



## Mengniu (2319 HK) Downgrade on near-term turbulence

- FY19 revenue growth reached 14.6% YoY, mainly supported by the liquid milk segment (14.3% YoY) and milk powder segment (30.8% YoY)
- GPM and OPM slightly improved; excluding the impacts of Junlebao disposal, NPM was 4.4% in FY19 vs. 5.4% as reported (FY18: 4.6%)
- Expect FY19-22E revenue CAGR at 9.5%; more challenges ahead especially in 2020 due to the pandemic
- Downgrade to **HOLD** due to turbulence in 2020; TP implies 51.09x/35.59x 20E/21E P/E, or 3.54x/3.27x 20E/21E P/B

**FY 19 revenue grew 14.6% YoY.** FY19 revenue was supported by growth in the liquid milk segment (14.3% YoY) and milk powder segment (30.8% YoY). However, revenue of ice cream segment declined by 5.9% YoY. According to the Group, its market share of the UHT milk products and fresh milk products in the offline channels increased from 26.4% and 3.1% in 2018 to 27.2% and 7.1% in 2019. Maintaining its No.1 position for the second year, the Group's liquid milk market share in the e-commerce channel increased from 24.6% in 2018 to 26.7% in 2019.

**Margin improved in FY19 on one-off gains.** GPM increased from 37.4% in FY18 to 37.6% in FY19, and OPM increased from 5.1% in FY18 to 5.5% in FY19. NPM (to shareholders of the Company) rose from 4.4% in FY18 to 5.2% in FY19. However, the disposal of Junlebao in FY19 resulted to one-off gain items. Excluding the impact of these one-off items, the Group's NPM would be 4.4% in FY19 vs. 5.4% as reported (FY18: 4.6%).

**Efficient working capital management.** The Group's total CCC increased to -1 days in FY19 from -9 days in FY18, as the inventory turnover days was up by 2 days while payable turnover days decreased by 5 days. The Group's working capital condition remains healthy.

**More turbulence ahead.** The Covid-19 outbreak, according to the Group, has impacted its 1H20 and overall FY20 performance. In addition, the disposal of Junlebao in FY19 would also lead to decline in margins in FY20E. We expect FY20E revenue growth would be 3.4% YoY, supported by the 5.2% YoY growth in the liquid milk segment; FY20E NPM (to shareholders of the Company) would fall to 2.7%. For 2021E, we expect growth to resume, with revenue increasing by 11.9% YoY and NPM (to shareholders of the Company) rising to 3.5%. We project FY19-22E revenue CAGR to be 9.5%.

**Downgrade to HOLD; adjust TP to HK\$ 30.5.** Based on the expected turbulence in FY20E, we lower our forecasts of its revenue and earnings growth. The Group may face further pressure if the post-pandemic recovery is slow, market competition turns stiff, or imported products increase as a result of the Sino-US trade deal enforcement. Our DCF-derived TP represents 51.09x/35.59x 20E/21E P/E, or 3.54x/3.27x 20E/21E P/B. Downgrade to **HOLD**.

**Risk factors:** 1) Macroeconomic risk; 2) Commodity price risk; 3) Food safety risk; 4) M&A risk; 5) Product concentration risk; 6) Product competitiveness risk; 7) Biological asset revaluation risk; 8) Currency exchange risk; 9) Prolonged COVID-19 outbreak; 10) Decline in dividend payout due to projected lower EPS growth.

### Results and Valuation

FY ended Dec 31	2018A	2019A	2020E	2021E	2022E
Revenue (RMB mn)	68,977	79,030	81,738	91,487	103,881
Chg (% YoY)	14.66	14.57	3.43	11.93	13.55
Net Profit (RMB mn)	3,043	4,105	2,145	3,080	3,545
Chg (% YoY)	48.60	34.91	(47.74)	43.56	15.08
Basic EPS (RMB)	0.78	1.05	0.55	0.78	0.90
Chg (% YoY)	48.10	34.66	(48.03)	43.56	15.08
P/E (x)	32.82	24.37	46.90	32.67	28.39
BVPS (RMB)	6.42	7.40	7.87	8.51	9.26
P/B (x)	3.98	3.45	3.25	3.00	2.76
DPS (RMB)	0.18	0.18	0.10	0.17	0.19
Yield (%)	0.71	0.71	0.39	0.65	0.75
ROAA (%)	5.14	5.93	2.74	3.63	3.86
ROAE (%)	12.73	15.11	7.14	9.55	10.13

