



Company Report

Yashili (1230 HK)

May 16, 2013

Rating: Buy

TP: HK\$3.61

Key data

| | |
|---------------------------|-------------|
| Share price (HK\$) | 3.41 |
| Upside potential (%) | 5.9 |
| 52Wk H/L(HK\$) | 3.36 / 1.14 |
| Issued shares (mn) | 3,539 |
| Market cap (HK\$m) | 11,786 |
| 30-day avg vol (HK\$m) | 146.5 |
| Auditors | KPMG |
| Major shareholder (%): | |
| Zhang Int' Investment | 52.2 |
| Carlyle Asia Partners III | 24.4 |

Source: Company & Bloomberg

Revenue composition in FY12 (%)

| | |
|---|-------|
| Yashili pediatric milk formula products | 67.8% |
| Scient pediatric milk formula products | 17.9% |
| Nutrition products | 13.4% |
| Others | 0.9% |

Source: Company

Share performance (%)

| | Absolute | Relative* |
|-------|----------|-----------|
| 1-mth | 28.7 | 21.6 |
| 3-mth | 28.2 | 30.2 |
| 6-mth | 84.3 | 71.5 |

*Relative to Hang Seng Index

Source: Bloomberg

1 year share price performance



Source: Bloomberg

Analyst

Report Date: 16 May 2013

Lisa Lee

Tel: (852) 2147 8809

Email: lisailee@abci.com.hk

Growth driven by new product

We expect growth in 2013 and 2014 will be fuelled by products upgrade and capacity expansion plan in New Zealand. Short term share price will be supported by 14% dividend yield (DPS: Rmb0.396; ex div date: 11 Jun.) We initiate our coverage with a HOLD recommendation with TP set at HK\$3.61.

Growth from products upgrade: Targeting at mid to high end customers, the group positioned itself as a premium producer who procured 100% imported raw milk powder from overseas (primarily from New Zealand). The group's 2013 strategy is to continue to improve its product mix. In Nov 2012, the group launched a new imported high end milk powder product, 'Super α -Golden Stage series', which is expected to contribute to 10% of the segment's revenue in 2013. In order to secure a stable supply of raw material and accelerate the upgrade in product mix, the management indicated CAPEX in New Zealand project will reach Rmb1.1bn in 2013 and 2014, in which production capacity will increase by 60% to over 50k tons and production is expected to commence in 2014.

GP margin expansion: We believe GP margin of the group is not likely to be affected by drought in New Zealand in the beginning of this year as management has already locked in raw milk powder costs in 1H2013. Average purchasing price of whole powder milk and skimmed powder milk for Jul 2012 to Mar 2013 was US\$3,286/ton and US\$3,373/ton respectively. Spot milk powder price is expected to fall in 2H2013 which is the normal rainy season in New Zealand. With new product rolling out and steady costs growth, we estimate GP margin of the group to expand slightly from 53.7% to 54.0%.

Extensive distribution network: The group sells its products through 1,500 regional distributors and 105,000 retail outlets, including 20,000 maternity stores. In 2013, the group will put more focus on increasing single-store sales by strengthening promotions, activities and staffing in major stores.

Valuation: Based on our DCF model with 7.8% WACC, we value the stock at HK\$3.61, which represents est FY13 PE of 18.3x and PB of 3.16x. Our appraised share value provides 5.9% of upside potential and we initiate coverage with HOLD rating.

Risk factors: Supply risks and FX risks due to heavy reliance on imports, intense competition from both foreign and domestic competitors, rely to suppliers, credit to back working capital

Results and valuation

| (FY ended Dec 31) | FY10A | FY11A | FY12A | FY13E | FY14E |
|----------------------------|----------|----------|----------|----------|----------|
| Revenue (Rmb mn) | 2,954 | 2,958 | 3,655 | 4,335 | 5,081 |
| Chg (%YoY) | 14.2 | 0.1 | 23.6 | 18.6 | 17.2 |
| Net Income (Rmb mn) | 502 | 306 | 468 | 560 | 674 |
| Chg (%YoY) | 24.1 | -39.0 | 53.0 | 19.5 | 20.5 |
| EPS (Rmb) | 0.144 | 0.087 | 0.133 | 0.158 | 0.191 |
| Chg (%YoY) | - | -39.2 | 52.4 | 18.9 | 20.5 |
| NBV (Rmb/share) | 1.066 | 1.084 | 1.158 | 0.915 | 0.994 |
| PE (x) | - | - | 20.0 | 16.8 | 14.0 |
| PB (x) | - | - | 2.30 | 2.91 | 2.68 |
| ROAA (%) | 14.99 | 6.71 | 9.17 | 10.74 | 12.97 |
| ROAE (%) | 20.06 | 8.13 | 11.89 | 15.30 | 19.96 |
| Net D/E (%) | Net cash | Net cash | Net cash | Net cash | Net cash |

