Sep 1, 2014
Company Report
Rating: Hold
TP: HK$ 40.8

Share price (HK$)	35.9
Est. share price return	13.65%
Est. dividend yield	0.78%
Est. total return	14.43%

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

Analyst: Paul Pan
Tel: (852) 2147 8829
Email: paulpan@abci.com.hk

Key Data

52Wk H/L(HK$)	43.8/31.1
Issued shares (mn)	1,958.38
Market cap (HK$ mn)	70,305.83
3-mth avg daily turnover (HK$ mn)	210.64
Major shareholder(s) (%):	
COFCO Dairy Investments Ltd.,	23.94
Prominent Achiever Ltd.,	7.56

Source(s): Company, Bloomberg, ABCI Securities

Key data

Segment revenue contribution (%)	2013	1H14
- Liquid milk	87.4	84.2
- Ice cream	7.0	7.7
- Milk formula	5.0	7.5
- Other dairy products	0.6	0.6

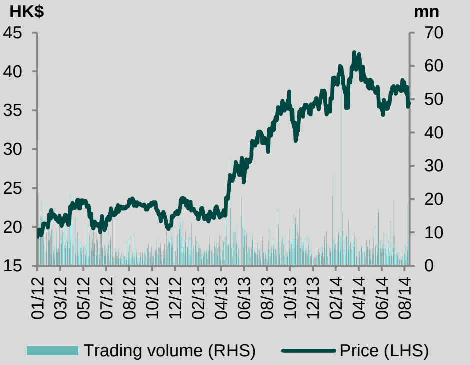
Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	(5.8)	(6.6)
3-mth	(4.8)	(10.4)
6-mth	(10.1)	(18.3)

*Relative to HSI
Source(s): Bloomberg, ABCI Securities

Stock performance



Source(s): Bloomberg, ABCI Securities

Mengniu (2319 HK)

Limited synergy in near term while industry overhangs remain; reinitiate with HOLD

Mengniu is one of the leading dairy product manufacturers in China with a wide product portfolio and a successful liquid milk business. In recent years, Mengniu has been actively seeking for new growth drivers externally by acquiring Yashili and forming strategic partnerships with well-established foreign dairy brands - Arla Foods, Danone, and WhiteWave. Internally, Mengniu also changes and diversifies its product mix to cover a wider range of dairy products. The latest 1H14 results demonstrate Mengniu's ability to adjust product mix and increase sales volume by strengthening its promotional efforts. Despite its success in brand building, we do not see any significant new growth drivers in the near term. We maintain a conservative stance on Mengniu's near-term prospects and resume our coverage with a **HOLD** rating. Our TP of HK$40.8 represents 32x FY14 P/E and 23.7x FY15 P/E.

Industry competition and upstream cost pressure do not pose major threats to Mengniu. In 1H14, the Chinese dairy market faced an intense competition resulting from high inventory level in the distribution channels. In addition, raw milk price has been trending up despite recent deceleration. The competitive environment drove up Mengniu's inventory turnover days and selling & distribution expenses substantially, but the Group's revenue still managed to grow. In addition, the Group's ability to pass on increasing costs to consumers enables its margins to increase during the same period. We believe that the Group would be able to sustain its growth momentum while maintaining decent margins.

Diversified product portfolio with emphasis on liquid milk segment. Although Mengniu's current product portfolio covers almost all dairy product categories, its business still relies heavily on the liquid milk segment, especially the UHT milk sub-segment. We believe Mengniu will diversify away from the UHT milk with the incorporation of Yashili and through expanding its yogurt and milk beverage business. The adjustment process, however, will be gradual.

Strategic partnerships to drive growth. Mengniu's strategic partnership with Danone is on track. Healthy revenue growth in the yogurt product segment indicates that this partnership would propel further growth in its yogurt business. However, Yashili's lackluster performance may hamper Mengniu's milk formula business. We expect synergies between Mengniu and Yashili to gradually occur in longer term. Finally, even though the plant-based protein drinks presents exciting growth opportunities, we expect the partnership between Mengniu and WhiteWave would generate limited revenue.

Recommend HOLD with TP at HK$ 40.8. We target the valuation at 32x FY14E P/E based on the fact that Mengniu has been trading at the high-end of its valuation range. Although the 1H14 results mostly surprised on the upside, with uncertainties clouding over upstream raw milk supply and the changes in the downstream market dynamics, we adopt a conservative view on the Group's near-term prospects and resume our coverage with a **HOLD** rating.

Risk factors: 1) Product portfolio bias; 2) Fluctuating raw milk costs; 3) Food safety issues; 4) Regulatory policies may increase costs; 5) Business partnership execution risk.

Results and Valuation

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Revenue (RMB mn)	**36,000**	**43,357**	**52,742**	**62,571**	**72,144**
Chg (%,YoY)		20.44	21.65	18.64	15.30
Net Income (RMB mn)	**1,303**	**1,631**	**1,981**	**2,678**	**3,442**
Chg (%,YoY)		25.16	21.49	35.15	28.55
Basic EPS (RMB)	**0.74**	**0.89**	**1.01**	**1.37**	**1.76**
P/E (x)	23.95	32.60	28.19	20.90	16.34
BVPS (RMB)	7.06	8.37	9.71	12.06	14.99
P/B (x)	2.50	3.46	2.94	2.37	1.92
DPS(RMB)	0.16	0.20	0.22	0.30	0.39
Yield (%)	0.93	0.69	0.78	1.05	1.35
ROAE (%)	10.88	11.71	11.53	12.56	12.99
Net gearing (%)*	net cash	11.39	0.91	net cash	net cash

Source(s): Bloomberg, ABCI Securities estimates

Table of content

Mengniu (2319 HK)

A leading dairy product manufacturer

China Mengniu Dairy Company Limited (Mengniu) is one of the leading dairy product manufacturers in China. Established in 1999, Mengniu manufactures, markets, distributes, and sells UHT milk, milk beverage, yogurt, ice cream, milk formula, and dairy snacks throughout China. Over the years, Mengniu has developed a number of well-recognized brands such as Milk Deluxe, Yoyi C, and Champion yogurt. Currently, Mengniu is one of the top dairy brands in China.

Mengniu has been undergoing major transformations in the past few years. One of the most milestones in Mengniu's history is the investment from China Oil and Food Corporation (COFCO) in 2009, who later on increased its stakes in the Group after the initial investment and deepened its involvement in the Group's management. Mengniu's current CEO, Ms. Sun Yiping, was appointed by COFCO in 2012 and has been since expanding the Mengniu dairy empire ever since. We believe Mengniu's M&A deals and partnerships with well-known international brands revealed the Group's ambition to become a leading dairy manufacturer in China.

Product portfolio

Overview of product development

As the market leader, Mengniu categorized its products into different segments from early on. The adoption of product segment classification enables Mengniu to analyze its target consumer groups, develop different products accordingly and formulate market strategies to compete with peers.

Exhibit 1 : Mengniu's brand and product portfolio

	Liquid milk					Revenue contribution (%)			
	UHT milk	Milk beverage	Yogurt/ Probiotic beverage	Fresh milk	Ice cream	1H14	1H13	2013	2012
Star Brands	Milk Deluxe; Future Star Kid Milk	Fruit milk drink	Champion; Yoyi C			35.3	34.3	34.9	30.5
Backbone Brands	Mengniu	Suansuan Ru				41.9	43.7	44.0	49.2
Profit contributor brands	Xin Yang Dao				Mood for Green	8.7	10.5	8.3	10.2
Opportunity brands	Awakening Youth Milk; Arla Foods; Just Yogurt	Latte		Mengniu Modern Ranch	Deluxe	4.7	3.5	3.1	1.5

Source(s): Company, ABCI Securities

There are 4 major brand categories in Mengniu's product portfolio: (1) Star Brands, (2) Backbone Brands, (3) Profit contributor brands and (4) Opportunity brands. The Group gained the most success with its liquid milk business, which has the highest number of Star Brand products, such as Yoyi C, Milk Deluxe and Fruit Milk Drink. Recent changes in the revenue mix from the 4 brand categories suggest that Mengniu's future strategy is to focus on brands with high-growth potentials and lucrative margins. Therefore, we expect Mengniu would continue to strengthen its products under the Star Brand in the near future.

Liquid milk segment remains the major contributor

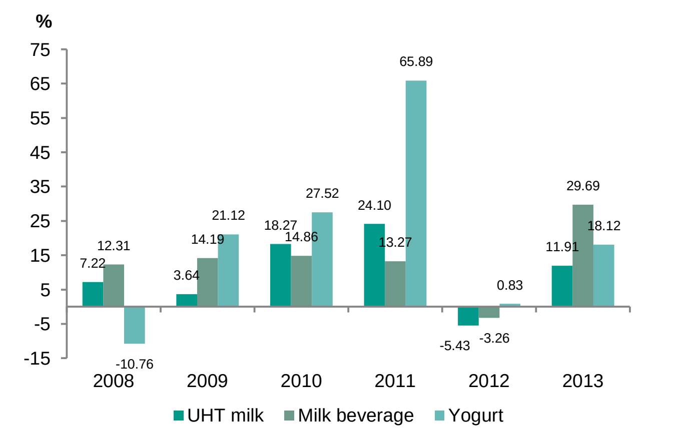
Mengniu's liquid milk contribution to total revenue in 1H14 declined to 84.2% vs. 88.3% in 1H13, mainly because revenue contribution from the Group's other products segment increased and changes in the product portfolio composition. Hence, we expect that revenue share of the liquid milk segment will decline to around 83% in the next 3 years. In addition we believe that the 3 product categories (UHT milk, Milk beverage, Yogurt/ Probiotic beverage) in the liquid milk segment present varying growth opportunities.

