



## Yili (600887 CH)

### Proven capability in expanding margins; upgrade to BUY

- Topline growth accelerated in 2H16; non-consolidation of a subsidiary led to lower full-year growth; the Group maintains its dominance in UHT and chilled product markets in China
- The Group has taken proactive measures to counter against slowdown in growth
- Margin expanded despite lower growth momentum
- The Group is strategizing to expand its focus on downstream businesses
- Upgrade to **BUY**; current TP represents FY17E/18E P/E of 20.56x/17.32x, and FY17E/18E P/B of 3.72x/3.38x

**Growth momentum slowed.** With growth accelerating in 2H16, the Group's FY16 revenue edged up by 0.41% YoY despite the decline of 0.21% YoY in 1H16. The slow growth can be partially attributable to the non-consolidation of revenue from Youran Livestock Holding since May 2016. Growth in FY16 revenue and core revenue would have been 2.8% YoY and 2.94% YoY if the 2015 figures were recalculated on a non-consolidation basis. In FY16, the Group's market share of UHT milk and total sales value of chilled products were ranked 1<sup>st</sup> in China. Market penetration of its UHT milk products also increased by 0.3 ppt to 77.1%.

**Proactive product mix adjustment to fight slowdown in growth.** Liquid milk product, chilled product, and milk formula segments in FY16 recorded revenue change of 5.03% YoY, 2.35% YoY, and (15.38)% YoY. A more detailed analysis by the Group revealed that product mix adjustment led to revenue increase of 6.25% YoY, 3.39% YoY, and 2.68% YoY for the three respective segments. For the liquid milk product segment, increased volume also boosted up revenue by 2.42% YoY.

**Proven capability in expanding margins.** Despite the slowing growth momentum, margins expanded in FY16. NPM increased to 9.34% from 7.67% in FY15, thanks to GPM improvement, well-managed SG&A expenses, lower interest expense on reduced borrowing, as well as increases in non-operating profit and investment income. ROAA and ROAE also increased to 14.35% and 26.29% from 11.71% and 23.99% in FY15. FY16 is the 6<sup>th</sup> year the Group has recorded higher margins across the board.

**Reposition to expand its focus.** In FY16, the Group divested a subsidiary that resulted in a 100% reduction in biological assets. In addition, the Group ramped up investment in relevant businesses (e.g. packaging). Such change may signal the Group's strategy to expand its focus on downstream business.

**Upgrade to BUY, TP at RMB 21.30.** The Group has proven its ability in raising margins, maintaining market dominance, and fine-tuning its downstream strategy. We expect the Group to maintain a mid-single-digit topline growth and continue to expand its margins over the next few years. We are confident that the changing business model will boost its profitability and return metrics. Upgrade to **BUY** and adjust TP to RMB 21.30, which represents FY17E/18E P/E of 20.56x/17.32x and FY17E/18E P/B of 3.72x/3.38x.

**Risk factors:** 1) Macroeconomic risk; 2) Commodity price risk; 3) Food safety risk; 4) M&A risk, 5) Investment risk

#### Results and Valuation

FY ended Dec 31	2015A	2016A	2017E	2018E	2019E
Revenue (RMB mn)	60,360	60,609	64,476	68,582	72,974
Chg (% YoY)	10.88	0.41	6.38	6.37	6.40
Net Profit (RMB mn)	4,632	5,662	6,298	7,474	9,448
Chg (% YoY)	11.76	22.24	11.24	18.67	26.41
Basic EPS (RMB)	0.76	0.93	1.04	1.23	1.55
Chg (% YoY)	11.76	22.37	11.40	18.67	26.41
P/E (x)	24.49	20.01	17.96	15.14	11.97
BVPS (RMB)	3.30	3.80	5.73	6.30	6.90
P/B (x)	5.65	4.90	3.25	2.95	2.70
DPS (RMB)	0.45	0.60	0.66	0.78	0.99
Yield (%)	2.42	3.22	3.52	4.21	5.33
ROAA (%)	11.71	14.35	13.70	13.67	16.11
ROAE (%)	23.99	26.29	21.76	20.44	23.54

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

Apr 10, 2017

Rating: BUY

TP: RMB 21.30

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Share price (RMB)	18.61
Est. share price return	14.45%
Est. dividend yield	3.52%
Est. total return	17.98%
Previous Rating&TP	HOLD;RMB19.82
Previous report date	Sep 26, 2016

