



Yili (600887 CH)

Improved margins in 1Q17

- In 1Q17, Yili's revenue, gross profit, and net profit grew 3.03% YoY, 10.49% YoY and 11.58% YoY
- The Group's NPM improved from 9.34% in FY16 to 10.98% in 1Q17; OPM rose from 8.56% in FY16 to 12.15% in 1Q17.
- Termination of Shengmu acquisition would reduce near-term M&A execution risk
- Recent actions of Yili and Mengniu show diverging business strategy
- Reiterate **BUY**; current TP represents FY17E/18E P/E of 20.55x and 17.28x and FY17E/18E P/B of 3.72x and 3.38x

Decent growth momentum in 1Q17. In 1Q17, Yili recorded revenue growth of 3.03% YoY, a decent improvement over the 0.41% YoY in FY16. Gross profit grew 10.49% YoY, while net profit (to shareholders of the Company) rose 11.58% YoY. Growth momentum in 1Q17 suggests a decent recovery.

Continued margin expansion. Although GPM declined slightly from 38.25% in FY16 to 37.93% in 1Q17; NPM improved from 9.34% in FY16 to 10.98% in 1Q17; OPM expanded from 8.56% in FY16 to 12.15% in 1Q17. The margin improvement can be attributed to the lower SG&A/sales ratio (FY16: 28.99% vs. 1Q17: 25.03%). In 1Q17, ROAA increased from 3.9% in 1Q16 to 4.24% while ROAE was 7.24% vs. 7.42% in 1Q16.

Terminating Shengmu acquisition reduces M&A execution risk. The Group announced its decision to terminate the Shengmu acquisition. Meanwhile, Mengniu's acquisition of Modern Dairy is in the final stage. We believe Yili's decision would reduce the related M&A execution risk. The Group has signaled to focus on the downstream business by disposing all of its upstream business in FY16. In addition, the upstream business is turning less attractive as upstream dairy market remains fragmented and imported milk powder continues to exert pressure on domestic raw milk price.

The changing business models of industry leaders. Recent actions taken by Yili and Mengniu show divergent management philosophies between the two. Mengniu is building an integrated model to enhance its product quality management while Yili chooses to focus on brand building and downstream product development. In our view, Yili's consumer-oriented strategy would allow it to gain a stronger foothold in the highly competitive consumer market in China.

Reiterate BUY with TP at RMB 21.3. Growth and profitability outlook for the Group in FY17 remains decent based on its results in 1Q17. Termination of the Shengmu acquisition would benefit the Group by reducing the M&A execution risk in near term. We reiterate **BUY**. Our current TP represents FY17E/18E P/E of 20.55x and 17.28x and FY17E/18E P/B of 3.72x and 3.38x.

Risk factors: 1) Macroeconomic risk; 2) Commodity price risk; 3) Food safety risk; 4) Investment risk

Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	60,360	60,609	64,476	68,621	73,051
Chg (% YoY)	10.88	0.41	6.38	6.43	6.46
Net Profit (RMB mn)	4,632	5,662	6,302	7,495	9,490
Chg (% YoY)	11.76	22.24	11.31	18.93	26.63
Basic EPS (RMB)	0.76	0.93	1.04	1.23	1.56
Chg (% YoY)	11.76	22.37	11.47	18.93	26.63
P/E (x)	24.24	19.81	17.77	14.94	11.80
BVPS (RMB)	3.30	3.80	5.73	6.30	6.89
P/B (x)	5.59	4.85	3.22	2.92	2.67
DPS(RMB)	0.45	0.60	0.66	0.79	1.00
Yield (%)	2.44	3.26	3.56	4.27	5.41
ROAA (%)	11.71	14.35	13.71	13.71	16.18
ROAE (%)	23.99	26.29	21.77	20.50	23.66

Source(s): Bloomberg, ABCI Securities estimates

Company Report

May 8, 2017

Rating: BUY

TP: RMB 21.30

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Share price (RMB)	18.42
Est. share price return	15.64%
Est. dividend yield	3.56%
Est. total return	19.19%
Previous Rating&TP	BUY;RMB21.30
Previous report date	Apr 10, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(RMB)	20.66/14.25
Issued shares (mn)	6,079.00
Market cap (RMB mn)	111,975.18
3-mth ADT (RMB mn)	1,098.95