In terms of UHT milk, we expect that Mengniu's would strategize to strengthen its Star Brands category, which include the Milk Deluxe, and Future Star Kid's Milk. These brands would help deliver higher margins. Factoring in Mengniu's product portfolio strategy, we expect revenue contributions from the UHT milk products would be 48.7%, 48.4%, 47.9% for 2014E -16E, respectively.

For the milk beverage segment, Mengniu has been targeting the younger demographics. Therefore, success of this segment would lie in swift product development, cultivation of new product brands, as well as successful branding for new products to attract the targeted consumers. It is possible that some existing products in the milk beverage category would migrate to the Star Brands in the future. We project that revenue contribution from the milk beverage segment would be relatively stable at ~22.4% in the next 3 years.

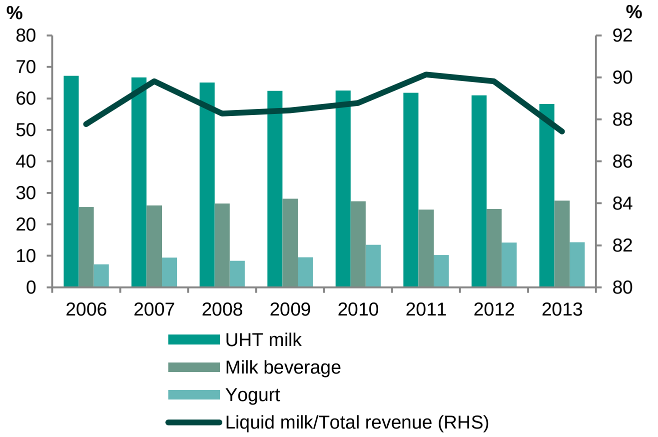
Mengniu's yogurt business could be a new growth driver. It has recently launched its new product line, Just Yogurt, which caters to the demand for UHT yogurt drink. Mengniu's partnership with Danone will also enhance the former's product quality and brand equity of the yoghurt segment. Since consumers are more sophisticated in their choices of dairy products and would prefer yogurt drinks offering more health benefits, Mengniu's yogurt sales will be supported. We expect that revenue contribution from Mengniu's yogurt products will rise going forward (2014E: 12.6%; 2015E: 12.8%; 2016E: 12.9%).

Exhibit 2: Sub-segment growth of Mengniu's liquid milk business



Source(s): Company, ABCI Securities

Exhibit 3: Revenue composition of liquid milk segment



Source(s): Company, ABCI Securities

Milk formula segment

In 1H14, Mengniu's milk formula product segment revenue grew 390.7% YoY and accounted for 7.5% of the Group's total revenue. The revenue and contribution increase was mainly due to the incorporation of Yashili's results. Milk formula business in Mengniu and Yashili in fact witnessed varying degrees of decline, signaling that Mengniu's now expanded milk formula business will take longer to improve. Given the inherent weakness in Mengniu's milk formula business, we expect revenue contribution from this segment to remain at ~8% for the next 3 years.

Ice cream product segment

Revenue from Mengniu's ice cream products was up only by 1.7% YoY, contributing 7.7% to total revenue in 1H14 vs. 9.46% in 1H13. In our view, performance of its ice cream segment would not improve significantly in 2014 as no major changes have been observed in the brand portfolio management. We project that the average revenue contribution from the ice cream segment to be ~ 7.7% for the next 3 years.

Other dairy products segment

The segment has registered substantial growth of 161.4% YoY for 1H14, but its contribution to the Group's revenue is still minimal at 0.58% for the period. We believe sales growth in other dairy products, which mainly include cheese and dairy snacks, will be slow. Cheese, which is still a novelty product for the Chinese consumers, has gained more popularity only recently in certain first-tier cities. Due to the short development history and immature production technique among the domestic manufacturers, the cheese market is still mostly dominated by foreign brands. In our view, the perceived higher quality of foreign brands and the low penetration of the product in the Chinese market makes growth prospect of this segment limited in the near term. Hence, we expect the segment's revenue contribution to be ~0.6% for the next 3 years.

Domestic competitive landscape

Market overview

The Chinese dairy market expanded rapidly from 2007-13 at a CAGR of 13.1%. According to Frost & Sullivan, the annual sales of the Chinese dairy market will continue to grow in a fast pace. China's dairy market, however, is still dominated by liquid milk, which includes UHT milk, pasteurized milk, and yogurt. A number of factors are propelling growth in the Chinese dairy market, with urbanization, consumers' demand for dairy products, increased health consciousness, and improved logistics being some of the major ones,

Exhibit 4: China's dairy market sales

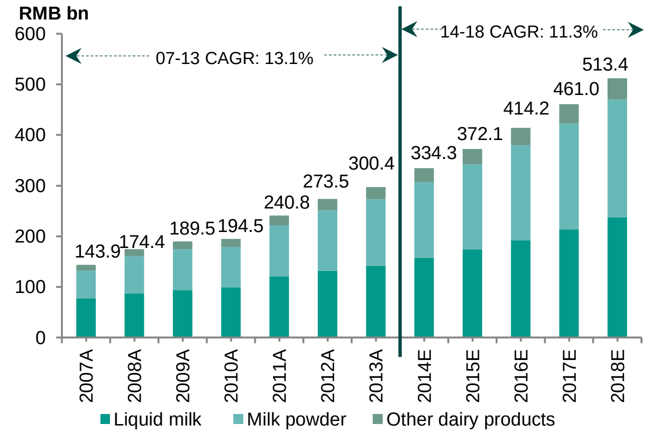


Exhibit 5: China's liquid milk sales breakdown

Note: 1) Liquid milk includes UHT milk, pasteurized milk, yogurt; 2) Milk powder includes consumer milk powder products and industrial milk powder products; 3) Other dairy products include chees, cream, condensed milk, lactose, etc.
Source(s): Frost & Sullivan, ABCI Securities estimates

Intensifying competition and market segmentation

Although the market size is expanding, competition has intensified in the dairy product market in recent years, as signaled by frequent introduction of new products, sales promotion events, and higher emphasis on product and brand packaging. Stiffening competition in the Chinese dairy market, which we believe will persist in the long run, may seem to be the result of increasing number of industry players. We believe, however, consumers' changing preferences for dairy products is the underlying cause of the heightening competition, which in turn will bring about further market segmentation in the dairy product market.

We believe that industry players in the Chinese dairy market can be divided into 3 tiers based on their sizes. The 1st tier refers to the national players, namely, Mengniu, Yili, and Bright Dairy. The 2nd tier includes regional players, such as Beijing Sanyuan Dairy, Royal Dairy, and Yantang Dairy. The 3rd tier players focus almost solely on the local markets and post no immediate threat to players in the first two tiers.

Mengniu still maintained its dominant position in 1H14 despite the tough market conditions. Its market shares in the liquid milk product category, UHT milk product category, and chilled milk product category reached 25.2%, 27.6 % and 18.5%, respectively. We believe that Mengniu's leading market position would enable it to achieve economies of scale, product diversification, and better pricing power. Based on these assumptions, we expect that Mengniu's total sales will grow at 21.6% YoY, 18.6% YoY, and 15.3% YoY in 2014E -16E.

Exhibit 6: Classification of market competition

Company	Year established	Market coverage	Product offering	General description
First tier – national players				
Mengniu	1999	National coverage	UHT milk, milk beverage, yogurt, ice cream, milk formula, other dairy products	A national player with a wide product portfolio that ncludes some of the well-known brands such as Deluxe, Champion and Yoyi C. It has conducted a series business deals to consolidate its upstream raw milk supply and strengthen its product offerings in milk formula, yogurt, and other dairy products
Yilli	1993	National coverage	UHT milk, milk beverage, yogurt, ice cream, milk formula	A national player whose product portfolio is very similar to Mengniu's, but with a much bigger market share in the milk formula business and also has its own raw milk production which contributes to part of its revenue
Bright Dairy	1996	Eastern, central, northern, southern regions of China	UHT milk, milk beverage , yogurt, pasteurized milk, milk formula, cheese, fruit juice	A national player with a smaller geographical presence than Yili and Mengniu; the first to introduce UHT yogurt drink Momchilovtsi to the market; the first national player to overcome geographical barriers to sell pasteurized milk in places other than Shanghai where its headquarter is located
Second tier – regional players				
Beijing Sanyuan Food	1997	Beijing, Tianjin, Hebei, eastern and southern regions of China	UHT milk, milk beverage, yogurt pasteurized milk, milk formula, cheese	A regional player with a long history in Beijing; it also owns a fast food restaurant chain business
Guangxi Royal Dairy	2001	Guangxi, Yunnan, other major cities	UHT milk, pasteurized milk, yogurt, citrus milk	A regional player whose market is mostly concentrated in Guangxi, and whose signature products are made of buffalo milk
Yantang Dairy	2002	Guangdong, Hunan Fujian, Jiangxi, Guangxi, Hainan	UHT milk, pasteurized milk, yogurt	An established player who is based in Guangzhou and has recently filed for IPO
Third tier – local players				
Mostly small players that only have influences on local markets; these players do not present substantial threat to the first and second tier players				