Source(s): Bloomberg, ABCI Securities

#### Key Data

52Wk H/L (RMB)	20.66/13.98
Issued shares (mn)	6,079.00
Market cap (RMB mn)	113,130.19
3-mth ADT (RMB mn)	892.24

Major shareholders	(%)
Hohhot Investment Co Ltd	9.90
HK Securities Clearing Co	5.74
Pan Gang	3.89
China Securities Finance Corp	2.79
Inner Mongolia Power Corp	1.82

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	2.25	(0.39)
3-mth	4.37	(0.40)
6-mth	16.53	8.71

\* 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 Apr 7, 2017



**Exhibit: Equity investment by the Group**

English Name	Chinese Name	Type	Value (RMB mn)	
			FY-15 end	FY-16 end
N/A	呼伦贝尔盛鑫投资有限公司	LT equity investment	18.82	18.88
N/A	山东新巨丰科技包装股份有限公司	LT equity investment	103.06	116.20
China Youran Dairy Holding Limited	N/A	LT equity investment	0	1,447.29
N/A	北京久阳智慧投资基金管理有限公司	LT equity investment	0	48.73
Bank of Chengdu	成都银行股份有限公司	AFS investment	81.25	81.25
Mianyang Science&Technology Industrial Investment Fund (LLP)	绵阳科技城产业投资基金	AFS investment	131.01	90.36
CITICPE	中信产业投资基金管理有限公司	AFS investment	121.50	121.50
N/A	内蒙古伊生生物科技有限公司	AFS investment	0.40	0.40
N/A	深圳市华泰瑞麟股权投资基金合伙企业	AFS investment	50.00	34.00
N/A	合众创亚(呼和浩特)包装有限公司	AFS investment	10.42	10.42
N/A	国开博裕一期(上海)股权投资合伙企业	AFS investment	178.99	194.23
N/A	呼市驻海口办事处	AFS investment	0.05	0.05
N/A	呼市商城房地产	AFS investment	0.30	0.30
Synergetic Innovation Fund Management	协同创新基金	AFS investment	20.00	20.00
N/A	北京华泰新兴产业成长投资基金(有限合伙)	AFS investment	0	25.00
CITICPE Holdings Limited	N/A	AFS investment	30.56	35.20
China Huishan Dairy Holdings Company	中国辉山乳业控股有限公司	AFS investment	361.29	0

Source: Company, ABCI Securities

**Consolidated income statement (2015A-2019E)**

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E
<b>Revenue</b>	<b>60,360</b>	<b>60,609</b>	<b>64,476</b>	<b>68,582</b>	<b>72,974</b>
- Core revenue	58,764	59,614	62,742	66,406	70,128
- Liquid milk	47,151	49,522	52,259	55,434	58,677
- Chilled product	4,098	4,194	4,335	4,479	4,736
- Milk formula	6,447	5,456	5,270	5,561	5,722
- Mixed feed	1,058	408	844	894	953
- Guarantee income	9	33	35	37	39
- Non-core revenue	1,100	698	1,196	1,577	2,079
- Interest income	496	297	538	599	767
COGS	(38,376)	(37,427)	(38,577)	(39,673)	(41,076)
<b>Gross profit</b>	<b>21,984</b>	<b>23,182</b>	<b>25,899</b>	<b>28,909</b>	<b>31,897</b>
- Core gross profit	21,387	22,813	25,245	28,152	30,926
- Liquid milk	16,069	17,808	20,070	22,703	25,359
- Chilled product	1,489	1,806	2,021	2,164	2,248
- Milk formula	3,609	3,065	2,597	2,690	2,680
- Mixed feed	212	101	522	557	600
- Guarantee income	9	33	35	37	39
- Non-core gross profit	100	72	116	158	205
- Gross profit on interest income	496	297	538	599	767
Business tax and levies	(251)	(420)	(441)	(478)	(505)
S&D expenses	(13,258)	(14,114)	(15,184)	(16,670)	(17,247)
Admin expenses	(3,456)	(3,457)	(4,410)	(4,645)	(4,896)
<b>Operating profit</b>	<b>5,019</b>	<b>5,191</b>	<b>5,864</b>	<b>7,116</b>	<b>9,250</b>
Asset impairment expense	(14)	(46)	(61)	(66)	(71)
Investment income	186	399	435	498	616
Non-operating profit/(loss)	629	1,112	1,137	1,201	1,274
Net finance income/expense	(297)	(24)	15	20	15
<b>Pretax profit</b>	<b>5,524</b>	<b>6,632</b>	<b>7,390</b>	<b>8,769</b>	<b>11,084</b>
Tax	(869)	(963)	(1,084)	(1,286)	(1,624)
<b>Net profit</b>	<b>4,654</b>	<b>5,669</b>	<b>6,306</b>	<b>7,483</b>	<b>9,460</b>
- Profit attributable to shareholders	4,632	5,662	6,298	7,474	9,448
- Minority interest	23	7	8	10	12
Cash dividend	2,729	3,647	3,983	4,766	6,027
EPS (RMB)					
- Basic	0.76	0.93	1.04	1.23	1.55
- Diluted	0.76	0.93	1.04	1.23	1.55
<b>Cash DPS (RMB)</b>	<b>0.45</b>	<b>0.60</b>	<b>0.66</b>	<b>0.78</b>	<b>0.99</b>

