农银国际
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

Mengniu (2319 HK)
Cautious over laggard subsidiaries and slowing market expansion

- 1H17 growth momentum was solid, supported by turnaround in milk formula segment and accelerating growth in ice cream segment; cost-cutting measures also helped support a higher margin
- Slower market share expansion and decelerated growth in liquid milk segment may indicate consumer preference change and reduced competitiveness; performance of Yashili and Modern Dairy weigh on overall results
- Upgrade to **HOLD** on improving growth momentum in 1H17 and expectation of stabilized margins in the future; current TP represents 28.84x/25.27x 17E/18E P/E or 2.98x/2.76x 17E/18E P/B

Solid growth in 1H17. Revenue grew 8.1% YoY, supported by higher growth in ice cream segment (+16.55% YoY) and turnaround in the milk formula segment with a 7.61% YoY growth (1H16: -6.92% YoY). Revenue of the liquid milk segment slowed to 6.78% YoY, dragged by decelerated growth of UHT milk (+2.46% YoY) and Yogurt (+18.18% YoY).

Cost-cutting measures were effective. The Group successfully slashed its COGS and elevated GPM to 35.64%. Admin. costs were lowered, equivalent to 3.69% of revenue in 1H17 (1H16: 4.17%), offsetting partially the higher S&D expense-to-sales ratio. OPM thus increased to 6.13% from 5.60% in 1H16.

Market share expanded at a slower pace. In 1H17, Mengniu's market share in liquid milk increased by 0.4ppt to 27.8%, and market share of its UHT products was up 1.3ppt to 28.4%. Those figures were lower than Yili's, whose shares in liquid milk and UHT products markets were up 2.1ppt and 3.2ppt to 28.8% and 33.8%. The Group's smaller increase of market shares in the two product categories, as well as the decelerated growth in its liquid milk segment, may indicate a change in consumer preference and reduced competitiveness of its products.

Performance of two major subsidiaries continues to be a concern. In 1H17, Yashili's revenue declined by 15.7% YoY and had a net loss of RMB 121.9mn (1H16 net profit: RMB 15.1mn); Modern Dairy's revenue grew 5.17% YoY but net loss widened by 16.57% YoY. Lackluster performance of the two major subsidiaries has compromised the overall results of Mengniu and may trigger additional goodwill impairment in the future. E.g., substantial decline in 2016 net profit was caused by the RMB 2,254mn goodwill impairment for Yashili.

Recommend HOLD with TP of HK$ 20.3. We have revised up our rating to HOLD based on the accelerated growth in 1H17; we also expect a revenue growth at above 8% YoY in 2016-19E and stable margins in coming years. Our major concerns are the reduced gain in market share and the two underperforming subsidiaries. Current TP represents 28.84x/25.27x 17E/18E P/E or 2.98x/2.76x 17E/18E P/B, which represents a premium over Yili's.

Risk factors: 1) Macroeconomic risk; 2) Commodity price risk; 3) Food safety risk; 4) M&A risk, 5) Product concentration risk; 6) Product competitiveness risk

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	**49,027**	**53,779**	**58,433**	**63,548**	**68,835**
Chg (%,YoY)	*(2.04)*	*9.69*	*8.65*	*8.75*	*8.32*
Net Profit (RMB mn)	**2,367**	**(751)**	**2,310**	**2,638**	**2,712**
Chg (%,YoY)	*0.70*	*(131.73)*	*N/A*	*14.24*	*2.79*
Basic EPS (RMB)	**0.61**	**(0.19)**	**0.59**	**0.67**	**0.69**
Chg (% YoY)	*0.66*	*(131.69)*	*N/A*	*14.16*	*2.79*
P/E (x)	*27.06*	*N/A*	*27.99*	*24.52*	*23.85*
BVPS (RMB)	5.63	5.30	5.71	6.16	6.60
P/B (x)	*2.93*	*3.11*	*2.89*	*2.67*	*2.49*
DPS(RMB)	0.14	0.09	0.14	0.16	0.17
Yield (%)	*0.85*	*0.54*	*0.86*	*0.97*	*1.01*
ROAA (%)	4.84	(1.50)	4.38	4.52	4.38
ROAE (%)	10.85	(3.50)	10.68	11.32	10.82

Source(s): Bloomberg, ABCI Securities estimates

Company Report
Sep 13, 2017
Rating: HOLD
TP: HK$ 20.3

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Share price (HK$)	19.70
52Wk H/L(HK$)	19.9/13.811
Est. share price return	3.05%
Est. dividend yield	0.86%
Est. total return	3.90%
Previous Rating & TP	SELL;HK$14.16
Previous report date	Apr 10, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