Source(s): Bloomberg, Companies, IPO prospectus of Yantang Dairy, ABCI Securities

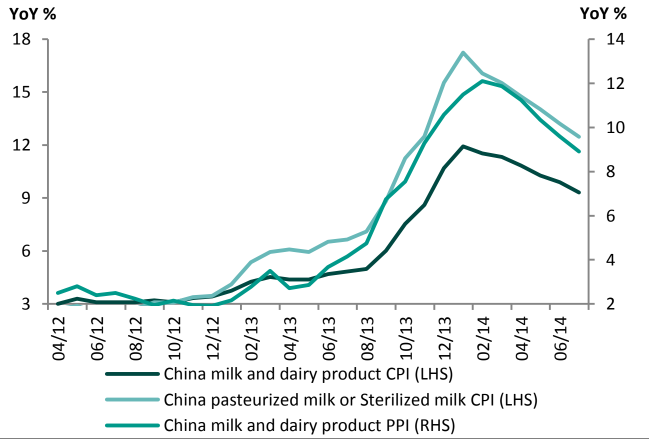
Disequilibrium in demand and supply will subside in 2H14

Statistical evidences suggest disequilibrium in the dairy product market in 1H14. The tapering CPI of milk and dairy products in China suggests the occurrence of price wars, while the decline in milk and dairy production volume indicates overstocking in the distribution channels.

Our on-site visits to various retail outlets confirmed these statistics. Competition is fierce in the dairy milk market. Major domestic brands were offering deals mainly in the form of giveaways and discounts in order to increase inventory turnover rate. However, we also notice that the overstocking issue has been somewhat alleviated, and expect the market situation will improve gradually in 2H14.

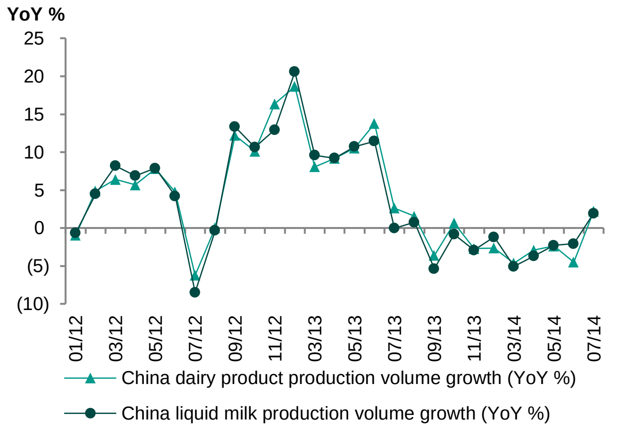
Although market competition intensified in 1H14, Mengniu's profitability was unscathed as its GPM and NPM improved. We believe this is attributable to its aggressive sales promotion and continuous efforts to adjust its product mix in 1H14. Selling and distribution costs, as a result, went up by 22.8% YoY. Even though we believe that the inventory level in distribution channel is decreasing, market competition will remain stiff going forward. Therefore, we expect its S&D expenses-to-sales ratio will be at ~20.3% for 2014E-16E.

Exhibit 7: China's milk and dairy product CPI and PPI



Source(s): Bloomberg, ABCI Securities

Exhibit 8: China milk and dairy production volume growth



Source(s): Ministry of Commerce, ABCI Securities

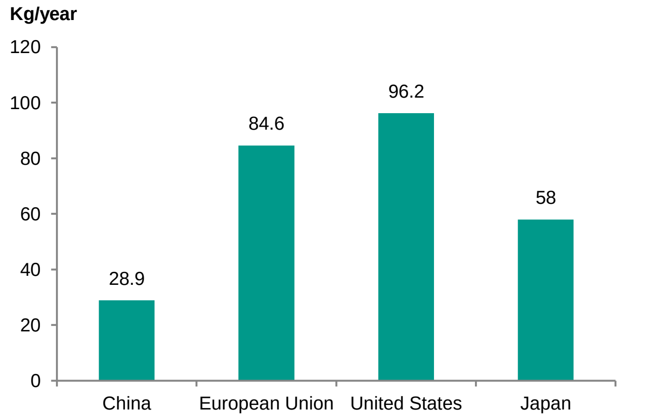
Exhibit 9: Discounts and giveaways are common for dairy products in retails

Source(s): ABCI Securities

Cost pressure remains but not a concern for Mengniu

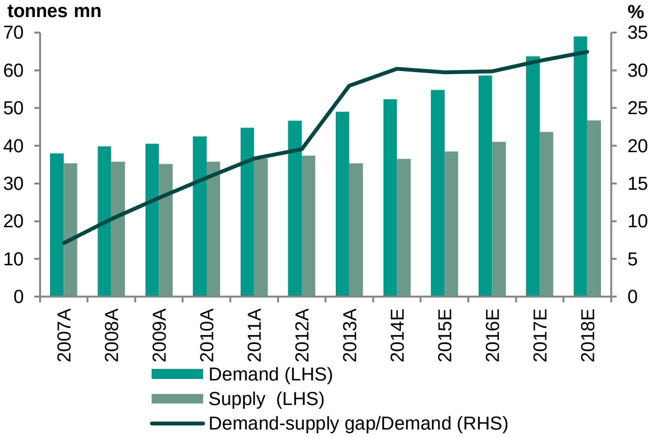
Contrary to the rapid increase in dairy product demand, the growth in supply will be much slower. The large reduction of dairy cows in previous years, slow recovery pace in the number of dairy cows, and lagging expansion of dairy farms have strained the supply of dairy cows. Seeking dairy cow imports in international market is possible, but the stringent import and quarantine policies, as well as supply constraint in the international market, reduce the dairy cow growth through this channel. Therefore, we believe that the growth in raw milk demand will outpace the growth in supply in the medium term.

Exhibit 10: Per capita dairy product consumption



Source(s): Frost & Sullivan, Shengmu IPO prospectus ABCI Securities

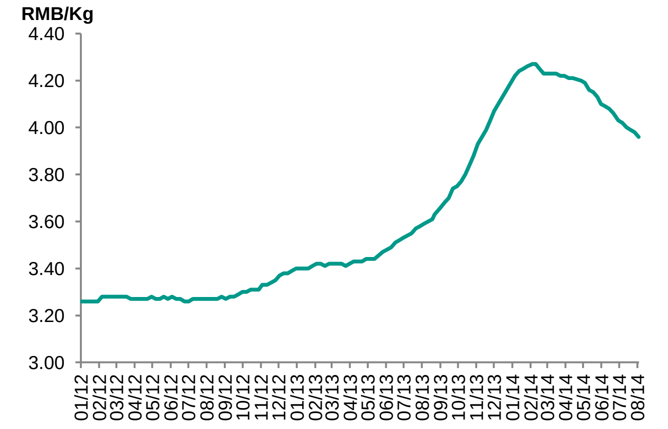
Exhibit 11: Raw milk demand-supply divergence is expected to widen



Note: Frost & Sullivan, Huishan IPO prospectus, Shengmu IPO prospectus, ABCI Securities

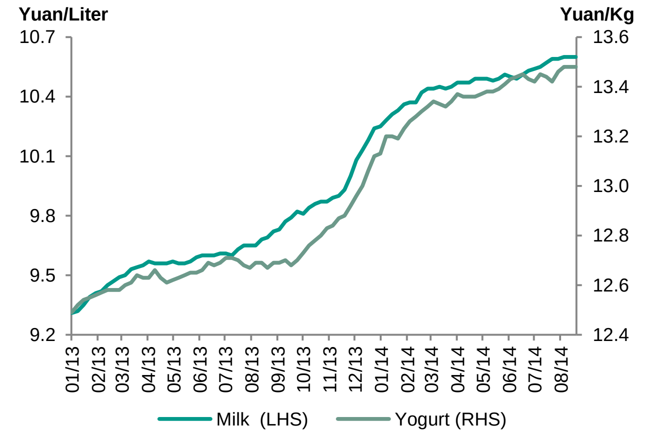
The raw milk price hike that lasted from Apr 2013 to Feb 2014 foretells that raw milk price hike may persist in the future based on the demand and supply dynamic in China. We believe that rising raw milk costs will pose more pressure to dairy companies focusing more on the downstream business.

Exhibit 12: Raw milk price in major production area



Source(s): Wind, Ministry of Agriculture, ABCI Securities

Exhibit 13: Milk and yogurt retail prices indicate dairy manufacturers' ability to pass on costs to consumers



Source(s): Wind, Ministry of Commerce, ABCI Securities

Although Mengniu is a downstream dairy product manufacturer, its1H14 results illustrated that the Group is less vulnerable to rising costs than its major competitors. Its recent investment in upstream raw milk suppliers, efforts on product-mix enhancement, increasing market promotion efforts, and capability to pass on costs to consumers are the major factors that support the Group's margins. Hence, we project that Mengniu's GPM and NPM would gradually improve from 26.98% and 3.76% in 2013 to 30.07% and 4.77% in 2016.

