China Consumer Staples

Beverage initiation feedback: Investors prefer growth visibility and focus on execution

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Post our beverage coverage expansion with initiations on Eastroc Beverage and CR Beverage on Dec 4, we held numerous marketing meetings with onshore and offshore investors. In general, investors agreed with our investment thesis/framework on the beverage sector and our preference for players with secular growth/strong life-cycle categories. We expect strong growth to support Eastroc rerating on top of high multiples (share price up c.14% in last week). For CR Beverage, we see a more favorable N-T risk-reward (self-help margin expansion visibility vs. low trading P/E at teens).

In this note, we address questions from investors. **For Eastroc,** we see key debates surrounding 1) TAM growth, 2) competitive dynamics, 3) capacity expansion, 4) margin sustainability, and 5) overseas expansion (announced to set up an Indonesia subsidiary on Dec 13); **For CR Beverage,** we see key debates surrounding 1) unit manufacturing cost savings, 2) water competition, and 3) beverage business prospect.

Eastroc Beverage

Top investor concerns/questions: 1) TAM expansion drivers: What are the growth prospects for the energy drink industry? **2) Competition dynamics:** What if Red Bull regains its market share? **3) Impact from capacity expansion:** How can the rapid capacity expansion help Eastroc's topline growth and what is the cost? **4) Outlook for non-energy-drink category growth**, e.g., electrolyte water ; **5) Margin sustainability** amid rapid expansion; **6)** The market landscape for the energy drink industry in South East Asia.

Q1: What are the growth prospects for the energy drink industry and the market share evolution?

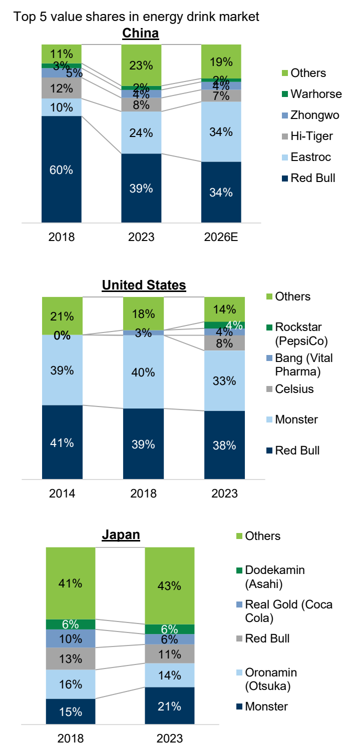
We expect the energy drinks market to grow at 7.2% CAGR mainly driven by the volume growth in 2023-28E as: 1) China's energy drinks industry is still relatively under-penetrated vs. the Asian markets e.g., Vietnam (1.2x vs. China) and Thailand

(1.4x), and more significantly behind developed countries such as the USA (2.0x vs. China), in terms of consumption volume per capita. 2) We expect more average consumption of energy drinks in China vs. other countries on the back of relatively longer working hours in China; 3) customer group is evolving beyond its traditional customer base of working class to white collar and younger generations; 4) ASP might be diluted by Eastroc as a value product taking market share.

We believe on the back of its strengthened presence in the energy drink industry nationwide, Eastroc still has room to further gain shares riding on its expanding channel and capacity network. Our scenarios suggest upside for Eastroc to further gain shares when referencing the US market.

Exhibit 1: Eastroc's revenue could be increased further by 12%/20% based on our scenarios
Scenario analysis

Scenarios for energy drink market shares		
Base case: Eastroc in China		
China energy drink market	**2024E**	**2026E**
Retail market size (value, Rmb mn)	99,771	116,480
Retail market size (volume, k ton)	8,155	9,780
Eastroc		
Energy drinks ex-fac sales (Rmb mn)	**13,337**	**19,001**
Energy drinks retail sales (Rmb mn)	27,402	39,039
Energy drinks sales volume (k ton)	3,124	4,495
Total sales value (Rmb mn)	**16,055**	**24,372**
Eastroc		
Value share (2024E)	**27%**	**34%**
Volume share (2024E)	**38%**	**46%**
Scenario #1: Eastroc to reach value share same as Red Bull in 2023 in the US (latest top 1 player) by 2026E		
Eastroc in China		
Retail value share		**38%**
Eastroc's sales value of energy drinks (Rmb mn)		21,317
+/- % vs. base case 2026E		**+12%**
Scenario #2: Eastroc to reach value share same as Monster in 2018 in the US (No.2 player's recent high) by 2026E		
Eastroc in China		
Retail value share		**40%**
Eastroc's sales value of energy drinks (Rmb mn)		22,734
+/- % vs. base case 2026E		**+20%**



Source: Company data, Goldman Sachs Global Investment Research, Euromonitor

In our US/Japan case study, we see the overall China energy drink market is still in an upcycle and a relatively early stage vs. the US/ Japan, where we observed more diversified trends —

- **Differentiated concepts prevailing (e.g., healthy, gen-Z) even in the energy drinks market:** The US as a relatively more mature market, saw new entrants with differentiated brands/ concepts taking shares from existing players in the past decade, e.g, sugar free positioning of Bang and Celsius. Bang's active and featured marketing campaigns via social media platforms targeting younger generation could be another plus for its popularity. Consumers concentrate towards the top 5 brands, resulting in rising aggregate market shares.
- **Red Bull is seen losing share across markets, despite its still dominant market**

share: Red Bull (including TCP/ Austria) kept losing value shares in China, the US and Japan in the past decade, likely because of its aging brand perceptions and/or less attractive pricing.

- **The growth pathway of Celsius and Monster presented helpful lessons for Eastroc:** We see 1) new product launches (e.g., more flavors/ packaging styles) and 2) deep channel penetration played key roles to their market share gains in the history.

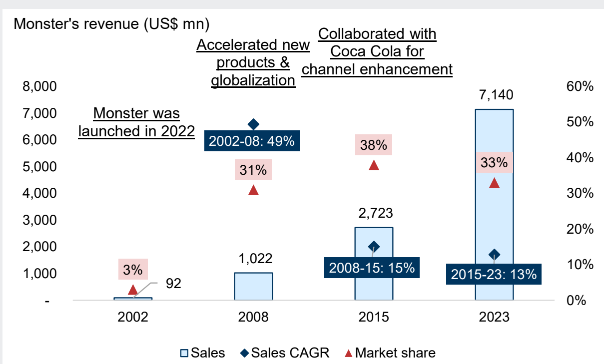
Case study: The growth pathway for Monster and Celsius in the US

With the carbonates markets in the US saturated at around 2000 in per capita consumption terms, the energy drinks market saw newer product launches in 2000-2007, exemplified by PepsiCo's AMP and SoBe, Rockstar (acquired by PepsiCo in 2020), Coca Cola's KMX, Monster and Celsius, among others, attempting to gain shares from long-standing brand Red Bull.

Monster, launched in 2002, gained market shares all the way to 30%+ by 2008 via a differentiated brand, flavors and package. The company boosted its sales growth in 2008 by accelerating new product launches and globalization, and managed to maintain DD% sales growth since 2015 by enhancing channel capability via collaborating with Coca Cola.

