



Mengniu (2319 HK)

Market share increased in FY17; upgrade to BUY

- Revenue was up by 11.9% YoY, supported by improvement in weaker product segments such as ice cream and milk powder
- Market share in liquid milk and UHT milk increased, but Mengniu was only ranked second as major competitor was able to increase its market share
- Margin improved in FY17, yet heavy cost pressure persisted due to marketing efforts and lackluster performance of major subsidiaries
- Upgrade to **BUY**; current TP represents 38.12x/25.88x 18E/19E P/E and 3.80x/3.46x 18E/19E P/B

Revenue growth of 11.9% YoY in FY17. Total revenue growth was up 2.7 ppt over FY16, mainly supported by improved performance in the ice cream, milk powder, and other product segments. Revenue growth of liquid milk segment, however, slightly decreased to 10.2% YoY, as revenue growth of UTH milk and yogurt decreased. Meanwhile, the Group's receivable turnover days only increased by 2 days and CCC further decreased to -8 days (FY16: ~0 day).

Liquid milk remained as major revenue contributor. Revenues of ice cream, milk formula, and other product segments jointly contributed to 11.9% of total revenue (FY16:10.6%). Within the liquid milk segment, UHT milk accounted for 42.7% of total revenue, while that of yogurt increased to 29%. The Group's overall market share increased and was ranked second in the liquid milk and UHT product categories since its main competitor, Yili (600887 CH), has gained market share as well.

Subsidiaries weighed on performance. GPM improved to 35.2% in FY17. NPM (to owners of the Company) was 3.4%, higher than the normalized NPM of 2.7% in FY16. However, the Group has ramped up marketing efforts to boost growth. E.g., display space leasing fees increased by 56.6% YoY in FY17. In addition, lackluster performance of the Group's subsidiaries, namely, Modern Dairy and Yashili, also weighed on the Group's overall margin. Nonetheless, Yashili's revenue in 2H17 rose 22% YoY and net loss in FY17 narrowed by more than 40%, which could be a signal for further improvement.

Upgrade to BUY, TP at HK\$ 29.36. We believe that the Group would be able to attain 2017-20E revenue CAGR of 13.85% due to its strong competitiveness proven by its dominance in the market throughout the years. The change in product composition would continue to improve GPM, which we expect to reach ~ 37% in 2019E. Due to more aggressive marketing efforts, higher S&D expenses can be expected. Nonetheless, NPM (to owners of the Group) would reach 5.59% in 2020E. We remain conservative over the outlook on its major subsidiaries despite signs suggestive of a turnaround do exist. Upgrade to **BUY**. Our DCF-derived TP of HK\$ 29.36 represents 38.12x/25.88x 18E/19E P/E and 3.80x/3.46x 18E/19E P/B.

Risk factors: 1) Macroeconomic risk; 2) Commodity price risk; 3) Food safety risk; 4) M&A risk, 5) Product concentration risk; 6) Product competitiveness risk

Results and Valuation

FY ended Dec 31	2016A	2017A	2018E	2019E	2020E
Revenue (RMB mn)	53,779	60,156	69,109	78,715	88,775
Chg (% YoY)	9.69	11.86	14.88	13.90	12.78
Net Profit (RMB mn)	(751)	2,048	2,420	3,565	4,960
Chg (% YoY)	(131.73)	N/A	18.18	47.30	39.15
Basic EPS (RMB)	(0.19)	0.53	0.62	0.91	1.26
Chg (% YoY)	(131.69)	N/A	17.17	47.28	39.15
P/E (x)	N/A	42.45	36.23	24.60	17.68
BVPS (RMB)	5.30	5.76	6.18	6.78	7.60
P/B (x)	4.21	3.88	3.61	3.29	2.94
DPS(RMB)	0.09	0.12	0.16	0.25	0.38
Yield (%)	0.40	0.54	0.71	1.14	1.68
ROAA (%)	(1.51)	3.82	4.01	5.59	7.08
ROAE (%)	(3.50)	9.43	10.33	14.01	17.57

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Apr 4, 2018

Rating: BUY

TP: HK\$ 29.36

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Share price (HK\$)	27.90
52Wk H/L(HK\$)	28.5/14.109
Est. share price return	5.23%
Est. dividend yield	0.54%
Est. total return	5.77%
Previous Rating&TP	HOLD;HK\$20.3
Previous report date	Sep 13, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