Strategic partners bring in new opportunities

Mengniu has been actively forming partnerships with domestic and foreign brands to further develop its business. These partnerships will present more opportunities to further strengthen its position as the leading dairy product producer in China.

Exhibit 14: Recent deals to form new partnerships

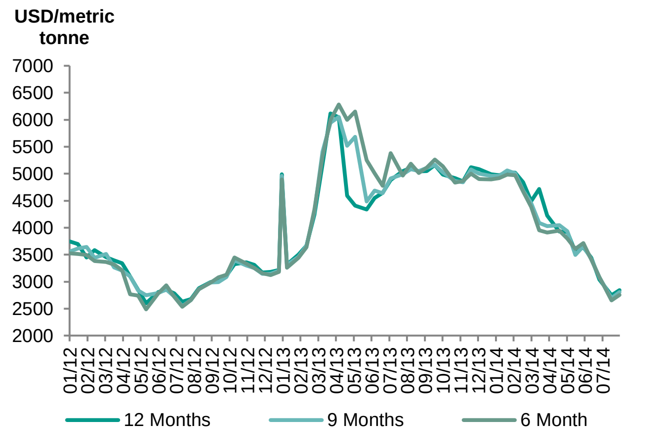
Counter party	Announce ment Date	Motivation	Current status
Danone	February 12, 2014	Expansion of yogurt product business	1. Strategic focus will be the marketing of Yoyi C and Champion from Mengniu as well as Bio from Danone 2. Ma'anshan plant has been upgraded in accordance with the global production and quality management standards of Danone Group 3. Aiming to improve asset utilization ratio, strengthen economies of scale, enhance the cost efficiency, with a prudent view on capex spending
WhiteWave	January 5, 2014	Develop plant-based protein drinks	1. Completed the acquisition of Yashili Zhengzhou 2. Engage in preparation works for factory production, conducting technical upgrades 3. Launch plant-based beverages by the end of the year
Yashili	June 18, 2013	To strengthen Mengniu's milk formula business	1. Acceleration of the e-commerce channel establishment 2. Extension of the cooperation between Yashili and Arla Foods

Source(s): Company, ABCI Securities

Yashili – synergistic value is yet to be realized

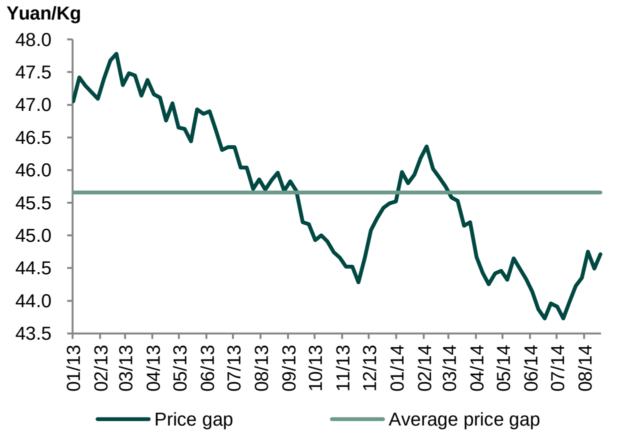
Imbalanced product portfolio could be a factor hampering Mengniu's future growth. In order to develop a full range of dairy products, Mengniu acquired Yashili in 2013. However, recent development in Mengniu's milk formula segment suggests that the business is still under pressure, especially from Yashili.

Exhibit 15: New Zealand whole-milk powder commodity futures prices



Source(s): Bloomberg, ABCI Securities

Exhibit 16: Retail price gap between foreign and domestic milk formula brands in China



Source(s): Ministry of Commerce, ABCI Securities

Yashili, as a major revenue contributor in the segment, has seen its revenue and net profit declining by 28.2% and 28.7% in 1H14. We believe these declines were attributable to the intensifying competition and the resultant price war, as well as changing consumer behaviors. Looking ahead, we believe that Yashili is still under pressure for the following reasons: 1) decline in whole milk powder commodity futures prices would result in price cuts from foreign competitors, thus weakening Yashili's pricing power; 2) the expansion of e-commerce channels could benefit its future growth but could incur large expenditures in the near term; 3) intense competition still exists as foreign and domestic brands are fighting for market shares; 4) consumers are more inclined to choose foreign brands for milk formula, which is reflected in the ability of foreign brands' ability to charge premium.

In addition, we believe that it takes time for Mengniu and Yashili to create synergy. Mengniu's milk formula products, which orients to the high-end market, is different from Yashili's focus on the lower-end ones. Furthermore, Yashili is still building its brand equity and its scale is relatively small, making it more difficult for the two to achieve synergy.

Cooperation with Danone to strengthen Mengniu's chilled yogurt business

The positive partnership between Mengniu and Danone was reflected by the 1H14 results. Revenue of the yogurt business and its contribution to liquid milk revenue increased in 1H14. We believe that the partnership between Mengniu and Danone will continue to be mutually beneficial. Danone will be able to tap into the developed distribution network of Mengniu to enhance its product penetration in China, while Mengniu will be able to benefit from Danone's management expertise, product development skills, and operational efficiency.

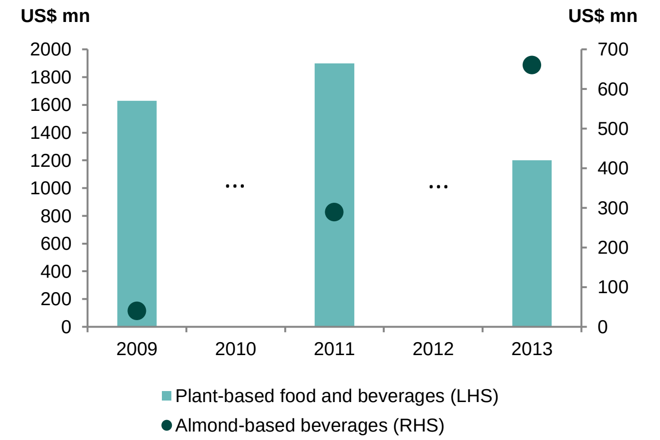
In addition, we believe that the yogurt products under Mengniu and Danone have different target markets. Danone's yogurt products currently focus on the high-end market, while the ones by Mengniu are catered to a broader consumer group. We believe that the two companies would not change their market positioning in the near term. In our view, as long as a sufficient degree of product differentiation and appropriate market distribution channels are in place, the partnership will continue to benefit both parties.

WhiteWave – venturing into a new business realm

According to Mengniu, the joint-stock company under the Mengniu-WhiteWave partnership has been upgrading the factory facilities and preparing for actual production. The plant-based protein beverage product line is expected to be launched by the end of year.

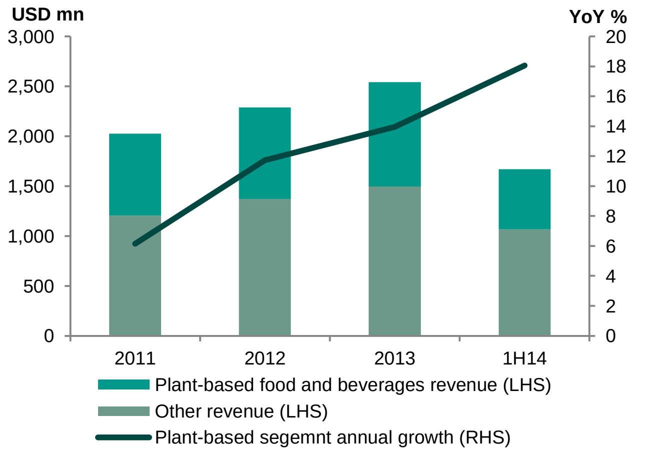
WhiteWave is an established dairy product company that manufactures and sells planted-based food and drinks, coffee creamers and beverages, and premium dairy product across the U.S. and Europe. It houses several well-known brands of plant-based protein drinks, such as "Silk" and "Alpro".

Exhibit 17: U.S. plant-based food and beverages and almond-based beverages revenue



Source(s): WhiteWave annual report and prospectus, ABCI Securities

Exhibit 18: WhiteWave plant-based food and beverage revenue and growth



Source(s): WhiteWave annual report, ABCI Securities calculation

We believe this partnership presents exciting new opportunities for Mengniu. However, since this is a new business for Mengniu, we believe it will take time for the Group to improve the products and familiarize with the target consumer groups. Thus, we expect the new segment would not contribute significantly to Mengniu's revenue in the short-to- medium term.

Future industry trends and impact on Mengniu

The dairy product market in China will continue to evolve. We have identified 4 major forces that would determine the future of the industry: 1) shifting consumer preferences; 2) growing domestic competitors; 3) shocks from foreign competitors; 4) government policy support.

Consumers' changing preference brews opportunities for smaller players

As the Chinese government is spearheading the urbanization process, urban population will continue to grow, driving up demand for a wider range of dairy products. For the liquid milk market, we believe that the urban consumers, especially the educated ones, become increasingly aware of the nutritional benefits of other types of dairy products, such as pasteurized milk or yogurt. Although regional/local players have lower economies of scale and brand recognition, they could leverage on their long-term relationships with local customers and geographical advantages to compete against national brands.

