



August 29, 2013  
Equity Focus  
Rating: BUY  
TP: HK\$ 3.03

Share price (HK\$) 2.55  
Est. share price return 18.8%  
Est. dividend yield 0.4%  
Est. total return 19.2%

Previous Rating & TP BUY; HK\$ 2.93  
Previous Report Date May 16, 2013

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**Key Data**

52Wk H/L(HK\$)	2.90/1.86
Issued shares (mn)	4,818.5
Market cap (HK\$ mn)	12,287.3
3-mth avg daily turnover (HK\$ mn)	19.7
Major shareholder(s) (%):	
China Mengniu Dairy	27.99
Yimu Holdings Co. Ltd	15.41
Xinmu Holdings Co. Ltd	14.81

Source(s): Company, Bloomberg, ABCI Securities

**FY13 Revenue breakdown (%)**

Sales of raw milk	93.0
Sales of processed milk	7.0

Source(s): Company, ABCI Securities

**Share performance (%)**

	Absolute	Relative*
1-mth	6.4	8.0
3-mth	(4.6)	(0.3)
6-mth	(3.8)	0.9

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

**1-Year stock performance (HK\$)**



Source(s): Bloomberg

## China Modern Dairy (CMD, 1117 HK)

More milk, more money. Maintain BUY.

- FY13 net profit dropped 16.0% to RMB 342mn due to unexpected revaluation loss. Excluding fair value change, net profit increased 38.0% YoY to RMB 380.6mn
- Milk yield per cow continue to rise and we expect cash EBITDA margin to expand in FY14E
- Increased cooperation with Mengniu will help secure sales growth, especially since Mengniu purchased an additional 27% stake in CMD back in May 2013
- Maintain BUY with TP at HK\$3.03, based on DCF model with a WACC of 7.9%. Our TP represents 23.9x FY14E P/E or 1.95x FY14E P/B

**Results missed estimates on revaluation loss.** China Modern Dairy reported FY13 revenue increased by 47.9% YoY to RMB 2,480.6mn, driven by higher sales volume and ASP. Raw milk sales increased 31.4% YoY to 567,021 tons while ASP increased 12.3% YoY to RMB 3.89/kg. However, CMD recorded a net revaluation loss of RMB 38.6mn for the first time (vs. a revaluation gain of RMB 131.5mn in FY12) due to adjustment of key assumptions including culling rate, milk yield, raw milk price, etc. As a result, net profit dropped 16.0% to RMB 342mn, missing the market estimate (RMB 425mn) by 25%.

**Margin is expected to rise as yield per cow increases.** To exclude the impact of revaluation change, investors should focus on cash EBITDA (i.e. EBITDA minus revaluation change). Cash EBITDA increased 53.3% YoY to RMB 677.8mn while the corresponding margin widened 0.9ppt to 27.3%. Management indicated the cash EBITDA margin would gradually rise to 30% as efficiency increased. As CMD has been able to transfer costs to customers (ASP increased 12.3% YoY while cost per ton of milk increased 9.7% YoY in FY13), we believe CMD's cash EBITDA margin will rise on the increasing milk yield per cow. Average milk yield per cow increased 1.7% YoY to 8.23tons in FY13, and CMD targets to reach 9.0tons by 2015.

**Increased cooperation with Mengniu to drive sales growth.** Sales to Mengniu accounted for 83.7% of total raw milk sales in FY13, lower than 97.8% in FY12. Since Mengniu bought an additional 27% stake in CMD back in May 2013, it is likely that cooperation of the two companies will increase and this may propel sales in CMD. Purchases from CMD accounted for 15%-16% of Mengniu's total raw milk purchase in 1H13 compared to 12% in 2012, and it is expected to increase to 18% in 2014. Apart from its own branded UHT milk launched in 2012, CMD and Mengniu are planning to establish a brand to produce pasteurized milk. This may become a new growth driver of CMD.