Issued shares (mn)	3,927.36
Market cap (HK\$ mn)	109,573.38
3-mth ADT (HK\$ mn)	395.26

Major shareholders	(%)
COFCO	31.41
JP Morgan Chase	5.95
Citi Group	5.05

Source(s): Bloomberg, HKEX

% of total revenue	FY18E
Liquid milk	88.94
Ice cream	3.77
Milk formula	6.06

Source(s): ABCI Securities estimates

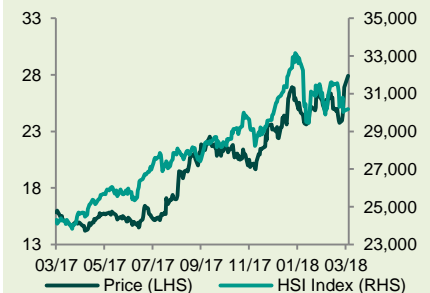
Sector Performance (%)

	Absolute	Relative*
1-mth	10.06	11.18
3-mth	19.23	20.06
6-mth	29.77	21.93

* Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year price performance (HK\$)

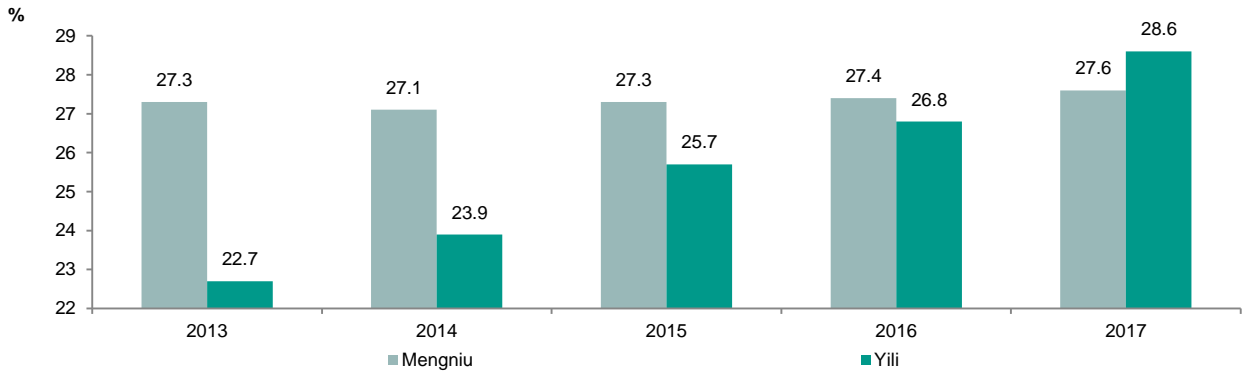


Source(s): Bloomberg, ABCI Securities

* All pricing and market data as of closing of Apr 3, 2018

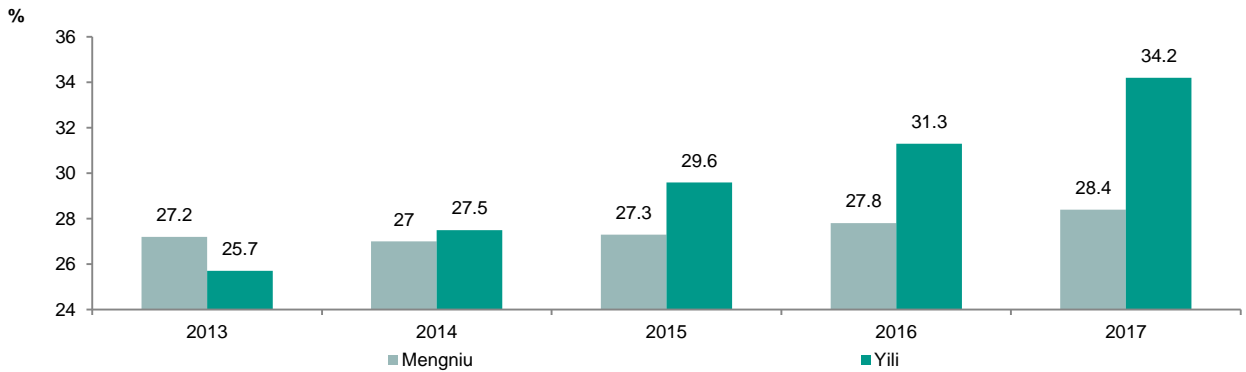


Exhibit 1: Mengniu's liquid milk market share in China



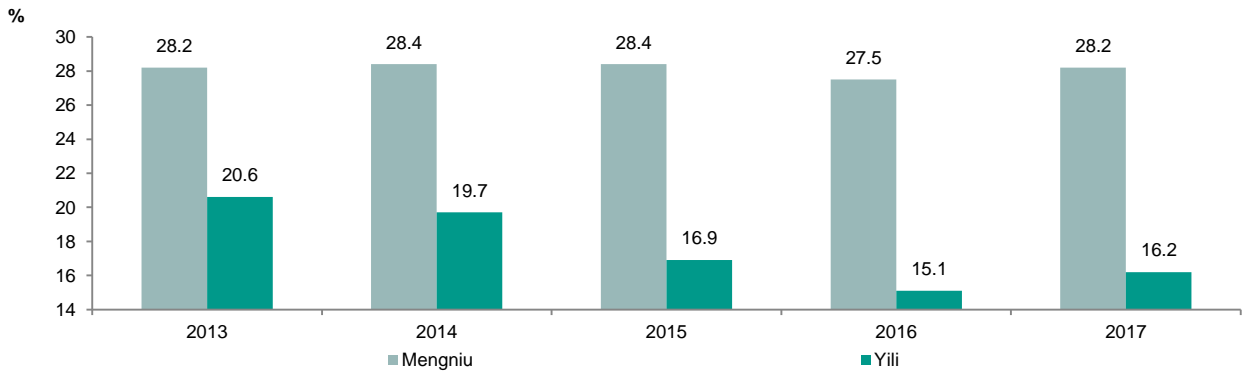
Source(s): Mengniu annual result presentation material, ABCI Securities

Exhibit 2: Mengniu's UHT milk market share in China



Source(s): Mengniu annual result presentation material, ABCI Securities

Exhibit 3: Mengniu's chilled product market share in China



Source(s): Mengniu annual result presentation material, ABCI Securities