Moreover, rapid logistics development in China enables more efficient delivery of dairy products. With a more advanced cold-chain logistic system, sales of other products will continue to grow and compete with UHT milk for market share. This could be an opportunity for regional/local players to expand their geographical presence and rack up market shares against the national brands.

We have observed that numerous regional/local dairy manufacturers are sieging market shares in other dairy product categories such as yogurt and pasteurized milk. To become successful in these underdeveloped products, Mengniu would have to compete in a highly fragmented market with a large number of incumbents.

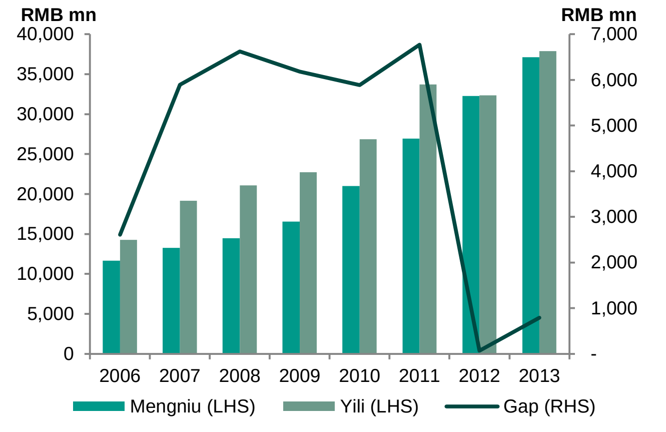
Big players are getting bigger

Mengniu and Yili, the two largest dairy market players, have been fighting neck to neck for shares in the liquid milk market. Since end-2011, Yili has been catching up quickly with Mengniu, with the difference in liquid milk sales narrowing from RMB 6,769 mn in 2011 to RMB 787mn in 2013. In addition, Bright Dairy is another rapidly expanding industry player with revenues in liquid milk and other dairy products recording double-digit growth in 1H14. It also has been increasing its geographical penetration, with its sales in areas outside Shanghai and overseas growing 41% and 36% YoY.

Apart from direct market confrontation, domestic competitors have been trying to acquire more market shares with new products in recent years. As the pioneer in the UHT yogurt market, Bright Dairy officially launched a UHT yogurt called "Mosilian" (莫斯利安) nationwide in 2012. Thanks to the health -oriented branding effort, total sales of "Mosilian" (莫斯利安) reached RMB 3.22 bn in 2013, representing an annual growth rate of 106.5% YoY and 20% of Bright Dairy's dairy product sales for the year. In addition, we have seen a slew of derivative products emerged based on existing product lines, such as milk beverage drinks with various new flavors.

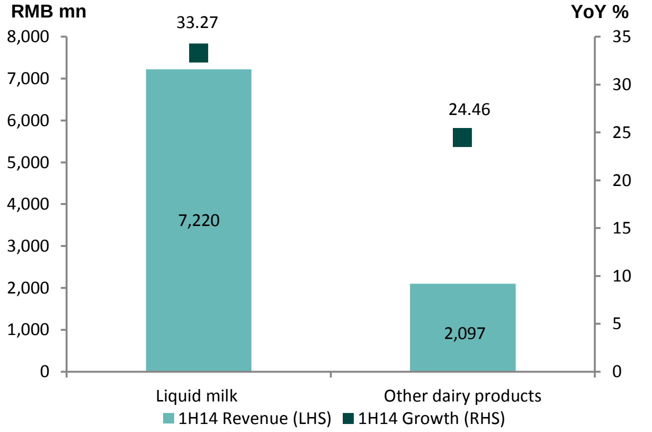
We believe that the big dairy players are solidifying their market positions by leveraging on their brand equity, large consumer base, and high economies of scale. While Mengniu has all these qualities. The Group would need to accelerate its product innovation and expand by inorganic growth to compete with its major rivals, Yili and Bright Dairy.

Exhibit 19: Yili is catching up with Mengniu in liquid milk product sales (RMB mn)



Source(s): Companies' financial reports, ABCI Securities

Exhibit 20: Bright Dairy is a rapidly growing player in the dairy industry



Source(s): Companies' financial reports, ABCI Securities

Overseas competitors – a new force in the Chinese dairy market

Overseas competitors are creating a new multi-level competitive landscape in the Chinese dairy market. Currently, foreign dairy brands are tapping into the Chinese market via traditional retail channels and unconventional e-commerce portals. In addition, the foreign dairy brands are targeting the UHT milk market as well as the yogurt and pasteurized milk markets. Our research shows that a wide variety of yogurt and pasteurized milk products are already available in the high-end supermarkets in the first-tier cities.

Exhibit 21: Official online stores of Anchor and Lactana on T-mall

Source(s): tmall.com, ABCI Securities

Exhibit 22: Foreign brand yogurt and pasteurized milk products have entered the Chinese market

Source(s): ABCI Securities

These foreign competitors are offering products at attractive prices. Our research shows that the prices of these foreign brands, both in the physical retail outlet and on the e-commerce platforms, are highly competitive compared to Yili's Satine and Mengniu's Milk Delux. We believe there are 3 reasons for such competitive pricing: 1) the e-commerce platform can reduce cost significantly through disintermediation; 2) these foreign brands are willing to sacrifice part of their profits for more market shares in China.

Exhibit 23: Examples of foreign brand UHT milk sold on e-commerce websites in China

Brand		Origin	Price range (Yuan/ 250 ml)	Official online store
Foreign brands				
Anchor		Australia	5.2 - 6.3	√
Devondale		Australia	4.0 – 7.2	X
Emmi		Swiss	5.8 – 6.5	X
Oldenburger		Germany	3.8 – 7.4	X
Domestic brands				
Mengniu		China	4.2 - 6.3	√
Yili		China	5.4 - 6.3	√
Bright Dairy		China	4.1 - 4.4	√

* Price does not include shipping fees, as of Sep 1, 2014
Source(s): tmall.com, ABCI Securities

In our view, foreign brands are still young in the Chinese dairy market. The market share of foreign brands is negligible compared to those of the domestic players. Although foreign brands are perceived by the Chinese consumers to possess higher quality, consumer acceptance of unfamiliar foreign brands will take time and considerable efforts will be needed to enhance market penetration of these foreign brands. Therefore, the threat of new foreign rivals' entry is not significant at present.

We believe that the entry of foreign dairy brands will be positive to the Chinese dairy markets. These new competitors will raise the industry standards and expand consumers' choices. This in turn will force dairy product manufacturers to improve their product qualities and accelerate product development.

Government policy to extend support for the industry

The latest policy support for the industry was announced in June. The MIIT, NDRC, MOF, and CFDA jointly released the "Proposal to accelerate the consolidation of milk formula industry" (《推动婴幼儿配方乳粉企业兼并重组工作方案》), proposing the establishment of 10 milk formula groups with respective annual revenue of over RMB 2bn and raising industry concentration of the top 10 domestic brands to 65% by end-2015. Moreover, the proposal also aims to create 3-5 large infant milk formula groups that have an individual annual revenue of more than RMB 5mn, and further increases market concentration of the top 10 domestic brands to 80% by 2018. The new policy is an extension of the "Double lifting" policy ("双提"方案) proposed in 2013.

We believe that the new policy will benefit the national dairy companies like Mengniu, which will be able to leverage on their existing market position and strong brand to consolidate horizontally. Combined with the more stringent oversight on the foreign-branded milk formula, the new policy will provide a more favorable environment for the domestic players.

In addition, the relaxation of the “one-child policy”, acceleration of the urbanization process, and the government’s goal to improve personal income level will serve as the positive catalysts for the Chinese dairy product market. We believe Mengniu will benefit from the expanding market potentials going forward.

Risk factor analysis

Product portfolio bias

Mengniu received most of its revenue from the liquid milk segment, in particular, the UHT milk sub-segment. Its major rival, Yili, has a more balanced product portfolio in our view. In addition, Mengniu's product portfolio is more oriented to the high-end markets, which enables higher margins at the expense of losing the larger, lower-end market. Inability to diversify product portfolio to cover different market segments could be detrimental to Mengniu's prospects.

Fluctuating raw milk costs could be a supply-side shock

As we have analyzed before, limited supply and growing demand in the raw milk industry at present could result in more volatility in raw milk price going forward. Although Mengniu has the ability to pass on rising costs to consumers, any major raw milk supply disruptions could hamper Mengniu's margins.

Food safety issues

The milk industry has not seen major food safety crisis similar to the melamine scandal occurred in 2008, but there are sporadic food-safety incidents. We believe that as Chinese regulators have increased their regulatory oversight of the industry and the better quality control systems have been adopted by dairy product manufacturers. Thus, probability of another major food safety crisis are lowered. Nonetheless, food safety will always be an inherent risk of the industry and new issues will occur as the industry evolves.

Regulatory policies may increase costs

The increasing regulatory oversight and more stringent industry standards help restore consumers' confidence in the Chinese dairy industry. However, recent litigations revolving the labeling of dairy products shows regulatory policies could mean that industry players may need to commit higher costs and more resources on the compliance issues.

