



Company Report

China Mengniu (2319 HK)

May 16, 2013

Rating: Buy
TP: HK\$28.1

Key data

Share price (HK\$)	24.35
Upside potential (%)	15.5
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	6.1	0.2
3-mth	7.5	9.2
6-mth	11.2	3.5

*Relative to Hang Seng Index

Source: Bloomberg

1 year share price performance

HK\$



Source: Bloomberg

Analyst

Report Date: 16 May 2013

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Breakthrough in FY13

Backed by strong shareholder structure and balance sheets, we are expecting a recovery in 2013 and possible margin expansion will serve as a breakthrough catalyst. We consider recent acquisition of China Modern Dairy's stakes as a valuable buy, which helps the group in securing a stable supply of quality raw milk sources. We raise our TP by 6.8% to HK\$28.1, based on 22.0x FY13 PER. Maintain Buy.

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 infant formula 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 1.6ppts to 26.7% in FY13.

Stable supply of quality raw milk: The group shareholdings in China Modern Dairy (1117 HK) increased from 1% to 28% after acquisition of 1.296bn of shares from private equity investors KKR and CDH at HK\$2.45/share. HK\$2.45 represent est 2013 PE of 19.2x, which is 23% lower than its historical average since listed in Nov 2010, therefore we consider the deal as a valuable buy for Mengniu. The stakes acquisition is also in line with Mengniu's management strategy in ensuring the quality and securing the supply of raw milk source.

Valuation. We estimate the acquisition of Modern Dairy will raise group's est 2013/2014 EPS by 5.3%/5.4%. Therefore, we raise our TP by 6.8% to HK\$28.1, based on 22.0x FY13 PE (which is still 15% lower than the historical average). Maintain BUY.

Risks: Food safety risks, market competition, management risks

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	1,889	2,191
Chg (%YoY)	10.9%	28.4%	-20.9%	50.3%	16.0%
EPS (Rmb)	0.71	0.91	0.71	1.02	1.19
Chg (%YoY)	4.4%	27.3%	-21.4%	43.9%	15.9%
NBV (Rmb/share)	5.61	6.49	7.04	7.95	8.95
PE (x)	-	21.5	27.4	19.0	16.4
PB (x)	-	3.0	2.8	2.5	2.2
ROAA (%)	7.9%	8.5%	6.1%	8.7%	8.7%
ROAE (%)	13.5%	15.0%	10.5%	14.2%	14.7%
Net D/E (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company annual reports, ABCI Securities estimates



Profit Forecast

FY ended Dec 31 (Rmbmn)	FY10	FY11	FY12	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)
Gross profit	7,786.4	9,592.2	9,054.6	10,858.8	12,306.9
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	128.0	152.0
EBIT	1,495.4	1,948.5	1,508.2	2,392.6	2,802.3
Interest income	87.9	173.1	218.6	170.1	170.1
Finance costs	(45.2)	(60.9)	(41.8)	(37.3)	(43.0)
EBT	1,538.1	2,060.6	1,685.0	2,525.3	2,929.4
Tax	(182.2)	(276.1)	(245.5)	(378.8)	(439.4)
MI	(118.6)	(195.3)	(182.4)	(257.6)	(298.8)
Net profit attributable to owners	1,237.3	1,589.3	1,257.1	1,888.9	2,191.2
D&A	(718.9)	(851.8)	(1,053.1)	(1,281.3)	(1,456.8)
EBITDA	2,214.3	2,800.3	2,561.3	3,673.9	4,259.1
Dividends	278.1	350.0	282.9	415.6	482.1
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	78.3	78.3	79.3
Total issued & issuable shares	1,775.7	1,818.4	1,846.5	1,846.5	1,847.5
Per share value (Rmb)					
FD EPS	0.711	0.905	0.711	1.023	1.186
NBV	5.615	6.490	7.037	7.945	8.950
DPS	0.160	0.198	0.160	0.235	0.273

Source: Company annual reports (for historical figures only), ABCI Securities estimates

Key Financial Ratio

FY ended Dec 31	FY10	FY11	FY12	FY13F	FY14F
Profitability ratio					
Gross profit margin	25.7%	25.7%	25.1%	26.7%	26.9%
EBIT margin	4.9%	5.2%	4.2%	5.9%	6.1%
EBITDA margin	7.3%	7.5%	7.1%	9.0%	9.3%
Net profit margin	4.1%	4.3%	3.5%	4.6%	4.8%
ROAA	7.9%	8.5%	6.1%	8.7%	8.7%
ROAE	13.5%	15.0%	10.5%	14.2%	14.7%
Cost ratio					
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%
Leverage					
Current ratio	1.55	1.44	1.40	1.46	1.52
Quick ratio	1.36	1.20	1.19	1.25	1.32
Net debt/total equity	Net cash	Net cash	Net cash	Net cash	Net cash
Working capital cycle					
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: Company annual reports (for historical figures only), ABCI Securities estimates