Source(s): Company, ABCI Securities estimates



**Consolidated balance sheet (2015A-2019E)**

FY ends at Dec 31 (RMB mn)	2015A	2016A	2017E	2018E	2019E
Cash and cash equivalent	13,084	13,824	20,400	23,435	24,950
Trade and bills receivable	719	686	700	728	845
Inventory	4,663	4,326	4,678	4,674	5,232
Others	1,320	1,357	1,165	1,304	1,510
<b>Total current assets</b>	<b>19,786</b>	<b>20,193</b>	<b>26,944</b>	<b>30,140</b>	<b>32,538</b>
PP&E	14,559	13,137	12,589	11,694	11,027
Biological assets	1,299	0	0	0	0
Goodwill	11	11	2,243	2,243	2,243
AFS investment	985	612	674	741	815
LT equity investment	122	1,631	1,865	2,150	2,497
Others	2,870	3,678	8,383	9,696	11,529
<b>Total non-current assets</b>	<b>19,845</b>	<b>19,070</b>	<b>25,753</b>	<b>26,523</b>	<b>28,111</b>
<b>Total assets</b>	<b>39,631</b>	<b>39,262</b>	<b>52,697</b>	<b>56,663</b>	<b>60,649</b>
Trade and bills payable	6,642	7,091	7,176	7,555	7,915
ST borrowings	6,190	150	216	229	245
Others	5,370	7,667	9,218	9,277	9,226
<b>Total current liabilities</b>	<b>18,202</b>	<b>14,907</b>	<b>16,610</b>	<b>17,060</b>	<b>17,386</b>
LT Borrowings	0	0	6	7	9
Others	1,283	1,119	989	962	984
<b>Total non-current liabilities</b>	<b>1,283</b>	<b>1,119</b>	<b>995</b>	<b>969</b>	<b>993</b>
Shareholders' equity	19,984	23,082	34,812	38,324	41,932
Minority interest	162	154	281	310	339
<b>Total equity</b>	<b>20,146</b>	<b>23,236</b>	<b>35,093</b>	<b>38,633</b>	<b>42,271</b>
<b>Total liabilities and equity</b>	<b>39,631</b>	<b>39,262</b>	<b>52,697</b>	<b>56,663</b>	<b>60,649</b>

Source(s): Company, ABCI Securities estimates

**Consolidated cash flow statement (2015A-2019E)**

FY ends at Dec 31 (RMB mn)	2015A	2016A	2017E	2018E	2019E
Net profit	4,654	5,669	6,306	7,483	9,460
Depreciation and amortization	1,794	1,657	1,597	1,648	1,719
Change in working capital	2,898	5,849	223	281	(1,408)
Others	190	(359)	(152)	(289)	(382)
<b>Cash flow from operating activities</b>	<b>9,536</b>	<b>12,817</b>	<b>7,975</b>	<b>9,123</b>	<b>9,388</b>
Change in PP&E, intangible assets, and other non-current assets	(3,626)	(3,396)	(5,268)	(6,084)	(7,244)
Acquisition of associates' share	0	0	(4,606)	0	0
Others	139	153	62	109	117
<b>Cash flow from investing activities</b>	<b>(3,487)</b>	<b>(3,243)</b>	<b>(9,813)</b>	<b>(5,975)</b>	<b>(7,128)</b>
Change in borrowings	(2,586)	(6,038)	71	15	18
Cash flow related to dividend payment, interest payment, or profit distribution	(2,659)	(2,776)	(4,497)	(3,481)	(5,672)
Proceed from share placement	0	0	9,000	0	0
Others	(1,034)	0	0	0	0
<b>Cash flow from financing activities</b>	<b>(6,279)</b>	<b>(8,815)</b>	<b>4,574</b>	<b>(3,467)</b>	<b>(5,654)</b>
<b>Net change in cash</b>	<b>(229)</b>	<b>760</b>	<b>2,736</b>	<b>(318)</b>	<b>(3,394)</b>
ForEx effect	(14)	235	54	69	86
<b>Cash and cash equivalent - end</b>	<b>12,217</b>	<b>13,211</b>	<b>16,001</b>	<b>15,752</b>	<b>12,444</b>

