key Metrics					
P/E (reported) (x)	10.4	9.2	8.5	6.4	4.9
Core P/E (x)	10.4	9.2	8.5	6.4	4.9
P/BV (x)	2.0	1.9	1.6	1.3	1.1
P/NTA (x)	2.0	1.9	1.6	1.3	1.1
Net dividend yield (%)	1.9	2.2	2.4	3.1	4.1
FCF yield (%)	6.7	10.8	4.0	8.2	12.0
EV/EBITDA (x)	5.9	5.7	4.7	3.3	2.2
EV/EBIT (x)	7.6	7.6	5.6	4.4	2.9
Income Statement					
Revenue	1,269.2	1,572.1	1,888.5	2,430.7	3,078.6
Gross profit	537.7	721.6	881.1	1,177.1	1,546.9
EBITDA	227.3	306.5	359.2	481.7	636.0
Depreciation	(6.0)	(10.2)	(12.4)	(22.0)	(30.8)
Amortisation	(1.8)	(3.3)	(1.9)	(1.9)	(1.9)
EBIT	219.6	293.0	344.9	457.8	603.3
Net interest income / (exp)	7.7	7.4	5.9	6.2	7.2
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	0.0	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	227.3	300.4	350.8	464.0	610.5
Income tax	(34.5)	(57.5)	(87.6)	(115.9)	(152.6)
Minorities	0.0	0.0	0.0	0.0	0.0
Reported net profit	192.7	242.9	263.2	348.1	458.0
Core net profit	192.7	242.9	263.2	348.1	458.0
Balance Sheet					
Cash & Short Term Investments	736.7	644.0	680.2	791.7	965.7
Property, Plant & Equip (net)	142.5	174.6	312.2	440.2	559.4
Intangible assets	5.9	4.5	3.0	1.6	0.1
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	185.3	421.7	495.2	535.0	631.8
Total assets	1,090.5	1,264.4	1,509.8	1,787.2	2,175.2
ST interest bearing debt	30.0	0.0	0.0	0.0	0.0
LT interest bearing debt	0.0	4.9	4.4	4.0	3.6
Other liabilities	112.1	99.9	135.5	135.0	157.3
Total Liabilities	142.1	104.8	139.9	139.0	160.8
Shareholders Equity	948.4	1,159.6	1,369.9	1,648.2	2,014.4
Minority Interest	0.0	0.0	0.0	0.0	0.0
Total shareholders equity	948.4	1,159.6	1,369.9	1,648.2	2,014.4
Cash Flow					
Pretax profit	227.3	300.4	350.8	464.0	610.5
Depreciation & amortisation	7.7	13.5	14.3	23.9	32.7
Adj net interest (income)/exp	1.1	(5.6)	(5.6)	(6.0)	(7.0)
Change in working capital	(5.1)	(11.6)	(37.9)	(40.2)	(74.6)
Cash taxes paid	(34.9)	(57.5)	(87.6)	(115.9)	(152.6)
Other operating cash flow	1.1	0.7	0.0	0.0	0.0
Cash flow from operations	186.6	243.7	239.3	331.5	415.9
Capex	(58.1)	(3.3)	(150.0)	(150.0)	(150.0)
Free cash flow	128.5	240.4	89.3	181.5	265.9
Dividends paid	0.0	(36.8)	(52.6)	(69.6)	(91.5)
Equity raised / (purchased)	529.8	0.0	0.0	0.0	0.0
Change in Debt	14.2	25.1	(0.5)	(0.4)	(0.4)
OTH investing/financing cash flow	0.0	0.0	0.0	0.0	0.0
Effect of exch rate changes	0.0	0.0	0.0	0.0	0.0
Net cash flow	663.9	(12.7)	36.2	111.5	174.0

FYE 31 Dec (CNY m)	FY11A	FY12A	FY13E	FY14E	FY15E
Key Ratios					
Growth ratios (%)					
Revenue growth	51.5	23.9	20.1	28.7	26.7
EBITDA growth	32.1	34.8	17.2	34.1	32.0
EBIT growth	29.6	33.4	17.7	32.7	31.8
Pretax growth	32.8	32.2	16.8	32.3	31.6
Reported net profit growth	30.5	26.0	8.3	32.2	31.6
Core net profit growth	30.5	26.0	8.3	32.2	31.6
Profitability ratios (%)					
EBITDA margin	17.9	19.5	19.0	19.8	20.7
EBIT margin	17.3	18.6	18.3	18.8	19.6
Pretax profit margin	17.9	19.1	18.6	19.1	19.8
Payout ratio	20.0	20.0	20.0	20.0	20.0
DuPont analysis					
Net profit margin (%)	15.2	15.5	13.9	14.3	14.9
Revenue/Assets (x)	1.2	1.2	1.3	1.4	1.4
Assets/Equity (x)	1.1	1.1	1.1	1.1	1.1
ROAE (%)	35.2	23.0	20.8	23.1	25.0
ROAA (%)	27.5	20.6	19.0	21.1	23.1
Liquidity & Efficiency					
Cash conversion cycle	20.3	17.9	18.8	20.0	22.1
Days receivable outstanding	21.6	23.9	24.6	25.1	26.8
Days inventory outstanding	26.9	24.8	23.9	23.8	21.4
Days payables outstanding	28.2	30.8	29.6	28.9	26.2
Dividend cover (x)	5.0	5.0	5.0	5.0	5.0
Current ratio (x)	6.2	6.7	7.5	8.5	nm
Leverage & Expense Analysis					
Asset/Liability (x)	7.7	nm	nm	nm	nm
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Net interest cover (x)	na	na	na	na	na
Debt/EBITDA (x)	0.1	0.0	0.0	0.0	0.0
Capex/revenue (%)	4.6	0.2	7.9	6.2	4.9
Net debt/ (net cash)	(706.7)	(639.1)	(675.8)	(787.7)	(962.1)

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