

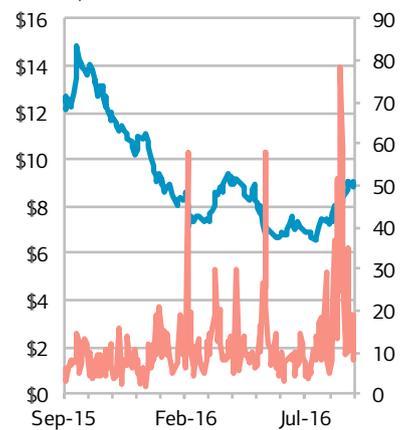
September 22, 2016
Company Update

Jeff Dorr
jeff@jcapitalresearch.com
+852 2534 7405

Tingyi (322 HK)

| | |
|---------------------|-----------------|
| Price | HKD 8.70 |
| Rating | BUY |
| Price Target | HKD 9.40 |
| Difference | 8% |
| Market Cap | HKD 49 bln |
| Avg. Volume (3m) | 11 mln |
| P/E | 27x |

Tingyi (322 HK) last share price in HKD (blue) and volume (pink, in mln shares)



Source: Bloomberg

Tingyi (322 HK): Distributor Survey Cautious About the Recovery

▶ **Tingyi beverage sales in the tea, water, and juice segments are up**

Our proprietary survey says that in Q3 2016 sales rose 48% QoQ and 3% YoY due to hot weather and aggressive discounting in bottled water. While the positive trend supports our view that Tingyi will engineer a turnaround, we are unconvinced the improvement is sustainable. Distributors say it's because of the weather.

▶ **Bottled water volumes have increased 75% QoQ and 16% YoY**

Results are strong due to hot weather and Tingyi's volume promotions rather than because of fundamental improvement in demand.

▶ **Tingyi noodles sales are up 14% QoQ and down 12% YoY**

We have positive feedback on Tingyi's re-release of the "Classic" noodle series.

▶ **On a DCF basis, we maintain our "BUY" recommendation with a price target of HKD 9.40.**

We prefer the DCF method for valuing Tingyi because it captures the long term turnaround of the business.

▶ **On a near term earnings basis, we think the stock is fully valued**

We forecast earnings of USD 150 mln for 2016 and USD 245 mln in 2017. Our 2016 and 2017 estimates are 16% and 3% below consensus, respectively. At a 20x forward multiple on 2017's USD 245 mln in earnings, we arrive at a target price of HKD 6.90 per share.

Table of Contents

- 3 Distributor Survey: Growth, with Caveats**
- 3 Survey Structure – Our Panel**
- 5 Summary Observations**
- 6 Beverages – Hot Weather Spurs Sales**
- 6 Bottled Water**
- 6 Volume Growth from Hot Weather and Discounting**
- 7 Bottled Water Sales – Perceptions Vary by Region**
- 8 Bottled Water – Regional Pricing and Heavy Discounting During Peak Season**
- 9 Tingyi Beverages - High Distributor Inventory Leads to Unregulated Sales**
- 11 Noodles Turnaround – Too Soon to Tell**
- 11 Noodles Volume Growth – Slow Improvement**
- 13 Noodles Pricing – One Price Across all Regions, No Discounts**
- 14 UPC Noodles Gaining Traction in the Premium Segment**
- 15 Notable Commentary**
- 18 Disclaimer**

We are looking for the turning point.

Distributor Survey: Growth, with Caveats

Tingyi saw sharp declines in volumes and margins in H1 2016 due to its price hike in noodles in October of 2015, rainy weather that affected the beverages division, and a misguided change in packaging of bottled water. Sales in the noodles and beverages segments fell 14% in H1 2016, and net profit tumbled 65% YoY on operating deleverage. In H1 2016, Tingyi earned a paltry 1.6% in net margin in the beverages category and 3.9% net margin in noodles.

