

Apr 2, 2015
Company Report
Reinitiate: HOLD
TP: HK\$ 2.17

Share price (HK\$) 2.08
Est. share price return 4.45%
Est. dividend yield 0
Est. total return 4.45%

Previous Rating & TP N/A
Previous Report Date Resume coverage

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Key Data

52Wk H/L(HK\$) 2.55/1.93
Outstanding shares (mn) 6,354.40
Market cap (HK\$ mn) 13,217.15
3-mth avg daily turnover (HK\$ mn) 5.54
Major shareholder(s) (%):
Zhao Hongyu 56.56
Hongliang Zhao 8.09
Credit Suisse AG 6.22
China Mengniu Dairy 6.22

Source(s): Bloomberg, ABCI Securities

Revenue contribution of business segments

(%)	FY13	FY14
Dairy farming	73.51	65.33
- Organic raw milk	30.86	34.32
- Non-organic raw milk	42.65	31.01
Liquid milk	26.49	34.67

Source(s): Company, ABCI Securities

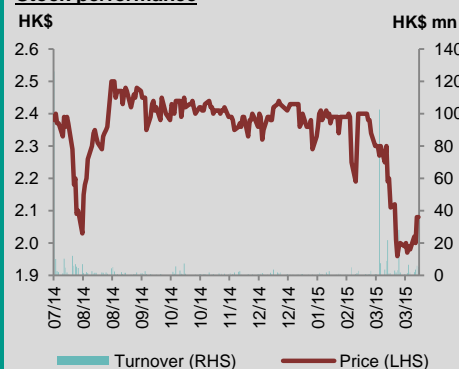
Share price performance (%)

	Absolute	Relative*
1-mth	(9.57)	(11.56)
3-mth	(14.40)	(20.85)
6-mth	(15.10)	(26.14)

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Stock performance



Source(s): Bloomberg, ABCI Securities

Shengmu (1432 HK)

Stellar FY14 results but industry environment remains unfavorable; reinitiate with **HOLD**

- China Shengmu Organic Milk Limited (Shengmu) is an integrated dairy company in China producing raw milk for internal use and external customers. It also manufactures, markets, distributes, and sells its own-branded liquid milk products
- Shengmu has 19 organic dairy farms and 12 non-organic dairy farms. Its organic and non-organic herd sizes were 64,769 and 38,483 as of end-FY14. Compared to end-FY13, the number of its organic dairy farms increased by 6 in FY14; organic herd size increased by 34,148 (+111.52% YoY) while non-organic herd size increased by 8,647 (+28.98% YoY)
- In FY14, Shengmu's revenue, gross profit, and net profit grew by 86.45% YoY, 118.14% YoY, and 117.3% YoY, respectively; GPM, OPM, and NPM reached 50.17%, 44.52%, and 33.35%, respectively
- Shengmu current product portfolio includes UHT whole milk, UHT low-fat milk, UHT kids milk, and UHT yogurt. Going forward, it will develop new product lines including milk beverages

FY14 results show significant improvement. Shengmu's FY14 revenue, gross profit and net profit grew 86.45% YoY, 118.14% YoY, and 117.3% YoY; GPM, OPM, and NPM reached 50.17%, 44.52%, and 33.35%, respectively. Shengmu's ASP of liquid milk declined to RMB 14.43k/tonne from RMB 14.63k/tonne in FY13. Its longer cash conversion cycle also indicates favorable terms were extended to customers.

Production capacity will support Shengmu's future development. Shengmu's number of organic dairy farms increased by 6 in FY14; organic herd size expanded by 34,148 (+111.52% YoY), and non-organic herd size increased by 8,647 (28.98% YoY). We believe the enlarged production capacity would be sufficient for future development.

Upstream business may be hampered by unfavorable industry environment. Price of international milk powder futures price remains uncertain as the drought situation in New Zealand and the upcoming removal of EU milk production quota complicate the outlook. Low domestic raw milk price and the high inventory of milk powder would hamper Shengmu's upstream business performance.

Downstream business to face intensifying competition. We believe it would be challenging for Shengmu to develop its downstream business as due to stiffening competition imposed by domestic and foreign players.

Re-Initiate with HOLD; TP at HK\$2.17. Based on our DCF model and peer valuation, we reinitiate our coverage with a **HOLD** recommendation. Our TP of HK\$2.17 represents an upside of 4.45% and 20.02x FY15E P/E.

Risk factors: 1) Farm management risk ; 2) Heavy dependence on organic feed ; 3) Regulatory risk; 4) Customer concentration risk; 5) Capacity expansion risk; 6) Geographical concentration risk.