Source(s): Bloomberg, ABCI Securities estimates

## Company Report Apr 15, 2020 Rating: HOLD TP: HK\$ 30.5

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Share price (HK\$)	28.00
52Wk H/L (HK\$)	34.6/24.35
Est. share price return	8.93%
Est. dividend yield	0.39%
Est. total return	9.32%
Previous Rating&TP	BUY; HK\$35.0
Previous report date	Feb 11, 2020

Source(s): Bloomberg, ABCI Securities estimates

### Key Data

Issued shares (mn)	3,935.73
Market cap (HK\$ mn)	110,200.54
3-mth ADT (HK\$ mn)	323.08

Major shareholders	(%)
COFCO	31.37
Schroder	7.03
FIL Limited	6.72

Source(s): Bloomberg, HKEX

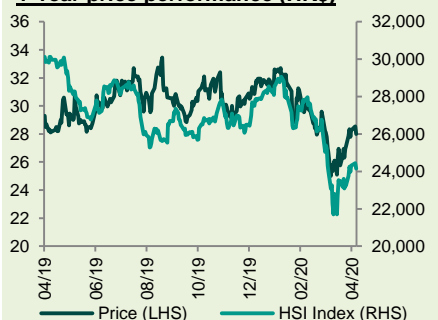
### Sector Performance (%)

	Absolute	Relative*
1-mth	4.87	4.35
3-mth	(13.58)	2.33
6-mth	(11.25)	(2.67)

\* Relative to HSI

Source(s): Bloomberg, ABCI Securities

### 1-Year price performance (HK\$)



Source(s): Bloomberg, ABCI Securities

Note:

- 1) All pricing and market data as of Apr 15, 2020;
- 2) RMB/HKD: 1.0952



**Exhibit 1: Change in assumptions, projections, and valuations**

Exhibit 11: Change in assumptions, projections, and valuations					
FY ends at Dec 31	Current report		Previous report		Rationale
	FY20E	FY21E	FY20E	FY21E	
<b>Assumptions</b>					
GPM (%)	37.16	38.08	39.03	39.57	Adjusted based on FY19 margin profile and expected impact of COVID-19 outbreak
Pretax margin (%)	3.57	4.54	6.31	7.16	
NPM (to shareholders of the Company) (%)	2.62	3.37	4.65	5.33	
D/E (%)	72.22	72.88	51.29	53.36	Adjusted based on FY19 ratio
D/A (%)	30.19	30.49	22.31	21.28	Adjusted based on FY19 rate
Tax rate (%)	23.4	23.4	20.7	20.0	
Revenue growth (YoY %)	3.43	11.93	13.79	14.20	Adjusted based on FY19 results and expected impact of COVID-19 outbreak
- Liquid milk	5.23	11.27	11.71	12.80	
- Ice cream	(13.88)	31.26	4.35	4.32	
- Milk powder	(5.84)	12.77	34.57	30.11	
- Others	(4.15)	9.17	37.65	10.00	
<b>Projections</b>					
DRO (days)	16	15	17	17	Adjusted based on FY19 results
DIH (days)	36	36	41	41	
DPO (days)	54	54	55	56	
CCC (days)	(1)	(2)	3	3	
ROAA (%)	2.74	3.63	5.04	5.76	Weakening margins weigh on returns
ROAE (%)	7.14	9.55	13.51	16.04	
EPS (US\$)	0.55	0.78	1.03	1.35	Adjusted based on slowdown in earnings growth due to the impact of COVID-19 in 2020 and change in number of shares
<b>Valuations</b>					
TP (HK\$)	30.5		35.0		Lower earnings growth drives down valuation; the lower earnings in FY20&FY20 also results in higher P/E in these two years
P/E (x)	51.09	35.59	30.53	23.29	
P/B (x)	3.54	3.27	3.96	3.57	