Issued shares (mn)	3,926.26
Market cap (HK$ mn)	77,347.24
3-mth ADT (HK$ mn)	183.52

Major shareholders	(%)
COFCO	31.44
Commonwealth Bank of Australia	9.96
JP Morgan Chase	5.94
Schroders	5.07

Source(s): Bloomberg, HKEX

% of total revenue	FY17E
Liquid milk	88.62
Ice cream	4.45
Milk formula	5.91

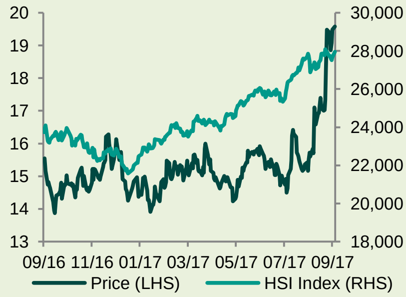
Source(s): ABCI Securities estimates

Price Performance (%)

	Absolute	Relative*
1-mth	26.28	21.70
3-mth	26.12	15.84
6-mth	28.59	7.94

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

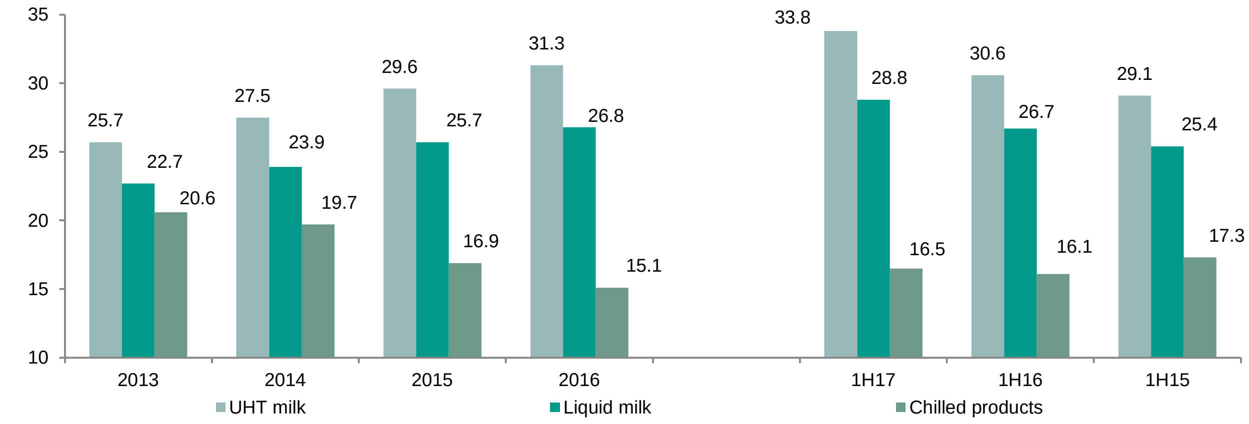
1-Year price performance (HK$)



Source(s): Bloomberg, ABCI Securities

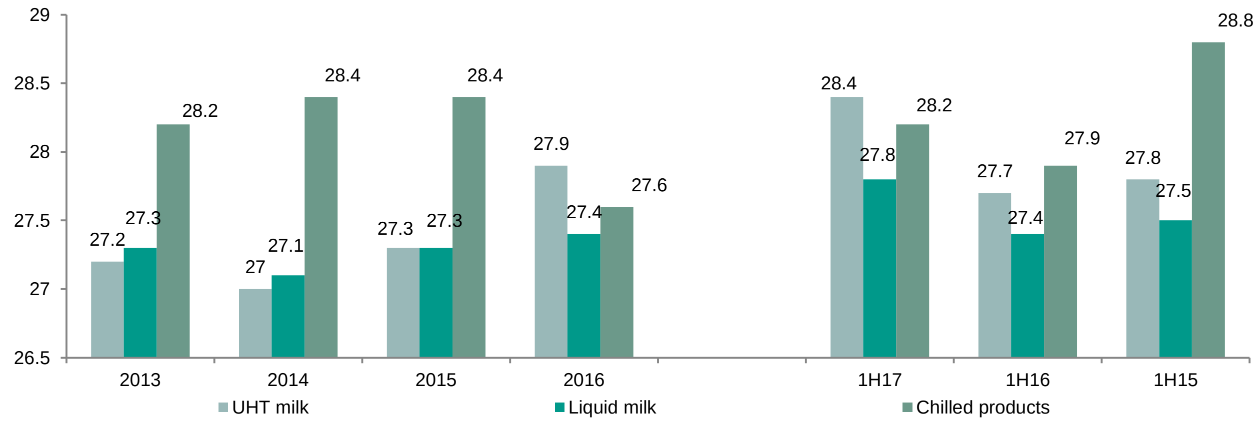
* All pricing and market data as of closing of Sep 13, 2017