Results and Valuation

FY ended Dec 31	2013A	2014A	2015E	2016E	2017E
Revenue (RMB mn)	1,143.71	2,132.43	2,870.91	3,980.49	5,355.75
Chg (% YoY)	63.21	86.45	34.63	38.65	34.55
Net Income (RMB mn)	327.31	711.23	551.73	876.54	1,374.44
Chg (% YoY)	67.18	117.30	(22.43)	58.87	56.80
Basic EPS (RMB cent)	7.50	11.80	8.68	13.79	21.63
P/E (x)	N/A	17.37	18.89	11.89	7.53
BVPS (RMB)	N/A	0.59	0.70	0.81	1.03
P/B (x)	N/A	4.15	2.94	2.53	2.00
DPS (RMB)	N/A	N/A	N/A	N/A	N/A
Yield (%)	N/A	N/A	N/A	N/A	N/A
ROAA (%)	13.28	14.81	7.33	9.18	11.36
ROAE (%)	22.37	23.85	11.90	16.15	20.75

Source(s): Company, Bloomberg, ABCI Securities estimates



Solid performance in FY14

Improved margin and strong growth

Shengmu's GPM, OPM, and NPM improved from 42.88%, 35.76%, and 28.62% in FY13 to 50.17%, 44.52%, and 33.35% in FY14, respectively. As a result, ROAA and ROAE both increased to 14.81% and 23.85% in FY14 from 13.28% and 22.37% in FY13.

In addition, the Company's sales continued to grow, thanks to the improved raw milk price and the expanding liquid milk segment. In FY14, the Company's overall sales grew 86.4% YoY. Meanwhile, sales of organic raw milk business and liquid milk business surged 107.36% YoY and 144.03% YoY. We believe effective marketing and distribution efforts boosted liquid milk sales, while the Group's niche strategy that focuses on the high-end organic milk market also proved to be a success.

Financial positions improved, but management of working capital weakened

Shengmu's leverage ratios fell in FY14. Debt-to-asset and debt-to-equity ratios decreased to 22.86% and 44.07% in FY14 from 29.94% and 54.57% in FY13. The decreasing leverage was mainly due to the IPO proceeds raised in 2014 that reduced debt financing need.

Both the receivable turnover days and inventory turnover days increased, from 14 days and 151 days in FY13 to 39 days and 178 days in FY14; payable turnover days, however, only increased from 75 days to 79 days. This lengthened the cash conversion cycle from 90 days in FY13 to 139 days in FY14. We believe the Company has provided favorable terms to its customers in order to boost sales.

Herd size expansion on track

By end-FY14, total herd size of Shengmu increased to 103,252 from 60,457 by end-FY13. By end-FY14, the organic herd comprised 30,768 calves and heifers and 34,001 milkable cows; the non-organic herd had 17,425 calves and heifers and 21,031 milkable cows. Meanwhile, the Group expanded the number of dairy farms from 13 by end-FY13 to 19 by end-FY14. The aggressive expansion in herd size, especially for the organic herd, demonstrates the Company's confidence in the prospects of its organic milk product segment.

Company overview: A leading organic milk producer in expansion

Overview

China Shengmu Organic Milk Limited (Shengmu) is an integrated dairy company in China. It produces raw milk for its internal use and external customers, as well as manufactures, markets, distributes, and sells its own-branded liquid milk products.

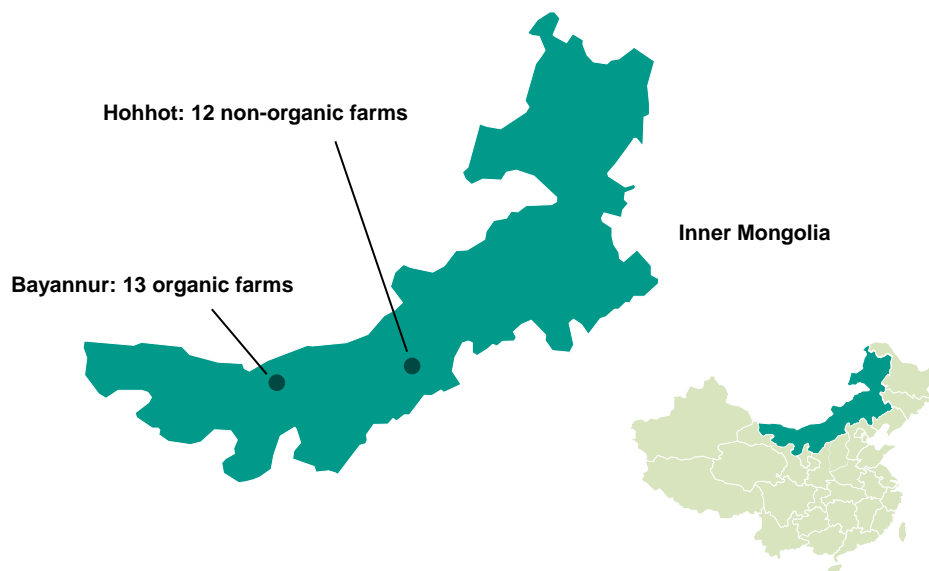
According to report by Frost and Sullivan (F&S), the Group captured a 54.2% market share in China's organic raw milk production in 2013. Major dairy product manufacturers, such as Mengniu, Yili, and Want Want, are the customers of the Group's organic raw milk. Shengmu also holds multiple organic product certificates covering the production of agricultural produce and feeds, manufacturing facilities, and liquid milk products, according to public record published on PRC Certification and Accreditation Administration's website.