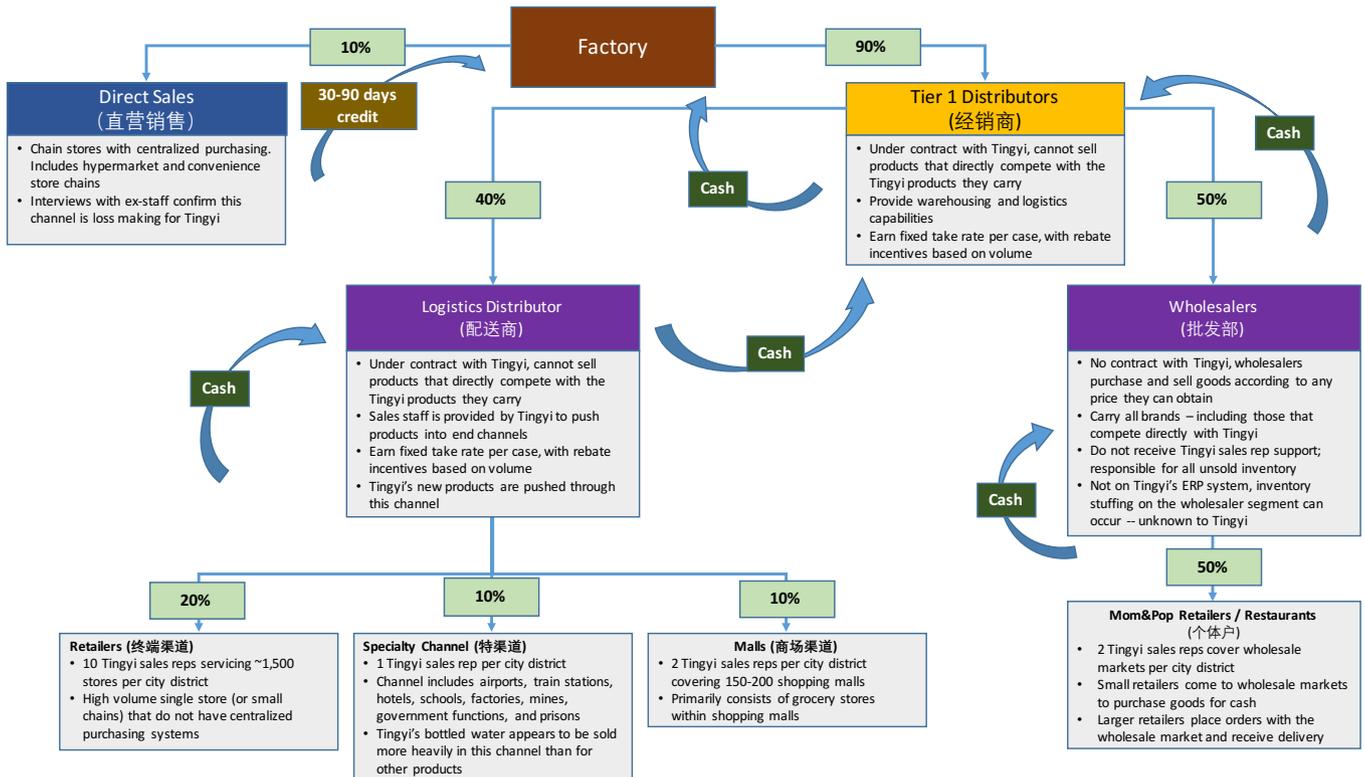
We are looking for the turning point. We expect long-term net margins in beverages to reach about 6-8%, and net margins in the noodles business to reach 9-10%, in line with Tingyi's historical performance and those of its peers. Such improvement should drive net margins from the 2% earned in H1 2016 to approximately 8%. In order to achieve these improvements, Tingyi must first gain sales traction in sales.

To determine when that turn will come for Tingyi, we conducted our first quarterly survey of Tingyi distributors.

Survey Structure – Our Panel

We attempted to survey Tingyi from the most consolidated view possible -- Tingyi's Tier 1 distributors. To illustrate whom we contacted in our poll, we have sketched a diagram of Tingyi's value chain. We spoke with Tingyi's Tier 1 distributors (in yellow), as Tier 1 distributors are responsible for moving roughly 90% of Tingyi's total volumes. Our sampling of the market is admittedly small – we contacted 20 out of roughly 30,000 distributors who contract directly with Tingyi. Our objective was to gauge sales trends in bottled water and Tingyi's new "Classic" noodle series – Tingyi main weak points in the past several quarters. We also attempted to gain insight into how Tingyi compensates distributors relative to other packaged goods companies, and how Tingyi performs as a business partner. We surveyed 10 noodles distributors and 10 beverages distributors across China at the end of August 2016.

September 22, 2016



Source: J Capital Interviews and Analysis

Table 1. Our Panel - Noodles Distributor Details

| | Hunan | Hunan | Hunan | Shanxi | Shanxi | Ningxia | Shanxi | Anhui | Anhui | Hunan |
|--------------------------------|--------|--------|--------|--------|--------|---------|--------|---------|---------|-------|
| Annual Sales (RMB mlns) | 40 mln | 21 mln | 15 mln | 35 mln | 27 mln | 50 mln | 21 mln | 6.5 mln | 3.5 mln | 6 mln |
| Warehouse (sqm) | 2000 | 1000 | 500 | 400 | 600 | 100 | 400 | 800 | 300 | 1000 |

Table 2. Our Panel - Beverages Distributor Details

| | Jiangsu | Jiangsu | Fujian | Hunan | Fujian | Guang-dong | Heilong-jiang | Guang-dong | Guang-dong | Hubei |
|---------------------------|---------|---------|--------|---------|---------|------------|---------------|------------|------------|--------|
| Annual Sales (RMB) | 33 mln | 3.5 mln | 17 mln | 2.2 mln | 8.7 mln | 45 mln | 130 mln | 110 mln | 25 mln | 14 mln |
| Warehouse (sqm) | 2,200 | 600 | 2,000 | 2,000 | 1,700 | 2,000 | 46,000 | 3,200 | 1,100 | 1,000 |

Summary Observations

Beverages (survey through August, Q3 2016):