**Maintain BUY.** We estimate FY14E sales volume to grow by 28.7% YoY given the number of dairy cows will increase by 10% YoY and the proportion of milkable cows will also rise to 52% in FY14E from 48% in FY13. Based on our DCF model with a 7.9% WACC, we value the stock at HK\$3.03, representing 23.9x FY14E P/E or 1.95x FY14E P/B.

**Risk factors:** 1) Customer concentration risk; 2) Diseased cow; 3) Related party transactions.

**Results and Valuation**

FY ended June 30	2011A	2012A	2013A	2014E	2015E
Revenue (RMB mn)	1,113	1,678	2,481	3,508	4,600
Chg (% YoY)	88.8	50.7	47.9	41.4	31.1
Cash EBITDA (RMB mn)	315	442	678	963	1,318
Chg (% YoY)	160.7	40.4	53.3	42.1	36.8
Net Income (RMB mn)	225	398	324	493	732
EPS (RMB)	0.052	0.082	0.067	0.100	0.149
Chg (% YoY)	102.8	59.6	-18.9	50.2	48.4
BVPS (RMB)	0.973	1.056	1.051	1.224	1.368
Chg (% YoY)	224.9	8.5	-0.4	16.5	11.7
P/E (x)	-	-	30.2	20.1	13.5
P/B (x)	-	-	1.91	1.64	1.47
ROE (%)	7.36	8.19	6.39	9.00	11.72
ROA (%)	4.04	5.12	3.27	4.17	5.53
DPS(RMB)	0.00	0.00	0.00	0.008	0.012
Yield (%)	0.00	0.00	0.00	0.41	0.60
Net gearing*(%)	10.6	40.4	70.8	71.7	73.1

\* Net gearing=Net debt/Total equity;

Source(s): Bloomberg, ABCI estimates



**Consolidated income statement (2011A-2015E)**

FY Ended June 30 (RMB mn)	2011A	2012A	2013A	2014E	2015E
Revenue	1,113.4	1,677.6	2,480.6	3,508.0	4,599.7
Cost of sales	(730.3)	(1,148.7)	(1,655.8)	(2,248.1)	(2,866.2)
<b>Gross profit</b>	<b>383.0</b>	<b>528.9</b>	<b>824.8</b>	<b>1,259.9</b>	<b>1,733.4</b>
Gain arising from changes in fair value	55.5	131.5	(38.6)	(50.0)	(50.0)
Other income	101.9	116.6	106.3	100.0	100.0
Employee benefits expense	(89.6)	(128.0)	(170.8)	(249.1)	(322.0)
Depreciation	(67.3)	(94.8)	(135.5)	(162.0)	(189.5)
Share of profit of an associate	0.0	2.0	3.4		
Net foreign exchange loss	(17.4)	(4.3)	9.1		
Other gains and losses	(1.2)	(1.1)	(2.4)		
Other expenses	(61.9)	(72.0)	(92.6)	(147.3)	(193.2)
<b>EBIT</b>	<b>303.0</b>	<b>478.8</b>	<b>503.7</b>	<b>751.5</b>	<b>1,078.8</b>
Finance costs	(59.1)	(71.3)	(153.7)	(219.0)	(254.0)
<b>EBT</b>	<b>243.9</b>	<b>407.5</b>	<b>350.0</b>	<b>532.5</b>	<b>824.8</b>
Tax	(0.0)	(0.1)	(8.1)	(26.6)	(74.2)
MI	(19.3)	(8.8)	(18.2)	(12.6)	(18.8)
<b>Net profit to owners of company</b>	<b>224.6</b>	<b>398.5</b>	<b>323.8</b>	<b>493.2</b>	<b>731.8</b>
<b>EBITDA</b>	370.4	573.6	639.2	913.5	1,268.3
<b>Cash EBITDA</b>	314.8	442.1	677.8	963.5	1,318.3
Dividends	0.0	0.0	0.0	39.5	58.5
No. of issued shares at end of period (mn)	4,800.0	4,800.0	4,800.0	4,812.3	4,812.3
Issuable shares (mn)					
Share options (mn)	-	87.4	104.1	104.1	104.1
Total issued & issuable shares (mn)	<b>4,800.0</b>	<b>4,887.4</b>	<b>4,922.7</b>	<b>4,922.7</b>	<b>4,922.7</b>
<b>Per share value (Rmb)</b>					
<b>FD EPS</b>	0.052	0.082	0.067	0.100	0.149
<b>NBV</b>	0.973	1.056	1.051	1.224	1.368
<b>DPS</b>	-	0.000	0.000	0.0082	0.0122