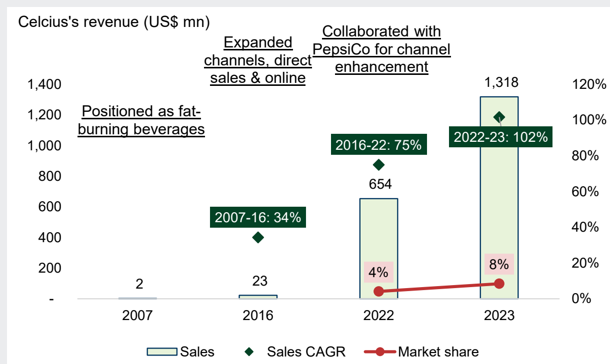
Celsius, launched in 2007, stayed at a relatively small scale until proactively expanding distribution channels and brand awareness since 2016, from which it managed to accelerate its market shares in the energy drinks market, with a differentiated position of fat-burning, sugar-free energy drinks. In 2022, Celsius partnered with PepsiCo to further enhance the channel network, and it doubled its sales in 2023 to US$1.3bn.

Exhibit 2: Monster boosted its sales growth in 2008 by accelerating new product launches and globalization, and managed to maintain DD% sales growth since 2015 by enhancing channel capability via collaborating with Coca Cola
Monster's revenue (US$ mn), CAGR and market shares (%)



Source: Company data, Euromonitor, Data compiled by Goldman Sachs Global Investment Research

Exhibit 3: Celsius accelerated its market share in the energy drinks market mainly by proactively expanding distribution channels and brand awareness, with a differentiated position of fat-burning, sugar-free energy drinks
Celsius's revenue (US$ mn), CAGR and market shares (%)



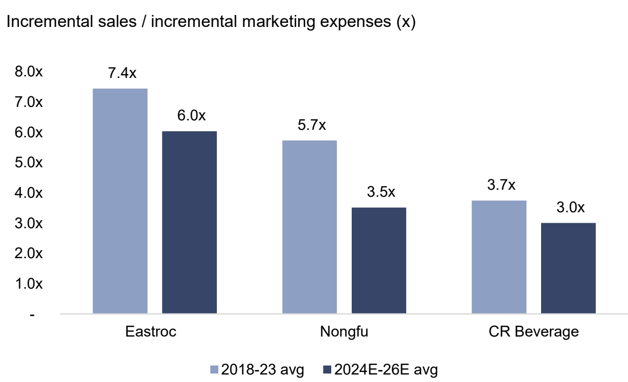
Source: Company data, Data compiled by Goldman Sachs Global Investment Research, Euromonitor

Q2: What if Red Bull regains its market share?

As we discussed in our initiation (link), Red Bull has been in the litigation dispute since 2016, leading to the limitation of its marketing/ advertising activities and hence losing shares over time. Investors asked what could be the potential implications for Eastroc if Red Bull resumed normal operation some time in the future.

- We believe Eastroc has developed solid footprints nationwide in the past years, and the competitive edges in brands/ channels/ marketing have been enhanced along the way, which enhanced its non-Guangdong sales mix to 73% in 9M24 vs. 39% in 2018. Its effective distribution is reflected in the higher returns from incremental marketing spend vs. Nongfu and CR Bev in the history.
- Regarding product features, we see Eastroc's 500ml PET bottle is better positioned as value-for-money (retail priced at Rmb5 vs. Red Bull's 250ml can priced at Rmb6), and it also satisfies more drinking demand in a day and is easier to carry along when working/ driving as the PET bottle can be capped again.
- We estimate that Eastroc also grants higher channel profits despite lower RSP vs. Red Bull to distributors/ retailers, which could act as incentives for the retail distribution.

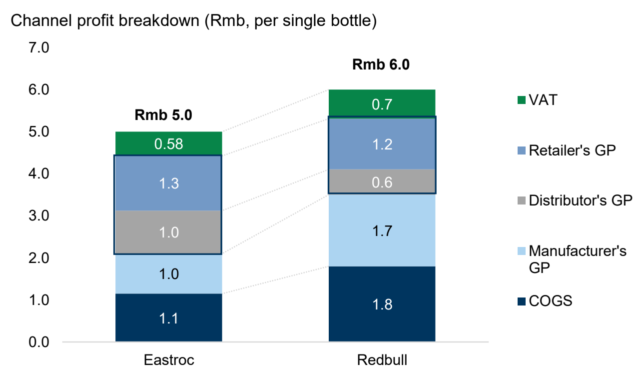
Exhibit 4: Eastroc has made higher returns from incremental marketing spend (measured by incremental sales) vs. Nongfu/ CR Bev



For CR Beverage, we only apply 2021-2023 for average ratio calculation

Source: Company data, Goldman Sachs Global Investment Research

Exhibit 5: Eastroc grants distributors/retailers higher channel profits vs. Redbull despite lower RSP



500ml/ 250ml for one bottle of Eastroc Special Drink / Red Bull

Source: Company data, Goldman Sachs Global Investment Research

What if ? - margin impact under Eastroc's capacity expansion but assuming competition deteriorates: On the potential impact of Red Bull's revitalization in China, our bear case scenario assumes no share gains and no GPM expansion since 2025E, which would lead to 17~35% lower EBIT in 2025E-28E. The depreciation would account for 9%~13% of EBIT in bear case vs. 7%~9% in the base case in the same period.

Exhibit 6: Our bear case scenario of no share gain & GPM expansion since 2025E implies a 17~35% lower EBIT, with D&A accounting for 9~13% of EBIT vs. 7~9% for base case, in 2023-28E

Scenario analysis of the impact from additional D&A of new factories on EBIT

Scenario analysis: D&A impact from capacity expansion on EBIT amid intensified competition						
Assumption: no market share gain in Energy drinks since 2025E with Red Bull coming back						
	2023	2024E	2025E	2026E	2027E	2028E
Base case						
Market shares in energy drinks	**24%**	**27%**	**31%**	**34%**	**35%**	**36%**
Energy drink sales	10,336	13,337	16,241	19,001	21,852	24,474
Other drink sales	914	2,706	3,987	5,358	6,920	8,720
GP	**4,851**	**7,240**	**9,175**	**11,133**	**13,209**	**15,301**
GPM	43%	45%	45%	46%	46%	46%
EBIT	**2,379**	**3,816**	**4,955**	**6,121**	**7,373**	**8,666**
Bear case: no market share gains & GPM expansion since 2025E						
Market shares in energy drinks	**24%**	**27%**	**27%**	**27%**	**27%**	**27%**
Energy drink sales	10,336	13,337	14,522	15,571	16,920	18,506
yoy %			9%	7%	9%	9%
+/- % vs. base case			-11%	-18%	-23%	-24%
Total sales	11,263	16,055	18,522	20,941	23,852	27,238
GP	**4,851**	**7,240**	**8,352**	**9,444**	**10,756**	**12,283**
+/- % vs. base case			-9%	-15%	-19%	-20%
SG&A (excl. Depr, same as base case)	(2,230)	(3,087)	(3,845)	(4,575)	(5,254)	(5,902)
Depreciation	(242)	(337)	(376)	(437)	(582)	(733)
EBIT	**2,379**	**3,816**	**4,132**	**4,431**	**4,920**	**5,648**
+/- % vs. base case	0%	0%	-17%	-28%	-33%	-35%
Depreciation as % of base case EBIT	*10.2%*	*8.8%*	*7.6%*	*7.1%*	*7.9%*	*8.5%*
Depreciation as % of bear case EBIT	*10.2%*	*8.8%*	*9.1%*	*9.9%*	*11.8%*	*13.0%*
Depreciation as % of base-case GP	*5.0%*	*4.7%*	*4.1%*	*3.9%*	*4.4%*	*4.8%*
Depreciation as % of bear-case GP	*5.0%*	*4.7%*	*4.5%*	*4.6%*	*5.4%*	*6.0%*

Source: Company data, Goldman Sachs Global Investment Research

Q3: How can the rapid capacity expansion help Eastroc's topline growth and what is the cost?

