



Yili (600887 CH) Outstanding 2Q17 performance; reiterate BUY

- Superb 2Q17 performance elevated 1H17 results; product segments saw double-digit growth in revenue although GP increased in slower rates
- The Group was in a net cash position and management of working capital was efficient. Leverage went up as short-term debts increase
- Expansion of Yili's market share in the liquid milk and UHT products markets showed strong product competitiveness, which would support future growth and margin
- Reiterate **BUY**; current TP represents 25.13x and 23.19x FY17E/18E P/E and 4.62x and 4.16x FY17E/18E P/B

A superb 2Q17 elevated 1H17 results. 1H17 revenue grew 11.32% YoY and GP edged up 9.23% YoY. OP growth accelerated to 21.96% YoY. Improvement of 1H17 results was mainly supported by outstanding performance in 2Q17 where revenue, GP, and OP grew 19.94% YoY, 29.04% YoY, and 33.07% YoY, respectively. However, it is worth noting that pretax profit and NP (to owners of the company) for 2Q17 declined by 19.93% YoY and 24.24% YoY due to lower investment income, non-operating loss, increased finance costs, and a higher effective tax rate. As a result, pretax margin and NPM (to owners of the company) were lower than those in 1Q17 and 2Q16.

Profit growth of liquid milk and milk formula segments was lower than that of the topline. 1H17 revenue growth of liquid milk segment, chilled product segment, and milk formula segment were 12.75% YoY, 10.62% YoY, and 19.95% YoY, respectively. GP growth of chilled product segment and milk formula segment were 11.30% YoY and 16.26% YoY, while liquid milk segment saw a lower growth of 8.90% YoY. GPM for liquid milk segment, chilled product segment, and milk formula segment were 35.93%, 43.92%, and 56.74% in 1H17 vs. 37.19%, 43.65% and 58.54% in 1H16.

Net cash position and efficient working capital management although leverage went up. Net cash at end-1H17 was RMB 11,758mn, lower than the RMB 13,673mn by end-2016 or RMB 12,765mn by end-1Q17. CCC further decreased to -20 days, driven by the 5-day decrease in inventory turnover and 4-day decrease in payable turnover. However, leverage level went up - total debt-to-equity was 30% by end-1H17 vs. 12.22% by end-1Q17, mainly driven by the increase in short-term debts.

Market share expansion shows ability to achieve decent growth. Strong momentum in 1H17 coincides with an increasing market share. According to Mengniu's presentation material, Yili's market share in the liquid milk market increased by 2.1ppt to 28.8% in 1H17; its share in the UHT product market was up 3.2ppt to 33.8% in 1H17; market share in chilled product market share also gained 0.4ppt to 16.5% in 1H17. We believe increased market share illustrate competitiveness of Yili's products. We project 2016-19E total revenue CAGR to be 6.54%, supported by 5.82%/4.0%/8.71% CAGRs in the liquid milk/chilled products/milk formula segments. We expect GPM would improve from 38.25% in 2016 to 41.79% in 2019E.

Reiterate BUY with TP at RMB 26.40. We reiterate **BUY** based on the impressive momentum, improving margins, and expanding market shares in 1H17. Current TP represents 25.13x and 23.19x FY17E/18E P/E and 4.62x and 4.16x FY17E/18E P/B.

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	64,053	68,525	73,305
Chg (% YoY)	10.88	0.41	5.68	6.98	6.98
Net Profit (RMB mn)	4,632	5,662	6,385	6,919	7,309
Chg (% YoY)	11.76	22.24	12.78	8.37	5.62
Basic EPS (RMB)	0.76	0.93	1.05	1.14	1.20
Chg (% YoY)	11.76	22.37	12.94	8.37	5.62
P/E (x)	30.92	25.27	22.37	20.65	19.55
BVPS (RMB)	3.30	3.80	5.72	6.35	7.13
P/B (x)	7.13	6.19	4.11	3.70	3.30
DPS(RMB)	0.45	0.60	0.66	0.73	0.77
Yield (%)	1.91	2.55	2.83	3.09	3.26
ROAA (%)	11.71	14.35	12.38	10.37	9.98
ROAE (%)	23.99	26.29	22.08	18.86	17.84

Source(s): Bloomberg, ABCI Securities estimates

Company Report Sep 12, 2017 Rating: BUY TP: RMB 26.40

Analyst: Paul Pan
Tel: (852) 2147 8829
Email: paulpan@abci.com.hk

Share price (RMB)	23.50
52Wk H/L(RMB)	24.22/15.83
Est. share price return	12.34%
Est. dividend yield	2.83%
Est. total return	15.17%
Previous Rating&TP	BUY;RMB21.30
Previous report date	May 8, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

Issued shares (mn)	6,079.00
Market cap (RMB mn)	141,275.96
3-mth ADT (RMB mn)	1,283.62

Major shareholders (%)

Hohhot Investment Co Ltd	9.88
HK Securities Clearing Co	8.44
China Securities Finance Corp	4.76
Pan Gang	3.88
Sunshine Insurance	1.79
Source(s): , Bloomberg, Company	

% of core revenue

	FY17E
Liquid milk	83.51
Chilled product	6.93
Milk formula	9.51

Source(s): ABCI Securities estimates

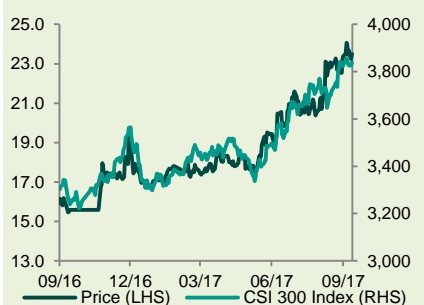
Price Performance (%)

