



# Company Report

China Mengniu (2319 HK)

March 28, 2013

**Rating: Buy**  
**TP: HK\$26.3**

### Key data

Share price (HK\$)	22.0
Upside potential (%)	19.4
52Wk H/L(HK\$)	24.4 / 19.5
Issued shares (mn)	1,768
Market cap (HK\$m)	41,199
30-day avg vol (HK\$m)	146.5
Auditors	Ernst & Young
Major shareholder (%):	
COFCO	28.0
Arla Foods	5.9

Source: Company & Bloomberg

### Revenue composition in FY12 (%)

Liquid milk products	89.6
Ice cream products	8.8
Other dairy products	1.6

Source: Company

### Share performance (%)

	Absolute	Relative*
1-mth	(4.5)	(2.5)
3-mth	(2.5)	(1.5)
6-mth	(9.4)	(16.0)

\*Relative to Hang Seng Index

Source: Bloomberg

### 1 year share price performance



Source: Bloomberg

### Analyst

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## Breakthrough in FY13

FY12 NP dropped 20.9% YoY to Rmb1,257mn, which was 8.3% below consensus. The group recorded revenue of Rmb36,080mn, down 3.5% YoY while sales in 2HFY12 dropped 3.5% HoH to Rmb17,719mn. The decline was mainly attributable to the drop in sales volume which was a result of the group's strategy in streamlining its products. GP margin of the group dropped from 25.7% in FY11 to 25.1% in FY12 due to the rise of raw milk cost as the group tried to enhance product quality control by increasing the proportion of milk sources purchased from scaled farms. We believe product streamlining and quality control will start to take positive effect in 2013 onwards. We raise our PER valuation from 20.0x to 22.0x with our TP rising from HK\$25.8 to HK\$26.3. We maintain our Buy rating on the stock.

**Cash cow:** Strong balance sheet continues to be one of the group's key highlights. Net cash inflow from operating activities amounted to Rmb2,006.9mn, while net cash reached Rmb5,204.6mn as at the end of FY12. The strong balance sheet will be the key for the group to maintain sustainable growth and development. CAPEX of the group is estimated to be Rmb2,600mn (vs Rmb2,163mn in FY11).

**Breakthrough in FY13.** The decline in sales volume in FY12 was due to the Flavacin M1 incident happened at the end of 2011, while restructuring in business operations including product streamlining and quality control enhancement since mid 2012 had a negative effect on the group's performance in the initial stage. However, we believe the new policies will start to take positive effect in 2013. We expect the benefits of product mix improvement will outweigh the negative effect of eliminating less profitable SKUs, especially given a lower base in FY12. Proportion of high-end products of the group increased from 25% in FY11 to 27% in FY12. Key brands such as Milk Deluxe and Future Star achieved double-digit growth in 2012. We expect revenue to grow by 12.9% YoY to Rmb40,731mn in FY13. There will be further upside when the group introduces other high-end products including milk powder with imported milk source and cheese in view of continued cooperation with Arla Foods. Moreover, as quality milk sources already accounted for 93% of the total purchases in FY12, we expect raw milk cost growth to slow down and GPM will increase by 1.6ppt to 26.7% in FY13.

**Valuation.** Due to slower growth in FY12, we have lowered our FY13 EPS by 8.9% to Rmb0.955. However, as we are more confident on the group's product quality control and product mix improvement, we raise our PER valuation from 20.0x to 22.0x, (which is still 15% lower than the historical average). We raise our TP from HK\$25.8 to HK\$26.3. Maintain BUY.

## Results and valuation

(FY ended Dec 31)	FY10A	FY11A	FY12A	FY13E	FY14E
Revenue (Rmb mn)	30,265	37,388	36,080	40,731	45,765
Chg (%YoY)	17.7%	23.5%	-3.5%	12.9%	12.4%
Net Income (Rmb mn)	1,237	1,589	1,257	1,763	2,047
Chg (%YoY)	10.9%	28.4%	-20.9%	40.2%	16.1%
EPS (Rmb)	0.71	0.91	0.71	0.95	1.11
Chg (%YoY)	4.4%	27.3%	-21.4%	34.3%	16.1%
NBV (Rmb/share)	5.61	6.49	7.04	7.87	8.81
PE (x)	-	19.4	24.8	18.4	15.9
PB (x)	-	2.7	2.5	2.2	2.0
ROAA (%)	7.9%	8.5%	6.1%	8.2%	8.2%
ROAE (%)	13.5%	15.0%	10.5%	13.3%	13.9%
Net D/E (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company, ABCI Securities estimates



**Exhibit 3: Consensus**

FY ended Dec 31 (Rmbmn)	New Forecast		Consensus		Difference	
	2013F	2014F	2013F	2014F	2013F	2014F
Revenue	40,731	45,765	43,660	48,823	-6.7%	-6.3%
Adjusted EBITDA	10,859	12,307	11,090	12,596	-2.1%	-2.3%
Net profit	1,763	2,047	1,662	1,933	6.1%	5.9%
FD EPS (Rmb/share)	0.955	1.108	0.949	1.138	0.6%	-2.6%