Consolidated income statement (2016A-2020E)

FY ends at Dec 31 (MB mn, except per share data)	2016A	2017A	2018E	2019E	2020E
Revenue	53,779	60,156	69,109	78,715	88,775
- Liquid milk	48,103	53,015	61,466	69,905	78,505
- Ice cream	2,180	2,513	2,605	2,636	2,666
- Milk formula	3,151	4,042	4,187	4,982	5,962
- Others	346	585	851	1,193	1,642
COGS	(36,144)	(38,973)	(44,610)	(50,178)	(55,422)
Gross profit	17,635	21,183	24,500	28,538	33,353
Other income	702	338	427	472	639
SG&A	(15,907)	(17,366)	(20,353)	(23,191)	(26,037)
Other expenses	(2,851)	(1,182)	(1,451)	(1,653)	(1,864)
Operating profit	(420)	2,972	3,123	4,166	6,090
Net finance cost	184	184	343	528	687
Share of profits from JV and associates	(225)	(532)	(366)	(83)	113
Pretax profit	(461)	2,625	3,099	4,611	6,890
Tax	(351)	(594)	(700)	(1,040)	(1,556)
Profit from discontinued operation	0	0	0	0	0
Net profit	(813)	2,031	2,400	3,571	5,334
- Profit attributable to shareholders	(751)	2,048	2,420	3,565	4,960
- Minority interest	(62)	(17)	(20)	6	373
EPS (RMB)					
- Basic	(0.19)	0.53	0.62	0.91	1.26
- Diluted	(0.19)	0.53	0.62	0.91	1.26
DPS (RMB)	0.09	0.12	0.16	0.25	0.38

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2016A-2020E)