- ▶ Weather in the first half of Q3 2016 was hotter than in Q2, leading to better beverage sales across the industry. **Across water, tea, and juice categories, distributors anticipate that Q3 2016 sales will increase 48% QoQ and about 3% YoY.**
- ▶ Distributors anticipate that Q4 beverage sales will grow about 7% YoY
- ▶ In the bottled water category, which has in recent quarters proved a drag on Tingyi's profitability, distributors are reporting even more robust numbers. Over the distributors we surveyed, sales of bottled water have increased 76% QoQ and 16% YoY. This is in part due to hot weather, and in part due to Tingyi's aggressive promotions in the category and introduction of Tingyi's new RMB 2 Youyue brand in Q2 2016
- ▶ When sales are strong, inventory build at the distributor level is a non-issue. One beverages distributor reported that his entire stock of beverages inventory sold out in 10 days in July due to hot weather. On balance, we have been told that distributors typically hold two weeks' worth of inventory in their warehouses, and a maximum of one month.
- ▶ Tingyi typically gives distributors less margin than competitors but balances this with higher volumes.

Noodles survey through August (Q3 2016):

- ▶ September is the key month for noodles sell-in in Q3. Our survey was completed at the end of August
- ▶ Distributors surveyed toward the end of August indicated that they expected total noodle sales to grow 14% QoQ but that sales would remain lower than Q3 2015 (about -12% YoY)
- ▶ Distributors anticipate Q4 2016 noodle sales to still be down about 4% YoY
- ▶ The success of Tingyi's reintroduced "Classic" noodle series is **immensely important** to Tingyi's profitability in the noodles category. In our survey (which examines only the traditional trade channel), we learned that **Tingyi's classic flavor comprises 65-75% of volume of bowl noodles, and that bowl noodles comprise approximately 65% of total volumes sold.** Distributors also stated that the "Classic" series is the highest volume brand within the pack noodle segment.
- ▶ In our conversations with ex-Tingyi sales reps in the noodles channel, we learned that the noodles business in modern trade is about breakeven or slightly loss-making. The traditional trade channel,

which comprises ~90% of Tingyi’s sales, is the only profitable channel for Tingyi. Hence, Tingyi’s “Classic” Series re-introduction in the traditional channel is of high importance.

- ▶ Distributors universally blamed last year’s poor sales on the October price hike. Distributors saw sales gradually improving after Tingyi’s price cut in June, but we are not seeing a speedy turnaround.

Beverages– Hot Weather Spurs Sales

Our beverage survey indicates that beverages as a whole (excluding Pepsi) have improved for Tingyi in Q3 2016 – leaping by 48% QoQ and 3% YoY.

Table 3. Bottled Water, Tea, Juice Volume Growth (Q3 2016)

| | Jiang-su | Jiang-su | Fu-jian | Hu-nan | Fu-jian | Guang-dong | Heilong-jiang | Guang-dong | Guang-dong | Hu-bei | Avg |
|------------|----------|----------|---------|--------|---------|------------|---------------|------------|------------|--------|-----|
| QoQ | 68% | 132% | 43% | 13% | 55% | 27% | 37% | 32% | 25% | 47% | 48% |
| YoY | 26% | 18% | 3% | -10% | -19% | 12% | -11% | -3% | 10% | 10% | 3% |

Distributors mainly cited hot weather, promotional activity on water, and introductions of new products like Tingyi’s new Youyue bottled water as contributing factors behind growth.

“...Volumes are up mainly on account of weather and on new products Tingyi is rolling out including Apple Jasmine Tea, NongNong Tea, and Youyue water...”

Beverages Distributor, Yangzhou, Jiangsu

“... Sales volume is clearly higher than last year. In 2016, Tingyi's policy emphasized bottled water sales, and it has increased efforts to take market share...”

Beverages Distributor, Quanzhou, Fujian

Bottled Water

Volume Growth from Hot Weather and Discounting

Within the bottled water category, our survey sample indicates strong improvement in water sales through August, Q3 2016. On average, distributors in our sample reported QoQ increases of 77% and YoY increases of 16%.

Table 4. Bottled Water, Tea, Juice Volume Growth (Q3 2016)

| | Jiang-su | Jiang-su | Fu-jian | Hu-nan | Fu-jian | Guang-dong | Heilong-jiang | Guang-dong | Guang-dong | Hu-bei | Avg |
|------------|----------|----------|---------|--------|---------|------------|---------------|------------|------------|--------|-----|
| QoQ | 141% | 202% | 27% | -9% | 76% | 120% | 118% | 34% | 40% | 20% | 77% |
| YoY | 62% | 78% | 4% | 0% | 22% | -19% | -8% | -8% | 17% | 6% | 16% |

“... The increase in sales is due to hot weather. This year July and August have been much hotter than last year, when it rained a great deal. In addition, Tingyi has been promoting bottled water, and introduced a new 2 RMB bottled water product (Tingyi's Youyue brand).”