Shengmu is also developing its downstream product lines. As of end-2014, the Group's liquid milk product portfolio includes organic UHT whole milk, organic UHT low-fat milk, organic UHT children's milk, and organic UHT yogurt.

Production facilities

The Group strategically set up the production operation in the Ulan Buh desert, where Shengmu Forage plants forage crops and the Group operates the organic dairy farms. According to the F&S Report, Ulan Buh desert is ideal for operating organic dairy farms.

Exhibit 1: Location and the number of the Group's dairy farms in Inner Mongolia as at end-2013



Source(s): The Company

Sales network

The Group sells its liquid milk products through distributors. As at end-2013, it had 316 distributors covering 31 provinces, municipalities and autonomous regions in China. The Group plans to expand the distribution network to over 400 by end-2014 and increase its penetration into the 3rd and 4th tier cities.

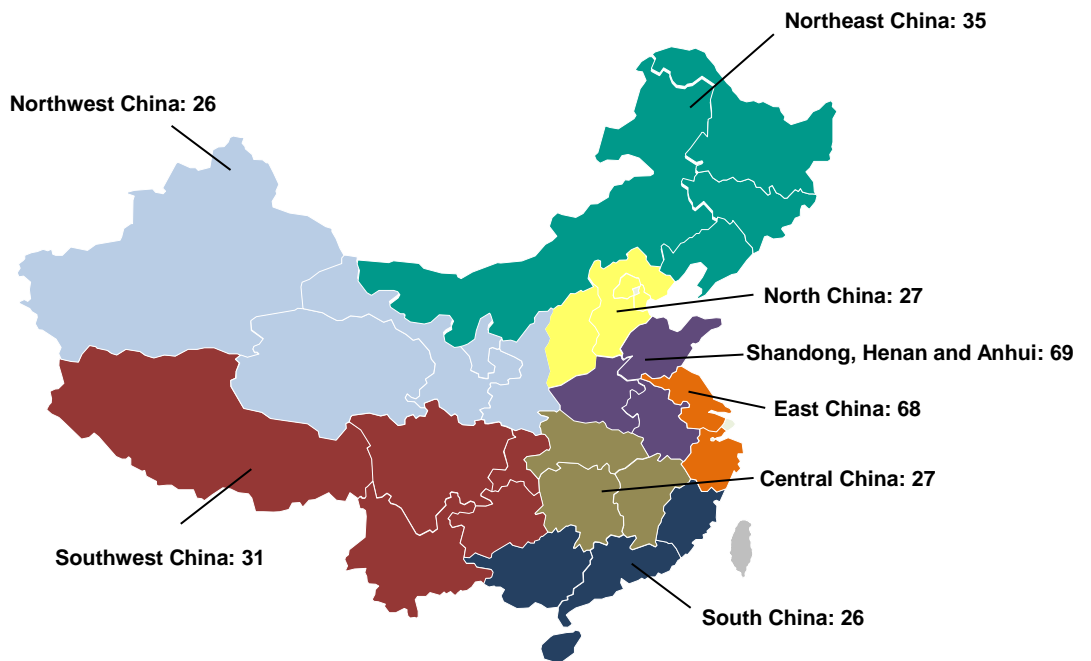


Exhibit 2: Geographic distribution of the Group's distributors

	As at end-2012	As at end-2013
Southwest China	2	31
Northeast China	16	35
North China	12	27
East China	19	68
South China	8	26
Central China	13	27
Shandong, Henan and Anhui	26	69
Northwest China	8	26
Beijing	1	3
E-commerce Channels	3	4
Total	108	316