Major shareholders (End 1Q17)

	(%)
Hohhot Investment Co Ltd	9.88
HK Securities Clearing Co	6.48
Pan Gang	3.88
China Securities Finance Corp	2.33
Sunshine Insurance	1.79

Source(s): , Bloomberg, Company

% of core revenue

	FY17E
Liquid milk	83.29
Chilled product	6.91
Milk formula	8.40

Source(s): ABCI Securities estimates

Sector Performance (%)

	Absolute	Relative*
1-mth	(1.02)	3.47
3-mth	1.77	2.44
6-mth	2.22	2.53

* Relative to CSI 300 Index

Source(s): Bloomberg, ABCI Securities

1-Year price performance (RMB)



Source(s): Bloomberg, ABCI Securities

* All pricing and market data as of closing of May 8, 2017

Consolidated income statement (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E	1Q16	1Q17
Revenue	60,360	60,609	64,476	68,621	73,051	15,326	15,790
- Core revenue	58,764	59,614	62,742	66,406	70,128	0	N/A
- Liquid milk	47,151	49,522	52,259	55,434	58,677	0	N/A
- Chilled product	4,098	4,194	4,335	4,479	4,736	0	N/A
- Milk formula	6,447	5,456	5,270	5,561	5,722	0	N/A
- Mixed feed	1,058	408	844	894	953	0	N/A
- Guarantee income	9	33	35	37	39	0	N/A
- Non-core revenue	1,100	698	1,196	1,577	2,079	0	0
- Interest income	496	297	538	638	845	101	74
COGS	(38,376)	(37,427)	(38,577)	(39,673)	(41,076)	(8,870)	(9,801)
Gross profit	21,984	23,182	25,899	28,948	31,975	6,456	5,990
- Core gross profit	21,387	22,813	25,245	28,152	30,926	N/A	N/A
- Liquid milk	16,069	17,808	20,070	22,703	25,359	N/A	N/A
- Chilled product	1,489	1,806	2,021	2,164	2,248	N/A	N/A
- Milk formula	3,609	3,065	2,597	2,690	2,680	N/A	N/A
- Mixed feed	212	101	522	557	600	N/A	N/A
- Guarantee income	9	33	35	37	39	N/A	N/A
- Non-core gross profit	100	72	116	158	205	N/A	N/A
- Gross profit on interest income	496	297	538	638	845	N/A	N/A
Business tax and levies	(251)	(420)	(441)	(478)	(505)	(92)	(119)
S&D expenses	(13,258)	(14,114)	(15,184)	(16,679)	(17,265)	(3,882)	(3,359)
Admin expenses	(3,456)	(3,457)	(4,410)	(4,659)	(4,916)	(787)	(594)
Operating profit	5,019	5,191	5,864	7,131	9,289	1,695	1,918
Asset impairment expense	(14)	(46)	(61)	(66)	(71)	(25)	(27)
Investment income	186	399	435	498	616	12	47
Non-operating profit/(loss)	629	1,112	1,137	1,201	1,275	171	97
Net finance income/expense	(297)	(24)	20	30	24	(17)	14
Pretax profit	5,524	6,632	7,395	8,794	11,134	1,835	2,049
Tax	(869)	(963)	(1,085)	(1,290)	(1,631)	(278)	(312)
Net profit	4,654	5,669	6,310	7,504	9,503	1,557	1,736
- Profit attributable to shareholders	4,632	5,662	6,302	7,495	9,490	1,554	1,734
- Minority interest	23	7	8	10	12	3	3
Cash dividend	2,729	3,647	3,986	4,780	6,054	0	0
EPS (RMB)							
- Basic	0.76	0.93	1.04	1.23	1.56	0.26	0.29
- Diluted	0.76	0.93	1.04	1.23	1.56	0.26	0.29
Cash DPS (RMB)	0.45	0.60	0.66	0.79	1.00	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	1Q16	1Q17
Cash and cash equivalent	13,084	13,824	22,623	25,656	27,152	12,573	15,815
Trade and bills receivable	719	686	700	729	846	1,074	1,218
Inventory	4,663	4,326	4,678	4,674	5,232	5,096	4,858
Others	1,320	1,357	1,173	1,313	1,521	1,370	1,468
Total current assets	19,786	20,193	29,175	32,372	34,750	20,113	23,359
PP&E	14,559	13,137	12,589	11,694	11,027	14,721	13,235
Biological assets	1,299	0	0	0	0	1,310	0
Goodwill	11	11	11	11	11	11	11
AFS investment	985	612	674	741	815	974	606
LT equity investment	122	1,631	1,865	2,150	2,497	126	1,654
Others	2,870	3,678	8,383	9,696	11,530	2,711	3,700
Total non-current assets	19,845	19,070	23,521	24,291	25,880	19,852	19,205
Total assets	39,631	39,262	52,696	56,663	60,631	39,964	42,564
Trade and bills payable	6,642	7,091	7,176	7,557	7,917	387	6,662
ST borrowings	6,190	150	216	229	244	5,390	3,050
Others	5,370	7,667	9,219	9,288	9,239	11,203	6,547
Total current liabilities	18,202	14,907	16,610	17,074	17,401	16,981	16,259
LT Borrowings	0	0	6	7	9	0	0
Others	1,283	1,119	989	962	984	1,267	1,344
Total non-current liabilities	1,283	1,119	995	969	993	1,267	1,344
Shareholders' equity	19,984	23,082	34,810	38,310	41,899	21,552	24,804
Minority interest	162	154	281	310	339	165	157
Total equity	20,146	23,236	35,091	38,620	42,238	21,716	24,961
Total liabilities and equity	39,631	39,262	52,696	56,663	60,631	39,964	42,564