Beverages Distributor, Yangzhou, Jiangsu

The improvement in bottled water sales should have a meaningful impact on beverage earnings for Tingyi in Q3 2016, since historically this category has been the main drag on utilization in the beverages category. Tingyi's bottled water plants are separate from its tea/juice/CSD production facilities, and logistics costs are high for bottled water relative to its RMB 1 price. This means low utilization in one plant cannot easily offset another in a different region.

The increase in bottled water sales is encouraging to our long thesis, but the increase in Q3 2016 sales may only be due to hot weather and Tingyi discounting, neither of which is a sustainable path to profitability. **This makes us remain cautious on the sustainability of Tingyi's improvement in the bottled water category. We would prefer to hear that new packaging introduced at the end of Q2 is resulting in improved sales, but to date we have not received this feedback.**

The one positive observation is that Tingyi's improvement in bottled water sales seems to be outpacing Tingyi's improvement in the tea/juice/bottled water categories as a whole, so perhaps the change in packaging is causing some improvement in bottled water sales. Then again, this could be due to promotional activity.

Bottled Water Sales – Perceptions Vary by Region

Tingyi's bottled water has traditionally suffered from market perception as a low end-product typically sold to factories, mines, hotels, and government for functions. Tingyi has tried to remedy this and gain exposure to higher-price water by offering three different price tiers, rolled out at the end of Q2 2016 – Master Kong (Tingyi's predominant RMB 1 bottled wa-

Low utilization in one plant cannot easily offset another in a different region.

September 22, 2016

ter product), Youyue (Tingyi's RMB 2 bottled water), and Hanyang Spring (Tingyi's RMB 3 bottled water product).

In high-tier, coastal cities we found that Tingyi's bottled water sales are increasingly losing share to higher-priced competitors such as C'estbon and Nongfu, as consumers upgrade. In interior provinces such as Hubei, we heard that Tingyi's bottled water sales are strong, and have displaced competitors such as Coca Cola:

"... Consumer tastes are changing. [Consumers] feel that spring water and purified water are healthy to consume, so every year there is steady growth in these categories. Tingyi's water is positioned in the low-mid segment (Youyue brand entered the market at the end of last year, and had no brand effect). Tingyi's water is generally sold at factories and mines via the specialty channel. In Shenzhen these types of industries are gradually declining -- the specialty channel isn't as nimble as the model in which Tingyi's competitors compete, so it is very difficult to effect change. The end result is that is that inventories at the logistics distributors and distributors aren't moving, but at the wholesaler level inventories are light since the majority of Tingyi's water doesn't get sold through this channel..."

Beverages Distributor, Shenzhen, Guangdong

"... Before, Jinmailang's water and Coke's water in this region sold well, but now you hardly see Coke's water in the market. Today, it's mainly Tingyi, Wahaha, C'estbon, and Nongfu. New competing products have decreased and our Tingyi volumes have naturally increased..."

Beverages Distributor, Chibi, Hubei

Bottled Water – Regional Pricing and Heavy Discounting During Peak Season

We attempted to survey distributors to monitor any price changes or changes in rebates for bottled water. Consistent with management interviews, bottled water is priced differently in different regions.

Distributors reported that Tingyi had not implemented any changes in pricing or rebates for bottled water in recent quarters, but indicated that Tingyi has increased promotions by giving increased numbers of free cases of water.

Table 5. Bottled Water: Distributor Pricing and Take per Case

| | Jiang-su | Jiang-su | Fu-jian | Hu-nan | Fu-jian | Guang-dong | Heilong-jiang | Guang-dong | Guang-dong | Hu-bei | Avg* |
|----------------------------|----------|----------|---------|---------|---------|------------|---------------|------------|------------|---------|------|
| Pack Size | 24 pack | 24 pack | 24 pack | 24 pack | 24 pack | 24 pack | 12 pack | 24 pack | 24 pack | 24 pack | |
| Incom-ing Price | 13.0 | 13.0 | 13.5 | 11.5 | 13.5 | 13.5 | 6.0 | 13.5 | 13.2 | 12.8 | 13.1 |
| Sales Price | 14.0 | 14.0 | 14.7 | 12.5 | 14.7 | 14.8 | 6.8 | 14.8 | 14.4 | 14.6 | 14.3 |
| Dist. Take per Case | 1.0 | 1.0 | 1.2 | 1.0 | 1.2 | 1.3 | 0.8 | 1.3 | 1.2 | 1.8 | 1.2 |

*Excluding Heilongjiang

“... Sales are up because Tingyi introduced a new brand of Youyue water. Sales have also increased due to increased discounting. Coke cut its water price to was cut to RMB 9 per case, so Tingyi increased its discount to 20 free cases per 100 ...”

Beverages Distributor, Heyuan, Guangdong

“... Tingyi hasn’t implemented a price change in bottled water, but it is discounting by increasing the number of free cases that are given. In H1 2016, Tingyi was giving 8-10 cases per 100 purchased. In Q3 2016 Tingyi increased it to 18 free cases...”