Source(s): The Company

Exhibit 3: The number of distributors across China as at end-2013



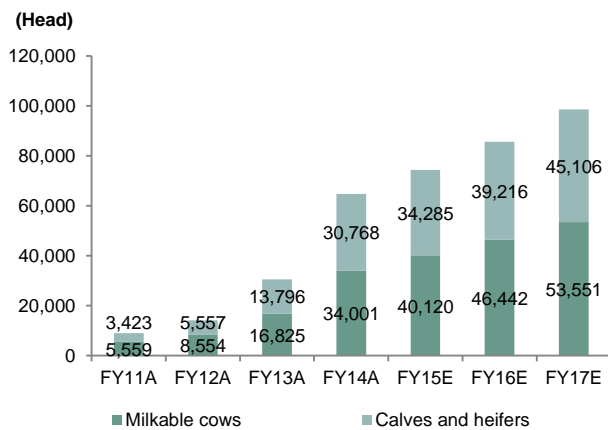
Source(s): The Company, ABCI Securities

Production capacity growth would normalize

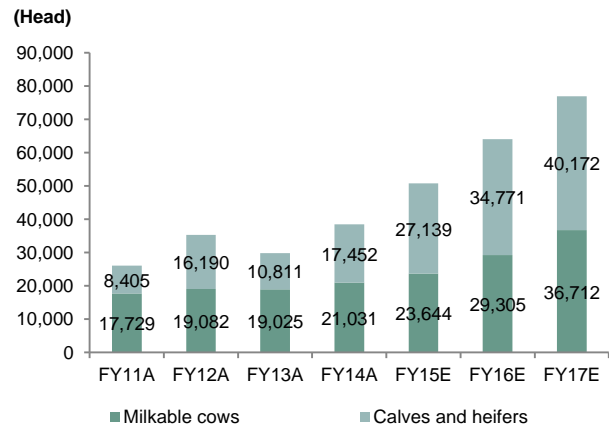
Shengmu's herd size expanded rapidly in FY14. As of end-FY14, the total herd size grew 70.79% YoY to 103,252; the number of organic cows rose 111.52% YoY to 64,769, while that of the non-organic cows increased 28.98% YoY to 38,483. As of end-FY14, the number of organic farms increased to 19 from 13, while the number of non-organic farms stayed at 12.

We expect the expansion of herd size would slow going forward. As industry condition is recovering and the Company is transitioning from growth stage to the maturity stage, we expect growth in organic herd size would decrease to 14.88% YoY, and the growth in non-organic herd size would maintain at ~30% YoY by end-FY15, similar to the 29% YoY growth in FY14. I

We expect Shengmu's milk yield would continue to improve in the future. Such improvement would help the Group sustain its volume growth in raw milk production supporting its expanding raw milk and downstream businesses.

Exhibit 4: Organic herd size analysis


Source(s): Company, ABCI Securities estimates

Exhibit 5: Non-organic herd size analysis


Source(s): Company, ABCI Securities estimates

Diversified portfolio reduces risk

In FY14, Shengmu was able to boost sales of liquid milk product segment. Liquid milk product segment recorded an impressive revenue growth of 144.03% YoY. Shengmu's effort to promote its downstream business also marks a successful diversification of its product portfolio. Revenue contribution from the liquid milk product segment increased from 26.49% in FY13 to 34.67% in FY14, as contribution from organic raw milk moderately increased to 34.32% while that of premium non-organic raw milk edged down slightly to 31.01%.

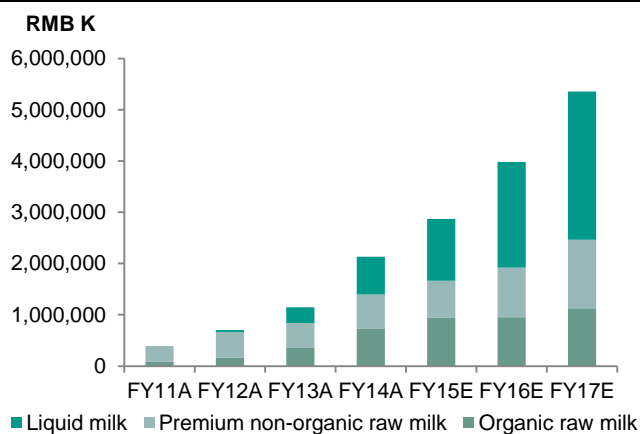
Shengmu's current liquid milk product is composed with UHT milk and UHT yogurt. According to its IPO prospectus, the Company would launch new product lines that include milk beverages in the next few years. Shengmu has achieved such a certain degree of diversification in a short period of time since the launch of its first liquid milk product, and we believe that contribution from its downstream business would increase in the future. A larger downstream business would provide Shengmu with more flexibility to cope with the changing market environment and reduce dependence on its industrial customers. Nonetheless, we expect growth in the liquid milk segment would mostly be driven by increasing sales of the existing product lines whereas contribution from the new product lines would be limited.

2H14 results could be inflated by unsustainable practices

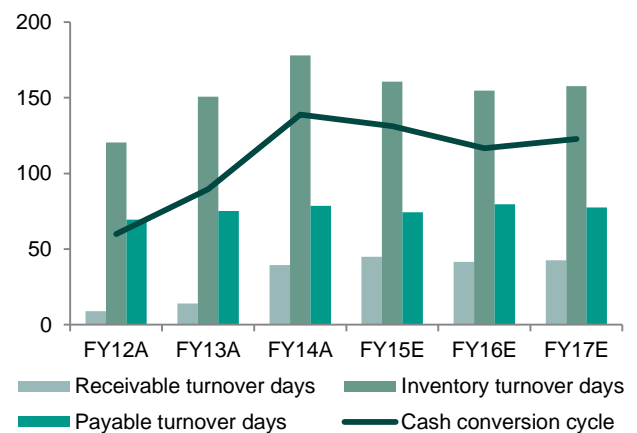
Shengmu's 2H14 results were outstanding. Its revenue and net profit increased to RMB 1,226.8mn and RMB 432.1mn from RMB 905.6mn and RMB 279.1mn in 1H14. Revenue and net profit of Modern Dairy, its closest peers, decreased from RMB 2,584.5mn and RMB 523.2mn in 1H14 to RMB 2,442.2mn and RMB 212.2mn in 2H14. Other less comparable peers such as YST Dairy and Mengniu also show a similar declining trend in 2H14.

