

Mar 27, 2015
Company Report
Rating: BUY
TP: HK\$ 41.63

Share price (HK\$)	38.5
Est. share price return (%)	8.13
Est. dividend yield (%)	1.07
Est. total return	9.20

Previous Rating & TP	40.8
Previous Report Date	Sep 1, 2014

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Key Data

52Wk H/L(HK\$)	43.8/27
Outstanding shares (mn)	1,959.63
Market cap (HK\$ mn)	75,445.87
3-mth avg daily turnover (HK\$ mn)	177.60
Major shareholder(s) (%):	
COFCO Dairy Investment Ltd.	23.92
Prominent Achiever Ltd.	7.55
Commonwealth Bank of Australia	7.02
JP Morgan Chase & Co.	6.98

Source(s): Bloomberg, ABCI Securities

Revenue composition (%)

As % of total revenue	FY14	FY13
Liquid milk	85.99	87.42
- UHT milk	47.36	50.86
- Milk beverage	23.82	24.05
- Yogurt	14.81	12.51
Ice cream	5.43	6.97
Milk formula	7.91	5.02
Others	0.01	0.01

Source(s): Company, ABCI Securities

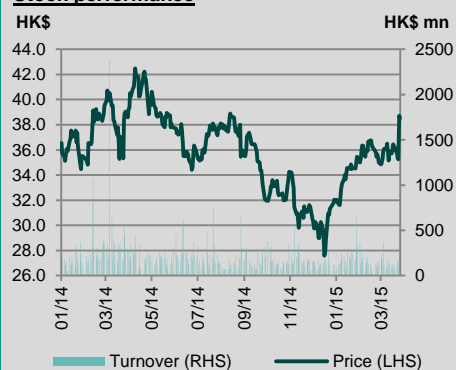
Share price performance (%)

	Absolute	Relative*
1-mth	10.00	10.92
3-mth	23.00	17.64
6-mth	15.62	11.43

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Stock performance



Source(s): Bloomberg, ABCI Securities

Mengniu (2319 HK)

FY14 results show leadership remains intact;
Upgrade to **BUY**

- FY14 results indicate Mengniu's leading market position remains intact
- Earnings and margin improvements reflect better cost control and fallen raw material costs in FY14
- Product diversification is in progress with creation of new product lines and horizontal expansion of existing products
- We expect the Mengniu would perform consistently in FY15 with its leading position, new products, and marketing strategy
- We remain cautious on the Group's development strategy with Yashili and its milk formula business

Satisfactory FY14 results. Mengniu's FY14 revenue grew 15.44% yoy, lower than the 20.44% yoy in FY13. SG&A/sales increased from 22.54% in FY13 to 24.99% in FY14, but the Group's effective cost control lifted GPM, OPM, and NPM from 26.98%, 4.27%, and 3.76% in FY13 to 30.84%, 5.32%, and 4.70% in FY14, respectively. Although inventory turnover days increased from 22.7 to 36.5 on increased use of milk powder as raw material, the Group's cash conversion cycle was still in the negative territory (-5.51 days), indicating an efficient working capital management.

Product portfolio continues to diversify. Mengniu has undergone major structural shifts in product portfolio, which includes horizontal expansion of existing product lines and product mix changes. As a result, revenue contribution from UHT milk segment decreased to 47.36% while that of the yogurt segment increased to 14.81% in FY14. The Group also ventured into the plant-based drink business with WhiteWave. We expect Mengniu to continue diversifying its products for higher growth and an increased mix of high-margin products.

Industry condition is favorable to Mengniu. We believe that even if prices of domestic raw milk and international milk powder futures start to rebound by end-1H15, Mengniu will still enjoy a low production cost in FY15. We expect Mengniu's leading position, new product launches, and integrated marketing approach would allow it to outperform peers.

Remain cautious on milk formula segment. Mengniu's milk formula business has been underperforming in the industry. We remain cautious on Yashili as to whether it could successfully enhance its distribution network, improve branding strategies, or synergize with Mengniu's internal milk formula business.