Beverages Distributor, Huizhou, Guangdong

“... Tingyi hasn’t increased pricing in bottled water or rebates, but it is giving away more boxes. Tingyi recently changed started giving away 12 boxes for every 100 purchased instead of 8...”

Beverages Distributor, Chibi, Hubei

Tingyi Beverages - High Distributor Inventory Leads to Unregulated Sales

According to our conversations with management, our understanding is that Tingyi only allows regional pricing in the bottled water category. We have been told that all other categories have flat pricing nationally to discourage arbitrage in different regions. However, our checks in the juice category show price disparities across different regions. We have not yet performed the same checks in tea in the same granularity, but our on-the-ground checks with ex-Tingyi sales reps suggest that arbitragers are trading tea as well.

Table 6. Juice: Distributor Pricing and Take per Case

| | Jiang-su | Jiang-su | Fu-jian | Hu-nan | Fu-jian | Guang-dong | Heilong-jiang | Guang-dong | Guang-dong | Hu-bei | Avg |
|----------------------------|----------|----------|---------|---------|---------|------------|---------------|------------|------------|---------|------|
| Pack Size | 15 pack | 15 pack | 15 pack | 15 pack | 15 pack | 15 pack | 15 pack | 15 pack | 15 pack | 15 pack | |
| Incoming Price | 28.0 | 28.0 | 29.0 | 26.5 | 29.0 | 29.0 | 30.5 | 29.1 | 28.8 | 24.8 | 28.3 |
| Sales Price | 31.0 | 31.0 | 30.3 | 27.5 | 30.3 | 30.4 | 31.7 | 30.4 | 29.0 | 26.4 | 29.8 |
| Dist. Take per Case | 3.0 | 3.0 | 1.3 | 1.0 | 1.3 | 1.4 | 1.2 | 1.3 | 0.2 | 1.6 | 1.5 |

Beverage distributors complained that different pricing / discounting in different regions resulted in inventory movement across regions. Some of these pricing discrepancies are the result of Tingyi’s distributors taking on much inventory, earning rebates on the increased volume, and offloading the products at lower prices than they should. Large retailers from the direct sales channel, who receive promotional fees, are also guilty parties. In other instances, Tingyi simply charges different prices in different geographies, and the price gap warrants price arbitraging between different regions exploit those disparities.

“... Because now is the peak season for beverages, Tingyi is pushing inventory onto distributors. Some distributors are overloaded with inventory and are selling their warehouse goods to arbitragers in the Pearl River Delta region from Hubei. The price difference between regions is about 2-3 RMB, including rebates...”

Beverages Distributor, Chibi, Hubei

“... Leakage of goods from other regions is a serious problem. At present, Heyuan area has an online platform where consumers can order goods, and the price is cheaper than our selling price...”

Beverages Distributor, Heyuan, Guangdong

“...Tingyi has a lot of goods that are arbitraged from other regions. Originally Tingyi sales in Longmen were very low, but goods from Guangzhou and other regions are always leaking into this region, which is hurting local sales. Tingyi's management can't find an effective way to solve the problem. That said, Tingyi sales are stable ... Inventories are normal. If it wasn't for the leakage of goods, our inventory levels would be even lower...”

Beverages Distributor, Huizhou, Guangdong

September 22, 2016

“... Online sales and arbitragers might make up a total of 10-15% of sales for Tingyi. Because this portion of sales is against Tingyi's internal rules, and is strictly against regulation, most distributors will count this within the wholesaler segment. They won't talk about it openly to outsiders. For online sales its usually via O2O platforms. The difference between the arbitrage model and the normal Tingyi sales channel is that the goods aren't coming directly from the factory. They are first sitting in retail stores or in distributor warehouses. It's usually because distributors or stores in the direct sales channel overstocked due to pressure from Tingyi sales reps, or due to their overly optimistic expectations on sales. The distributors and direct sales stores will work discreetly with Tingyi reps and give large volumes to arbitragers to reduce their inventory. Arbitragers don't care what region they sell to and have no restrictions. The arbitrage channel has razor thin margins but high volumes...”

Beverages Distributor, Shenzhen, Guangdong

Price discrepancies between regions are not unique to Tingyi, however. C'estbon (a bottled water company) was also cited as offering price discrepancies in different regions which are then arbitrated

“... C'estbon has too much product leakage from other regions. The price discrepancy for C'estbon is over RMB 5 for Guangdong compared to internal regions in China, and sales of C'estbon in interior China aren't good. C'estbon has too few sales reps, and after sales support is weak. That said, C'est bon is well received by the end consumer. Volumes are huge. A lot of distributors love it and hate C'estbon at the same time...”

Beverages Distributor, Shenzhen, Guangdong

Noodles Turnaround – Too Soon to Tell

Noodles Volume Growth – Slow Improvement

Across our survey, noodles distributors estimated an improvement in Q3 over Q2 due to the release of Tingyi's “Classic” noodle offering. We note that it still may be too early to speak to a noodles turnaround, as September is the key month in Q3 for noodles sales. Our survey was completed toward the end of August.