We believe, however, that Shengmu's results could have been inflated by its overall business strategies. Cash conversion cycle increased to 139 days as of end-FY14 from 90 days as of end-FY13. In particular, inventory turnover days and receivable turnover days increased to 178 days and 39 days, while payable turnover days stayed relatively flat at 79 days. This suggests that the Company may have provided its customers or distributors with favorable terms, and inventory level could be high in its distribution channels. In addition, the Company's ASP of liquid milk products declined from RMB 14.63k/tonne in FY13 to RMB 14.43k/tonne, suggesting that the Company continues to cut price to promote the downstream business.

Therefore, it raises the question of sustainability of Shengmu's performance. We believe the Group is still in its initial stages of promoting its own-branded products and much marketing efforts are still needed for the Group to gain market share. Nonetheless, prolongation of practices such as extension of payment period for customers could hamper the Group's future performance.

Exhibit 6: Product portfolio diversifies


Source(s): Company, ABCI Securities estimates

Exhibit 7: Cash conversion cycle


Source(s): Company, ABCI Securities estimates

Upstream business should brace for more challenges

In FY14, Shengmu's revenue from dairy farming segment (after elimination) grew 65.7% YoY in FY14; sales of organic raw milk sales grew 107.36% YoY while that of premium non-organic raw milk rose 35.56% YoY.

The risen revenue can be attributed to both higher volume and ASP. For organic raw milk business, external sales volume grew 93.97% YoY to 132,906 tonnes while ASP grew 6.90% YoY to RMB 5.51k/tonne. For the premium non-organic raw milk business, external sales volume grew 24.89% YoY while ASP grew 8.45% YoY to RMB 4.75k/tonne. The strong growth in sales volume can be attributed to Shengmu's close business relationship with the national dairy product manufacturers and the fine quality of its products. Higher raw milk price in 2014 also allowed Shengmu to command higher prices from its industrial customers.

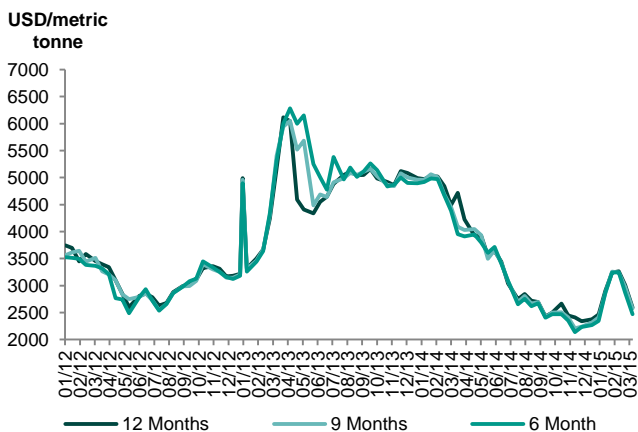
Raw milk sales continue to face challenges

Domestic raw milk price has been declining since mid-Feb 2014. The decrease of international milk formula price and the increased use of milk powder as raw material have increased the downside pressure on domestic raw milk price.

The downturn has continued despite the drought condition in New Zealand and potential supply disruption in the international milk powder market. The latest domestic raw milk price reached 3.41 Yuan/kg as of Mar 31, 2015, 0.01 Yuan/kg lower than the week before. We believe raw milk price would deteriorate further.

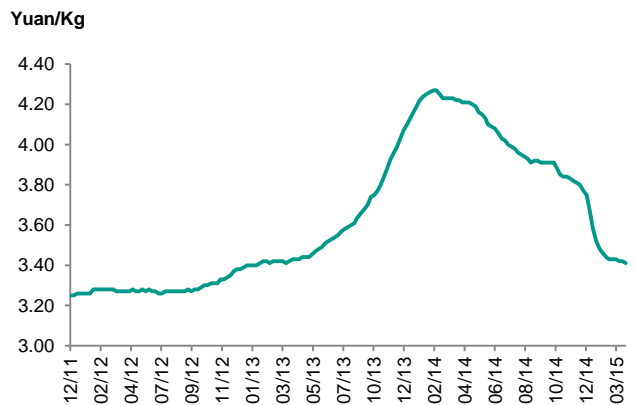
The increase in international milk formula futures prices has been short-lived. We believe domestic raw milk price is unlikely to experience a turnaround soon since the inventory level of milk formula is still high. In addition, current price of international milk formula futures (12-month contract: US\$ 2,595 per metric tonne as of Apr 1, 2015) is still relatively low compared to its peak (12-month contract: US\$ 6,119 per metric tonne). Therefore, dairy product manufacturers may continue to increase inventory for milk formula.

