



August 30, 2013
Equity Focus
Rating: BUY
TP: HK\$ 34.8

Share price (HK\$) 31.75
Est. share price return 9.51%
Est. dividend yield 0.80%
Est. total return 10.31%

Previous Rating & TP BUY; HK\$ 32.0
Previous Report Date Jun 19, 2013

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Key Data

52Wk H/L(HK\$)	33.70/19.98
Issued shares (mn)	1,831.9
Market cap (HK\$ mn)	58,162.7
3-mth avg daily turnover (HK\$ mn)	22.3
Major shareholder(s) (%):	
COFCO	27.8
Arla Foods	5.9

Source(s): Company, Bloomberg, ABCI Securities

1H13 Revenue breakdown (%)

Liquid milk products	88.4
Ice cream products	9.5
Other dairy products	2.2

Source(s): Company, ABCI Securities

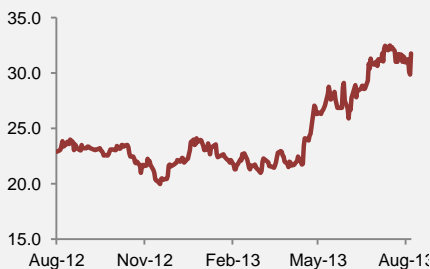
Share performance (%)

	Absolute	Relative*
1-mth	0.0	1.1
3-mth	17.4	21.1
6-mth	46.7	55.5

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance



Source(s): Bloomberg

China Mengniu (2319 HK)

China's most ambitious dairy queen. Maintain BUY

- Mengniu 1H13 net profit increased 16.2% YoY to RMB 749mn, in line with market expectation
- Developing high-end yoghurt and formula milk businesses help counteract against rising raw milk costs and achieve higher GP margins
- The Group will turn from net cash to net debt position after a series of M&As. Our FY13E net debt-to-equity ratio estimate is 26.9%
- M&A contribution will be fully reflected in the Group's FY14 P&L. We raise our TP from HK\$32.0 to HK\$34.8, based on 25.0x of FY14E P/E

Results in line with expectation. Mengniu reported 1H13 revenue increased by 13.3% YoY to RMB 20,668mn, mainly attributable to product structure change and increase in ASP. Revenue from liquid milk segment, which accounted for 88.4% of Mengniu's total revenue, increased by 14.4% YoY to RMB 10,940.8mn. Mengniu remained as the largest player in China's liquid milk industry and accounted for 25.5% of market share in 1H13 (vs. 25.4% in 2H12), while the second largest player, Yili, had a 22.8% market share for the same period. The Group's deliberate effort to develop more products with higher margins resulted in an increased GP margin of 26.7% in 1H13, compared to 24.7% in 2H12 and 25.5% in 1H12. 1H13 net profit increased by 16.2% YoY to RMB 749mn, which is in line with market expectation (market estimate: RMB 753mn).

Expanding product lines to attain higher profitability. Apart from the liquid milk business, Mengniu's ambitious moves, including the formation of a JV with the Danone Group and cooperating with Arla Food and Yashili (1230 HK), have showed management's determination to develop more comprehensive product lines, especially the yoghurt and high-end milk formula businesses, in order to maintain its market leader position in the industry. We believe these new products will boost GP margin and help overcome rising raw milk costs. We estimate GP margin to expand from 25.1% in FY12 to 27.6% in FY13E and 29.6% in FY14E.

Switching from a net cash to net debt position. Mengniu's net cash position dropped to RMB 3,412.4mn as at June 13 (vs. RMB 5,178.3mn as at Dec 2012) after acquiring a 26.9% stake in China Modern Dairy(1117 HK). The total cash consideration for the acquisition of Yashili in Aug 2013 amounted to ~RMB 8.1bn, which will be settled by loans. After acquiring Yashili, Mengniu will turn from net cash to net debt position and we estimate that the FY13E net debt-to-equity ratio to be 26.9% (as compared to Yili's 1H13 net debt-to-equity 7.72%).

Maintain BUY. Contribution from China Modern Dairy and Yashili, of which Mengniu has acquired stakes in May and Aug, on the P&L will be fully reflected in FY14 P&L. By applying the PER valuation method and rolling our valuation over to FY14 forecasts, we raise our TP from HK\$ 32.0 to HK\$ 34.8, based on 25.0x FY14E P/E. Our TP implies a 9.2% upside potential. Maintain BUY.