Source: Company annual reports, ABCI Securities estimates



Profit Forecast

| FY ended Dec 31 (Rmbmn) | FY10 | FY11 | FY12 | FY13F | FY14F |
|--|----------------|----------------|----------------|----------------|----------------|
| Revenue | 2,954.4 | 2,957.8 | 3,655.1 | 4,335.1 | 5,080.7 |
| Cost of sales | (1,272.6) | (1,419.5) | (1,693.5) | (2,059.2) | (2,387.9) |
| Gross profit | 1,681.7 | 1,538.3 | 1,961.7 | 2,341.0 | 2,769.0 |
| Other revenue | 61.2 | 28.7 | 37.6 | 50.0 | 50.0 |
| Other net loss | (0.6) | (0.3) | (0.4) | 0.0 | 0.0 |
| S&D | (957.5) | (1,061.9) | (1,222.7) | (1,430.6) | (1,651.2) |
| Admin expenses | (182.8) | (185.5) | (202.1) | (238.4) | (279.4) |
| Other expenses | (11.5) | (6.5) | (14.7) | (26.0) | (30.5) |
| EBIT | 590.6 | 313.0 | 559.4 | 695.9 | 857.8 |
| Finance income | 11.9 | 65.1 | 89.7 | 104.0 | 104.0 |
| Finance costs | (13.0) | (2.7) | (2.8) | (28.0) | (31.9) |
| EBT | 589.5 | 375.4 | 646.3 | 772.0 | 930.0 |
| Tax | (86.3) | (67.0) | (175.9) | (210.0) | (253.0) |
| MI | (0.8) | (2.2) | (2.0) | (2.2) | (2.7) |
| Net profit attributable to owners | 502.4 | 306.3 | 468.5 | 559.7 | 674.3 |
| D&A | 75.4 | 79.2 | 81.8 | 118.9 | 153.9 |
| EBITDA | 666.0 | 392.2 | 641.2 | 814.9 | 1,011.8 |
| Dividends | 234.7 | 200.1 | 1400.3 | 393.4 | 473.9 |
| No. of issued shares at end of period (mn) | 3,500.0 | 3,508.9 | 3,522.9 | 3,539.2 | 3,539.2 |
| Issuable shares: | | | | | |
| Share options | 0.0 | 0.0 | 0.0 | 20.0 | 20.0 |
| Total issued & issuable shares | 3,500.0 | 3,508.9 | 3,522.9 | 3,559.2 | 3,559.2 |
| Per share value (Rmb) | | | | | |
| FD EPS | - | 0.087 | 0.133 | 0.158 | 0.191 |
| NBV | - | 1.084 | 1.158 | 0.915 | 0.994 |
| DPS | - | 0.057 | 0.396 | 0.111 | 0.134 |

Source: Company annual reports (for historical figures only), ABCI Securities estimates

Key Financial Ratio

| FY ended Dec 31 | FY10 | FY11 | FY12 | FY13F | FY14F |
|------------------------------|----------|----------|----------|----------|----------|
| Profitability ratio | | | | | |
| Gross profit margin | 56.9% | 52.0% | 53.7% | 54.0% | 54.5% |
| EBIT margin | 20.0% | 10.6% | 15.3% | 16.1% | 16.9% |
| EBITDA margin | 22.5% | 13.3% | 17.5% | 18.8% | 19.9% |
| Net profit margin | 17.0% | 10.4% | 12.8% | 12.9% | 13.3% |
| ROAA | 15.0% | 6.7% | 9.2% | 9.8% | 10.9% |
| ROAE | 20.1% | 8.1% | 11.9% | 13.5% | 15.4% |
| Cost ratio | | | | | |
| S&D/revenue | -32.4% | -35.9% | -33.5% | -33.0% | -32.5% |
| Admin expenses/revenue | -6.2% | -6.3% | -5.5% | -5.5% | -5.5% |
| Effective tax rate | -14.6% | -17.8% | -27.2% | -27.2% | -27.2% |
| Leverage | | | | | |
| Current ratio | 5.01 | 4.47 | 2.76 | 2.42 | 2.09 |
| Quick ratio | 4.45 | 3.75 | 2.31 | 1.93 | 1.65 |
| Net debt/total equity | Net cash | Net cash | Net cash | Net cash | Net cash |
| Working capital cycle | | | | | |
| Receivables turnover days | 16.8 | 15.1 | 4.0 | 3.5 | 4.0 |
| Inventory turnover days | 97.9 | 124.5 | 132.6 | 130.0 | 130.0 |
| Payables turnover days | 163.9 | 156.9 | 188.5 | 190.0 | 190.0 |

Source: Company annual reports (for historical figures only), ABCI Securities estimates