Exhibit 8: New Zealand whole milk powder futures contract price



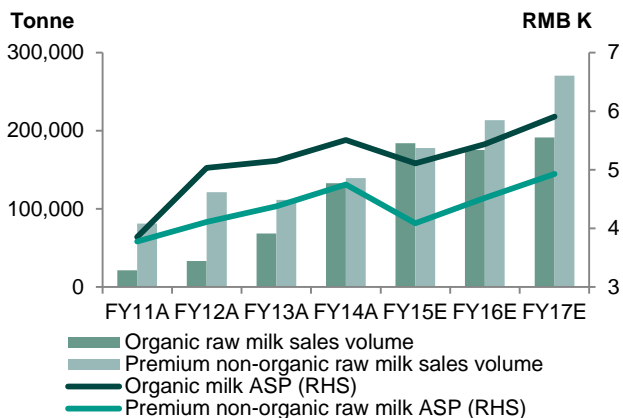
Source(s): Bloomberg, ABCI Securities

Exhibit 9: Raw milk price in China continues to decline



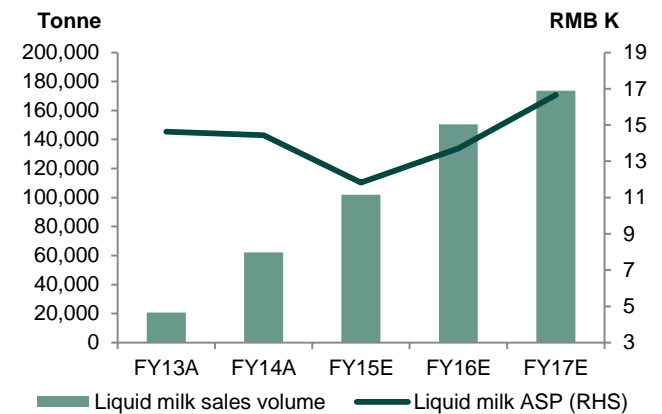
Source(s): Wind, ABCI Securities

Exhibit 10: Raw milk sales volume and ASP



Source(s): Company, ABCI Securities estimates

Exhibit 11: Liquid milk sales volume and ASP



Source(s): Company, ABCI Securities estimates

Based on the industry environment, we believe the current destocking process of milk powder inventory would be completed by 3Q15. However, Shengmu's raw milk business would continue to be impacted by the weak ASP. Our projection of Shengmu's organic raw milk ASP and premium non-organic raw milk ASP would reach RMB 5,112 per tonne and RMB 4,089 per tonne for FY15E. We believe Shengmu's raw milk sales volume would rise further, and estimate the sales volume for organic and premium non-organic raw milk to grow 55.94% YoY and 30.93% YoY in FY15E.

“Organic” advantage may take longer to monetize

Retail prices of milk and yogurt products have been fluctuating since Dec 2014. CPI of dairy products in Jan and Feb 2015 dropped to -0.51% YoY and -1.49% YoY. The price decline reflects the decreasing raw material costs and increasing price pressure amid intensifying competition.

We believe the decline in CPI for dairy products can be partially attributed to increasing price competition in the market. Domestic brands have already had a wide variety of product offerings ranging from UHT milk, chilled yogurt, to UHT yogurt. Since 2014, the domestic market has been engaging in continuous price wars due to reduced product costs, which resulted in a general shift to a volume-driven sales strategy. Shengmu, as a new dairy product brand in China, has been affected by the tough market environment. It has to raise brand awareness while slashing prices for its products.

The Company's ASP of its organic liquid milk decreased to RMB 14.43k/tonne in FY14. According to the Company website, all of the Company's products are priced between RMB 25.42k/tonne and RMB 36k/tonne. Based on our calculation, the simple average product selling price was around RMB 30.42k/tonne. This illustrates that the Company was under intense pressure to offer big discounts in direct sales or to distributors to increase market shares.

Moreover, competition in the organic milk market segment is stiff. Well-established national brands have launched organic or high-end dairy product lines (such as Mengniu's Telunsu [特仑苏] Yili's Jindian [金典]). Regional players have also launched their own organic milk products (such as Huishan Dairy's Jersey Farm Organic UHT Milk [杰茜牧场有机牛奶]). Increasing presence of liquid milk products from Australia, Europe and the U.S. is also eroding market shares of domestic players as consumers perceived foreign brands to have a better quality. As the production quota of milk in the EU is about to be removed in April 2015, we expect more foreign dairy products will enter the Chinese market. Overall, intensifying competition will continue to pose challenges for Shengmu.