Results and Valuation

FY ended Dec 31	2010A	2011A	2012A	2013E	2014E
Revenue (RMB mn)	30,265	37,388	36,080	42,176	50,846
Chg (% YoY)	17.7	23.5	-3.5	16.9	20.6
Net Income (RMB mn)	1,237	1,589	1,257	1,674	2,019
EPS (RMB)	0.71	0.91	0.71	0.91	1.10
Chg (% YoY)	4.4	27.3	-21.4	28.0	20.6
BVPS (RMB)	5.61	6.49	7.04	8.97	9.99
Chg (% YoY)	13.74	15.60	8.43	27.42	11.42
P/E (x)	-	-	35.2	27.5	22.8
P/B (x)	-	-	3.6	2.8	2.5
ROE (%)	13.5%	15.0%	10.5%	11.6%	11.6%
ROA (%)	7.9%	8.5%	6.1%	6.8%	6.6%
DPS(RMB)	0.160	0.198	0.160	0.187	0.201
Yield (%)	0.92	1.34	0.90	0.80	0.97

*Net gearing=Net debt/Total equity

Source(s): Bloomberg, ABCI estimates



Exhibit 1: China Mengniu's 1H13 results

P&L	1H13	2H12	1H12	HoH Chg	YoY Chg	Remarks
	RMB mn	RMB mn	RMB mn	(%)	(%)	
Revenue	20,668	17,837	18,244	15.9	13.3	Driven by changes in product structure and ASP growth.
Cost of sales	(15,149)	(13,426)	(13,600)	12.8	11.4	
Gross Profit	5,519	4,411	4,644	25.1	18.9	
Gross Margin (%)	26.7	24.7	25.5	+2.0ppt	+1.3ppt	
Other income and gains	130	148	109	(12.6)	19.2	
Gain arising from changes in fair value less cost to sell of dairy cows	13					
S&D	(3,807)	(3,234)	(3,192)	17.7	19.3	S&D/ Revenue increased to 18.4% in 1H13 vs. 17.5% in 1H12 due to increased investment in sales channel and sales staff costs. Estimate will stay at this level in 2H13.
Admin expenses	(810)	(632)	(563)	28.1	43.7	
Other operating expenses	(138)	(71)	(125)	93.4	10.3	
Share of profits and losses of associates	30	74	(60)	(60.1)	(149.0)	
EBIT	937	696	812	34.6	15.5	
EBIT Margin (%)	4.5	3.9	4.4	+0.6ppt	+0.1ppt	
Interest income	132	117	102	13.3	30.1	
Finance costs	(34)	(31)	(11)	8.2	218.6	
Profit before tax	1,036	782	903	32.5	14.7	
Tax	(186)	(91)	(155)	104.5	20.0	
Profit after tax	850	691	748	23.0	13.6	
Minority Interest	(101)	(79)	(103)	27.4	(2.3)	
Net profit	749	612	645	22.4	16.2	
NP margin	3.6	3.4	3.5	+0.2ppt	+0.1ppt	
Sales breakdown						
Liquid milk products	18,263	16,374	15,963	11.5	14.4	
UHT Milk	10,941	10,064	9,642	8.7	13.5	
Milk Beverages	4,732	4,048	3,991	16.9	18.6	
Yoghurt	2,590	2,261	2,331	14.5	11.1	
Ice cream products	1,954	1,013	2,158	92.9	(9.4)	Management emphasized they will streamline ice cream products by eliminating less profitable SKUs like what they are doing in liquid milk segment
Other dairy products	451	450	122	0.3	268.8	
Total	20,668	17,837	18,244	15.9	13.3	
Sales breakdown (%)						
Liquid milk products	88.4	91.8	87.5	(3.4)	+0.9	
UHT Milk	52.9	56.4	52.8	(3.5)	+0.1	
Milk Beverages	22.9	22.7	21.9	+0.2	+1.0	
Yoghurt	12.5	12.7	12.8	(0.1)	(0.2)	
Ice cream products	9.5	5.7	11.8	+3.8	(2.4)	
Other dairy products	2.2	2.5	0.7	(0.3)	+1.5	
Total	100.0	100.0	100.0	0.0	0.0	

Balance sheet	June-13	Dec-12	June-12	HoH %	YoY %	Remarks
	RMB mn	RMB mn	RMB mn			
Gross debt	3,977	574	574	593.1	593.1	
Cash	7,389	5,778	5,752	27.9	28.5	
Net debt	(3,412)	(5,205)	(5,178)	(34.4)	(34.1)	Will change to net debt position after acquiring Yashili
Key indicators						
Current ratio	1.06	1.40	1.44			
Inventory turnover days	18.4	21.0	20.1			
Trade receivable turnover days	10.1	8.3	8.3			
Trade payable turnover days	54.4	49.7	51.2			

Source(S): Company, ABCI Securities



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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 from 2007-2011

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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