In general, we think the QoQ changes are perhaps more telling than the YoY changes for Tingyi's noodle sales. Last September, distributors stocked

Table 7. Noodles Volume Growth (Q3 2016)

| | Hu- nan | Hu- nan | Hu- nan | Shan- xi | Shan- xi | Ning- xia | Shan- xi | Anhui | Anhui | Hu- nan | Avg |
|-------------------|------------|------------|------------|-------------|-------------|--------------|-------------|-------|-------|------------|------|
| QoQ | 5% | 8% | 5% | 68% | 50% | 26% | -10% | 4% | -5% | -15% | 14% |
| YoY | -18% | -15% | -17% | -12% | -15% | -17% | -22% | 8% | -8% | 0% | -12% |
| Q4 YoY | -15% | -12% | -10% | -11% | -5% | -11% | -5% | 15% | 5% | 10% | -4% |

about one month's worth of Tingyi inventory before the price hike in October. Even if Tingyi sales remain marginally lower in Q3 2016 vs last year, we would take the news as a positive. Distributor feedback has been favorable toward Tingyi's price reduction:

"... Tingyi's price hike is the main factor behind weak sales in 2016. Last October the classic series was cancelled and replaced with "Liao Feng" series with a price hike. This June the 'Classic' series was reintroduced, and the 'Liao Feng' series was cut to only two flavors. UPC's directly competing product didn't hike prices. Although sales of the 'Classic' series has been influenced by the changes, it's still selling pretty well in this region right now..."

Noodles Distributor, Tongcheng, Anhui

"... The decline in Tingyi's sales is due to the October 2015 price change. In Q3 prices were adjusted downward, the market welcoming the change..."

Noodles Distributor, Hengyang, Hunan

Distributors universally noted that Tingyi's "Classic" series is their top selling series by volume, and that the series obtains the best shelf space at end retailers. Tingyi's lower end noodle series such as Fumanduo and more premium offerings such as Tangdashi and Zhenliaoduo received poor feedback, but volumes of these series are low and nearly inconsequential in the context of Tingyi's "Classic" series.

"... Tingyi's RMB 4.0 Classic Bowl in classic three flavors Braised Beef, Spicy Beef, and Pickled Cabbage are the best sellers. The Classic series in these three flavors have the best shelf space at retailers. Tingyi's turn around has been quick. Tingyi's 6 RMB Tangdashi (汤大师) and Zhenliaoduo (诊疗多) are selling the worst. Only a small group of A grade retailers can sell at this price. These expensive products have low penetration..."

Noodles Distributor, Tong Cheng, Anhui

“... Tingyi's ‘Classic’ Braised Beef noodle is the best seller -- it is irreplaceable in the market. Super Fumanduo (超级福满多) is the worst seller of Tingyi's products. It's market position hasn't been well received. Positioned Above it is the higher priced Happy Bowl (凯信通), positioned below is the mid-tier Mianjingshuang bowl (面经爽桶)...”

Noodles Distributor, Hengyang, Hunan

In our survey, we asked distributors what portion of sales the “Classic” series comprised in bowl noodles. Tingyi’s “Classic” series bowl noodle, which retails for RMB 4.0, seems to comprise some 65-75% of Tingyi’s bowl noodles sales volume.

Table 8. Classic Flavor Volumes as % of Total Bowl Volume

| | Hu-nan | Hu-nan | Hu-nan | Shan-xi | Shan-xi | Ning-xia | Shan-xi | Anhui | Anhui | Hu-nan | Avg |
|----------------|--------|--------|--------|---------|---------|----------|---------|-------|-------|--------|-----|
| Q3 2016 | 89% | 80% | 81% | 98% | 97% | 97% | 9% | 71% | 58% | 55% | 74% |
| Q2 2016 | 86% | 90% | 79% | 65% | 73% | 69% | 4% | 73% | 60% | 60% | 66% |
| Q3 2015 | 91% | 81% | 72% | 88% | 98% | 98% | 8% | 71% | 77% | 64% | 75% |

Table 9. Bowl Noodles Vol. as % of Total Noodles Vol.

| | Hu-nan | Hu-nan | Hu-nan | Shan-xi | Shan-xi | Ning-xia | Shan-xi | Anhui | Anhui | Hu-nan | Avg |
|----------------|--------|--------|--------|---------|---------|----------|---------|-------|-------|--------|-----|
| Q3 2016 | 81% | 77% | 73% | 40% | 46% | 45% | 56% | 70% | 75% | 73% | 64% |
| Q2 2016 | 86% | 80% | 75% | 35% | 46% | 45% | 50% | 73% | 77% | 78% | 65% |
| Q3 2015 | 81% | 77% | 76% | 39% | 44% | 46% | 57% | 68% | 68% | 70% | 63% |

Noodles Pricing – One Price Across all Regions, No Discounts

Distributors appear to purchase noodles at a consistent national price regardless of region – 36.5 for a 12 pack of classic bowl noodles and RMB 45.5 for a 24 pack box of Classic series packets. Unlike drinks, Tingyi keeps a national price on noodles to avoid arbitrage between different regions. With drinks, the opportunity for arbitrage is lower due to higher transport costs (compared to noodles).