Business partnership execution risk

Mengniu's current strategic partnership with Danone and WhiteWave, as well as its acquisition of Yashili present new growth opportunities, but the key to success will hinge on the ability of the companies to cooperate successfully. Failure to resolve any major contentions arise would impede growth in companies involved.

In addition, Mengniu's investment in Yashili has been underperforming. The delay in synergy realization could incur higher costs and the failure to revert the declining trend in Yashi would hurt Mengniu's overall milk formula business in the short term. Therefore, the execution capability will be the key for Mengniu to sustain its success.

Financial analysis and valuation

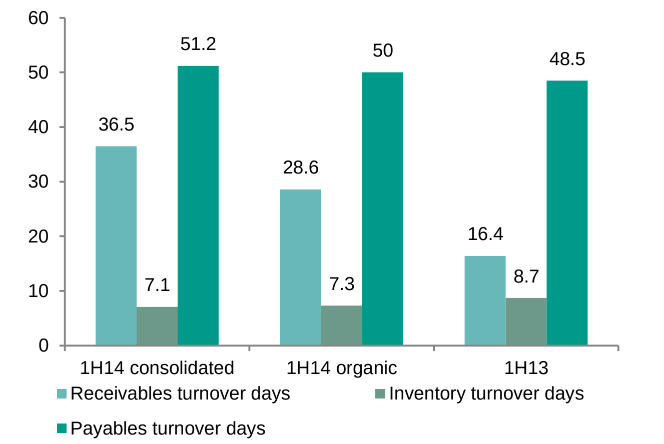
1H14 results recap

As discussed earlier, Mengniu's 1H14 results were outstanding. Margins improved despite intensifying market competition and higher selling and distribution costs. Mengniu's effective sales tactics and cost-management skills are impressive.

Moreover, receivables turnover days improved, suggesting distributors' willingness to pay in advance to obtain products. We take it as a sign that Mengniu's products are still highly popular in the Chinese dairy market, and distributors are willing to pay in advance to in order to stock up Mengniu's products in their inventories.

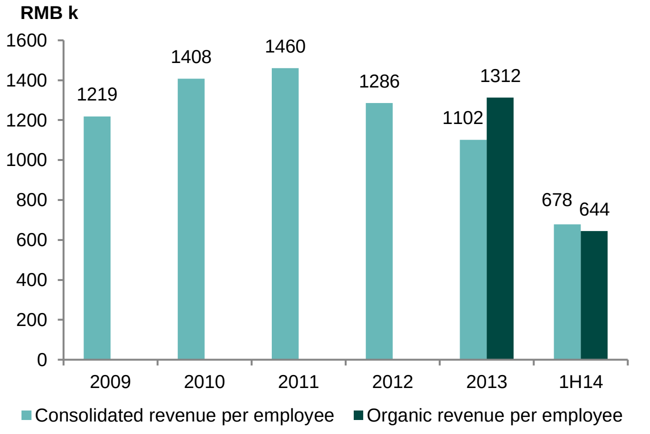
The 1H14 results also shed lights on potential issues. First of all, inventory turnover days increase in 1H14, suggesting that Mengniu may have overestimated market demand and produced in excessive quantity. Given the short product shelf life, the increase of inventory turnover days to approximately a month could mean that Mengniu may need to cut price in 3Q. If the price cut does occur, Mengniu's revenue would be negatively impacted, although the bottom line would be less affected thanks to the declining raw milk costs.

Exhibit 24: Mengniu's cash conversion cycle components



Source(s): Companies' financial reports, ABCI Securities

Exhibit 25: Revenue per employee shows efficiency problem

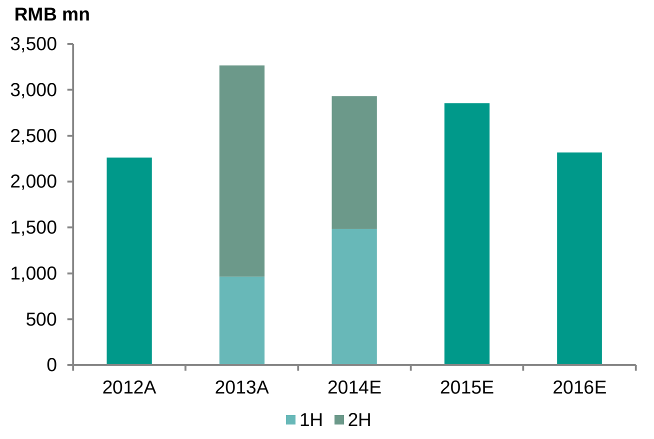


Source(s): Companies' financial reports, ABCI Securities

Secondly, Mengniu's stellar performance in 1H14 was mainly the result of aggressive market promotion and product mix adjustment, as reflected by its higher selling and distribution costs and product mix changes. To boost sales in the long term, however, Mengniu would need to accelerate new product development and expand its product portfolio with its new strategic partners. In our view, cultivating new growth drivers should be the priority of the Group in face of the stiffening competition. In fact, the organic revenue per employee actually was lower than the consolidated revenue per employee in 1H14, indicating the limitation of relying on promotional efforts and internal product mix adjustment as major profitability boosters.

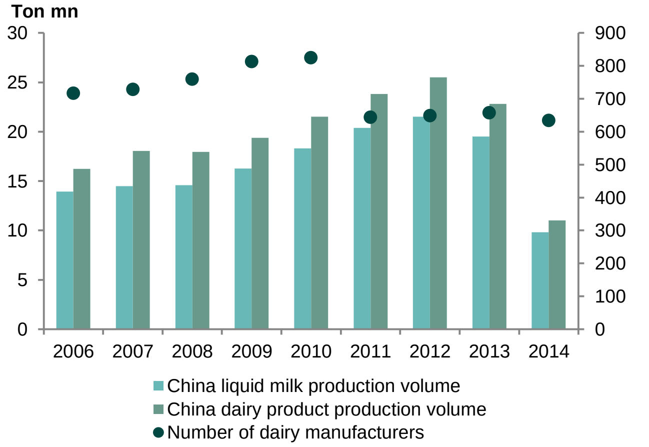
Thirdly, capex in 1H14 was mostly in line with our expectation. We expect Mengniu's capex would decline in the next few years, as the Group explicitly indicated that it would be prudent on its yogurt segment and a higher proportion of the Group's capex would be allocated to brands with high growth potentials. However, given the strong demand as reflected by its 1H14 results, we believe it is possible that the Group would outsource production to existing manufacturers at favorable prices. If so, consistency in product quality will be a concern.

Exhibit 26: Projection of Mengniu's capex



Source(s): Company, ABCI Securities estimates

Exhibit 27: Industry-wide capacity issue exists



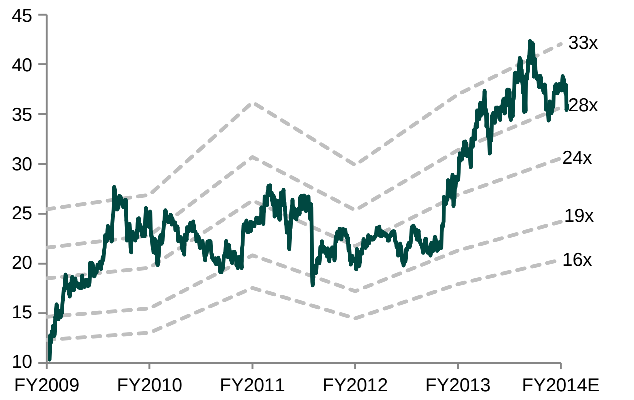
Source(s): Companies' financial reports, ABCI Securities

Valuation

Mengniu's shares closed at HK$ 35.9 on September 1st, representing a 12M trailing P/E of 32.0x and a FY14 P/E of 28.2x. Mengniu's current stock price is still relatively expensive compared to Yili (600887 CH), whose FY14 P/E is standing at 21.2x. This is a possible signal that the market may rotate between the two stocks in the short term.