Additional capex and D&A: The company announced the plan to build 4 new large factories in 2024, with Tianjin factory to be completed by end-2026 and Zhongshan/Kunming/Haitian factories to commence production in 2027. Investment in the 4 plants amounts to Rmb4.0bn, as 26% of 2024-2026 aggregated OCF. We expect PP&E Capex to increase to c.Rmb1.9bn in 2025-26E with c.75% invested in new projects, vs. Rmb1.0bn in 2024E and Rmb774/860mn in 2023/2022, bringing c.Rmb100~300mn additional D&A in 2027-28E.

Exhibit 7: We expect Eastroc's new factory projects to bring c.Rmb100~300mn more D&A in 2027-28E
Eastroc's new factory plans and additional capex/D&A

Projects (Rmb mn)	Total investment	Construction starting date	Completion date	Straight-line allocation				
				2024	**2025**	**2026**	**2027**	**2028**
Tianjin	600	Mar-24	End-2026	200	200	200		
Chongqing	100		End-2024	100				
Zhongshan	1080	Nov-24	Nov-27	120	360	360	240	
Kunming	1000	Sep-24	Mar-27	150	400	400	50	
Haikou	1200	Est. Early 2025	Est. 2H27		480	480	240	
		2022	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Capex of new projects				570	1440	1440	530	
As % of GSe PPE capex				***55%***	***75%***	***75%***	***43%***	
Current GSe PPE capex		860	774	1,040	1,923	1,925	1,238	963
PPE Capex as % of Sales		***10.1%***	***6.9%***	***6.5%***	***9.5%***	***7.9%***	***4.3%***	***2.9%***
Total PPE		2,762	3,301	4,004	5,551	7,039	7,695	7,925
Tianjin							600	600
Chongqing					100	100	100	100
Zhongshan								1,080
Kunming							750	1,000
Haikou							600	1,200
PPE accumulated addition					**100**	**100**	**2,050**	**3,980**
# useful years					*15*	*15*	*15*	*15*
Depreciation addition					**7**	**7**	**137**	**265**

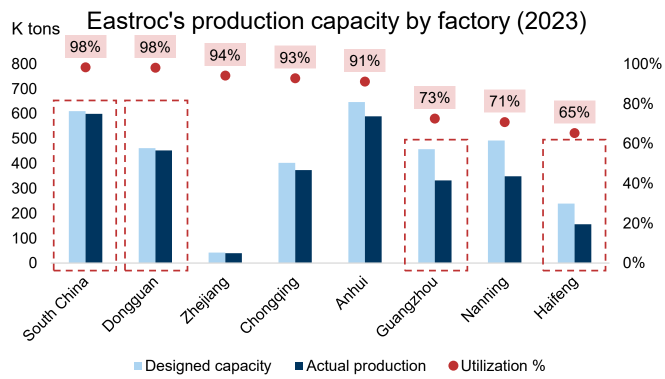
GSe	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Depreciation	**212**	**242**	**337**	**376**	**437**	**582**	**733**
as % of total PPE	7.7%	7.3%	8.4%	6.8%	6.2%	7.6%	9.2%
as % of CAPEX	24.6%	31.2%	32.4%	19.5%	22.7%	47.0%	76.1%
as % of sales	2.5%	2.1%	2.1%	1.9%	1.8%	2.0%	2.2%
as % of net profit	14.7%	11.8%	10.4%	9.0%	8.4%	9.3%	10.0%

Source: Company data, Goldman Sachs Global Investment Research

However, we still expect utilization ratio to remain high in 2024-28E, even after new capacities ramp up. We observe intermittent supply shortage of some products in selected regions in 2024 per our channel checks, echoing the estimated above 100% utilization rate in 2024E, vs. 86% in 2023. The bright sides are: 1) Eastroc can leverage cross-region capacities and add shifts to increase supply; 2) our scenario analysis indicates that additional D&A from new projects has manageable impacts on EBIT even under our bear case of no share gain & GPM expansion since 2025E with Red Bull coming back (Exhibit 6).

Exhibit 8: 5 of Eastroc's 8 factories reached 90%+ capacity utilization rate in 2023; 53% of Eastroc's current capacity is located within Guangdong

Production capacity by factory (2023)



Source: Company data, Data compiled by Goldman Sachs Global Investment Research

Q4: Will the electrolyte water Bushuila (new SKU since 2023) be able to grow further?

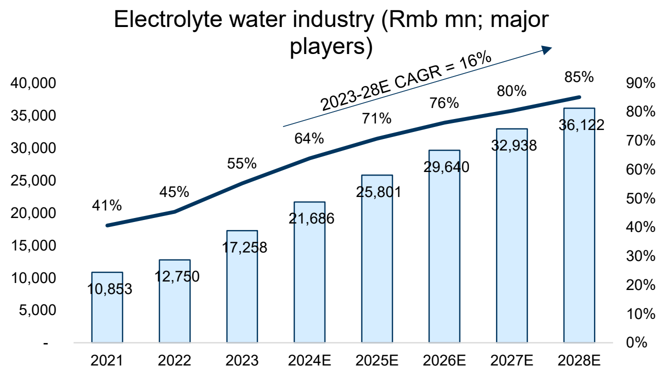
The sports drink industry has seen acceleration in 2020-23 due to rising health/hydration awareness post the pandemic, in which electrolyte water was the key driver at +19% CAGR in 2020-23 (vs. other sports drinks at +8%). After China's reopening, the recovering demand for outdoor activities/ traveling became a tailwind for electrolyte water's further penetration, leading to greater competition with numerous new entrants amid fast industry growth to-date.

We expect the electrolyte water market to grow at 26% in 2024E (vs. 17%/35% in 2022/23) to Rmb22bn, where both Eastroc's Bushuila and Chi Forest's Alienergy will likely reach nearly Rmb4bn sales as key share gainers.

For Bushuila, we see strong potential for it to grow as a blockbuster SKU, positioning as a value-for-money, young and sporty brand with functional benefits, and it has recorded Rmb1.2bn ex-fac sales (>3x yoy) in 9M24 driven by Eastroc's solid channel network in South China and digitalized distribution capability.

We observed that the near-term growth constraints for Bushuila include capacity limits and concentrated geographical distribution. We believe the fast ramp-up of Eastroc's fridges and wider POS penetration of non-energy drink categories amongst retail terminals provide visibility for cross-sell of Bushuila, and the company has been actively leaning resources to Bushuila and expanding beverage production capacity throughout the year to enhance the supply into 2025, hence we forecast continued fast ramp-up of Bushuila in the next three years and reach a leading position by 2026E.

