



February 13, 2014
Equity Focus
Rating: BUY
TP: HK\$ 46.1

Share price (HK\$) 37.95
Est. share price return 21.5%
Est. dividend yield 0.8%
Est. total return 22.3%

Previous Rating & TP BUY; HK\$ 38.9
Previous Report Date Oct 19, 2013

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Key Data

52Wk H/L(HK\$)	40.35/20.60
Issued shares (mn)	1,831.9
Market cap (HK\$ mn)	69,675
3-mth avg daily turnover (HK\$ mn)	195.1
Major shareholder(s) (%):	
COFCO	27.8
Arla Foods	5.9

Source(s): Company, Bloomberg, ABCI Securities

1H13 Revenue breakdown (%)

Liquid milk products	88.4
Ice cream products	9.5
Other dairy products	2.2

Source(s): Company, ABCI Securities

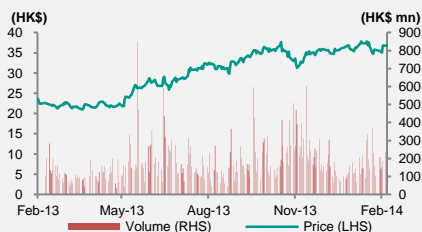
Share performance (%)

	Absolute	Relative*
1-mth	0.0	1.1
3-mth	17.4	21.1
6-mth	46.7	55.5

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance



Source(s): Bloomberg, ABCI Securities

China Mengniu (2319 HK)

Danone's raised stake improves balance sheet

- Danone will raise its stakes in Mengniu from 4.0% to 9.9% at HK\$ 42.5/share. In addition, COFCO, Danone and Arla will hold Mengniu together under a JV
- We view the additional stake acquisition and restructured shareholding as positive as it enhances Mengniu balance sheet and slash interest costs. Earnings dilutions will be less than 5% as a result
- We believe the Group's synergies with Danone and its increased control on raw milk sources will improve quality control and lower food safety risks. Moreover, the stock has been added to HSI. Hence, we revise our P/E valuation from 25.0x to 30.0x and raise our TP from HK\$38.9 to HK\$46.1.

Danone to double up its stakes in Mengniu means fastened ties between the two. Further to the alliance formed in May 2013, Danone is going to increase its existing stakes in Mengniu from 4.0% to 9.9%. In addition, the COFCO Group, Danone and Arla Foods have agreed to restructure their shareholding so that their combined stake of 31.5% (previously 27.7%) will be held by the JV company, COFCO Dairy Investments. A total of 121.2mn of new shares will be issued. After the share issuance, Danone will become the second largest shareholder of Mengniu; COFCO will remain as the largest (from 18% to 16.3% stakes) while Arla Foods will be as the third largest (from 5.7% to 5.3% stakes) shareholders. We believe the restructured shareholding will help align interests of different shareholders and facilitate policy execution in the long run. The increased stake by Danone will potentially facilitate synergies in the JV formed between Danone in Mengniu back in May 13.

Lower interest cost will offset earnings dilutions: The 121.2mn of new shares, representing 6.2% of the enlarged share capital, will be issued for subscription at HK\$ 42.5 per/share, which represents a 15.3% premium to the Group's closing on Feb 11. Net proceeds from the subscription is estimated to be HK\$ 5,137mn and will be used to repay Mengniu's bridge loan, which was obtained to finance Yashili's acquisition in Aug 2013. The bridge loan of RMB 6.5bn bears an interest rate of 1.5%. Mengniu issued bonds worth US\$ 500mn in Nov 2013 with a coupon rate of 3.5% to refinance part of the loan. We therefore estimate that repayment of the bridge loan would save about RMB 38mn in interest costs. With the enlarged capital, we estimate earnings dilution would be ~ 4% for FY14.

An enhanced balance sheet. This particular transaction will allow Mengniu to return to a net cash position since its acquisition of the 26.9% stake in China Modern Dairy (1117 HK) for HK\$ 3.2bn in May 2013 and Yashili for HK\$ 8.1bn in Aug 2013 (following the acquisition, Mengniu sold ~14% of shares for HK\$1.6bn and is currently holding a 76% stake in Yashili). The healthier balance sheet will allow the Group to continue its M&A maneuver going forward.