FY ends at Dec 31 (RMB mn)	2016A	2017A	2018E	2019E	2020E
Cash and cash equivalent	6,070	5,959	11,028	9,809	14,544
Trade and bills receivable	2,340	2,647	3,088	3,275	3,563
Inventory	3,314	3,510	5,319	5,713	6,525
Others	8,113	13,902	7,673	7,634	8,608
Total current assets	19,837	26,018	27,107	26,431	33,240
PP&E	13,970	14,079	15,836	17,038	18,495
Land use rights	984	1,056	1,341	1,430	1,528
Goodwill	4,528	4,533	4,533	4,533	4,533
Other Intangible assets	2,086	2,194	1,855	1,922	2,011
Others	7,719	10,259	11,926	13,483	15,546
Total non-current assets	29,287	32,121	35,491	38,406	42,112
Total assets	49,124	58,139	62,599	64,837	75,353
Trade and bills payable	5,406	6,342	7,453	7,597	9,150
ST borrowings	3,045	7,935	9,432	12,649	13,610
Others	6,852	8,289	7,583	6,513	10,015
Total current liabilities	15,303	22,566	24,468	26,759	32,775
LT Borrowings	5,542	6,015	4,988	1,978	1,985
Others	2,776	2,450	4,389	4,975	6,048
Total non-current liabilities	8,318	8,465	9,377	6,953	8,034
Shareholders' equity	20,845	22,604	24,261	26,630	29,849
Minority interest	4,659	4,503	4,492	4,495	4,694
Total equity	25,504	27,107	28,753	31,125	34,544
Total liabilities and equity	49,124	58,139	62,599	64,837	75,353

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2016A-2020E)

FY ends at Dec 31 (RMB mn)	2016A	2017E	2018E	2019E	2020E
Pretax profit	(461)	2,625	3,099	4,611	6,890
Depreciation and amortization	1,602	2,003	2,264	2,569	2,903
Change in working capital	1,897	1,558	(308)	(1,898)	4,506
Others	1,476	(681)	(432)	(1,460)	(2,502)
Cash flow from operating activities	4,513	5,505	4,623	3,822	11,797
Capex	(4,353)	(66,501)	(6,281)	(5,664)	(6,958)
Others	347	62,637	1,086	1,722	2,167
Cash flow from investing activities	(4,005)	(3,864)	(5,196)	(3,942)	(4,791)
Change in borrowings	(2,970)	5,363	470	208	968
Dividends paid	(611)	(349)	(471)	(613)	(1,003)
Others	(455)	430	1	(64)	(93)
Cash flow from financing activities	(4,036)	5,443	(1)	(469)	(128)
Net change in cash	(3,529)	7,084	(573)	(590)	6,878
Forex effect	51	(26)	(26)	(59)	(45)
Cash and cash equivalent - end	3,356	10,414	9,815	9,166	15,999

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2016A-2020E)

FY ends at Dec 31	2016A	2017A	2018E	2019E	2020E
Growth (YoY %)					
Revenue	9.69	11.86	14.88	13.90	12.78
Liquid milk	11.02	10.21	15.94	13.73	12.30
- UHT milk	11.64	7.70	8.50	12.37	4.94
- Milk beverage	(10.11)	5.33	18.82	6.22	12.57
- Yogurt	29.00	17.32	25.27	19.51	21.00
Ice cream	1.81	15.28	3.68	1.16	1.16
Milk powder	(2.41)	28.28	3.58	18.99	19.66
Other products	4.77	69.40	45.30	40.21	37.65
Gross profit	14.70	20.11	15.66	16.48	16.87
Operating profit	(115.86)	N/A	5.05	33.42	46.18
Net profit (to owners of the Group)	(131.73)	N/A	18.18	47.30	39.15
Profitability ratios (%)					
GPM	32.79	35.21	35.45	36.25	37.57
OPM	(0.78)	4.94	4.52	5.29	6.86
EBITDA margin	1.78	6.89	7.79	8.56	10.13
NPM (to owners of the Group)	(1.40)	3.40	3.50	4.53	5.59
Return ratios (%)					
ROAA	(1.51)	3.82	4.01	5.59	7.08
ROAE	(3.50)	9.43	10.33	14.01	17.57
ROIC	(3.14)	8.16	9.19	13.35	17.82
Liquidity ratio (x)					
Current ratio	1.30	1.15	1.11	0.99	1.01
Quick ratio	1.08	1.00	0.89	0.77	0.82
Cash ratio	0.46	0.28	0.47	0.39	0.46
Cash conversion cycle (days)					
Days of outstanding receivable	13	15	15	15	14
Days of inventory on hand	39	32	36	40	40
Days of outstanding payable	52	55	54	54	54
CCC	(0)	(8)	(3)	1	0
Leverage ratios (%)					
Total debt/Equity	33.67	51.46	50.52	47.42	45.54
Total debt/Total assets	17.48	23.99	23.04	22.56	20.70

Source(s): Company, ABCI Securities estimates



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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index. Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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