



Company Report

China Modern Dairy (1117 HK)

May 16, 2013

Rating: Buy
TP: HK\$2.93

Key data

Share price (HK\$)	2.65
Upside potential (%)	10.6
52Wk H/L(HK\$)	2.9 / 1.7
Issued shares (mn)	4,812
Market cap (HK\$m)	12,416
30-day avg vol (HK\$m)	146.5
Auditors	Deloitte
Major shareholder (%):	
China Mengniu	27.99
Yimu Holdings	15.41
Xinmu Holding	14.81
China Diamond	7.99
Gao Lina	5.22

Source: Company & Bloomberg

Revenue composition in FY12 (%)

Raw milk sales	100
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Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	10.9	4.8
3-mth	6.0	7.7
6-mth	35.9	26.4

*Relative to Hang Seng Index

Source: Bloomberg

1 year share price performance



Source: Bloomberg

Analyst

Report Date: 16 May 2013

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Time for harvest

Time for lucrative returns after heavy initial investment since listed. We also see signs of margin improvement as feed costs grow at a slower pace than ASP. Partnership with Mengniu and recent 27% stake acquisitions by Mengniu secured the group's sales for its increased capacity. We therefore initiate our research coverage with a BUY recommendation. Based on our DCF model, we set our TP at HK\$2.93.

Time for harvest for previous investment: The number of farms owned by the group has doubled to 22 since listed (Nov 2010) while number of dairy cows increased by 144% to 176,264. Going forward, the group has no plan to add any farms but will increase the utilization rate of farms and yield rate per cattle. It is expected number of dairy cows to reach 240,000 in FY15 while yield rate of cattle will increase from 8.09ton/yr in FY12 to 9.0ton/yr in FY15. We expect sales volumes to increase by 40.8% YoY to 607,608tons. Since it takes 9-15 months for commercial production after farm completed construction, we believe FY13-FY14 will be the harvest period for the intensive initial capital investment in FY11-FY12 and the group should turn net cash flow positive in FY14 as CMD stops importing cows and hence lower CAPEX.

Better margin ahead: Raw milk price is fixed with Mengniu in beginning of 2013 and management hints raw milk ASP to lie in between Rmb4,200-4250/ton, up 8.0-9.3% YoY, which should outweigh the expected 5% YoY increase in feed costs in FY13.

Strategic partnership with Mengniu: The 10-year off-take agreement signed with Mengniu in 2008 allows the group to sell all raw milk produced daily to Mengniu, and hence secured a long term demand from a high-quality customer. The group's large scale farm business model is aligned with Mengniu's strategy in improving product quality. We believe the group's production growth can be fully consumed by Mengniu as the group's supply only constituted to less than 5% of Mengniu's raw milk supply, which imply ample room for further business expansion with Mengniu.

Valuation: Based on our DCF model with 7.6% WACC, we value the stock at HK\$2.93, which represents est FY13 PE of 25.4x and PB of 2.03x. Our appraised share value provides 10.6% of upside potential and we initiate coverage with BUY rating.

Risk factors: Diseased cow, customer concentration risks, related party transactions, tax policy

Results and valuation

(FY ended Jun 30)	FY10A	FY11A	FY12A	FY13E	FY14E
Revenue (Rmb mn)	590	1,113	1,678	2,599	3,454
Chg (%YoY)	76.6	88.8	50.7	54.9	32.9
Net Income (Rmb mn)	53	225	398	452	612
Chg (%YoY)	24.5	322.7	77.4	13.4	35.4
EPS (Rmb)	0.025	0.052	0.082	0.092	0.124
Chg (%YoY)	-	102.8	59.6	11.6	35.4
NBV (Rmb/share)	0.299	0.973	1.056	1.147	1.274
PE (x)	-	-	25.6	23.0	17.0
PB (x)	-	-	2.0	1.8	1.7
ROAA (%)	1.49	4.04	5.12	4.78	5.50
ROAE (%)	2.96	7.36	8.19	8.54	10.51
Net D/E (%)	37.9	10.6	40.4	54.0	47.6