Exhibit 1: Market share by product – Yili (%)



Source(s): Mengniu presentation material, ABCI Securities

Exhibit 2: Market share by product – Mengniu (%)



Source(s): Mengniu presentation material, ABCI Securities

Consolidated income statement (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Revenue	**49,027**	**53,779**	**58,433**	**63,548**	**68,835**	**27,257**	**29,466**
- Liquid milk	43,327	48,103	51,785	57,020	62,034	23,762	25,372
- Ice cream	2,141	2,180	2,598	2,245	2,271	1,703	1,985
- Milk formula	3,229	3,151	3,451	3,623	3,804	1,660	1,786
- Others	330	314	600	660	726	132	322
COGS	(33,651)	(36,144)	(38,472)	(41,655)	(45,113)	(18,076)	(18,963)
Gross profit	**15,375**	**17,635**	**19,961**	**21,893**	**23,723**	**9,181**	**10,503**
Other income	521	702	574	625	677	170	127
SG&A	(12,856)	(15,907)	(16,476)	(18,114)	(19,802)	(7,585)	(8,231)
Other expenses	(393)	(2,851)	(1,110)	(1,144)	(1,239)	(219)	(593)
Operating profit	**2,648**	**(420)**	**2,949**	**3,259**	**3,358**	**1,525**	**1,806**
Net finance cost	245	184	276	408	426	127	38
Share of profits from JV and associates	138	(225)	(245)	(266)	(289)	(155)	(355)
Pretax profit	**3,030**	**(461)**	**2,980**	**3,401**	**3,495**	**1,498**	**1,489**
Tax	(510)	(351)	(496)	(564)	(579)	(313)	(374)
Net profit	**2,520**	**(813)**	**2,483**	**2,837**	**2,916**	**1,185**	**1,115**
- Profit attributable to shareholders	2,367	(751)	2,310	2,638	2,712	1,077	1,128
- Minority interest	153	(62)	174	199	204	107	(13)
EPS (RMB)							
- Basic	0.61	(0.19)	0.59	0.67	0.69	0.28	0.29
- Diluted	0.61	(0.19)	0.59	0.67	0.69	0.28	0.29
DPS (RMB)	**0.14**	**0.09**	**0.14**	**0.16**	**0.17**	**0.00**	**0.00**

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2015A-2019E)

FY ends at Dec 31 (RMB mn)	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Cash and cash equivalent	7,931	6,070	12,793	13,005	12,635	5,207	10,537
Trade and bills receivable	1,618	2,340	2,204	2,614	2,400	2,930	2,749
Inventory	4,340	3,314	4,475	4,678	5,214	3,469	3,323
Others	8,532	7,947	7,172	7,554	7,661	10,106	6,350
Total current assets	**22,420**	**19,671**	**26,644**	**27,851**	**27,910**	**21,711**	**22,959**
PP&E	12,539	13,970	13,236	14,376	15,176	13,070	13,768
Land use rights	889	984	1,252	1,341	1,430	968	1,012
Goodwill	5,851	4,528	4,528	4,528	4,528	8,568	6,637
Other Intangible assets	1,731	2,086	1,779	1,831	1,866	1,998	2,105
Others	7,223	7,937	8,924	10,534	12,390	5,009	8,308
Total non-current assets	**28,232**	**29,504**	**29,717**	**32,609**	**35,389**	**29,612**	**31,831**
Total assets	**50,653**	**49,176**	**56,361**	**60,460**	**63,299**	**51,323**	**54,789**
Trade and bills payable	4,644	5,406	5,944	6,198	7,041	5,780	6,594
ST borrowings	6,081	3,045	9,338	9,580	12,792	6,404	4,654
Others	5,251	6,852	5,207	6,388	5,494	5,084	6,038
Total current liabilities	**15,976**	**15,303**	**20,489**	**22,166**	**25,327**	**17,268**	**17,286**
LT Borrowings	4,970	5,542	4,994	4,989	1,979	3,769	9,524
Others	3,092	2,776	3,720	4,256	5,087	3,505	2,778
Total non-current liabilities	**8,061**	**8,318**	**8,713**	**9,245**	**7,066**	**7,274**	**12,302**
Shareholders' equity	22,136	20,845	22,407	24,193	25,939	22,284	21,669
Minority interest	4,479	4,659	4,751	4,857	4,966	4,497	4,590
Total equity	**26,615**	**25,504**	**27,158**	**29,050**	**30,905**	**26,781**	**26,259**
Total liabilities and equity	**50,653**	**49,124**	**56,361**	**60,460**	**63,299**	**51,323**	**55,847**