Revising TP to HK\$41.63; recommend BUY. Based on our outlook for the dairy product market and Mengniu in 2015, we revise up its TP to HK\$ 41.63 and upgrade our rating to **BUY**. The TP represents a 23.63x FY15E P/E and 20.37x FY16E P/E.

Risk factors: 1) Food safety risk; 2) Poor sales performance of new products; 3) Regulation-induced cost increase; 4) Risks related to cooperation with new business partners; 5) Political risk.

Results and Valuation

FY ended Dec 31	2013A	2014A	2015E	2016E	2017E
Revenue (RMB mn)	43,356.91	50,049.24	59,395.08	68,926.54	78,502.49
Chg (% YoY)	20.44	15.44	18.67	16.05	13.89
Net Income (RMB mn)	1,861.99	2,690.65	3,139.95	3,658.74	4,481.04
Chg (% YoY)	25.16	44.14	17.39	16.13	22.50
Basic EPS (RMB cent)	0.90	1.21	1.41	1.64	2.00
P/E (x)	31.58	21.16	21.88	18.86	15.29
BVPS (RMB)	5.51	8.68	9.78	11.02	12.52
P/B (x)	5.18	2.95	3.15	2.80	2.45
DPS (RMB)	0.27	0.35	0.41	0.48	0.59
Yield (%)	0.73	1.08	1.07	1.25	1.52
ROAA (%)	5.33	5.38	5.83	6.28	6.63
ROAE (%)	11.71	12.76	12.29	13.07	14.57

Source(s): Company, Bloomberg, ABCI Securities estimates

Appendix: Financial Statements of the Group

Consolidated income statement (2013A-2017E)

FY 13 ends at Dec 31 (RMB mn, except per share data)	2013A	2014A	2015E	2016E	2017E
Revenue	43,357	50,049	59,395	68,927	78,502
- Liquid milk	37,903	43,036	50,996	59,485	67,614
- Ice cream	3,023	2,716	3,124	3,190	3,431
- Milk formula	2,177	3,961	4,804	5,593	6,536
- Other revenue	253	336	470	659	922
COGS	-31,660	-34,616	-40,852	-47,883	-54,434
Gross profit	11,697	15,434	18,543	21,043	24,069
Other income	289	449	446	532	633
SG&A	-9,774	-12,505	-15,173	-17,321	-19,635
Other expenses	-360	-713	-553	-625	-699
EBIT	1,852	2,665	3,264	3,629	4,368
Net interest expense(-)/income(+)	199	208	248	382	559
Income from associate/JV	154	278	188	282	335
Profit before tax	2,205	3,150	3,699	4,293	5,261
Tax	-367	-459	-560	-635	-780
Profit from discontinued operation	24	0	0	0	0
Total net profit	1,862	2,691	3,140	3,659	4,481
- Profit to shareholders	1,631	2,351	2,760	3,205	3,926
- Minority interest	231	340	380	454	555
EPS (RMB)					
- Basic	0.904	1.210	1.408	1.635	2.003
- Diluted	0.896	1.203	1.407	1.634	2.001
DPS	0.267	0.347	0.414	0.482	0.586

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2013A-2017E)

As of Dec 31 (RMB mn, except per share data)	2013A	2014A	2015E	2016E	2017E
Cash and equivalent	7,102	4,650	5,104	7,125	9,871
Accounts receivables	754	1,148	1,083	1,521	1,437
Inventory	2,577	4,342	4,373	5,503	5,909
Other current assets	5,888	10,193	5,527	5,955	6,474
Total current assets	16,321	20,333	16,087	20,105	23,690
PP&E and construction in progress	10,522	11,697	13,068	14,032	15,708
Land use rights	1,049	1,051	1,104	1,209	1,297
Goodwill & intangibles	7,307	7,458	7,447	7,446	7,445
Other non-current assets	5,140	6,542	9,882	11,697	15,749
Total non-current assets	24,018	26,748	31,502	34,384	40,200
Total assets	40,339	47,081	47,589	54,489	63,890
Accounts payables	4,761	4,992	5,303	6,410	7,143
Short-term debt	8,462	4,361	1,576	2,736	3,802
Other current liabilities	4,841	4,999	6,346	8,255	12,252
Total current liabilities	18,063	14,351	13,225	17,401	23,197
Long-term debt	3,236	5,464	4,791	4,784	4,777
Other non-current liabilities	1,029	2,773	2,948	3,240	3,904
Total non-current liabilities	4,265	8,237	7,739	8,023	8,681
Total liabilities	22,328	22,588	20,964	25,425	31,878
Equity attributable to shareholders	15,361	21,489	23,421	25,615	28,267
Minority interest	2,650	3,003	3,204	3,449	3,745
Equities	18,011	24,493	26,626	29,064	32,012
Total liabilities and equity	40,339	47,081	47,589	54,489	63,890