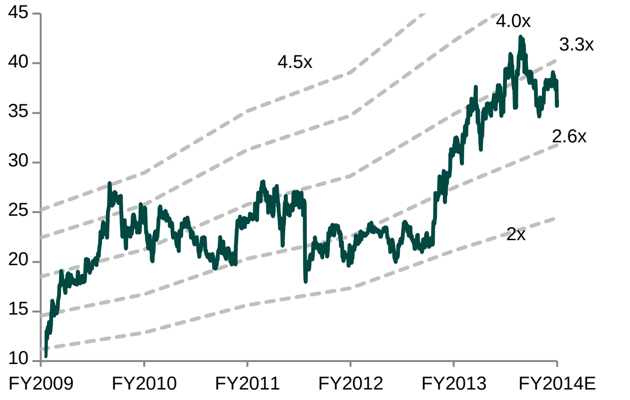
We use the P/E multiple as a benchmark metric to value Mengniu, and derive its valuation by comparing the counter against : (1) its direct competitors in China, which have an average FY14 P/E of 35.6x; (2) companies in the F&B sector, which have an average FY14 P/E of 29.7x in our selected samples; (3) international dairy product producers, which are trading at 24.2x FY14 P/E; (4) international F&B companies, which trading at 19.0x FY14 P/E. Our TP for Mengniu is set at HK $40.8, representing 32x FY14 P/E and 23.7x FY15 P/E, implying an upside of 13.65%. Reinitiate with **HOLD.**

Exhibit 28: P/E band chart



Source(s): Company, ABCI Securities estimates

Exhibit 29: P/B band chart



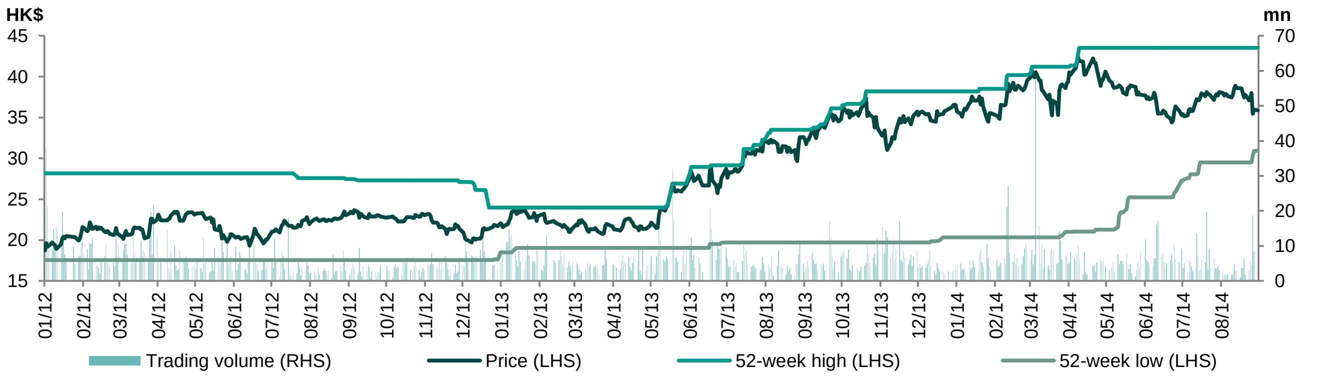
Source(s): Companies' financial reports, ABCI Securities estimates

Exhibit 30: P/E matrix

	28x	*29x*	*30x*	*31x*	*32x*	*33x*	*34x*	*35x*	*36x*
FY2009	21.6	22.4	23.1	23.9	24.7	25.5	26.2	27.0	27.8
FY2010	22.8	23.6	24.5	25.3	26.1	26.9	27.7	28.5	29.3
FY2011	30.7	31.8	32.9	34.0	35.1	36.2	37.3	38.4	39.5
FY2012	25.4	26.3	27.2	28.1	29.0	29.9	30.8	31.7	32.6
FY2013	31.4	32.5	33.6	34.8	35.9	37.0	38.1	39.2	40.4
FY2014E	**35.7**	**36.9**	**38.2**	**39.5**	**40.8**	**42.0**	**43.3**	**44.6**	**45.9**
FY2015E	48.1	49.8	51.5	53.2	55.0	56.7	58.4	60.1	61.8
FY2016E	61.5	63.7	65.9	68.1	70.3	72.5	74.7	76.9	79.1

Sources: Bloomberg, Company, ABCI Securities estimates

Exhibit 31: Mengniu's historical price



Source(s): Bloomberg, ABCI Securities

Exhibit 32: Peer comparison

Company name	Ticker	Currency	Price	Mkt Cap (mn)	Price performance (%)		P/E		P/B		EPS growth		ROAE	
					3 Month	YTD	14E	15E	14E	15E	14E	15E	14E	15E
China Dairy Product Manufacturers														
Mengniu	**2319 HK**	**CNY**	**35.90**	**70,305.83**	**(5.65)**	**(2.45)**	**28.19**	**20.9**	**2.94**	**2.37**	**13.85**	**35.15**	**11.53**	**12.56**
Yili	600887 CH	CNY	26.55	81,359.05	17.30	1.91	21.17	17.22	4.34	3.65	14.00	22.97	20.87	21.48
Bright Dairy	600597 CH	CNY	16.27	19,922.58	(6.76)	(26.71)	31.41	22.26	4.24	3.74	56.97	41.12	12.74	15.97
Beijing Sanyuan Foods	600429 CH	CNY	8.61	7,619.85	21.95	5.51	33.12	172.20	4.22	4.12	201.56	(80.77)	11.90	2.40
Guangxi Royal Dairy	002329 CH	CNY	16.95	3,627.30	26.68	38.71	56.88	40.65	3.85	3.57	75.29	39.93	7.27	10.67
Average (excluding Mengniu)					*14.79*	*4.85*	*35.64*	*63.08*	*4.16*	*3.77*	*86.96*	*5.81*	*13.20*	*12.63*
Average					*10.71*	*3.39*	*34.15*	*54.64*	*3.92*	*3.49*	*72.34*	*11.68*	*12.86*	*12.62*
China Food and Beverage Companies														
Want Want	151 HK	USD	9.81	129,453.02	(9.33)	(12.41)	23.44	20.42	7.36	6.30	3.85	14.81	34.96	34.49
Tingyi	322 HK	USD	21.75	121,811.34	(1.58)	(2.90)	31.18	25.51	4.98	4.48	23.29	22.22	16.32	18.09
Uni-president	220 HK	CNY	7.02	30,321.72	16.61	(7.04)	34.56	29.44	2.15	2.04	(33.95)	17.39	6.79	6.90
Average					*1.90*	*(7.45)*	*29.73*	*25.12*	*4.83*	*4.27*	*(2.27)*	*18.14*	*19.36*	*19.82*
China Milk Formula Manufacturers														
Biostime	1112 HK	CNY	28.20	17,085.11	(46.08)	(58.92)	16.87	14.68	4.97	4.19	(3.28)	14.94	30.25	31.21
Yashili	1230 HK	CNY	2.49	8,862.33	(24.77)	(47.58)	18.98	17.01	2.12	2.01	(16.13)	11.54	10.76	12.17
Beingmate	002570 CH	CNY	Suspended	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Average (excluding Beingmate)						*(35.43)*	*(53.25)*	*17.92*	*15.85*	*3.54*	*3.10*	*(9.71)*	*13.24*	*20.50*
Dairy Farm Operators														
Huishan	6863 HK	CNY	1.76	25,357.71	(4.35)	(37.14)	11.63	8.72	1.40	1.26	20.00	33.33	12.83	15.08
Modern Dairy	1117 HK	CNY	3.85	18,585.25	20.31	(8.33)	14.60	11.97	2.24	1.91	211.94	22.01	16.33	17.31
Yuanshengtai	1431 HK	CNY	1.36	5,315.90	(6.21)	(39.01)	9.06	7.19	0.92	0.82	35.23	26.05	10.78	12.45
Average					*3.25*	*(28.16)*	*11.76*	*9.29*	*1.52*	*1.33*	*89.06*	*27.13*	*13.32*	*14.95*
International Dairy Product Manufacturers														
Danone	BN FP	EUR	53.44	34,404.24	(2.18)	2.14	19.80	17.72	2.62	2.48	(2.91)	11.71	13.67	14.37
Whitewave	WWAV US	USD	35.02	6,098.60	11.21	52.66	35.20	29.65	5.40	4.58	34.46	18.69	16.57	17.24
Emmi Dean Foods	EMMN SW	CHF	338.75	1,812.25	7.11	25.30	17.68	15.37	1.60	1.47	3.81	15.00	8.11	9.60
Dean Foods	DF US	USD	16.18	1,517.25	(6.90)	(5.88)	N/A	17.32	2.28	2.17	(123.84)	555.61	(2.78)	9.24
Average					*2.31*	*18.56*	*24.22*	*20.02*	*2.98*	*2.68*	*(22.12)*	*150.25*	*8.89*	*12.61*
International Milk Formula Manufacturers														
Abbott	ABT US	USD	42.24	63,516.25	5.57	10.20	18.83	17.10	2.58	2.38	11.59	10.12	12.15	12.97
Mead Johnson	MJN US	USD	95.60	19,327.03	6.85	14.14	25.72	22.94	30.80	19.06	9.97	12.13	158.15	108.04
Fonterra	FSF NZ	NZD	6.15	9,876.89	0.82	6.03	41.28	19.90	2.06	2.07	(66.21)	107.38	3.52	7.27
Average					*4.41*	*10.12*	*28.61*	*19.98*	*11.81*	*7.84*	*(14.88)*	*43.21*	*57.94*	*42.76*
International Food and Beverage Companies														
Nestle	NESN VX	CHF	71.45	230,411.96	1.71	9.42	20.77	19.20	3.34	3.27	0.88	8.17	16.67	17.25
Mondelez	MDLZ US	USD	36.19	61,012.30	(3.80)	2.52	21.47	18.74	1.90	1.82	11.66	14.53	8.77	9.54
Kraft	KRFT US	USD	58.90	34,984.89	(0.94)	9.26	18.62	17.24	6.46	6.21	21.19	8.00	36.09	37.50
General Mills	GIS US	USD	53.38	32,564.70	(2.82)	6.95	17.64	16.56	4.92	4.68	7.30	6.54	27.43	28.20
Kellogg	K US	USD	64.97	23,397.18	(5.81)	6.39	16.57	15.76	5.68	5.02	4.03	5.10	33.99	32.45
Average					*(2.33)*	*6.91*	*19.01*	*17.50*	*4.46*	*4.20*	*9.01*	*8.47*	*24.59*	*24.99*
Total average (ex. Mengniu)					(1.58)	(6.92)	23.84	24.41	4.76	3.88	19.43	38.04	22.54	21.35
Total average					(2.17)	(7.13)	23.63	23.20	4.72	3.84	17.35	38.88	22.49	21.35