Pricing in the noodles category appears to be more consistent than that of the beverages category. Other than re-introduction of Tingyi’s “Classic” series and corresponding price cut, there appear to be no changes in pricing, rebates, or other forms of discounting.

Table 10. Pricing for RMB 4.0 Classic Bowl Noodle (12 Packs per Case)

| | Hu-nan | Hu-nan | Hu-nan | Shan-xi | Shan-xi | Ning-xia | Shan-xi | Anhui | Anhui | Hu-nan | Avg |
|----------------------------|--------|--------|--------|---------|---------|----------|---------|-------|-------|--------|------|
| Incoming Price | 36.5 | 36.5 | 36.5 | 36.5 | 36.5 | 36.5 | 36.5 | 36.5 | 36.5 | 36.5 | 36.5 |
| Sales Price | 37.5 | 37.5 | 37.5 | 37.5 | 37.5 | 37.5 | 37.5 | 39 | 39 | 37.5 | 37.8 |
| Dist. Take Per Case | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 | 2.5 | 2.5 | 1.0 | 1.3 |

Table 11. Pricing for RMB 2.5 Classic Pack Noodle (24 packs per Case)

| | Hu-nan | Hu-nan | Hu-nan | Shan-xi | Shan-xi | Ning-xia | Shan-xi | Anhui | Anhui | Hu-nan | Avg |
|----------------------------|--------|--------|--------|---------|---------|----------|---------|-------|-------|--------|------|
| Incoming Price | 45.5 | 45.5 | 45.5 | 45.5 | 45.5 | 45.5 | 45.5 | 45.5 | 45.5 | 45.4 | 45.5 |
| Sales Price | 46.5 | 46.5 | 46.5 | 47.0 | 47.0 | 47.0 | 47.0 | 48.0 | 48.0 | 46.5 | 47.0 |
| Dist. Take Per Case | 1.0 | 1.0 | 1.0 | 1.5 | 1.5 | 1.5 | 1.5 | 2.5 | 2.5 | 1.1 | 1.5 |

UPC Noodles Gaining Traction in the Premium Segment

Distributors felt UPC’s recent advertising campaign with Wang Han (a television host) was a hit success, and felt that UPC was getting good traction in the RMB 5+ premium noodles category with new premium products such as Tangdaren (汤达人).

“... UPC is doing well with its Pickled Cabbage series. The reason is that the flavor is outstanding, and the commercials with Wang Han has been successful ...”

Noodles Distributor, Hengyang, Hunan

“... UPC's performance has been good. UPC hasn't adjusted their

September 22, 2016

prices, and channel profit is good. Pickled Cabbage flavor is selling very well. UPC's Tangdaren (汤达人) is growing quickly, new products are getting traction..."

Noodles Distributor, Changsha, Hunan

"... UPC is doing well. New products including Tangdaren (汤达人), Douhui Xiaoguan (都会小管), and Xiangban Yicheng (相拌一城) are all well accepted by consumers..."

Noodles Distributor, Hengyang, Hunan

"... UPC's Tangdaren is doing relatively well. UPC's Tangdaren series is high end. It's a relatively high quality product, and its positioning in the market is clear..."

Noodles Distributor, Xi'an, Shanxi

Notable Commentary

Tingyi frequently gives distributors less profit on a per case basis relative to competitors.

"... Coke and UPC both give distributors better profit than Tingyi. Take rate per case approached RMB 4 per case, vs 2 RMB per case for Tingyi ..."

Beverages Distributor, Yangzhou, Jiangsu

"... UPC gives better profit to distributors. Typically profit per case is about RMB 0.5 - 1 better than Tingyi..."

Noodles Distributor, Changsha, Hunan

"...Red Bull gives more profit to distributors than Tingyi. Red Bull is nimble, exercises good operational control, and has good profit..."

Beverages Distributor, Shenzhen, Guangdong

"...Wahaha offers higher profit than Tingyi, and can be more flexible on prices to better suit the local market and helps manage excess inventory..."

Beverages Distributor, Chibi, Hubei

"... Wanglaoji (a beverages company in herbal tea) gives distributors good terms. Tingyi distributors only get about 5% margin. Wanglaoji distributors get about 15%..."

Noodles Distributor, Yan'An, Shanxi

September 22, 2016

“... Yili Milk gives distributors good margins. Tingyi gives about 5%, Yili gives about 20%...”

Noodles Distributor, Xi'an, Shanxi

Tingyi Beverage Sales are relatively Weaker in Large Bottle Sizes (1-2L)

“... Tingyi's distributors don't make great profit -- the Spring festival is when profit is highest, but Tingyi's family sized packages (2L series) doesn't sell well. UPC and Coke sell well in this segment, so Tingyi doesn't have any sales during the month of the Spring festival ... **If Tingyi can get its large bottled water product right, Q4 results could probably be flat with Q3 in the beverage segment, because during the Spring Festival, sales are relatively strong, but the only companies doing big volumes then are Coca Cola, Pepsi, and UPC -- so there is room for improvement for Tingyi...**”

Beverages Distributor, Chibi, Hubei

“... Sales of juice in large bottles have fallen dramatically, we are relying on 2 liter black tea for our Q3 numbers...”