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2015A-2019E)

FY ends at Dec 31 (RMB mn)	2015A	2016A	2017E	2018E	2019E	1Q16	1Q17
Net profit	4,654	5,669	6,310	7,504	9,503	999	1,736
Change in working capital	2,898	5,849	223	287	(1,410)	0	(1,071)
Others	1,984	1,299	1,445	1,359	1,336	(32)	(1,195)
Cash flow from operating activities	9,536	12,817	7,979	9,150	9,429	966	(530)
Change in PP&E, intangible assets, and other non-current assets	(3,626)	(3,396)	(5,268)	(6,084)	(7,244)	(690)	(649)
Others	139	153	62	109	117	11	170
Cash flow from investing activities	(3,487)	(3,243)	(5,206)	(5,975)	(7,128)	(679)	(478)
Change in borrowings	(2,586)	(6,038)	71	15	18	(800)	2,900
Cash flow related to dividend payment, interest payment, or profit distribution	(2,659)	(2,776)	(4,500)	(3,491)	(5,698)	(28)	(4)
Proceed from share placement	0	0	9,000	0	0	0	0
Others	(1,034)	(0)	(0)	0	0	0	218
Cash flow from financing activities	(6,279)	(8,815)	4,571	(3,477)	(5,680)	(828)	3,113
Net change in cash	(229)	760	7,344	(301)	(3,379)	(540)	2,105
ForEx effect	(14)	235	54	69	86	(37)	(37)
Cash and cash equivalent - end	12,217	13,211	20,609	20,376	17,084	12,634	15,280