Source: Bloomberg, ABCI Securities estimates

**Exhibit: Segment revenue breakdown (Rmb mn)**

Segment revenue	FY08	FY09	FY10	FY11	FY12
Liquid milk products	21,068.1	22,736.2	26,871.8	33,701.2	32,337.0
UHT Milk	13,694.3	14,196.2	16,790.4	20,837.6	19,706.2
Milk Beverages	5,604.1	6,387.3	7,336.2	8,309.6	8,038.8
Yoghurt	1,769.7	2,152.7	2,745.2	4,554.0	4,592.0
Ice cream products	2,626.5	2,685.1	3,111.5	3,258.6	3,171.5
Other dairy products	170.4	289.2	282.1	428.0	571.9
<b>Total</b>	<b>23,865.0</b>	<b>25,710.5</b>	<b>30,265.4</b>	<b>37,387.8</b>	<b>36,080.4</b>
<b>% of segment revenue</b>					
Liquid milk products	88.3%	88.4%	88.8%	90.1%	89.6%
UHT Milk	57.4%	55.2%	55.5%	55.7%	54.6%
Milk Beverages	23.5%	24.8%	24.2%	22.2%	22.3%
Yoghurt	7.4%	8.4%	9.1%	12.2%	12.7%
Ice cream products	11.0%	10.4%	10.3%	8.7%	8.8%
Other dairy products	0.7%	1.1%	0.9%	1.1%	1.6%
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
<b>Growth</b>					
Liquid milk products	10.0%	7.9%	18.2%	25.4%	-4.0%
UHT Milk	7.2%	3.7%	18.3%	24.1%	-5.4%
Milk Beverages	12.6%	14.0%	14.9%	13.3%	-3.3%
Yoghurt	26.6%	21.6%	27.5%	65.9%	0.8%
Ice cream products	31.9%	2.2%	15.9%	4.7%	-2.7%
Other dairy products	-4.0%	69.8%	-2.5%	51.8%	33.6%
<b>Total</b>	<b>11.9%</b>	<b>7.7%</b>	<b>17.7%</b>	<b>23.5%</b>	<b>-3.5%</b>

Source: The group

**Key Financial Ratio**

FY ended Dec 31	FY10	FY11	FY12F	FY13F	FY14F
<b>Profitability ratio</b>					
Gross profit margin	25.7%	25.7%	25.1%	26.7%	26.9%
EBIT margin	4.9%	5.2%	4.2%	5.6%	5.8%
Net profit margin	4.1%	4.3%	3.5%	4.3%	4.5%
ROAA	7.9%	8.5%	6.1%	8.2%	8.2%
ROAE	13.5%	15.0%	10.5%	13.3%	13.9%
<b>Cost ratio</b>					
S&D/revenue	-17.9%	-17.9%	-17.8%	-17.8%	-17.6%
Admin expenses/revenue	-3.4%	-3.0%	-3.3%	-3.5%	-3.5%
Effective tax rate	-11.8%	-13.4%	-14.6%	-15.0%	-15.0%
<b>Leverage</b>					
Current ratio	1.55	1.44	1.40	1.44	1.48
Quick ratio	1.36	1.20	1.19	1.23	1.29
Net debt/total equity	Net cash	Net cash	Net cash	Net cash	Net cash
<b>Working capital cycle</b>					
Receivables turnover days	7.0	6.9	8.3	9.0	9.0
Inventory turnover days	15.4	18.8	21.0	18.0	18.0
Payables turnover days	47.8	47.5	49.7	47.5	47.5