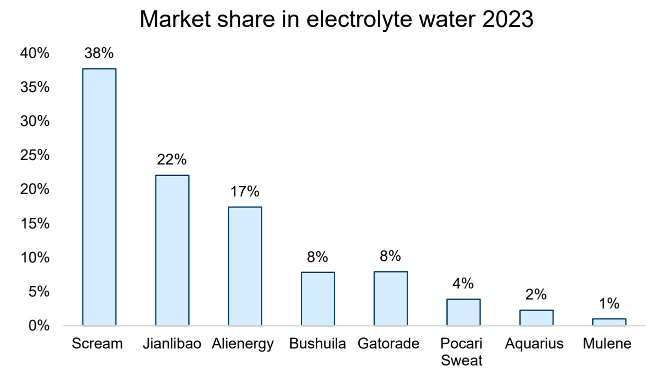
Exhibit 9: Electrolyte water industry is expected to grow fast at 16% CAGR in 2023-28E



The industry size is based on company releases, public newsflow, and GSe

Source: Company data, Goldman Sachs Global Investment Research

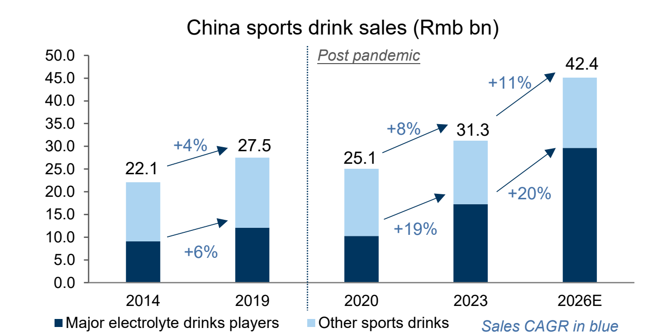
Exhibit 10: Bushuila has achieved 8% market share per our estimates in the first year of launch



The market share estimates are based on company releases, public news flows, and GSe

Source: Company data, Goldman Sachs Global Investment Research

Exhibit 11: We noted growth acceleration of China's electrolyte water sales post reopening in 2022/23

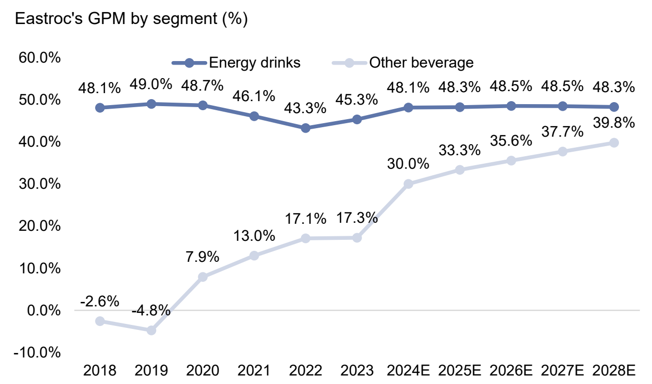


Source: Goldman Sachs Global Investment Research, Euromonitor

Q5: Is the margin profile sustainable amid rapid expansion?

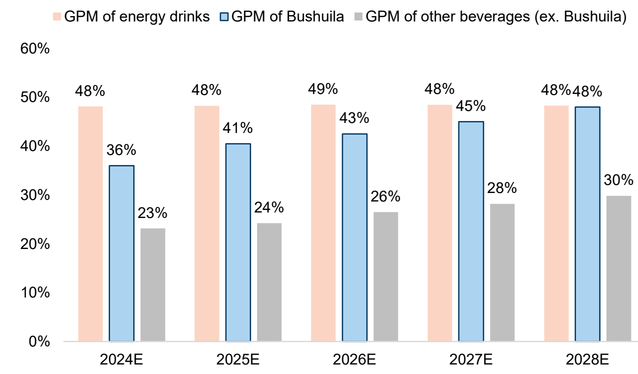
We believe non-energy drink GPM improvements from 17.3% in 2023 to 39.8% in 2028 are built on: 1) operating leverage and economies of scale in its fast-expanding stage; 2) moderating promotion as products mature; and 3) more favorable cost structure containing less sugar that is subject to commodity price swings vs. energy drinks. We see current investments in beverage showing efforts and the returns of incremental sales generated relative to marginal marketing expenses likely exceeded mgmt expectations in this year. We estimate that Bushuila's GPM already surpassed 30% in 2024 and will continue to expand given the rising economies of scales, and in the long run we see potential for Bushuila's GPM to surpass energy drinks because the raw material costs for Bushuila is probably lower than Eastroc Special Drinks (the latter contains more sugar and functional additives).

Exhibit 12: We expect the other beverage segment's GPM to expand as scaling up



Source: Company data, Goldman Sachs Global Investment Research

Exhibit 13: We expect Bushuila's GPM to catch up with that of energy drinks gradually



Source: Goldman Sachs Global Investment Research

Q6: What is the market landscape for the energy drink industry in South East Asia, given Eastroc announced a new factory launch in Indonesia recently?

On Dec 13, Eastroc announced the plan of setting up a subsidiary in Indonesia with the total investment amount up to US$200mn, which is Eastroc's first overseas factory/ branch for production/ distribution, vs. previously the company mainly leveraged export distributors for overseas sales.

We think it is positive to see overseas expansion of Eastroc's business starting from South East Asia, as many regions are still seeing low volume penetration of energy drink consumption (e.g., Philippines, Malaysia), and some have very scattered competitive landscape (e.g., Indonesia CR3 at 32% vs. Thailand's at 96%), which could offer opportunities to take shares given strong execution ability of Eastroc. However, the uncertainties would still exist in our view, for example the ASP of energy drinks in some regions (e.g., Indonesia, Vietnam, Philippines) has been lower than that of China, which could pose uncertainties to Eastroc's margin profiles.

Exhibit 14: Summary of ASEAN market landscape of energy drinks by country

	Indonesia	Thailand	Vietnam	Philippines	Singapore	Malaysia	World	Asia Pacific	China	India	Japan
Soft drinks											
Retail value of soft drinks (US$ mn)	9,805	8,761	5,396	9,239	1,198	1,539	1,038,037	229,498	94,372	15,541	48,535
Total volume of soft drinks (mn litre)	18,193	10,073	5,660	9,328	504	1,980	814,051	229,165	136,600	28,432	23,185
Retail ASP (US$/litre)	0.5	0.9	1.0	1.0	2.4	0.8	1.3	1.0	0.7	0.5	2.1
Energy drinks											
Retail value of energy drinks (US$ mn)	225	1,227	1,341	333	44	64	80,810	18,482	12,322	916	2,910
As % of soft drinks sales	*2%*	*14%*	*25%*	*4%*	*4%*	*4%*	*8%*	*8%*	*13%*	*6%*	*6%*
Total volume of energy drinks (mn litre)	258	507	893	290	9	26	20,875	7,814	7,233	632	527
Retail ASP (US$/litre)	0.87	2.42	1.50	1.15	4.97	2.42	3.87	2.37	1.70	1.45	5.52
Volume per capita (litre)	0.9	7.5	8.9	2.5	1.5	0.8	2.6	1.8	5.1	0.4	4.2
Top 5 players market share by volume (2023)	TCP: 13.6%	Osotspa: 49.4%	TCP: 34.6%	Asia Brewery: 68.6%	TCP: 59.4%	TCP: 56.2%	Monster: 16.6%	Eastroc: 22.9%	Eastroc: 33.0%	PepsiCo: 87.9%	Monster: 25.2%
	Wings: 10.1%	Carabao: 30.8%	Tan Hiep Phat: 23.4%	PepsiCo: 30.5%	Monster: 19.8%	Power Root: 19.1%	Red Bull GmbH: 12.5%	TCP: 19.3%	Reignwood: 20.1%	Red Bull: 7.0%	Asahi: 17.7%
	Kino: 8.7%	TCP: 15.6%	PepsiCo: 22.6%	TCP: 0.5%	Red Bull: 17.4%	Taisho Pharma: 8.7%	PepsiCo: 9.8%	PepsiCo: 13.9%	Zhongwo: 8.4%	Monster: 1.1%	Suntory: 15.2%
	Osotspa: 3.3%	ThaiBev: 1.0%	Masan: 7.5%			Perusahan: 5.0%	Eastroc: 8.7%	Zhongwo: 4.9%	Hi-Tiger: 8.0%		Red Bull GmbH: 12.6%
	Tempo Scan: 0.9%	Red Bull GmbH: 0.6%	Taisho Pharma: 1.0%			Red Bull GmbH: 2.0%	TCP: 7.4%	Monster: 3.0%	TCP: 2.1%		Otsuka: 10.8%
2018-23 CAGR (Energy drinks)											
Volume	21.7%	-0.7%	10.5%	0.5%	0.7%	-0.7%	10.9%	11.4%	13.1%	96.1%	4.5%
ASP	-14.7%	1.9%	2.5%	3.7%	1.8%	1.5%	-0.3%	-1.7%	-4.3%	-20.3%	-0.7%
Retail value	3.8%	1.1%	13.2%	4.2%	2.5%	0.8%	10.6%	9.5%	8.2%	56.3%	3.8%
2023-28 CAGR (Energy drinks)											
Volume	2.9%	1.5%	5.2%	2.7%	0.9%	1.1%	7.1%	7.0%	8.8%	18.9%	-1.4%
ASP	3.4%	2.6%	3.9%	4.4%	3.2%	2.9%	2.9%	0.3%	-1.4%	-2.1%	7.8%
Retail value	6.3%	4.2%	9.3%	7.2%	4.1%	4.1%	10.2%	7.3%	7.2%	16.4%	6.3%