Note: 1) Previous report was published on Feb 11, 2020

Source(s): The Company, ABCI Securities estimates



## Financial Statements

### Consolidated income statement

FY ends at Dec 31 (RMB mn, except per share data)	2018A	2019A	2020E	2021E	2022E
<b>Revenue</b>	<b>68,977</b>	<b>79,030</b>	<b>81,738</b>	<b>91,487</b>	<b>103,881</b>
- Liquid milk	59,389	67,878	71,431	79,481	89,924
- Ice cream	2,723	2,561	2,206	2,895	3,322
- Milk formula	6,017	7,870	7,410	8,356	9,578
- Other revenue	848	721	691	754	1,058
COGS	(43,193)	(49,351)	(51,361)	(56,649)	(64,100)
<b>Gross profit</b>	<b>25,784</b>	<b>29,679</b>	<b>30,377</b>	<b>34,838</b>	<b>39,782</b>
S&D expenses	(18,833)	(21,536)	(22,901)	(24,976)	(28,306)
Admin expenses	(2,915)	(3,319)	(3,755)	(3,825)	(4,333)
Others	(491)	(478)	(524)	(597)	(657)
<b>EBIT</b>	<b>3,544</b>	<b>4,345</b>	<b>3,197</b>	<b>5,440</b>	<b>6,485</b>
Net other income or gain/ expense or loss	291	624	220	(738)	(938)
Net interest expense/income	318	461	(683)	(745)	(924)
Income from associate/JV	(300)	175	184	193	203
<b>Profit before tax</b>	<b>3,853</b>	<b>5,605</b>	<b>2,917</b>	<b>4,150</b>	<b>4,826</b>
Tax	(649)	(1,310)	(682)	(970)	(1,127)
<b>Total net profit</b>	<b>3,204</b>	<b>4,296</b>	<b>2,236</b>	<b>3,181</b>	<b>3,699</b>
- Profit to shareholders	3,043	4,105	2,145	3,080	3,545
- Minority interest	161	190	90	101	154
<b>Dividend</b>	<b>709</b>	<b>712</b>	<b>392</b>	<b>654</b>	<b>752</b>
<b>EPS (RMB)</b>					
- Basic EPS	0.78	1.05	0.55	0.78	0.90
- Diluted EPS	0.78	1.05	0.54	0.78	0.90
<b>DPS (RMB)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

Source(s): The Group, ABCI Securities estimates

### Consolidated balance sheet

FY ends at Dec 31 (RMB mn)	2018A	2019A	2020E	2021E	2022E
Cash and cash equivalent	7,298	6,476	6,227	6,721	6,619
Trade and bills receivable	2,892	3,587	3,761	3,929	4,933
Inventory	4,282	5,090	5,151	6,144	6,637
Others	15,269	22,333	24,641	25,279	30,211
<b>Total current assets</b>	<b>29,741</b>	<b>37,486</b>	<b>39,780</b>	<b>42,073</b>	<b>48,399</b>
PP&E and CIP	2,203	2,231	2,733	2,730	3,307
Goodwill	4,681	4,719	4,719	4,719	4,719
Other intangible assets	2,298	7,583	7,963	8,361	8,779
Others	27,533	26,518	29,210	32,738	35,875
<b>Total non-current assets</b>	<b>36,716</b>	<b>41,052</b>	<b>44,625</b>	<b>48,547</b>	<b>52,679</b>
<b>Total assets</b>	<b>66,457</b>	<b>78,537</b>	<b>84,405</b>	<b>90,621</b>	<b>101,079</b>
Trade and bills payable	7,022	6,739	8,492	8,215	10,381
ST borrowings	6,523	13,838	13,589	14,417	17,064
Others	11,565	11,157	11,864	13,928	15,048
<b>Total current liabilities</b>	<b>25,109</b>	<b>31,734</b>	<b>33,945</b>	<b>36,560</b>	<b>42,493</b>
LT Borrowings	8,192	9,635	11,863	13,187	14,041
Others	2,691	3,822	3,315	2,965	3,536
<b>Total non-current liabilities</b>	<b>10,884</b>	<b>13,456</b>	<b>15,178</b>	<b>16,153</b>	<b>17,577</b>
Shareholders' equity	25,212	29,132	30,976	33,502	36,449
Minority interest	5,252	4,215	4,306	4,406	4,560
<b>Total equity</b>	<b>30,464</b>	<b>33,347</b>	<b>35,281</b>	<b>37,908</b>	<b>41,009</b>
<b>Total liabilities and equity</b>	<b>66,457</b>	<b>78,537</b>	<b>84,405</b>	<b>90,621</b>	<b>101,079</b>