Balance Sheet Forecast

| As of Dec 31 (Rmbmn) | FY10 | FY11 | FY12 | FY13F | FY14F |
|--------------------------------------|----------------|----------------|----------------|----------------|----------------|
| PPE | 706.6 | 729.5 | 743.9 | 1,228.2 | 1,574.3 |
| Others | 286.0 | 310.0 | 825.0 | 825.0 | 825.0 |
| Non-current assets | 992.5 | 1,039.5 | 1,568.8 | 2,053.2 | 2,399.2 |
| Inventories | 390.8 | 577.7 | 652.9 | 767.6 | 879.1 |
| Trades and bills receivable | 192.3 | 52.3 | 26.8 | 56.4 | 55.0 |
| Prepayments and deposits | 102.0 | 138.1 | 135.7 | 196.9 | 192.9 |
| Others | 43.8 | 254.3 | 500.5 | 500.5 | 500.5 |
| Cash and bank balances | 2,759.3 | 2,581.6 | 2,073.2 | 664.0 | 907.1 |
| Short-term bank deposits | 0.0 | 0.0 | 612.0 | 612.0 | 612.0 |
| Current assets | 3,488.2 | 3,604.1 | 4,001.0 | 2,797.3 | 3,146.6 |
| Trade and other payables | 499.9 | 720.1 | 1,028.6 | 1,047.5 | 1,359.2 |
| ST loans | 158.4 | 31.4 | 330.9 | 430.9 | 530.9 |
| Others | 37.8 | 54.8 | 91.4 | 91.4 | 91.4 |
| Current liabilities | 696.2 | 806.3 | 1,450.9 | 1,569.8 | 1,981.5 |
| Deferred income | 42.9 | 30.7 | 18.6 | 18.6 | 18.6 |
| Deferred tax liabilities | 11.7 | 2.6 | 18.0 | 18.0 | 18.0 |
| Non-current liabilities | 54.6 | 33.3 | 36.6 | 36.6 | 36.6 |
| Total assets | 4,480.7 | 4,643.6 | 5,569.9 | 4,850.5 | 5,545.8 |
| Net assets | 3,729.9 | 3,804.0 | 4,082.3 | 3,244.0 | 3,527.7 |
| Issued capital | 300.7 | 301.5 | 302.6 | 302.6 | 302.6 |
| Reserves | 3,430.1 | 3,501.2 | 3,776.5 | 2,935.9 | 3,216.9 |
| MI | (0.9) | 1.3 | 3.3 | 5.5 | 8.2 |
| Total equity | 3,729.9 | 3,804.0 | 4,082.3 | 3,244.0 | 3,527.7 |
| Equity attributable to owners | 3,730.8 | 3,802.7 | 4,079.1 | 3,238.5 | 3,519.5 |

Source: Company annual reports (for historical figures only), ABCI Securities estimates

Cash Flow Forecast

| As of Dec 31 (Rmbmn) | FY10 | FY11 | FY12 | FY13F | FY14F |
|--|----------------|----------------|------------------|------------------|----------------|
| EBITDA | 666.0 | 392.2 | 641.2 | 814.9 | 1,011.8 |
| Change in working capital | (340.8) | 144.6 | 253.1 | (186.5) | 205.5 |
| Others | 18.2 | 3.9 | 5.0 | 0.0 | 0.0 |
| Cash (used in)/generated from operations | 343.5 | 540.7 | 899.3 | 628.4 | 1,217.2 |
| Income tax paid | (30.5) | (82.4) | (127.3) | (210.0) | (253.0) |
| CF from operating activities | 313.0 | 458.3 | 772.0 | 418.4 | 964.3 |
| CAPEX | (52.7) | (106.5) | (208.2) | (600.0) | (500.0) |
| Others | 1.7 | (122.9) | (936.7) | 104.0 | 104.0 |
| Cash flows from investing activities | (51.0) | (229.4) | (1,144.9) | (496.0) | (396.0) |
| Net borrowing | 173.1 | 36.2 | 361.3 | 100.0 | 100.0 |
| Proceeds from issue of shares | 1,965.8 | 0.0 | 0.0 | 0.0 | 0.0 |
| Dividends paid | 0.0 | (234.7) | (200.1) | (1,400.3) | (393.4) |
| Interest paid | (12.9) | (2.6) | (2.7) | (28.0) | (31.9) |
| Others | (285.7) | (202.6) | (288.9) | (3.2) | 0.0 |
| Cash flows from financing activities | 1,840.4 | (403.7) | (130.4) | (1,331.5) | (325.2) |
| Net (decrease)/increase in cash and cash equivalents | 2,102.4 | (174.8) | (503.3) | (1,409.1) | 243.1 |
| Cash and cash equivalents at beginning of year/period | 660.6 | 2,759.3 | 2,581.6 | 2,073.2 | 664.0 |
| Effect of foreign exchange rates, net | (3.8) | (2.9) | (5.1) | 0.0 | 0.0 |
| Cash and cash equivalents at end of year/period | 2,759.3 | 2,581.6 | 2,073.2 | 664.0 | 907.1 |