China/ Thailand market sizes are based on GSe

Source: Euromonitor, Goldman Sachs Global Investment Research

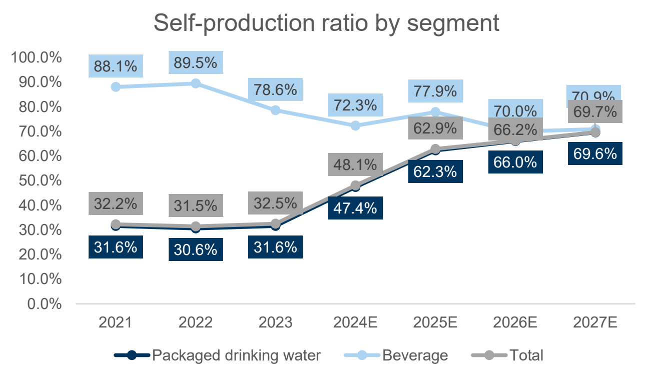
CR Beverage

Top investor concerns/questions: 1) Manufacturing cost savings: How will CR Bev achieve manufacturing cost savings? **2) Water competition:** How would the bottled water competition evolve in 2025? **3) Beverage business:** How is the visibility and speed of the beverage sales ramp-up?

Q1: How will it achieve manufacturing cost savings? What will be the change in margin profile in this process?

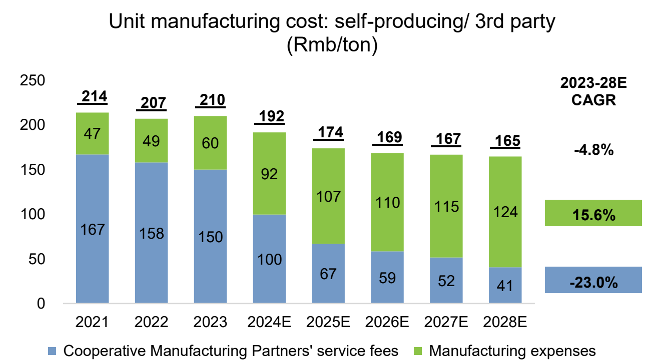
Unit manufacturing costs per unit for CMP (Cooperative Manufacturing Partners) stood at Rmb228/ton in 2023, 24% higher than that of in-house production at Rmb184/ton. Factoring in additional depreciation post newly owned factories commencing production, we estimated that the unit manufacturing costs of in-house production by new capacity still stand at **0.72x of CMP's service fee per ton** in 2023. We expect self-production ratio to increase from 31.6% in 2023 to **c.48%/c.70% in 2024E/2027E** as Chengdu/Yixing/Heyuan factories ramp up and Zhejiang/Wuyi Moutain/Hubei/Chongqing/Shanghai factories commence production. On top of self-production substitution, we also look for further production cost efficiency enhancement from the higher automation level/productivity of new factories and ongoing ESG efforts on reducing paper packaging/ plastic labels going forward. All in all, we expect the blended unit manufacturing cost to decrease by 20% from Rmb210 per ton in 2023 to Rmb167 per ton in 2027E.

Exhibit 15: We expect self-production ratio to increase to c.48%/c.70% in 2024E/2027E from 31.6% in 2023



Source: Company data, Goldman Sachs Global Investment Research

Exhibit 16: We expect the blended unit manufacturing cost to decrease at a -4.8% CAGR towards 2028E mainly driven by reduced CMP service fees



Source: Company data, Goldman Sachs Global Investment Research

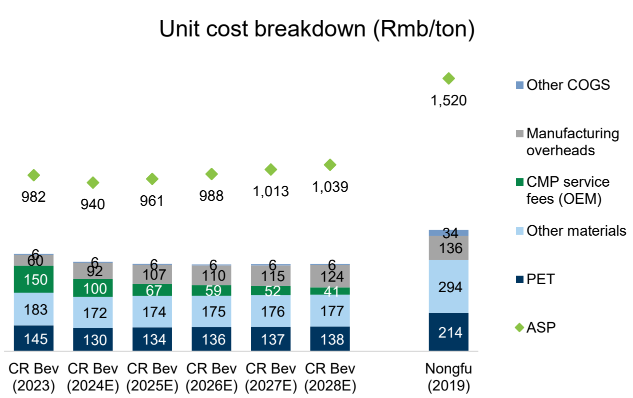
Exhibit 17: Post newly owned factories ramp up, cost per ton of in-house production by new capacity will be only 0.72x of CMP's service fee per ton in 2023

New capacity projects: Per-ton cost analysis	2021	2022	2023	2024E	2025E
Total investments					**4,287**
Years of depreciation					10
Incremental depreciation					429
Incremental depreciation per ton of incremental capacity (Rmb)					**62**
Incremental depreciation per ton of new production vol (Rmb)					**88**
Cooperative Manufacturing Partners' service fees per ton (Rmb/ton)	**243**	**227**	**228**	**192**	**181**
Self manufacturing costs per ton	**146**	**156**	**184**	**173**	**170**
D&A per ton of self-produced vol (Rmb)	71	80	104		
Implied self manufacturing labor cost per ton	75	76	81		
Implied self manufacturing cost per ton for newly added capacity					**165**
vs. CMP's service fees per ton in 2023					**0.72x**

Source: Company data, Goldman Sachs Global Investment Research

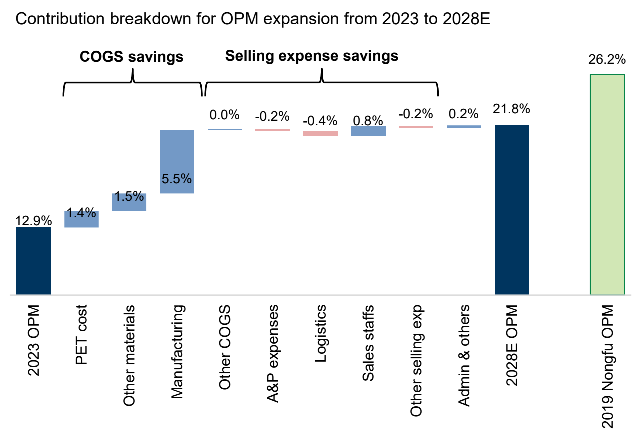
Compared with Nongfu, we see CR Beverage's reduced cost of manufacturing per ton by 2028E in our model is still above the unit manufacturing cost of Nongfu in 2019, and company's lower PET usage and other packaging materials (likely due to less beverage mix) contributes to its relatively lower unit cost. Therefore, we expect the OPM expansion to be primarily contributed by unit manufacturing cost savings.