Source: Company annual reports, ABCI Securities estimates



Profit Forecast

FY ended Jun 30 (Rmbmn)	FY10	FY11	FY12	FY13F	FY14F
Revenue	589.8	1,113.4	1,677.6	2,599.2	3,454.3
Cost of sales	(437.6)	(730.3)	(1,148.7)	(1,771.8)	(2,332.5)
Gross profit	152.2	383.0	528.9	827.4	1,121.8
Gain arising from changes in fair value	60.6	55.5	131.5	52.0	41.5
Other income	65.4	101.9	116.6	100.0	100.0
Employee benefits expense	(66.7)	(89.6)	(128.0)	(194.9)	(245.3)
Depreciation	(44.2)	(67.3)	(94.8)	(111.2)	(122.2)
Share of profit of an associate	0.0	0.0	2.0	-	-
Net foreign exchange loss	(1.2)	(17.4)	(4.3)	-	-
Other gains and losses	0.6	(1.2)	(1.1)	-	-
Other expenses	(29.5)	(61.9)	(72.0)	(109.2)	(145.1)
EBIT	137.2	303.0	478.8	564.1	750.8
Finance costs	(29.8)	(59.1)	(71.3)	(100.5)	(122.9)
EBT	107.4	243.9	407.5	463.6	627.8
Tax	(0.1)	(0.0)	(0.1)	0.0	0.0
MI	(54.2)	(19.3)	(8.8)	(11.6)	(15.7)
Net profit attributable to owners	53.1	224.6	398.5	452.0	612.2
D&A	44.2	67.3	94.8	222.3	244.3
EBITDA	204.5	397.8	701.1	808.4	1,011.6
Dividends	-	-	0.0	0.0	49.0
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:					
Share options	-	87.4	87.4	115.1	115.1
Total issued & issuable shares	4,800.0	4,887.4	4,887.4	4,927.4	4,927.4
Per share value (Rmb)					
FD EPS	0.025	0.052	0.082	0.092	0.124
NBV	0.299	0.973	1.056	1.147	1.274
DPS	-	-	0.000	0.000	0.010

Source: Company annual reports, (for historical figures only), ABCI Securities estimates

Key Financial Ratio

FY ended Jun 30	FY10	FY11	FY12	FY13F	FY14F
Profitability ratio					
Gross profit margin	25.8%	34.4%	31.5%	31.8%	32.5%
EBIT margin	23.3%	27.2%	28.5%	21.7%	21.7%
EBITDA margin	34.7%	35.7%	41.8%	31.1%	29.3%
Net profit margin	18.2%	21.9%	24.3%	17.8%	18.2%
ROAA	1.5%	4.0%	5.1%	4.8%	5.5%
ROAE	3.0%	7.4%	8.2%	8.5%	10.5%
Cost ratio					
Effective tax rate	-0.1%	0.0%	0.0%	0.0%	0.0%
Leverage					
Current ratio	0.68	2.10	0.73	0.80	1.13
Quick ratio	0.49	1.83	0.56	0.57	0.92
Net debt/total equity	37.9%	10.6%	40.4%	54.0%	47.6%
Working capital cycle					
Receivables turnover days	48.1	35.0	34.6	35.0	35.0
Inventory turnover days	51.7	51.9	43.6	45.0	45.0
Payables turnover days	125.4	123.0	119.2	120.0	120.0

Source: Company annual reports, (for historical figures only), ABCI Securities estimates



Balance Sheet Forecast

As of Jun 30 (Rmbmn)	FY10	FY11	FY12	FY13F	FY14F
PPE	1,578.4	2,221.3	2,964.6	3,442.3	3,598.0
Others	2,121.1	3,025.9	4,588.2	5,393.3	6,050.0
Non-current assets	3,699.5	5,247.2	7,552.8	8,835.6	9,648.0
Inventories	139.4	212.7	263.9	408.5	430.1
Trade and other receivables	76.8	136.8	181.0	317.4	345.0
Land use rights	1.2	1.4	1.7	1.7	1.7
Pledged bank balances	36.4	287.1	134.2	134.2	134.2
Bank balances and cash	251.0	1,021.7	518.3	568.5	1,427.6
Current assets	504.7	1,659.7	1,099.1	1,430.2	2,338.6
Trade and other payables	351.1	482.8	821.2	971.7	1,264.6
ST loans	384.6	303.8	664.2	790.0	790.3
Others	6.4	4.9	15.7	15.7	15.7
Current liabilities	742.1	791.6	1,501.1	1,777.3	2,070.6
LT loans	840.5	1,219.1	1,926.6	2,800.8	3,600.4
Others	51.9	173.5	91.4	91.4	91.4
Non-current liabilities	892.4	1,392.7	2,018.0	2,892.2	3,691.9
Total assets	4,204.2	6,906.9	8,651.8	10,265.9	11,986.6
Net assets	2,569.7	4,722.7	5,132.7	5,596.3	6,224.1
Share capital	0.3	413.1	413.1	413.1	413.1
Reserves	1,436.5	4,254.9	4,653.4	5,105.4	5,717.6
MI	1,133.0	54.7	66.2	77.8	93.5
Total Equity	2,569.7	4,722.7	5,132.7	5,596.3	6,224.1
Equity attributable to owners	1,436.7	4,668.0	5,066.5	5,518.5	6,130.6