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2013A-2017E)

FY ends at Dec 31 (RMB mn)	2013A	2014E	2015E	2016E	2017E
Profit before tax	2,229	3,150	3,699	4,293	5,261
Depreciation and amortization	1,218	3,322	2,919	4,112	4,594
Change in working capital	517	(2,520)	803	1,227	1,159
Finance cost	160	340	199	175	208
Interest income	(359)	(548)	(447)	(557)	(767)
Others	(481)	(664)	(784)	(872)	(1,070)
Total cash flow from operation	3,284	3,080	6,389	8,378	9,385
Change in PP&E	(12,597)	(3,278)	(13,365)	(17,381)	(22,819)
Change in biological assets	(364)	(124)	(64)	(90)	(126)
Change in land use rights	10	(2)	(53)	(105)	(88)
Others	(2,317)	(1,808)	6,927	9,725	13,540
Total Cash Flow From investing	(15,269)	(5,212)	(6,556)	(7,851)	(9,493)
Change in debt	7,840	(1,872)	(3,458)	1,153	1,059
Dividend paid	(385)	(492)	(680)	(812)	(946)
Others	4,876	5,497	(316)	(514)	(764)
Total Cash Flow From Financing	12,331	3,133	(4,454)	(172)	(650)
Net change in cash	346	1,001	(4,621)	355	(759)
Cash and cash equivalent at beg	2,918	3,355	4,556	135	690
Other changes	3,838	294	5,168	6,635	9,939
Cash and cash equivalent at end	7,102	4,650	5,104	7,125	9,871

Source(s): Company, ABCI Securities estimates

Key operating and financial ratios (2013A-2017E)

FY ended Dec 31	2013A	2014A	2015E	2016E	2017E
Growth measures (%)					
Sales growth	20.44	15.44	18.67	16.05	13.89
Gross profit growth	30.70	31.94	20.15	13.48	14.38
Operating profit growth	15.17	43.90	22.49	11.19	20.35
Net profit growth	25.16	44.14	17.39	16.13	22.50
Profitability ratios (%)					
Gross margin	26.98	30.84	31.22	30.53	30.66
EBIT margin	4.27	5.32	5.50	5.27	5.56
EBITDA margin	7.49	8.56	10.41	11.23	11.42
Pre-tax margin	5.08	6.29	6.23	6.23	6.70
Net margin	3.76	4.70	4.65	4.65	5.00
Return ratios (%)					
ROAA	5.33	5.38	5.83	6.28	6.63
ROAE	11.71	12.76	12.29	13.07	14.57
ROIC	5.84	5.88	6.35	7.00	7.47
Dividend yield	0.73	1.08	1.07	1.25	1.52
Liquidity ratio (%)					
Current ratio	90.36	141.68	121.64	115.54	102.13
Quick ratio	76.09	111.42	88.58	83.91	76.65
Cash ratio	42.42	34.18	40.72	42.72	44.02
Cash conversion cycle (days)					
Days of outstanding receivable	6.78	6.94	6.86	6.90	6.88
Days of inventory on hand	22.71	36.48	29.60	33.04	31.32
Days of outstanding payable	46.58	48.93	47.75	48.34	48.05
CCC	-17.09	-5.51	-11.30	-8.40	-9.85
Leverage ratios (%)					
Total debt/Equity	64.94	40.11	24.53	26.48	27.37
Total debt/Total assets	29.00	20.87	13.38	13.80	13.43

Source(s): Company, ABCI Securities estimates

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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 2007-2011

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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