A higher leverage in the future

Shengmu raised HK\$ 996.3mn in net proceeds through its IPO in 2014. According to the Group's announcement, RMB 376.06mn, or 47.17% of total amount raised, has been utilized. We believe financing needs would arise to support the Group's development plan. Debt-to-equity ratio and debt-to-asset ratio would gradually rise to ~ 60% and ~30% in FY15E-17E on increased debt financing, which is manageable in our view.

Exhibit 12: IPO funding allocation

Funding allocation	Proceeds allocated	Proportion of fund raised in IPO
Actual use of proceeds	(RMB mn)	(%)
1) Constructing 6 new organic dairy farms	58.15	7.29
2) Acquiring dairy cows from domestic or overseas markets	59.25	7.43
3) Sales and marketing activities and expansion of our distribution network	31.06	3.90
4) Expanding the liquid milk production capacity of the Group	37.36	4.69
5) Repayment of loan	120.18	15.07
6) Additional working capital and other general corporate purpose	70.06	8.79
Proposed use of proceeds – Pre-IPO	(HKD mn)	(%)
(assuming an Offer Price of HK\$2.67 per Share)		
1) Constructing 6 new organic dairy farms in 2014 - 2015	281	25
2) Acquiring no less than 15,000 dairy cows domestically and from overseas in 2014 - 2015	336	30
3) Sales marketing activities and expansion of distribution network	56	5
4) Expanding liquid milk production capacity	168	15
5) Repaying certain outstanding loans	168	15
6) Additional working capital and other general corporate purpose	112	10

Source(s): The Group's IPO prospectus, the Group's announcement of offering price and allotment results, ABCI Securities

IPO size and pricing	Actual	Projected
Offering price (HKD/share)	2.39	2.67
Fund raised - net (HKD mn)	996.3	1,121
Number of shares issued (mn)	444.8	419.9

Source(s): The Group's announcement of offering price and allotment results, ABCI Securities

TP at HK\$2.17; reinitiate HOLD

In the short term, the industry condition would create pressure for Shengmu's profitability and growth. We believe Shengmu's integrated business model and organic branding would give it certain competitive advantages in the long term.

Our DCF model assumes a WACC of 14.28%, a target debt-to-equity ratio of 45.71%, a 5% terminal growth for the best case scenario, and a 2% terminal growth rate for the worst case scenario. The derived price range is HK\$ 1.68 – 2.66, representing 15.52x – 24.51x FY15E P/E.

Currently, Shengmu's comparable peers, Modern Dairy and Huishan Dairy, are trading at an average 11.97x FY15E P/E. Mengniu, the pure downstream player in China, is trading at 22.99x FY15E P/E.

Based on the DCF analysis and the market valuation of its peers, we set our TP for Shengmu at HK\$ 2.17, which represents an upside of 4.45% from its current price, and 20.02x FY15E P/E. Considering the raw milk price outlook for FY15, the intensifying competition of the downstream market environment, and the Company's earnings outlook, we re-initiate our coverage for Shengmu with a **HOLD** rating.

Risk factors

Farm management risk

Recent incidents show that issues or problems in dairy farm management still exist. The majority of Shengmu's revenue comes from organic raw milk sales and organic liquid milk product sales. Disease outbreak, procedural errors, or omission in quality control of feed or water sources could lead to decline in milk quality or even product recalls, tarnishing the Group's reputation.

Heavy dependence on organic feed

Currently, Shengmu Forage is currently the major supplier of Shengmu's organic feeds. Any disruption of Shengmu Forage's production could lead to reduction in organic milk output. Rise in organic feed price soars would result in higher pressure on cost management.

Regulatory risk

Due to Shengmu's positioning as a quality raw milk supplier, its products are subject to a high level of scrutiny. Constant renewal of organic certificates has raised production and administrative costs. In addition, the gradual regulatory tightening in dairy industry also drive up compliance costs for Shengmu

Customer concentration risk

Mengniu accounted for 87.4%, 94.6%, and 58.3% of Shengmu's total revenue in 2011-13, respectively. Any adverse change in the industry, such as raw milk price decline, oversupply of raw milk, or changes of terms of supply contract could hurt Shengmu's performance.

Capacity expansion risk

Shengmu has been expanding its production capacity (both in herd size and the number of dairy farms) aggressively. If downstream is lower than expected over the next few years, the excessive capacity could weigh on Shengmu's performance.

Geographical concentration risk

Unlike some of its competitors, all of Shengmu's dairy farms are located in Inner Mongolia. Such a geographical concentration of dairy farms makes Shengmu susceptible to any unexpected change in the environment and operating condition in the region.