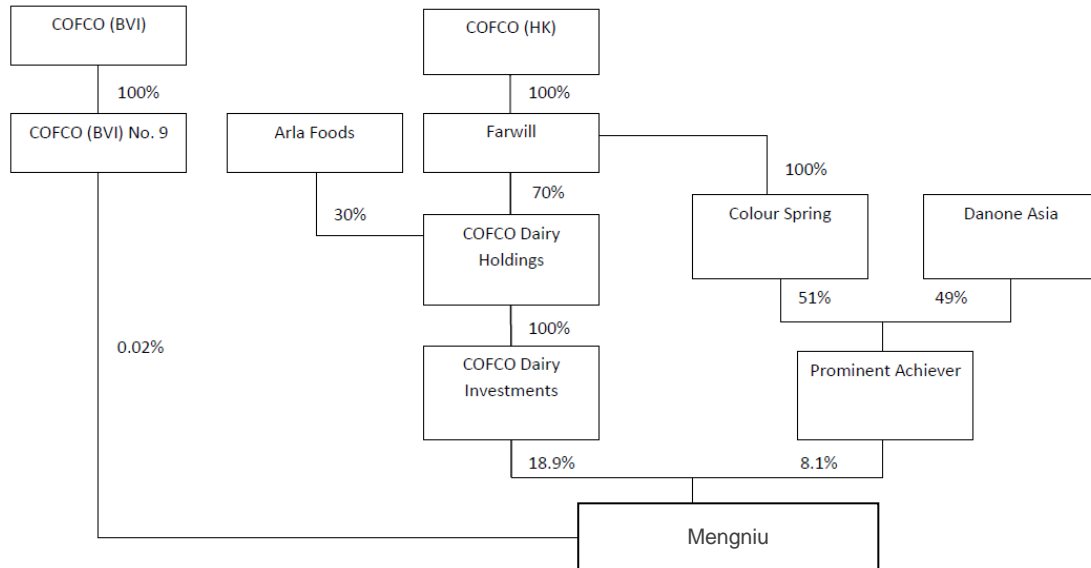
Maintain BUY with TP revised up to HK\$46.1. Given the Group's accelerated synergies with Danone and its enhanced control on raw milk sources, we expect product quality control to improve and food safety risks should be lower. In addition, the stock has been added to HSI, effective on 10 Mar. Hence, we revise our P/E valuation from 25.0x to 30.0x and raise our TP from HK\$ 38.9 to HK\$ 46.1. Maintain BUY.

Results and Valuation

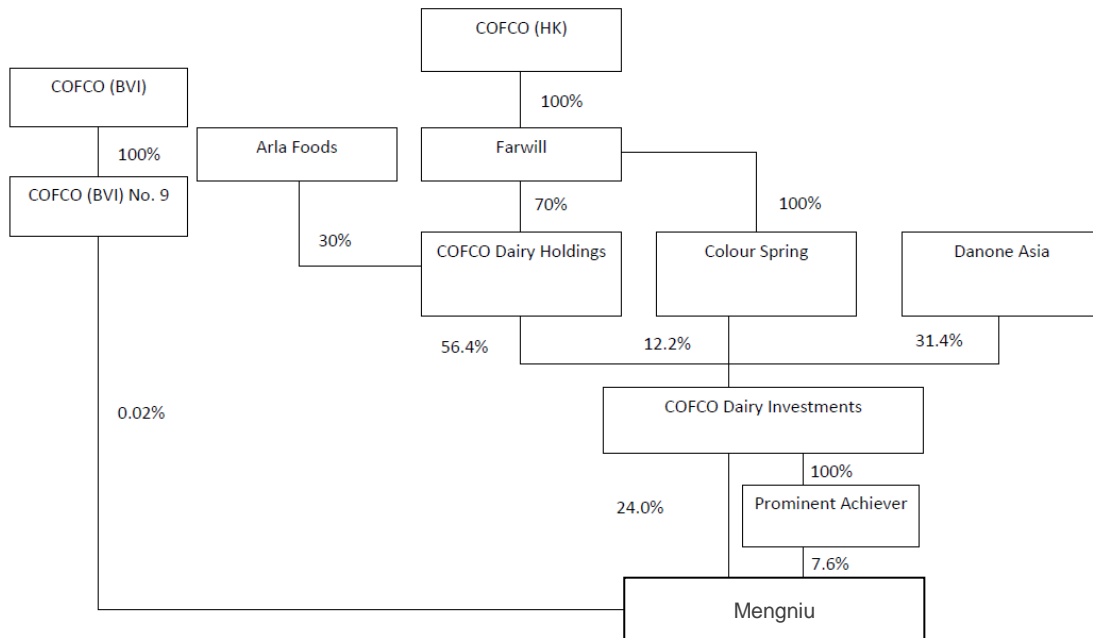
FY ended Dec 31	2010A	2011A	2012A	2013E	2014E
Revenue (RMB mn)	30,265	37,388	36,080	42,721	53,662
Chg (% YoY)	17.7	23.5	-3.5	18.4	25.6
Net Income (RMB mn)	1,237	1,589	1,257	1,698	2,351
EPS (RMB)	0.71	0.91	0.71	0.92	1.20
Chg (% YoY)	4.4	27.3	-21.4	29.8	29.9
BVPS (RMB)	5.61	6.49	7.04	8.98	9.55
Chg (% YoY)	13.74	15.60	8.43	27.60	6.35
P/E (x)	-	-	41.2	31.78	24.46
P/B (x)	-	-	4.2	3.27	3.07
ROE (%)	13.5%	15.0%	10.5%	11.8%	13.4%
ROA (%)	7.9%	8.5%	6.1%	7.7%	9.0%
DPS(RMB)	0.160	0.198	0.160	0.187	0.204
Yield (%)	0.92	1.34	0.90	0.70	0.90

*Post- transaction assumed

Source(s): Bloomberg, ABCI Securities estimates

Exhibit 1: Shareholder structure as of 11 Feb 2013


Source(s): Mengniu, ABCI Securities

Exhibit 2: Shareholder structure immediately after share restructuring completion and subscription completion


Source(s): Mengniu, ABCI Securities

Disclosures

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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 2009-2013

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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