Exhibit 18: We expect unit COGS to drop with help from in-house production and production efficiency, as ASP rises on increasing beverage sales contribution



Source: Company data, Goldman Sachs Global Investment Research

Exhibit 19: We expect significant OPM expansion of 8.9ppt in 2023-28E to be mainly driven by manufacturing cost savings and raw material cost benefits



Source: Company data, Goldman Sachs Global Investment Research

Q2: How would the bottled water competition evolve in 2025?

Overall, we hold a cautious view towards the packaged water segment due to the near-term pressure on ASP given the intensified competitive landscape since 2Q24, while we still look for volume growth as the key driver, supported by increasing packaged ratio and further penetration of mid-to-large pack water in in-home channels. As we think the intense competition could last longer (e.g., Wahaha also started its mineral water SKUs with promoted ASP at Rmb8.8/ 12 bottles in late Nov), we see little like-for-like price hike opportunities, while we do expect gradual ASP recovery towards 2023-level by 2028E, as Rmb2+ players still consistently gain shares from Rmb1.

Nongfu's strategic direction is still key: As Nongfu is also taking a step back and shaping its water pricing strategies less aggressive (incl. seasonally limiting its shipment of purified water 'the green bottle'), we look for a rebound in Nongfu's sales growth in 2025, while we expect CR Beverage to see sequentially less pricing pressure in the peak season in 2025 (vs. we expect a HSD% ASP decline in 3Q24 for CR Beverage), and expect Nongfu/ CR Beverage to gradually regain/ largely maintain the market shares going forward.

Despite near-term competition, we are positive in the long-term growth of bottled water category with a long product cycle and rising packaged ratio in China. In 2023-28E, we look for a 4.8% retail sales CAGR for the packaged water industry vs. 5.0% CAGR in 2018-2023; we expect purified water to outpace at a 6.1% CAGR.

We currently model 8% total revenue CAGR (4.3% water sales CAGR) for CR Beverage in 2023-26E. If the competition landscape turned more benign, our scenario 1 (assuming bottled water volume share to reach 18% and non-water to reach 1.1% value share in 2026E) suggests there could be an 18% upside to the base case net profit in 2026E.

Exhibit 20: Market share scenario analysis

Scenario 1 (enhanced water sales) and Scenario 2 (with faster beverage growth) will lead to meaningful financial upside of faster sales/NP growth vs. base case

Scenario analysis for CR Bev's market share changes Industry size	2023	2024E	2025E	2026E
Sales value (Rmb bn)				
Soft drinks	689	713	754	793
Bottled water	230	232	247	260
Non-water soft drinks	459	481	508	533
RTD tea	119	130	139	147
Sales volume (mn ton)				
Soft drinks	134	139	147	154
Bottled water	89	92	97	102
Non-water soft drinks	45	47	49	51
RTD tea	13	14	15	15
Base case: CR Beverage to maintain shares in water, but Nongfu to re-gain shares in 2025/26				
CR Bev volume share in water	15%	16%	16%	16%
Nongfu volume share in water	22%	19%	19%	20%
Other players' volume share in water	63%	65%	65%	64%
CR Bev value share in non-water soft drinks	0.5%	0.6%	0.8%	1.1%
CR Bev beverage retail sales	2.1	3.0	4.3	5.6
Scenario 1: CR Bev to gain shares, and Nongfu to maintain previous market share gain path				
CR Bev volume share in water	15%	16%	17%	18%
Nongfu volume share in water	22%	19%	20%	22%
Other players' volume share in water	63%	65%	63%	60%
Scenario 2: On top of scenario 1, CR Bev to accelerate beverage sales as Vitasoy's trajectory				
CR Bev value share in non-water soft drinks	0.5%	0.6%	1.3%	2.1%
CR Bev beverage retail sales	2.1	3.0	6.8	11.0

CR Bev's financial upside	Base case	Scenario 1	Scenario 2
Market shares			
2023			
Bottled water (volume)	15%	15%	15%
Non-water soft drinks (value)	0.5%	0.5%	0.5%
2026E			
Bottled water (volume)	16%	18%	18%
Non-water soft drinks (value)	1.1%	1.1%	2.1%
CR Bev total revenue			
2023	13.5	13.5	13.5
2026E	17.0	18.7	21.4
Beverage mix % 2026E	17%	15%	26%
2023-2026E CAGR	8%	11%	17%
CR Bev net profit			
2023	1.3	1.3	1.3
2026E	2.4	2.9	3.5
2023-2026E CAGR	22%	29%	37%
Net margins 2026E	14%	15%	16%
Net profits vs. base case 2026E	0%	18%	44%

For net profits in scenario 1 and 2, Assuming 1pp/2pp net margin increase from further operating efficiency
Assuming retail mark up for beverage is 2.0x

Source: Company data, Goldman Sachs Global Investment Research

Q3: What is our view on non-water beverage business ramp-up? How fast could it grow?

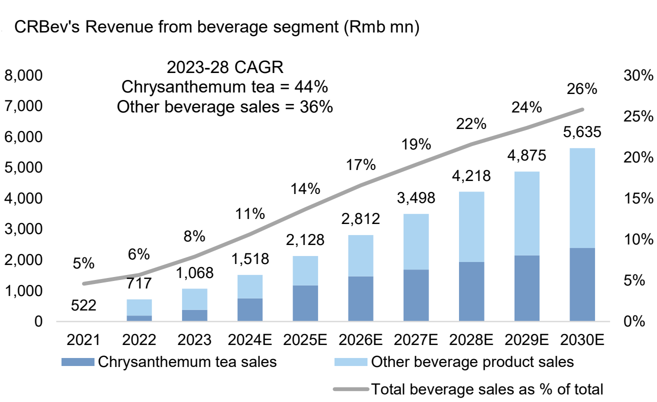
We note the beverage business has been facing capacity constraints issues for quite some time (self-owned beverage capacity kept at 80%+ in 2021-23). With Chengdu/ Yixing factories being put to use in 2024/2025E, we will see the self-owned beverage capacity to nearly double vs. 2023, leading to a higher room for CR Bev to invest more resources and rolling the segment out widely.

We expect the beverage segment to reach 22% of sales by 2028E vs. 8% in 2023, and vs. 53% for Nongfu in 2023, mainly driven by volume - **1) Category expansion:** The company has cooperated with Kirin since 2011 on both brand franchise and product

R&D. Brands under collaboration with Kirin now remains low in contribution, accounting for about 18% of beverage sales in 2023 (or LSD% of total sales). With the partnership with Kirin close to an end, the company started churning out new categories since 2018 and recorded initial success in Chinese herbal tea. Chrysanthemum tea (Zhi Ben Qing Run) has been doubling sales each year in 2023/24 vs. 2022 and accounts for 35% of beverage sales in 2023, holding a 39% market share per BrandCT, and we expect it to grow at a 44% CAGR in 2023-28E comparable to Vitasoy Lemon Tea's product sales growth/market share gain trajectory. **2) Beverage POS expansion:** We expect beverage's POS to reach c.4.1mn beverage POS by 2028E as 97% of water POS, vs. 1.3mn in 2023 as 67% of water POS. We see ample room for CR Bev's sales force to cross-sell compared with Nongfu/Eastroc, driving further beverage growth and enhancing operating efficiency. The investment in fridges would also lead to better cross selling opportunities and operating leveraging ahead (~500k fridges by end-2024E but most of the deployed fridges are sharing space to other brands' beverage products given that CR Beverage doesn't have enough SKUs to fill the space now).