Source(s): Company, ABCI Securities estimates

**Key Ratio (2011A-2015E)**

FY ended June 30	2011A	2012A	2013A	2014E	2015E
<b>Profitability ratio (%)</b>					
Gross profit margin	34.4	31.5	33.2	35.9	37.7
EBITDA margin	33.3	34.2	25.8	26.0	27.6
Cash EBITDA margin	28.3	26.4	27.3	27.5	28.7
EBIT margin	27.2	28.5	20.3	21.4	23.5
EBT margin	21.9	24.3	14.1	15.2	17.9
Net profit margin	21.9	24.3	13.8	14.4	16.3
ROAA	4.0	5.1	3.3	4.4	5.5
ROAE	7.4	8.2	6.4	8.6	11.7
<b>Cost ratio (%)</b>					
Employee benefits expense/ Sales	-8.1	-7.6	-6.9	-7.1	-7.0
Other expenses/ Sales	-5.6	-4.3	-3.7	-4.2	-4.2
Effective tax rate	0.0	0.0	-2.3	-5.0	-9.0
<b>Leverage (x)</b>					
Current ratio	2.10	0.73	0.46	0.57	0.61
Quick ratio	1.83	0.56	0.36	0.45	0.47
Net debt/total equity (%)	10.6	40.4	70.8	71.7	73.1
<b>Working capital cycle (days)</b>					
Inventory turnover days	51.9	43.6	66.8	45.0	45.0
Receivables turnover days	35.0	34.6	39.6	35.0	35.0
Payables turnover days	123.0	119.2	221.8	120.0	120.0

Source(s): Company, ABCI Securities estimates



**Consolidated balance sheet (2011A-2015E)**

<b>As of June 30 (RMB mn)</b>	<b>2011A</b>	<b>2012A</b>	<b>2013A</b>	<b>2014E</b>	<b>2015E</b>
PPE	2,221.3	2,964.6	3,772.3	4,948.3	5,569.2
Others	3,025.9	4,588.2	5,869.1	5,545.0	6,059.1
<b>Non-current assets</b>	<b>5,247.2</b>	<b>7,552.8</b>	<b>9,641.4</b>	<b>10,493.2</b>	<b>11,628.3</b>
Inventories	212.7	263.9	342.1	413.1	521.5
Trade and other receivables	136.8	181.0	357.7	378.6	503.5
Land use rights	1.4	1.7	1.7	1.7	1.7
Pledged bank balances	287.1	134.2	442.7	442.7	442.7
Bank balances and cash	1,021.7	518.3	378.0	768.6	865.2
<b>Current assets</b>	<b>1,659.7</b>	<b>1,099.1</b>	<b>1,522.3</b>	<b>2,004.7</b>	<b>2,334.7</b>
Trade and other payables	482.8	821.2	1,190.8	1,219.2	1,273.1
ST loans	303.8	664.2	1,331.0	1,532.7	1,777.7
ST debenture	0.0	0.0	700.0	700.0	700.0
Others	4.9	15.7	77.7	77.7	77.7
<b>Current liabilities</b>	<b>791.6</b>	<b>1,501.1</b>	<b>3,299.4</b>	<b>3,529.5</b>	<b>3,828.4</b>
LT loans	1,219.1	1,926.6	2,248.1	2,846.4	3,301.4
Others	173.5	91.4	107.5	107.5	107.5
<b>Non-current liabilities</b>	<b>1,392.7</b>	<b>2,018.0</b>	<b>2,355.5</b>	<b>2,953.8</b>	<b>3,408.8</b>
<b>Total assets</b>	<b>6,906.9</b>	<b>8,651.8</b>	<b>11,163.7</b>	<b>12,497.9</b>	<b>13,963.0</b>
<b>Net assets</b>	<b>4,722.7</b>	<b>5,132.7</b>	<b>5,508.7</b>	<b>6,014.6</b>	<b>6,725.8</b>
Share capital	413.1	413.1	414.6	414.6	414.6
Reserves	4,254.9	4,653.4	4,992.2	5,485.5	6,177.8
MI	54.7	66.2	101.9	114.6	133.4
Total Equity	<b>4,722.7</b>	<b>5,132.7</b>	<b>5,508.7</b>	<b>6,014.6</b>	<b>6,725.7</b>
<b>Equity attributable to owners</b>	<b>4,668.0</b>	<b>5,066.5</b>	<b>5,066.5</b>	<b>5,900.0</b>	<b>6,592.4</b>