Source(s): Company, ABCI Securities estimates



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

FY ends at Dec 31	2015A	2016A	2017E	2018E	2019E
<b>Growth (YoY %)</b>					
Revenue	10.88	0.41	6.38	6.37	6.40
Core revenue	9.87	1.45	5.25	5.84	5.61
- Liquid milk	11.19	5.03	5.53	6.08	5.85
- Chilled products	(4.34)	2.35	3.35	3.34	5.73
- Milk formula	7.21	(15.38)	(3.41)	5.52	2.90
- Mixed feed	35.14	(61.42)	106.69	5.99	6.59
- Guarantee income	2104.15	272.06	5.25	5.84	5.61
Non-core revenue	132.85	(36.50)	71.24	31.89	31.77
Gross profit	21.89	5.45	11.72	11.62	10.34
Core gross profit	22.65	6.66	10.66	11.52	9.85
- Liquid milk	22.93	10.82	12.70	13.12	11.70
- Chilled products	(0.85)	21.31	11.91	7.10	3.86
- Milk formula	31.56	(15.07)	(15.25)	3.58	-0.40
- Mixed feed	74.22	(52.55)	418.85	6.70	7.60
Non-core gross profit	(17.16)	(28.52)	61.68	35.79	29.88
Operating profit	8.79	3.43	12.98	21.35	29.98
EBITDA	11.62	0.04	8.78	17.54	25.29
Pretax Profit	15.41	20.07	11.43	18.66	26.39
Net profit (to owners of the Company)	11.76	22.24	11.24	18.67	26.41
<b>Profitability ratios (%)</b>					
GPM	36.42	38.25	40.17	42.15	43.71
Core-GPM	36.40	38.27	40.24	42.39	44.10
- Liquid milk	34.08	35.96	38.40	40.96	43.22
- Chilled products	36.32	43.05	46.62	48.31	47.46
- Milk formula	55.97	56.17	49.29	48.38	46.83
- Mixed feed	20.05	24.66	61.91	62.32	62.91
Non-core GPM	9.13	10.28	9.71	9.99	9.85
OPM	8.31	8.56	9.10	10.38	12.68
EBITDA margin	11.27	11.22	11.48	12.68	14.93
Pretax margin	9.15	10.94	11.46	12.79	15.19
NPM (to owners of the Group)	7.67	9.34	9.77	10.90	12.95
<b>Revenue contribution (%)</b>					
Core revenue/ total revenue	97.36	98.36	97.31	96.83	96.10
Non-core revenue/ total revenue	1.82	1.15	1.85	2.30	2.85
Interest income/ total revenue	0.82	0.49	0.83	0.87	1.05
<b>Core revenue composition</b>					
- Liquid milk	80.24	83.07	83.29	83.48	83.67
- Chilled products	6.97	7.04	6.91	6.75	6.75
- Milk formula	10.97	9.15	8.40	8.37	8.16
- Mixed feed	1.80	0.68	1.34	1.35	1.36
- Guarantee income	0.02	0.06	0.06	0.06	0.06
<b>Return ratios (%)</b>					
ROAA	11.71	14.35	13.70	13.67	16.11
ROAE	23.99	26.29	21.76	20.44	23.54
ROIC	37.62	58.41	85.16	102.42	129.09
<b>Liquidity ratio (x)</b>					
Current ratio	1.09	1.35	1.62	1.77	1.87
Quick ratio	0.83	1.06	1.34	1.49	1.57
Cash ratio	0.72	0.93	1.23	1.37	1.44
<b>Cash conversion cycle (days)</b>					
Days of outstanding receivable	3.28	3.45	3.14	3.01	3.15
Days of inventory on hand	47.22	44.58	43.82	44.62	46.11
Days of outstanding payable	55.98	64.22	65.15	67.11	67.56
CCC	(5.48)	(16.20)	(18.18)	(19.48)	(18.30)
<b>Leverage ratios (%)</b>					
Total debt/Equity	30.73	0.65	0.63	0.61	0.60
Total debt/Total assets	15.62	0.38	0.42	0.42	0.42

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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