



Company Rating:
Buy

Target price: HK\$32.0

Key Data

Share price (HK\$)	26.85
Upside potential (%)	19.2
52Wk H/L(HK\$)	29.3 / 19.8
Issued shares (mn)	1,768
Market cap (HK\$m)	48,691
30-day avg vol (HK\$m)	152.8
Auditors	Ernst & Young
Major shareholder (%):	
COFCO	27.8
Arla Foods	5.9

Source: Bloomberg, ABCI Securities

Revenue composition in FY12 (%)

Liquid milk products	89.6
Ice cream products	8.8
Other dairy products	1.6

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	(0.7)	9.9
3-mth	25.8	31.7
6-mth	24.0	32.2

*Relative to Hang Seng Index

Source: Bloomberg

1 year share price performance



Source: Bloomberg

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China Mengniu (2319 HK)

Mengniu acquiring Yashili

We participated in the teleconference held by Mengniu and Yashili. It was announced that Mengniu will launch a general offer to acquire all of the outstanding shares of Yashili. Shareholders of Yashili who are accepting the share offer will have a choice of either: i) cash offer for HK\$3.5/share ii) cash and share offer for HK\$2.82/share and 0.681 of share of a SPV set up by Mengniu to hold Yashili shares. As part of this offer, Yashili's controlling shareholders, Zhang International Investment Ltd. and CA Dairy Holdings, (who together hold 75.3% of Yashili shares) have irrevocably undertaken to accept the cash and share offer and cash offer respectively. The SPV shareholders will have a 3-year of lock up period.

Raising funds externally. Total consideration of the offer amounts to HK\$10,752-11,398mn, depending on shareholder's choice of offer. The acquisition will be financed through external resources, for which the management has not yet announced any details. However, in our view, we believe it is likely that Mengniu will finance the deal through debt instead of equity because i) we believe COFCO, as the largest single shareholder of Mengniu (which holds 27.8% of Mengniu's share), will not want to dilute Mengniu's shares in the short term after transferring 8.3% of Mengniu's shares to Danone to set up a yoghurt JV in China in May this year; ii) With COFCO as its largest shareholder, we believe Mengniu will get a favorable lending rate. For instance, COFCO-subsiary CPMC's cost of loans is around 1-3%p.a. In such a low interest rate environment, we believe Mengniu would prefer loans rather than issuance of new shares. However, after acquiring China Modern Dairy with cash of ~HK\$3,100mn, and if the deal will be financed totally by debt, Mengniu will turn from net cash to net debt situation. We estimate net debt will amount to Rmb6,453mn after acquisition and net debt/equity is estimated to be 40% (vs Yili:7.7%).

Impact of acquisition on Mengniu. According to AC Nielsen, Yashili accounted for 6.3% and 7.7% of the formula milk market share in China in 2012 in terms of sales value and volume respectively. Yili, the major competitor of Mengniu, produced 10.7% of sales from milk powder business and the strong growth of its milk powder business was the major reason why Yili's revenue exceeded that of Mengniu since 2010. We believe the move in acquiring Yashili can enlarge Mengniu's product portfolio as well as strengthen its market leader position in the dairy market. Concern is whether the acquisition will have conflict with Mengniu's cooperation with Arla's Foods which Mengniu will sell its formula milk products through Arla's brand. In addition, Yashili may face increasing market competition as it is a domestic brand and sells 85% of its products in tier 2 and 3 cities which foreign brands have not yet penetrated through.

Valuation. Assuming all shareholders (except Zhang Int') opt for the cash offer (in which Mengniu will hold 90% of Yashili), and assuming 3% of financing costs on a debt of Rmb11.4bn, we estimate EPS contribution from Yashili to Mengniu will amount to Rmb0.054 in 2013 (only incorporating Sep to Dec of Yashili's profit into Mengniu) and Rmb0.228 in 2014. In turn, we estimate that after the transaction, Mengniu's EPS will increase by 5.4% to Rmb1.078 in 2013 and 19.2% to Rmb1.414 in 2014. Based on 20x 2013PE of Yashili's contribution and 25x 2013 PE of Mengniu's existing business, Mengniu valuation will be HK\$33.2 as compared to our TP at HK\$32.0. We will review our target price once the detailed plan of acquisition is announced.



Disclosures

Analyst Certification

I, Lee Oi-yee, Lisa, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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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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