Beverages Distributor, Yangzhou, Jiangsu

Tingyi has a reputation for foisting inventory on distributors to hit monthly sales targets.

Tingyi's distributors complained that Tingyi forced inventory on them in order to meet sales targets. Relative to UPC and Coca Cola, Tingyi was much more forceful in forcing unwanted inventory on distributors.

“... Coke is good to work with. Distributors don't take responsibility for the results of Coke. Profit from the consumer pulls product sales [as opposed to Tingyi which forces inventory onto distributors via sales targets]...”

Beverages Distributor, Harbin, Heilongjiang

“... Tingyi's cooperation with distributors is poor. Tingyi is relentless in annually increasing sales targets, which forces distributors to take on more inventory. As a result there's a lot of old inventory sitting in the channel that hasn't been cleaned out...”

Beverages Distributor, Heyuan, Guangdong

“... Every month Tingyi sales reps push goods into the warehouse to meet sales targets, the sell through can't keep up...”

Beverages Distributor, Quanzhou, Fujian

“... Tingyi has high sales targets, which forces inventory into the warehouse...”

Beverages Distributor, Hengyang, Hunan

Tingyi has poor reputation for creativity in product development, but a strong reputation for high volumes, strict management, and enforcement of warehouse standards which results in consistent service for distributors.

“...Consumers are increasingly favoring water, but Tingyi's water sales have been stagnant. It's been difficult to break through. The introduction of new products has suffered setbacks -- in the last 4 years market reception of Tingyi's new products hasn't been good. Some have even been cancelled within 6 months of their introduction, so Tingyi hasn't been able to seize new opportunities. However, Tingyi has many SKUs, and brand recognition is relatively strong. In addition, Tingyi's organizational structure is stable. Although management style is inflexible, it is also strict, so overall sales won't fall in a significant way...”

Beverages Distributor, Shenzhen, Guangdong

“...Tingyi wants to change to new products, but the majority of the ones it releases die...”

Beverages Distributor, Heyuan, Guangdong

“... Tingyi's new products haven't been well received by the market. New products that were sold into the trade channel last year are still sitting in inventory...”

Beverages Distributor, Quanzhou, Fujian

“... We like to work with Baixiang for noodles. Baixiang doesn't have strict safety requirements on its warehouses, so we are able to save money compared to Tingyi...”

Noodles Distributor, Tongcheng, Anhui

“... Tingyi is the best brand to work with as a distributor. Tingyi has business in every region and dominates the market...”

Noodles Distributor, Hengyang, Hunan

Relative to competitors, Tingyi does not help its distributors resolve issues with unsold inventory.

“... Tingyi is introducing new products, but none are getting trac-

September 22, 2016

tion. Last year Tingyi introduced Green apple black tea. Sales were bad so Tingyi dropped the product. End retailers were left with excess inventory, and Tingyi didn't help them clear their inventory ...”

Beverages Distributor, Heyuan, Guangdong

“... UPC is good to work with. UPC reps help with managing old inventory that doesn't sell...”

Beverages Distributor, Huizhou, Guangdong

“... UPC is good to work with because it doesn't push distributors to take inventory. UPC also provides better compensation to distributors for products that expire, which reduces distributor losses...”

Noodles Distributor, Huaining, Anhui

“... Wahaha offers higher profit than Tingyi, and can be more flexible on prices to better suit the local market and helps manage excess inventory...”

Beverages Distributor, Chibi, Hubei

Disclaimer

This publication is prepared by J Capital Research Limited (“J Capital”), a Hong Kong registered company. J Capital is regulated as a company advising on securities by the Hong Kong Securities and Futures Commission (CE# AYS956) and is registered as an investment adviser with the U.S. SEC (CRD# 165324). This publication is distributed solely to authorized recipients and clients of J Capital for their general use in accordance with the terms and conditions of a Services Agreement and the J Capital Authorized User Content Agreement available [here](#). Unauthorized copying or distribution is prohibited. If you are reading this publication without having entered into a Services Agreement with J Capital, or having received written authorization to do so, you hereby agree to be bound by the J Capital Non-Authorized User Content Agreement that can be viewed [here](#). J Capital does not do business with companies covered in its publications, and nothing in this publication should be construed as a solicitation to buy or sell any security or product. In preparing this document, J Capital did not take into account the investment objectives, financial situation and particular needs of the reader. This publication is intended by J Capital only to be used by investment professionals. Before making an investment decision, the reader needs to consider, with or without the assistance of an adviser, whether the contents are appropriate in light of their particular investment needs, objectives and financial circumstances. J Capital accepts no liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this publication and/or further communication in relation to this document.