Source(s): Company, ABCI Securities estimates

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

FY ends at Dec 31	2015A	2016A	2017E	2018E	2019E	1Q16	1Q17
Growth (YoY %)							
Revenue	10.88	0.41	6.38	6.43	6.46	2.23	3.03
Core revenue	9.87	1.45	5.25	5.84	5.61	N/A	N/A
- Liquid milk	11.19	5.03	5.53	6.08	5.85	N/A	N/A
- Chilled products	(4.34)	2.35	3.35	3.34	5.73	N/A	N/A
- Milk formula	7.21	(15.38)	(3.41)	5.52	2.90	N/A	N/A
- Mixed feed	35.14	(61.42)	106.69	5.99	6.59	N/A	N/A
- Guarantee income	2104.15	272.06	5.25	5.84	5.61	N/A	N/A
Non-core revenue	132.85	(36.50)	71.24	31.89	31.77	N/A	N/A
Gross profit	21.89	5.45	11.72	11.77	10.46	14.13	10.49
Core gross profit	22.65	6.66	10.66	11.52	9.85	N/A	N/A
- Liquid milk	22.93	10.82	12.70	13.12	11.70	N/A	N/A
- Chilled products	(0.85)	21.31	11.91	7.10	3.86	N/A	N/A
- Milk formula	31.56	(15.07)	(15.25)	3.58	-0.40	N/A	N/A
- Mixed feed	74.22	(52.55)	418.85	6.70	7.60	N/A	N/A
Non-core gross profit	(17.16)	(28.52)	61.68	35.79	29.88	N/A	N/A
Operating profit	8.79	3.43	12.98	21.60	30.26	5.82	13.18
EBITDA	11.62	0.04	8.78	17.74	25.53	N/A	N/A
Pretax Profit	15.41	20.07	11.50	18.92	26.61	19.61	11.67
Net profit (to owners of the Company)	11.76	22.24	11.31	18.93	26.63	19.26	11.58
Profitability ratios (%)							
GPM	36.42	38.25	40.17	42.18	43.77	42.12	37.93
Core-GPM	36.40	38.27	40.24	42.39	44.10	N/A	N/A
- Liquid milk	34.08	35.96	38.40	40.96	43.22	N/A	N/A
- Chilled products	36.32	43.05	46.62	48.31	47.46	N/A	N/A
- Milk formula	55.97	56.17	49.29	48.38	46.83	N/A	N/A
- Mixed feed	20.05	24.66	61.91	62.32	62.91	N/A	N/A
Non-core GPM	9.13	10.28	9.71	9.99	9.85	N/A	N/A
OPM	8.31	8.56	9.10	10.39	12.72	11.06	12.15
EBITDA margin	11.27	11.22	11.48	12.70	14.97	N/A	N/A
Pretax margin	9.15	10.94	11.47	12.82	15.24	11.97	12.97
NPM (to owners of the Group)	7.67	9.34	9.77	10.92	12.99	10.14	10.98
Revenue contribution (%)							
Core revenue/ total revenue	97.36	98.36	97.31	96.77	96.00	N/A	N/A
Non-core revenue/ total revenue	1.82	1.15	1.85	2.30	2.85	N/A	N/A
Interest income/ total revenue	0.82	0.49	0.83	0.93	1.16	N/A	N/A
Core revenue composition						N/A	N/A
- Liquid milk	80.24	83.07	83.29	83.48	83.67	N/A	N/A
- Chilled products	6.97	7.04	6.91	6.75	6.75	N/A	N/A
- Milk formula	10.97	9.15	8.40	8.37	8.16	N/A	N/A
- Mixed feed	1.80	0.68	1.34	1.35	1.36	N/A	N/A
- Guarantee income	0.02	0.06	0.06	0.06	0.06	N/A	N/A
Return ratios (%)							
ROAA	11.71	14.35	13.71	13.71	16.18	3.90	4.24
ROAE	23.99	26.29	21.77	20.50	23.66	7.42	7.24
Liquidity ratio (x)							
Current ratio	1.09	1.35	1.76	1.90	2.00	1.18	1.44
Quick ratio	0.83	1.06	1.47	1.62	1.70	0.88	1.14
Cash ratio	0.72	0.93	1.36	1.50	1.56	0.74	0.97
Cash conversion cycle (days)							
Days of outstanding receivable	3.28	3.45	3.14	3.01	3.15	3.86	4.19
Days of inventory on hand	47.22	44.58	43.82	44.62	46.11	50.20	42.75
Days of outstanding payable	55.98	64.22	65.15	67.12	67.58	60.21	58.61
CCC	(5.48)	(16.20)	(18.18)	(19.49)	(18.32)	(6.15)	(11.66)
Leverage ratios (%)							
Total debt/Equity	30.73	0.65	0.63	0.61	0.60	24.82	12.22
Total debt/Total assets	15.62	0.38	0.42	0.42	0.42	13.49	7.17

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

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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