Source: The group (for historical figures only), ABCI Securities estimates



### Profit Forecast

FY ended Dec 31 (Rmbmn)	FY10	FY11	FY12F	FY13F	FY14F
Revenue	30,265.4	37,387.8	36,080.4	40,731.1	45,765.5
Cost of sales	(22,479.0)	(27,795.7)	(27,025.8)	(29,872.3)	(33,458.6)
<b>Gross profit</b>	<b>7,786.4</b>	<b>9,592.2</b>	<b>9,054.6</b>	<b>10,858.8</b>	<b>12,306.9</b>
Other income and gains	193.5	296.3	257.1	285.1	274.6
S&D	(5,429.1)	(6,694.7)	(6,425.8)	(7,250.1)	(8,054.7)
Admin expenses	(1,036.0)	(1,110.1)	(1,195.4)	(1,425.6)	(1,601.8)
Other operating expenses	(59.7)	(187.2)	(196.0)	(203.7)	(274.6)
Share of profits and losses of associates	40.4	52.1	13.9	0.0	0.0
<b>EBIT</b>	<b>1,495.4</b>	<b>1,948.5</b>	<b>1,508.2</b>	<b>2,264.6</b>	<b>2,650.3</b>
Interest income	87.9	173.1	218.6	129.8	129.8
Finance costs	(45.2)	(60.9)	(41.8)	(37.3)	(43.0)
<b>EBT</b>	<b>1,538.1</b>	<b>2,060.6</b>	<b>1,685.0</b>	<b>2,357.0</b>	<b>2,737.1</b>
Tax	(182.2)	(276.1)	(245.5)	(353.6)	(410.6)
MI	(118.6)	(195.3)	(182.4)	(240.4)	(279.2)
<b>Net profit attributable to owners</b>	<b>1,237.3</b>	<b>1,589.3</b>	<b>1,257.1</b>	<b>1,763.1</b>	<b>2,047.4</b>
Dividends	245.4	279.2	350.0	282.9	387.9
No. of issued shares at end of period (mn)	1,738.0	1,767.4	1,768.2	1,768.2	1,768.2
Issuable shares:					
Share options	37.7	51.0	77.3	78.3	79.3
Total issued & issuable shares	<b>1,775.7</b>	<b>1,818.4</b>	<b>1,845.5</b>	<b>1,846.5</b>	<b>1,847.5</b>
<b>Per share value (Rmb)</b>					
FD EPS	0.711	0.905	0.711	0.955	1.108
NBV	5.615	6.490	7.037	7.874	8.813
DPS	0.160	0.198	0.160	0.219	0.255

Source: The group (for historical figures only), ABCI Securities estimates

### Balance Sheet Forecast

As of Dec 31 (Rmbmn)	FY10	FY11	FY12F	FY13F	FY14F
PPE	5,380.4	6,806.5	7,891.9	9,230.8	9,993.7
Others	<b>2,261.1</b>	<b>3,008.6</b>	<b>3,337.6</b>	<b>3,300.9</b>	<b>3,281.7</b>
<b>Non-current assets</b>	<b>7,641.5</b>	<b>9,815.2</b>	<b>11,229.5</b>	<b>12,531.7</b>	<b>13,275.3</b>
Available for sale investment	-	-	240.0	240.0	240.0
Inventories	1,176.4	1,685.2	1,419.9	1,526.4	1,773.6
Trades and bills receivable	575.5	835.8	801.5	1,207.2	1,049.7
Prepayments and deposits	942.3	774.9	950.0	686.9	1,146.5
Other receivables	169.9	289.4	359.9	86.5	415.0
Investment deposits	0.0	102.8	160.0	160.0	160.0
Pledged deposits	102.4	175.3	51.6	51.6	51.6
Cash and bank balances	6,697.8	6,523.1	5,778.4	6,461.2	8,630.8
<b>Current assets</b>	<b>9,664.3</b>	<b>10,386.5</b>	<b>9,761.2</b>	<b>10,419.8</b>	<b>13,467.2</b>
Trade and bills payables	3,548.5	3,684.5	3,678.9	4,096.1	4,612.3
Interest-bearing bank loans	550.8	537.5	573.8	573.8	573.8
Others	<b>1,956.5</b>	<b>2,781.4</b>	<b>2,644.7</b>	<b>2,467.6</b>	<b>3,803.8</b>
<b>Current liabilities</b>	<b>6,238.3</b>	<b>7,225.8</b>	<b>6,980.6</b>	<b>7,220.9</b>	<b>9,073.3</b>
Interest-bearing bank loans	150.0	0.0	0.0	0.0	0.0
Others	700.0	927.0	927.0	927.0	927.0
<b>Non-current liabilities</b>	<b>850.0</b>	<b>927.0</b>	<b>938.2</b>	<b>938.2</b>	<b>938.2</b>
<b>Total assets</b>	<b>17,305.8</b>	<b>20,201.7</b>	<b>20,990.7</b>	<b>22,951.5</b>	<b>26,742.6</b>
<b>Net assets</b>	<b>10,217.5</b>	<b>12,048.8</b>	<b>13,071.8</b>	<b>14,792.4</b>	<b>16,731.1</b>
Issued capital	178.7	181.1	181.2	181.2	181.2
Retained earnings	2,050.2	3,074.3	3,745.8	5,226.0	6,885.5
Other reserves	7,529.2	8,215.6	8,516.3	8,516.3	8,516.3
MI	459.4	577.8	628.6	869.0	1,148.2
Total equity	<b>10,217.5</b>	<b>12,048.8</b>	<b>13,071.8</b>	<b>14,792.4</b>	<b>16,731.1</b>
<b>Equity attributable to owners</b>	<b>9,758.1</b>	<b>11,471.1</b>	<b>12,443.3</b>	<b>13,923.4</b>	<b>15,582.9</b>

Source: The group (for historical figures only), 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

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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