Source: Company annual reports (for historical figures only), ABCI Securities estimates

Cash Flow Forecast

As of Jun 30 (Rmbmn)	FY10	FY11	FY12	FY13F	FY14F
EBITDA	204.5	397.8	701.1	808.4	1,011.6
Change in working capital	2.6	10.1	121.2	(130.5)	243.6
Others	(88.1)	(97.1)	(279.7)	(22.0)	(16.5)
Cash (used in)/generated from operations	119.1	310.8	542.5	655.9	1,238.7
Interest paid	(1.0)	0.0	1.0	2.0	3.0
Income tax paid	0.9	(0.0)	(1.1)	(2.0)	(3.0)
CF from operating activities	119.0	310.8	542.4	655.9	1,238.7
CAPEX	(1,278.2)	(1,498.4)	(2,251.7)	(1,505.2)	(1,056.7)
Others	(21.6)	(471.7)	(277.6)	(655.9)	(1,238.7)
Cash flows from investing activities	(1,180.8)	(1,659.3)	(1,986.9)	(1,505.2)	(1,056.7)
Net borrowing	632.9	297.8	1,067.9	1,000.0	800.0
Proceeds from issue of shares	0.0	2,810.3	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Interest paid	(55.2)	(85.7)	(128.1)	(100.5)	(122.9)
Others	1.3	(903.1)	1.3	0.0	0.0
Cash flows from financing activities	579.1	2,119.3	941.1	899.5	677.1
Net (decrease)/increase in cash and cash equivalents	(482.8)	770.7	(503.4)	50.2	859.1
Cash and cash equivalents at beginning of year/period	733.7	251.0	1,021.7	518.3	568.5
Cash and cash equivalents at end of year/period	251.0	1,021.7	518.3	568.5	1,427.6

Source: Company annual reports (for historical figures only), ABCI Securities estimates

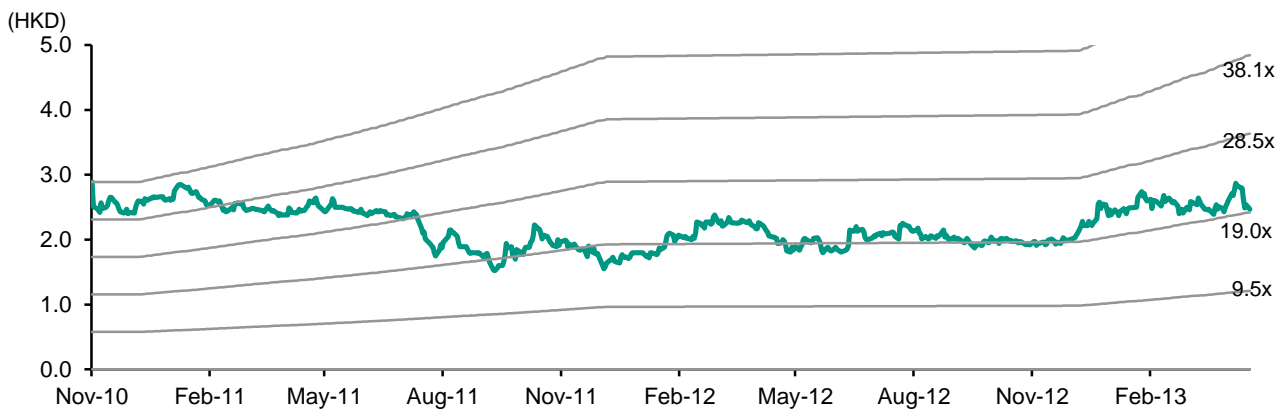


Exhibit: Financial forecasts vs Consensus (Rmb mn)

	Our forecast		Consensus		Difference	
	FY13F	FY14F	FY13F	FY14F	FY13F	FY14F
Revenue	2,599	3,454	2,556	3,480	1.69%	-0.74%
Gross Profit	827	1,122	848	1,175	-2.39%	-4.48%
Net profit	464	628	467	667	-0.76%	-5.83%
FD EPS (Rmb)	0.092	0.124	0.105	0.144	-12.64%	-13.73%

Source: Bloomberg; ABCI Securities estimates

Exhibit: Historical PE of the group



Source: Bloomberg, ABCI Securities

Exhibit: PE standard deviation of the group



Source: Bloomberg, ABCI Securities



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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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