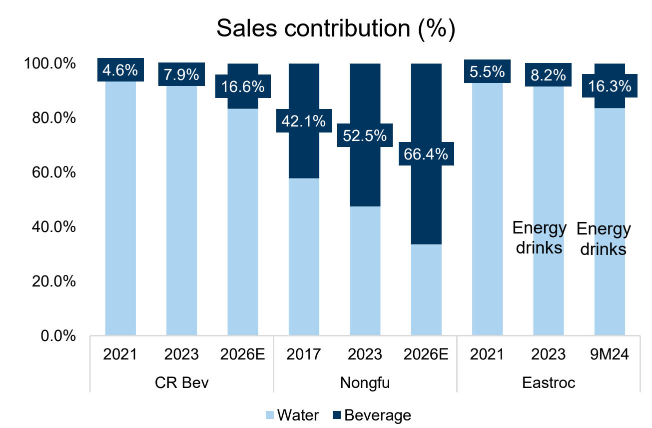
Admittedly, we see consistently intense competition in beverage space especially in the fast growing space, e.g., RTD tea, where the sugar-free tea category has been under the spotlight due to rapidly growing popularity in the past years. We think the competition risk could also apply to CR Beverage's RTD (Ready-to-drink) tea business despite still in early stages, where the execution in channel/ distribution and marketing activities become critical (as highlighted in key successful factor discussion in our primer).

Exhibit 21: We believe Herbal tea is a more promising category with a differentiated position within CR Beverage's beverage business



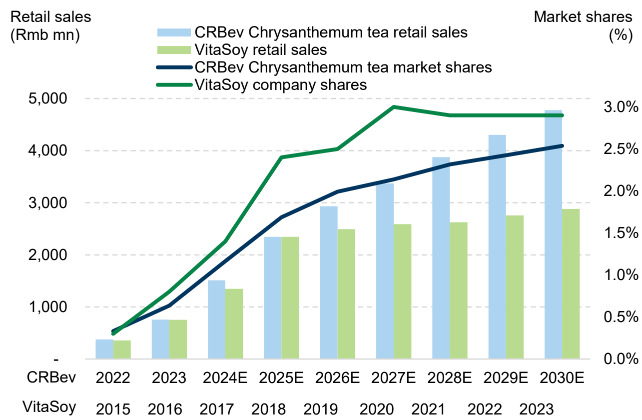
Source: Company data, Goldman Sachs Global Investment Research

Exhibit 22: We expect sales contribution from beverage to increase from 8% in 2023 to 17% by 2026E for CR Bev



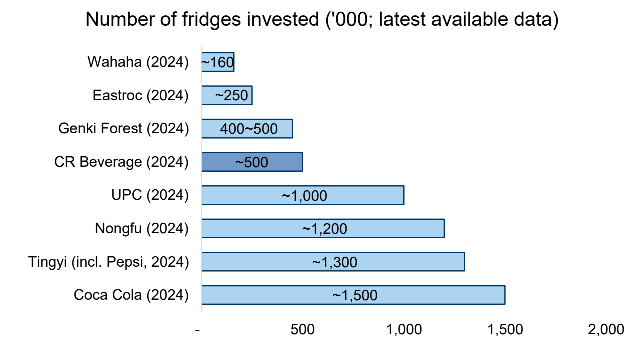
Source: Company data, Goldman Sachs Global Investment Research

Exhibit 23: We expect CR Beverage's Herbal tea category to replicate the growth trajectory of Vitasoy's Lemon tea category



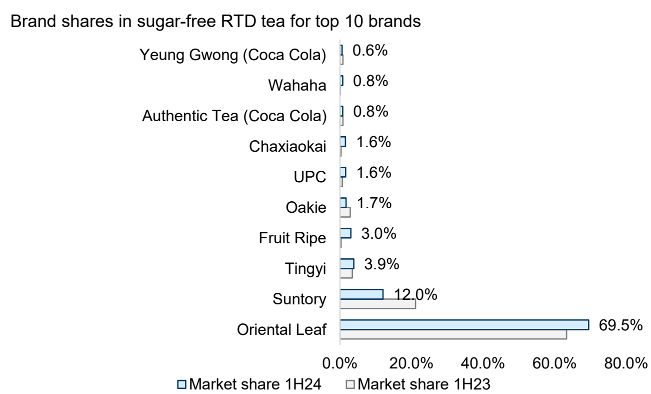
Source: Company data, Company data, Goldman Sachs Global Investment Research

Exhibit 24: Fridge investments in POS help boost cross-selling; CR Bev invested in doubling number of fridges in 2023 vs. 2021 and is expected to reach c.500k in 2024



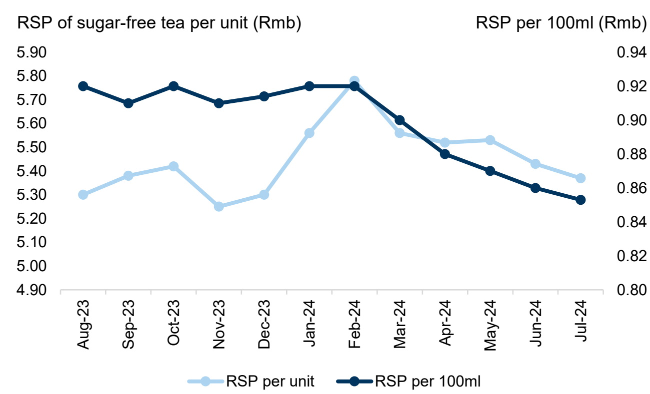
Source: Company data, Goldman Sachs Global Investment Research

Exhibit 25: Sugar-free RTD tea market is now concentrated with the top 2 players, while competition across large and small players remain intense



Source: Mashangying, Data compiled by Goldman Sachs Global Investment Research

Exhibit 26: The sequential declines in RSP of sugar-free RTD tea YTD as one reflection of intense competition