Source(s): Company, ABCI Securities estimates

**Consolidated cash flow statement (2011A-2015E)**

<b>FY ended June 30 (RMB mn)</b>	<b>2011A</b>	<b>2012A</b>	<b>2013E</b>	<b>2014E</b>	<b>2015E</b>
<b>EBITDA</b>	<b>370.4</b>	<b>573.6</b>	<b>639.2</b>	<b>913.5</b>	<b>1,268.3</b>
Change in working capital	10.1	121.2	(198.4)	(63.5)	(179.4)
Others	(69.6)	(152.2)	52.9	162.0	189.5
<b>Cash (used in)/generated from operations</b>	<b>310.8</b>	<b>542.5</b>	<b>493.7</b>	<b>1,012.0</b>	<b>1,278.4</b>
Interest paid	0.0	1.0	2.0	3.0	4.0
Income tax paid	(0.0)	(0.1)	(8.1)	(26.6)	(74.2)
<b>CF from operating activities</b>	<b>0.0</b>	<b>(1.0)</b>	<b>6.1</b>	<b>(3.0)</b>	<b>(4.0)</b>
CAPEX	<b>310.8</b>	<b>542.4</b>	<b>493.7</b>	<b>985.4</b>	<b>1,204.1</b>
Others	(1,498.4)	(2,251.7)	(1,537.1)	(1,175.8)	(1,514.1)
<b>Cash flows from investing activities</b>	<b>(471.7)</b>	<b>(277.6)</b>	<b>(493.7)</b>	<b>(985.4)</b>	<b>(1,204.1)</b>
Net borrowing	(1,659.3)	(1,986.9)	(1,537.1)	(1,175.8)	(1,514.1)
Proceeds from issue of shares	297.8	1,067.9	1,000.0	800.0	700.0
Dividends paid	2,810.3	0.0	0.0	0.0	0.0
Interest paid	0.0	0.0	0.0	0.0	(39.5)
Others	(85.7)	(128.1)	(100.5)	(219.0)	(254.0)
<b>Cash flows from financing activities</b>	<b>(903.1)</b>	<b>1.3</b>	<b>3.6</b>	<b>0.0</b>	<b>0.0</b>
Net (decrease)/increase in cash and cash equivalents	<b>2,119.3</b>	<b>941.1</b>	<b>903.1</b>	<b>581.0</b>	<b>406.6</b>
Cash and cash equivalents at beginning of year/period	770.7	(503.4)	(140.3)	390.6	96.6
<b>Cash and cash equivalents at end of year/period</b>	<b>251.0</b>	<b>1,021.7</b>	<b>518.3</b>	<b>378.0</b>	<b>768.6</b>

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 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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