Balance Sheet Forecast

As of Dec 31 (Rmbmn)	FY10	FY11	FY12	FY13F	FY14F
PPE	5,380.4	6,806.5	7,891.9	9,230.8	9,993.7
Others	2,261.1	3,008.6	3,337.6	5,800.9	5,781.7
Non-current assets	7,641.5	9,815.2	11,229.5	15,031.7	15,775.3
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	4,104.3	6,409.5
Current assets	9,664.3	10,386.5	9,761.2	8,062.8	11,246.0
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	2,139.0	3,003.7	2,728.0	2,551.0	3,887.2
Current liabilities	6,238.3	7,225.8	6,980.6	7,220.9	9,073.3
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
Non-current liabilities	850.0	927.0	938.2	938.2	938.2
Total assets	17,305.8	20,201.7	20,990.7	23,094.6	27,021.4
Net assets	10,217.5	12,048.8	13,071.8	14,935.4	17,009.9
Issued capital	178.7	181.1	181.2	181.2	181.2
Retained earnings	2,050.2	3,074.3	3,745.8	5,351.9	7,127.5
Other reserves	7,529.2	8,215.6	8,516.3	8,516.3	8,516.3
MI	459.4	577.8	628.6	886.1	1,184.9
Total equity	10,217.5	12,048.8	13,071.8	14,935.5	17,009.9
Equity attributable to owners	9,758.1	11,471.1	12,443.3	14,049.3	15,824.9

Source: Company annual reports (for historical figures only), ABCI Securities estimates

Cash Flow Forecast

As of Dec 31 (Rmbmn)	FY10	FY11	FY12	FY13F	FY14F
EBITDA	2,214.3	2,800.3	2,561.3	3,673.9	4,259.1
Change in working capital	151.7	37.9	(67.6)	264.5	974.5
Others	259.7	(75.3)	(167.9)	132.8	127.0
Cash (used in)/generated from operations	2,625.7	2,762.9	2,325.8	4,071.1	5,360.6
Interest paid	(38.9)	(46.4)	(19.2)	0.0	0.0
Income tax paid	(101.8)	(196.4)	(299.7)	(378.8)	(439.4)
CF from operating activities	2,485.1	2,520.1	2,006.9	3,692.3	4,921.2
CAPEX	(1,426.1)	(2,696.3)	(2,163.2)	(2,600.0)	(2,200.0)
Others	(3,263.5)	(1,468.8)	(3,082.8)	(6,192.3)	(4,921.2)
Cash flows from investing activities	(2,204.5)	(1,645.0)	(3,239.2)	(5,100.0)	(2,200.0)
Net borrowing	(130.1)	(277.0)	146.5	0.0	0.0
Proceeds from issue of shares	13.4	520.6	12.1	0.0	0.0
Dividends paid	(272.7)	(331.2)	(421.4)	(282.9)	(415.6)
Interest paid	(38.9)	(46.4)	(19.2)	0.0	0.0
Others	32.6	(104.2)	100.4	16.5	(0.4)
Cash flows from financing activities	(395.6)	(238.2)	(181.5)	(266.4)	(416.0)
Net (decrease)/increase in cash and cash equivalents	(114.9)	636.9	(1,413.8)	(1,674.1)	2,305.3
Cash and cash equivalents at beginning of year/period	3,986.6	3,775.3	4,359.9	2,943.9	1,269.8
Effect of foreign exchange rates, net	(96.4)	(52.2)	(2.2)	0.0	0.0
Cash and cash equivalents at end of year/period	3,775.3	4,359.9	2,943.9	1,269.8	3,575.0

Source: Company annual reports (for historical figures only), ABCI Securities estimates

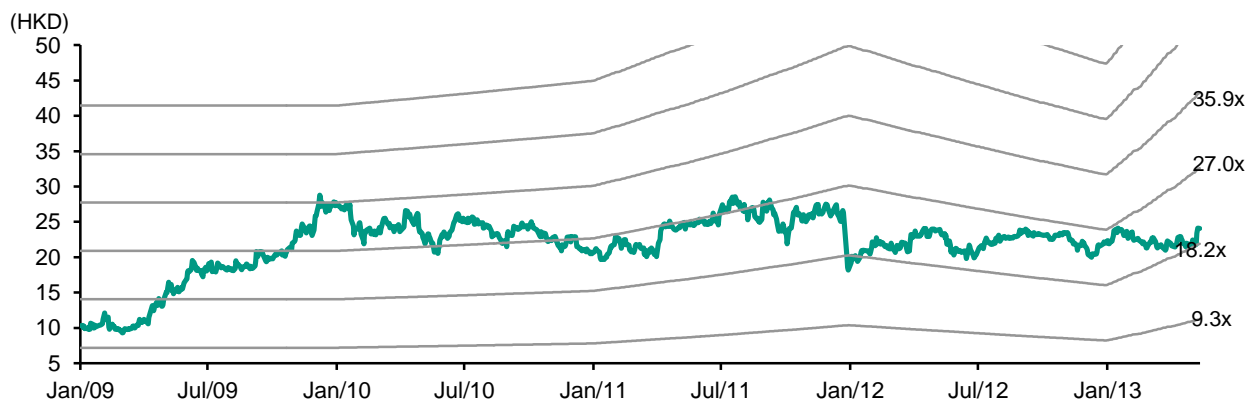


Exhibit: Financial forecasts vs Consensus (Rmb mn)

	Our forecast		Consensus		Difference	
	FY13F	FY14F	FY13F	FY14F	FY13F	FY14F
Revenue	40,731	45,765	41,426	47,439	-1.68%	-3.53%
Gross Profit	10,859	12,307	10,611	12,142	2.34%	1.35%
Net profit	1,889	2,191	1,609	1,968	17.40%	11.34%
FD EPS (Rmb)	1.023	1.186	0.918	1.120	11.44%	5.90%

Source: Bloomberg; ABCI Securities estimates

Exhibit: Historical PE of the group



Source: Bloomberg, ABCI Securities

Exhibit: PE standard deviation of the group



Source: Bloomberg, ABCI Securities



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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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