Source: Mashangying, Data compiled by Goldman Sachs Global Investment Research

Valuation Comp Tables

Exhibit 27: Valuation comps

Ticker	Company	Rating	Mkt cap	Ccy	Price	12-m TP	+/-	PE			TP Implied PE			23-26E	23-26E	EV/EBITDA			ROE	Div Yield	YTD perf
			US$ mn		12/13/2024			2024E	2025E	2026E	2024E	2025E	2026E	Rev CAGR	NP CAGR	2024E	2025E	2026E	2024E	2024E	%
F&B																					
9633.HK	Nongfu Spring	Buy	52,064	HKD	36.00	38.00	6%	30X	27X	24X	32X	28X	25X	12%	10%	19X	17X	15X	40%	2.3%	-19%
0322.HK	Tingyi	Neutral	7,475	HKD	10.32	10.60	3%	15X	14X	14X	15X	14X	14X	2%	9%	7X	7X	7X	20%	6.6%	11%
0220.HK	Uni-President China	Neutral	4,116	HKD	7.41	7.50	1%	16X	14X	13X	16X	15X	13X	6%	11%	8X	8X	7X	14%	6.8%	33%
2460.HK	China Resources Beverage	Buy	3,991	HKD	13.22	17.30	31%	16X	15X	12X	21X	19X	16X	8%	22%	8X	7X	5X	17%	9.7%	n.a.
605499.SS	Eastroc Beverage	Buy	17,950	CNY	251.27	258.00	3%	40X	31X	25X	41X	32X	26X	29%	36%	30X	23X	19X	46%	1.4%	79%
MNST	Monster Beverage Corp.	Buy	51,193	USD	52.76	61.00	16%	32X	27X	23X	37X	31X	27X	10%	10%	23X	19X	17X	23%	0.0%	-10%
KO	Coca-Cola Co.	Neutral	271,961	USD	63.12	65.00	3%	22X	21X	19X	23X	22X	20X	4%	6%	19X	18X	16X	44%	3.1%	6%
PEP	PepsiCo Inc.	Buy	217,735	USD	157.97	192.00	22%	19X	18X	17X	24X	22X	20X	3%	7%	15X	14X	13X	57%	3.4%	-9%
Avg.								**24X**	**21X**	**18X**	**26X**	**23X**	**20X**	**9%**	**14%**	**16X**	**14X**	**12X**	**33%**	**4.2%**	**13%**
Beer																					
1876.HK	Budweiser APAC	Buy	12,411	HKD	7.30	10.10	38%	16X	14X	13X	22X	19X	17X	1%	5%	5X	5X	4X	7%	5.5%	-48%
0291.HK	China Resources Beer	Buy	10,993	HKD	26.35	38.10	45%	15X	13X	12X	21X	19X	17X	2%	10%	9X	8X	6X	15%	3.3%	-16%
0168.HK	Tsingtao Brewery	Buy	9,451	HKD	54.40	58.30	7%	15X	14X	14X	16X	16X	15X	-1%	5%	8X	8X	7X	15%	4.1%	8%
600600.SS	Tsingtao Brewery	Neutral	14,662	CNY	79.00	66.80	-15%	24X	22X	21X	20X	19X	18X	-1%	5%	15X	14X	13X	15%	2.6%	10%
600132.SS	Chongqing Brewery	Neutral	4,518	CNY	67.95	56.60	-17%	24X	23X	21X	20X	19X	18X	2%	5%	9X	8X	8X	31%	3.7%	6%
002568.SZ	Shanghai Bairun	Neutral	4,076	CNY	28.25	16.40	-42%	36X	33X	29X	21X	19X	17X	7%	8%	25X	22X	20X	19%	1.4%	19%
Avg.								**22X**	**20X**	**18X**	**20X**	**18X**	**17X**	**2%**	**6%**	**12X**	**11X**	**10X**	**17%**	**3.4%**	**-3%**
Dairy																					
600887.SS	Yili Industrial	Buy	25,716	CNY	29.25	31.30	7%	19X	17X	15X	20X	18X	16X	1%	7%	13X	11X	10X	16%	3.9%	11%
2319.HK	Mengniu Dairy	Buy	9,171	HKD	18.04	19.90	10%	15X	12X	11X	17X	14X	12X	0%	8%	10X	9X	8X	9%	2.9%	-9%
6186.HK	China Feihe Ltd.	Neutral	6,784	HKD	5.90	4.40	-25%	11X	11X	11X	8X	8X	8X	4%	4%	6X	5X	5X	17%	5.8%	41%
Avg.								**15X**	**13X**	**12X**	**15X**	**13X**	**12X**	**1%**	**6%**	**10X**	**8X**	**7X**	**14%**	**4.2%**	**15%**
Snacks																					
002557.SZ	Chacha Food Co.	Sell	2,245	CNY	32.34	26.50	-18%	16X	15X	14X	13X	13X	12X	8%	12%	11X	10X	9X	17%	3.7%	-4%
002847.SZ	Yankershop Food	Buy	2,142	CNY	56.80	55.80	-2%	24X	20X	18X	24X	20X	18X	21%	20%	19X	16X	14X	41%	2.5%	12%
0151.HK	Want Want China	Sell	6,845	HKD	4.48	3.60	-20%	12X	13X	12X	10X	10X	10X	1%	0%	7X	7X	7X	23%	6.4%	-5%
Avg.								**18X**	**16X**	**15X**	**16X**	**14X**	**13X**	**10%**	**11%**	**12X**	**11X**	**10X**	**27%**	**4.2%**	**1%**

Data as of Dec 13, 2024

Source: Refinitiv Eikon, Goldman Sachs Global Investment Research

Price Target Risks and Methodology - Eastroc Beverage

We are Buy rated on Eastroc with a 12-month TP of Rmb258, based on a 32X 2025E P/E, with reference to historical average P/E of Monster Beverage.

Key risks: 1) Lower industry growth in energy drinks, 2) worse competitive landscape, 3) failure/slower ramp-up of Eastroc's new product launches, 4) potential capacity shortage with already high utilization ratio, 5) higher increases in raw material costs, 6) slower geographical expansion of Eastroc, 7) slower POS penetration/ deployment of fridges, and 8) reputational risks.

Price Target Risks and Methodology - China Resources Beverage

We are Buy rated on China Resources Beverage with a 12-month TP of HK$17.3, based on a 19.0x 2025E P/E referring to the avg. P/E of Tingyi/UPC during 2018-2024YTD given similar growth stages.

Key risks: 1) More intensified competition than expected in the bottled water market; 2) Slower than expected development of the beverage business; 3) Raw material price movements; 4) Uncertainty over channel/distribution management; 5) Reputational risks/ food security issues.

Disclosure Appendix

Reg AC

We, Leaf Liu, Hongda Zhong, Christina Liu, Julia Mu and Valerie Zhou, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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Growth is based on a stock's forward-looking sales growth, EBITDA growth and EPS growth (for financial stocks, only EPS and sales growth), with a higher percentile indicating a higher growth company. **Financial Returns** is based on a stock's forward-looking ROE, ROCE and CROCI (for financial stocks, only ROE), with a higher percentile indicating a company with higher financial returns. **Multiple** is based on a stock's forward-looking P/E, P/B, price/dividend (P/D), EV/EBITDA, EV/FCF and EV/Debt Adjusted Cash Flow (DACF) (for financial stocks, only P/E, P/B and P/D), with a higher percentile indicating a stock trading at a higher multiple. The **Integrated** percentile is calculated as the average of the Growth percentile, Financial Returns percentile and (100% - Multiple percentile).

Financial Returns and Multiple use the Goldman Sachs analyst forecasts at the fiscal year-end at least three quarters in the future. Growth uses inputs for the fiscal year at least seven quarters in the future compared with the year at least three quarters in the future (on a per-share basis for all metrics).

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Disclosures

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Goldman Sachs expects to receive or intends to seek compensation for investment banking services in the next 3 months: China Resources Beverage (HK$12.74) and Eastroc Beverage (Rmb250.56)

Goldman Sachs had an investment banking services client relationship during the past 12 months with: China Resources Beverage (HK$12.74) and Eastroc Beverage (Rmb250.56)

Distribution of ratings/investment banking relationships

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	Rating Distribution			Investment Banking Relationships		
	Buy	Hold	Sell	Buy	Hold	Sell
Global	49%	34%	17%	63%	57%	40%

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