Source: Company annual reports (for historical figures only), ABCI Securities estimates

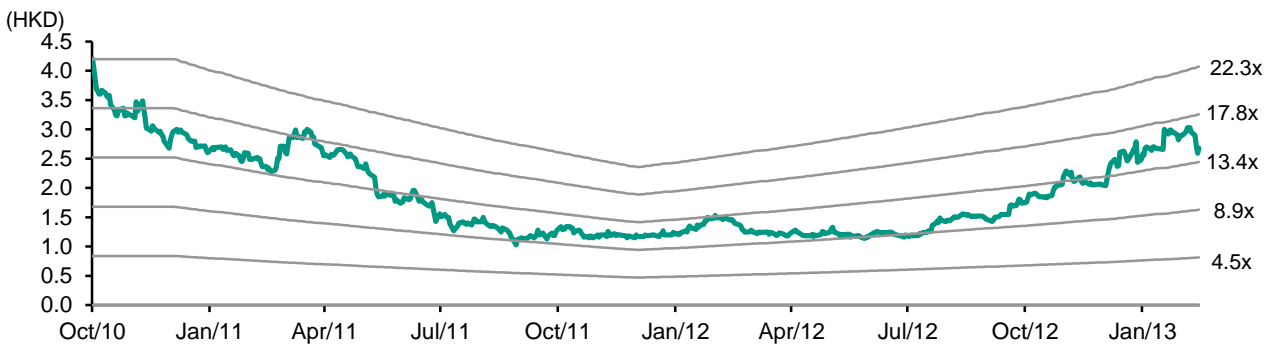


Exhibit: Financial forecasts vs Consensus (Rmb mn)

| | Our forecast | | Consensus | | Difference | |
|--------------|--------------|-------|-----------|-------|------------|---------|
| | FY13F | FY14F | FY13F | FY14F | FY13F | FY14F |
| Revenue | 4,419 | 5,423 | 4,467 | 5,647 | -1.07% | -3.97% |
| Gross Profit | 2,853 | 3,474 | 2,691 | 3,621 | 6.02% | -4.07% |
| Net profit | 866 | 1,045 | 948 | 1,168 | -8.58% | -10.50% |
| FD EPS (Rmb) | 1.375 | 1.659 | 1.549 | 1.924 | -11.21% | -13.75% |

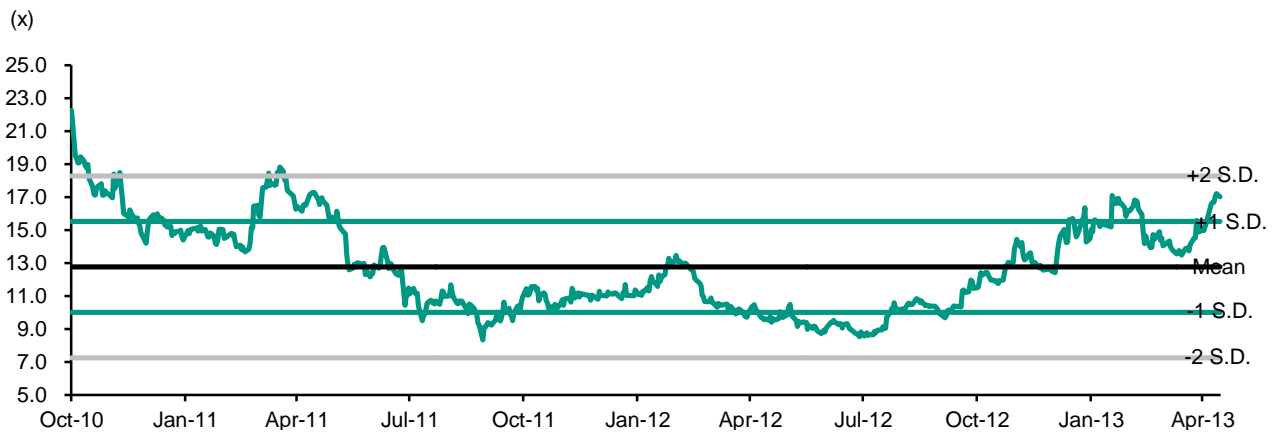
Source: Bloomberg; ABCI Securities estimates

Exhibit: Historical PE of the group



Source: Bloomberg, ABCI Securities

Exhibit: PE standard deviation of the group



Source: Bloomberg, 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

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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**Office address : ABCI Securities Company Limited, 13/F Fairmont House,
8 Cotton Tree Drive, Central, Hong Kong.**

Tel : (852) 2868 2183