Note: Data as of September 1, 2014
Sourre(s): Bloomberg, ABCI Securities estimates

Appendix: Financial Statements of the Group

Consolidated income statement (2012A-2016E)

FY 13 ends at Dec 31 (RMB mn, except per share data)	2012A	2013A	2014E	2015E	2016E	1H14	1H13
Revenue	**36,000**	**43,357**	**52,742**	**62,571**	**72,144**	**25,836**	**20,668**
- Liquid milk	32,336	37,903	44,129	52,272	59,973	21,765	18,262
- Ice cream	3,171	3,023	4,024	4,743	5,627	1,988	1,954
- Milk formula	442	2,177	4,272	5,181	6,111	1,934	394
- Other dairy products	51	253	316	375	433	1,488	57
COGS	(27,050)	(31,660)	(37,526)	(44,135)	(50,450)	(17,454)	(15,149)
Gross profit	**8,950**	**11,697**	**15,216**	**18,436**	**21,693**	**8,382**	**5,519**
Other income	249	289	462	541	622	254	119
SG&A	(7,398)	(9,774)	(12,749)	(15,238)	(17,652)	(6,859)	(4,608)
Other expenses	(194)	(360)	(627)	(670)	(729)	(556)	(136)
EBIT	**1,608**	**1,852**	**2,302**	**3,070**	**3,935**	**1,221**	**894**
Net interest expense(-)/income(+)	179	199	161	280	394	78	99
Income from associate/JV	(53)	154	246	332	449	183	30
Profit before tax	1,734	2,205	2,709	3,682	4,778	1,481	1,022
Tax	(245)	(367)	(469)	(646)	(875)	(253)	(186)
Profit from discontinued opeartion	0	24	0	0	0	0	14
Total net profit	**1,489**	**1,862**	**2,239**	**3,036**	**3,903**	**1,229**	**850**
- Profit to shareholders	1,303	1,631	1,981	2,678	3,442	1,049	749
- Minority interest	186	231	258	358	461	180	101
Basic EPS	0.74	0.89	1.01	1.37	1.76	0.54	0.42
Diluted EPS	0.71	0.89	1.01	1.37	1.76	0.53	0.42
DPS	0.16	0.20	0.22	0.30	0.39	N/A	N/A

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2012A-2016E)

As of Dec 31 (RMB mn, except per share data)	2012A	2013A	2014E	2015E	2016E	1H14	1H13
Cash and equivalent	5,752	7,102	9,090	10,850	12,764	8,677	7,389
Inventory	1,363	2,577	4,443	3,727	5,569	4,460	1,386
Accounts receivables	856	754	1,493	1,194	1,897	1,262	1,140
Others	1,877	5,888	6,318	7,447	8,552	5,294	2,647
Total current assets	**9,847**	**16,321**	**21,344**	**23,218**	**28,783**	**19,693**	**12,561**
Net fixed assets	7,739	9,246	10,600	12,198	12,952	9,185	8,161
Goodwill & intangibles	707	7,307	7,292	7,276	7,261	7,301	987
Other non-current assets	2,623	7,465	9,334	10,769	12,458	10,082	5,433
Total non-current assets	**11,069**	**24,018**	**27,226**	**30,244**	**32,671**	**26,568**	**14,580**
Total assets	**20,916**	**40,339**	**48,570**	**53,462**	**61,453**	**46,261**	**27,142**
Accounts payable	3,629	4,761	6,454	6,299	8,816	5,121	4,493
Short-term debt	599	8,554	6,924	6,091	4,268	5,296	3,991
Other current liabilities	2,628	4,748	5,789	6,808	7,788	5,761	3,346
Total current liabiliities	**6,857**	**18,063**	**19,167**	**19,197**	**20,872**	**16,178**	**11,830**
Long-term debt	0	3,236	2,607	2,282	1,582	4,816	19
Other non-current liabilities	938	1,029	2,360	2,102	2,019	2,036	949
Total non-current liabilities	**938**	**4,265**	**4,967**	**4,385**	**3,601**	**6,852**	**968**
Total liabilities	**7,795**	**22,328**	**24,133**	**23,582**	**24,473**	**23,030**	**12,797**
Shareholders' equity	12,489	15,361	19,007	23,627	29,363	20,274	13,722
Minority interest	632	2,650	5,430	6,253	7,617	2,957	623
Total equity	**13,121**	**18,011**	**24,437**	**29,880**	**36,980**	**23,230**	**14,345**
Net cash/(debt)	5,178	(4,596)	(441)	2,477	6,914	(1,308)	3,412
BVPS	7.06	8.37	9.71	12.06	14.99	11.14	7.89

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2012A-2016E)

FY ends at Dec 31 (RMB mn)	2012A	2013A	2014E	2015E	2016E
Profit before tax	1,734	2,205	2,709	3,682	4,778
Depreciation and amortization	995	1,216	1,607	1,984	2,390
Change in working capital	(288)	517	440	286	996
Finance cost	39	160	276	239	204
Interest income	(218)	(359)	(437)	(519)	(599)
Ohers	(380)	(455)	(717)	(996)	(1,260)
Total Cash Flow from Operation	**1,881**	**3,284**	**3,877**	**4,676**	**6,510**
CapEx	(2,263)	(12,597)	(2,930)	(2,854)	(2,317)
Others	(962)	(2,672)	(622)	(564)	(425)
Total Cash Flow From investing	**(3,225)**	**(15,269)**	**(3,551)**	**(3,418)**	**(2,742)**
Change in debt	280	10,890	(2,272)	(1,174)	(2,531)
Dividend paid	(350)	(290)	(367)	(436)	(589)
Others	11	1,732	3,411	1,213	289
Total Cash Flow From Financing	**(59)**	**12,331**	**772**	**(397)**	**(2,831)**
Net change in cash	**(1,402)**	**346**	**1,098**	**862**	**937**
Cash at the beginning	4,322	2,918	3,355	4,452	5,314
Adjustment for ForEx effect	(2)	91	0	0	0
Cash at the end of FY	**2,918**	**3,355**	**4,452**	**5,314**	**6,252**

Source(s): Company, ABCI Securities estimates

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

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E	1H14	1H13
Key assumptions (%)							
Sales growth		20.44	21.65	18.64	15.30	25.0	N/A
Effective tax rate	14.16	16.63	17.33	17.54	18.31	17.0	17.9
Profitability ratios (%)							
Gross margin	24.86	26.98	28.85	29.46	30.07	32.44	26.70
EBIT margin	4.47	4.27	4.36	4.91	5.45	4.72	4.33
EBITDA margin	7.23	7.08	7.41	8.08	8.77	7.90	7.28
Pre-tax margin	4.82	5.08	5.14	5.88	6.62	5.73	4.95
Core net margin	3.62	3.71	3.76	4.28	4.77	4.06	3.57
Total net margin	3.62	3.76	3.76	4.28	4.77	4.06	3.63
Return ratios (%)							
ROAA	6.37	5.33	4.46	5.25	5.99	3.25	N/A
ROAE	10.88	11.71	11.53	12.56	12.99	6.17	N/A
ROAC	10.39	8.11	7.12	8.85	10.24	6.90	N/A
ROIC	10.52	8.19	6.80	8.07	9.35	4.19	N/A
Liquidity ratio (%)							
Current ratio	1.44	0.90	1.11	1.21	1.38	1.22	1.06
Quick ratio	1.24	0.76	0.88	1.02	1.11	0.94	0.94
Cash ratio	0.84	0.39	0.47	0.57	0.61	0.54	0.62
Cash conversion cycle (days)							
Days of outstanding receivable	8.45	6.78	7.77	7.84	7.82	7.1	8.7
Days of inventory on hand	20.28	22.71	34.14	33.79	33.63	36.5	16.4
Days of outstanding payable	49.65	46.58	51.96	53.60	52.75	51.2	48.5
CCC	(20.92)	(17.09)	(10.04)	(11.98)	(11.30)	(7.6)	(23.4)
Cash flow measures (RMB mn)							
EBIT	1,608	1,852	2,302	3,070	3,935	1,221	894
EBITDA	2,603	3,069	3,910	5,055	6,327	2,042	1,504
FCFF	-347	-11,146	583	3,115	3,992	3,647	N/A
Leverage ratios (%)							
Total debt/Equity	4.75	65.97	39.44	28.43	16.17	44.08	28.18
Total debt/Total assets	2.98	29.46	19.84	15.89	9.73	22.13	14.90

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification
I, Hongxing(Paul) PAN, 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. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

Disclosures of Interests
ABCI Securities Company Limited and/or its affiliates may pursue financial interests to the companies mentioned in the report.

Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate
Hold	Market return – 6% ≤ 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 ≤180 day volatility/180 day benchmark index volatility
High	1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 ≤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.

Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.
Tel: (852) 2868 2183