Appendix: Financial Statements of the Group

Consolidated income statement (2013A-2017E)

FY ends at Dec 31 (RMB mn, except per share data)	2013A	2014A	2015E	2016E	2017E
Revenue	1,144	2,132	2,871	3,980	5,356
- Dairy farming segment	841	1,393	1,666	1,918	2,462
- Liquid milk segment	303	739	1,204	2,062	2,894
COGS	(653)	(1,063)	(1,926)	(2,519)	(3,181)
Gross profit	490	1,070	945	1,462	2,175
Other gains and income	16	109	87	161	261
SG&A	(97)	(230)	(347)	(549)	(728)
Operating profit	409	949	686	1,073	1,707
Net finance cost	(33)	(54)	(82)	(91)	(127)
Share of profit and losses of associates	(1,349)	(7,651)	(8,416)	(9,258)	(10,183)
Pre-tax profit	375	888	604	982	1,580
Tax	(1)	(4)	(2)	(4)	(6)
Net profit	374	884	602	979	1,574
- Profit attributable to owners	327	711	552	877	1,374
- Minority interest	47	173	50	102	200
EPS (RMB)					
- Basic	0.075	0.118	0.087	0.138	0.216
- Diluted	0.075	0.116	0.080	0.128	0.200

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2013A-2017E)

As of Dec 31 (RMB mn, except per share data)	2013A	2014A	2015E	2016E	2017E
Cash and bank balance	127	735	867	870	1,449
Trade and bills receivables	63	398	309	599	654
Inventories	335	701	994	1,141	1,608
Others	109	202	400	527	796
Total current assets	635	2,035	2,570	3,137	4,507
Biological assets	1,510	2,720	3,730	4,543	5,459
PP&E	923	1,658	2,129	2,748	3,520
Other non-current assets	45	78	142	93	197
Total non-current assets	2,477	4,456	6,001	7,384	9,176
Total assets	3,113	6,491	8,571	10,520	13,683
Trade and bills payables	191	424	481	683	867
Receipts in advance	82	32	148	123	207
Short-term debt	932	1,334	2,324	3,191	4,323
Other current liabilities	199	296	451	688	876
Total current liabilities	1,405	2,086	3,405	4,684	6,273
Total non-current liabilities	0	150	150	0	0
Total liabilities	1,405	2,236	3,555	4,684	6,273
Shareholders' equity	1,494	3,722	4,274	5,150	6,525
Minority interest	214	533	583	686	886
Equity	1,708	4,255	5,017	5,836	7,410
Total liabilities and Equity	3,113	6,491	8,571	10,520	13,683

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2013A-2017E)

FY ends at Dec 31 (RMB mn)	2013A	2014E	2015E	2016E	2017E
Profit before tax	375	888	604	982	1,580
Depreciation and amortization	29	60	103	137	179
Change in working capital	(65)	(482)	(244)	(64)	(506)
Finance cost	33	69	106	112	152
Income tax paid	(1)	(1)	(1)	(1)	(1)
Others	(8)	(87)	(69)	(140)	(238)
Cash flow from operating activities	364	446	500	1,027	1,167
Changes in PP&E	(442)	(770)	(556)	(704)	(889)
Changes in intangible assets	(490)	(883)	(797)	(886)	(620)
Others	(2)	(5)	(3)	(3)	(3)
Cash flow from investing activities	(934)	(1,657)	(1,356)	(1,593)	(1,512)
Net change of debt	586	525	941	681	1,077
Interest paid	(33)	(69)	(105)	(112)	(152)
Others	115	1,363	153	0	(0)
Cash flow from financing activities	668	1,819	989	569	925
Net change in cash	97	608	132	3	579
Cash at the beginning of period	30	127	735	867	870
Cash at the end of period	127	735	867	870	1,449

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2012A-2016E)

FY ended Dec 31	2013A	2014A	2015E	2016E	2017E
Revenue composition (%)					
Dairy farming business	73.51	65.33	58.05	48.20	45.97
- Organic raw milk	30.86	34.32	32.73	23.95	21.08
- Non-organic raw milk	42.65	31.01	25.31	24.24	24.89
Liquid milk business	26.49	34.67	41.95	51.80	54.03
Profitability ratios (%)					
Gross margin	42.88	50.17	32.92	36.72	40.61
EBIT margin	35.76	44.52	23.88	26.97	31.88
EBITDA margin	37.39	47.34	27.48	30.40	35.23
Pre-tax margin	32.78	41.62	21.04	24.68	29.50
Total net margin	28.62	33.35	19.22	22.02	25.66
Return ratios (%)					
ROAA	13.28	14.81	7.33	9.18	11.36
ROAE	22.37	23.85	11.90	16.15	20.75
ROIC	46.02	44.35	22.71	29.26	35.50
Liquidity ratio (%)					
Current ratio	45.22	97.55	75.50	66.96	71.86
Quick ratio	12.11	29.93	26.26	27.02	31.60
Cash ratio	9.05	35.22	25.46	18.56	23.10
Cash conversion cycle (days)					
Days of outstanding receivable	14	39	45	42	43
Days of inventory on hand	151	178	161	155	158
Days of outstanding payable	75	79	74	80	78
CCC	90	139	131	117	123
Leverage ratios (%)					
Total debt/Equity	54.57	44.07	49.32	54.67	58.34
Total debt/Total assets	29.94	22.86	28.87	30.33	31.60

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification

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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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