Source(s): The Group, ABCI Securities estimates



### Consolidated cash flow statement

FY ends at Dec 31 (RMB mn)	2018A	2019E	2020E	2021E	2022E
Pretax profit	3,853	5,605	2,917	4,150	4,826
Depreciation and amortization	1,838	2,260	1,501	1,696	1,906
Change in working capital	1,637	(1,439)	1,131	1,173	(1,806)
Others	(965)	(1,287)	(86)	(629)	(1,147)
<b>Cash flow from operating activities</b>	<b>6,363</b>	<b>5,139</b>	<b>5,463</b>	<b>6,390</b>	<b>3,779</b>
Change in PP&E and CIP	(2,916)	700	(7,090)	(4,512)	(5,950)
Others	(1,316)	(1,933)	(227)	(3,270)	(976)
<b>Cash flow from investing activities</b>	<b>(4,232)</b>	<b>(1,233)</b>	<b>(7,317)</b>	<b>(7,783)</b>	<b>(6,926)</b>
Change in borrowings	(383)	8,735	2,006	2,150	3,497
Others	(518)	(13,144)	(457)	(471)	(469)
<b>Cash flow from financing activities</b>	<b>(900)</b>	<b>(4,409)</b>	<b>1,549</b>	<b>1,679</b>	<b>3,028</b>
<b>Net change in cash</b>	<b>1,231</b>	<b>(504)</b>	<b>(305)</b>	<b>287</b>	<b>(119)</b>
Forex effect	10	11	4	(3)	4
<b>Cash and cash equivalent - end</b>	<b>4,370</b>	<b>3,877</b>	<b>3,576</b>	<b>3,859</b>	<b>3,744</b>

Source(s): The Group, ABCI Securities estimates

### Key operating and financial ratios

FY ends at Dec 31	2018A	2019A	2020E	2021E	2022E
<b>Growth (YoY %)</b>					
Revenue	14.66	14.57	3.43	11.93	13.55
- Liquid milk	12.02	14.29	5.23	11.27	13.14
- Ice cream	8.37	(5.95)	(13.88)	31.26	14.74
- Milk powder	48.87	30.78	(5.84)	12.77	14.62
- Other products	44.77	(14.95)	(4.15)	9.17	40.19
Gross profit	21.72	15.11	2.35	14.69	14.19
Operating profit	4.95	22.60	(26.44)	70.18	19.21
Pretax profit	46.77	45.49	(47.95)	42.25	16.29
Net profit (to shareholders of the Company)	48.60	34.91	(47.74)	43.56	15.08
<b>Profitability ratios (%)</b>					
GPM	37.38	37.55	37.16	38.08	38.30
OPM	5.14	5.50	3.91	5.95	6.24
Pretax margin	5.59	7.09	3.57	4.54	4.65
NPM (to shareholders of the Company)	4.41	5.19	2.62	3.37	3.41
<b>Return ratios (%)</b>					
ROAA	5.14	5.93	2.74	3.63	3.86
ROAE	12.73	15.11	7.14	9.55	10.13
<b>Liquidity ratio (x)</b>					
Current ratio	118.45	118.13	117.19	115.08	113.90
Quick ratio	101.40	102.09	102.01	98.27	98.28
Cash ratio	29.07	20.41	18.34	18.38	15.58
<b>Cash conversion cycle (days)</b>					
Days of outstanding receivable	15	15	16	15	16
Days of inventory on hand	33	35	36	36	36
Days of outstanding payable	56	51	54	54	53
CCC	(9)	(1)	(1)	(2)	(1)
<b>Leverage ratios (%)</b>					
Total debt/Equity	48.38	70.39	72.22	72.88	75.90
Total debt/Total assets	22.18	29.89	30.19	30.49	30.79
Net debt/Equity	24.42	50.97	54.57	55.15	59.76
Net debt/Assets	11.20	21.64	22.81	23.07	24.25

Source(s): The Group, ABCI Securities estimates

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Rating	Definition
Buy	Stock return $\geq$ Market return rate (10%)
Hold	- Market return (-10%) $\leq$ Stock return < Market return rate (10%)
Sell	Stock return < - Market return (-10%)

Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2008 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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