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2015A-2019E)

FY ends at Dec 31 (RMB mn)	2015A	2016E	2017E	2018E	2019E	1H16	1H17
Pretax profit	3,030	(461)	2,980	3,401	3,495	1,498	1,489
Depreciation and amortization	1,444	1,739	2,003	2,259	2,561	784	839
Change in working capital	(1,063)	3,010	(2,133)	1,086	(653)	828	(793)
Others	(1,502)	2,003	(502)	(743)	(724)	(435)	(145)
Cash flow from operating activities	**1,909**	**6,289**	**2,347**	**6,004**	**4,679**	**2,675**	**1,390**
Capex	(3,027)	(4,353)	(3,532)	(4,854)	(5,324)	(2,707)	(5,313)
Others	3,564	4,648	3,105	3,791	3,935	(1,503)	922
Cash flow from investing activities	**537**	**295**	**(427)**	**(1,063)**	**(1,389)**	**(4,209)**	**(4,392)**
Change in borrowings	882	(2,463)	5,744	237	201	(1,009)	5,590
Dividends paid	(655)	(622)	(349)	(636)	(719)	(608)	(349)
Others	462	(186)	(173)	(249)	(228)	(182)	44
Cash flow from financing activities	**689**	**(3,270)**	**5,222**	**(647)**	**(746)**	**(1,799)**	**5,284**
Net change in cash	**3,135**	**3,315**	**7,143**	**4,294**	**2,544**	**(3,333)**	**2,283**
Forex effect	93	(82)	(26)	(24)	(52)	33	62
Cash and cash equivalent - end	**6,834**	**10,066**	**17,184**	**21,454**	**23,946**	**3,534**	**12,411**

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2015A-2019E)

FY ends at Dec 31	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Growth (YoY %)							
Revenue	(2.04)	9.69	8.65	8.75	8.32	6.62	8.10
Liquid milk	0.67	11.02	7.65	10.11	8.79	8.30	6.78
- UHT milk	(9.86)	11.64	0.11	4.27	2.75	7.50	2.46
- Milk beverage	(12.46)	(10.11)	6.00	3.27	0.66	(13.11)	(0.11)
- Yogurt	55.48	29.00	20.80	21.66	19.51	31.57	18.18
Ice cream	(21.17)	1.81	19.16	(13.58)	1.16	3.59	16.55
Milk formula	(18.48)	(2.41)	9.51	5.00	5.00	(6.92)	7.61
Other products	(1.83)	4.77	73.58	10.00	10.00	(32.42)	143.48
Gross profit	(0.38)	14.70	13.19	9.68	8.36	12.75	14.39
Operating profit	(0.63)	(115.86)	N/A	10.52	3.03	3.65	18.36
Net profit (to owners of the Group)	0.70	(131.73)	N/A	14.24	2.79	(19.53)	4.70
Profitability ratios (%)							
GPM	31.36	32.79	34.16	34.45	34.46	33.68	35.64
OPM	5.40	(0.78)	5.05	5.13	4.88	5.60	6.13
EBITDA margin	8.63	1.78	8.47	8.68	8.60	7.91	7.77
NPM (to owners of the Group)	4.83	(1.40)	3.95	4.15	3.94	3.95	3.83
Return ratios (%)							
ROAA	4.84	(1.50)	4.38	4.52	4.38	4.23	4.29
ROAE	10.85	(3.50)	10.68	11.32	10.82	9.70	10.61
Liquidity ratio (x)							
Current ratio	1.40	1.29	1.30	1.26	1.10	1.26	1.33
Quick ratio	1.13	1.07	1.08	1.05	0.90	1.06	1.14
Cash ratio	0.54	0.45	0.67	0.63	0.54	0.34	0.61
Cash conversion cycle (days)							
Days of outstanding receivable	10	13	14	14	13	15	16
Days of inventory on hand	47	39	37	40	40	39	32
Days of outstanding payable	52	52	52	53	53	58	60
CCC	5	0	(1)	1	0	(3)	(12)
Leverage ratios (%)							
Total debt/Equity	41.52	38.86	53.19	50.52	48.23	38.08	54.08
Total debt/Total assets	21.82	17.46	25.43	24.10	23.34	19.87	25.92

Source(s): Company, ABCI Securities estimates

Disclosures

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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
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.

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