	Absolute	Relative*
1-mth	4.96	(0.43)
3-mth	14.52	5.45
6-mth	33.57	19.39

* 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 Sep 12, 2017

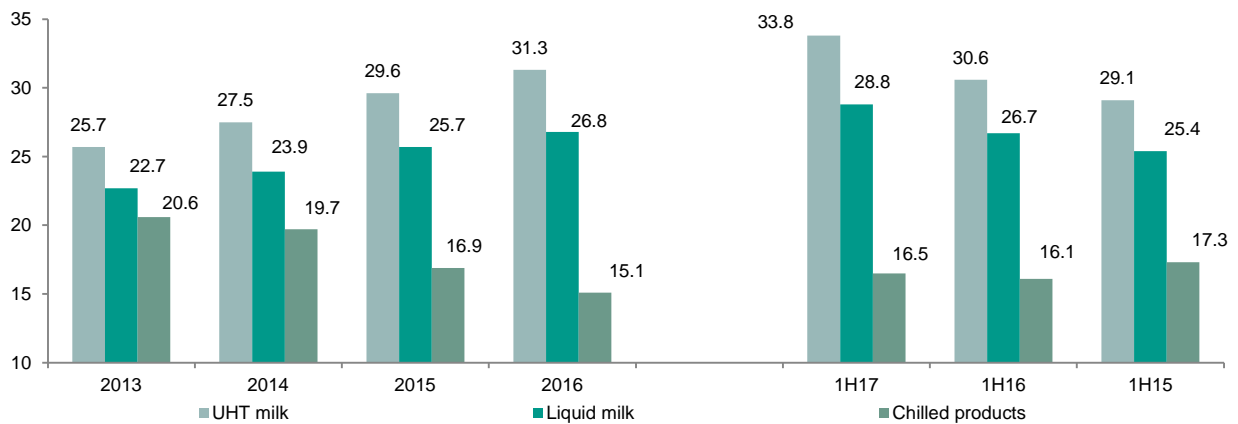


Exhibit 1: Quarterly financial performance

	1Q17	2Q17
Growth (YoY %)		
Total revenue	3.03	19.94
Total gross profit	(7.22)	29.04
Operating profit	13.18	33.07
Pretax profit	11.67	(19.93)
Net profit (to owners of the company)	11.58	(24.24)
Margins		
GPM	37.93	39.09
OPM	12.15	10.06
Pretax margin	12.97	9.03
NPM (to owners of the Company)	10.98	9.21

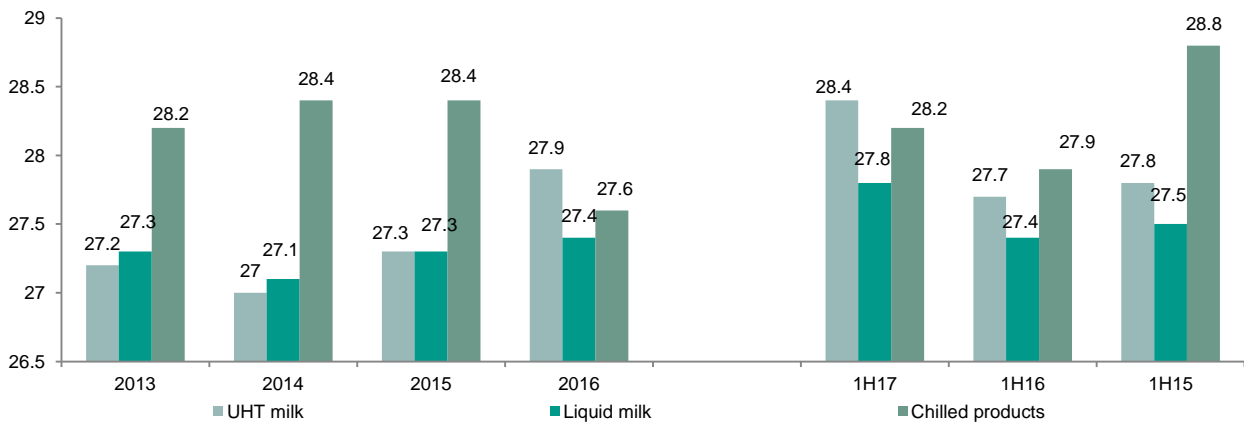
Source(s): Company, ABCI Securities

Exhibit 2: Market share by products – Yili (%)



Source(s): Mengniu presentation material, ABCI Securities

Exhibit 3: Market share by products – Mengniu (%)



Source(s): Mengniu presentation material, ABCI Securities



Consolidated income statement (2015A-2019E)

FY ends at Dec 31 (RMB mn, except per share data)	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Revenue	60,360	60,609	64,053	68,525	73,305	30,087	33,494
- Core revenue	58,764	59,614	62,577	66,463	70,444	29,378	32,798
- Liquid milk	47,151	49,522	52,259	55,434	58,677	23,495	26,490
- Chilled product	4,098	4,194	4,335	4,479	4,718	2,931	3,242
- Milk formula	6,447	5,456	5,949	6,512	7,010	2,534	3,039
- Others	1,067	441	35	37	39	419	27
- Non-core revenue	1,100	698	938	1,218	1,578	548	504
- Interest income	496	297	538	844	1,283	161	192
COGS	(38,376)	(37,427)	(38,022)	(39,993)	(42,674)	(18,268)	(20,583)
Gross profit	21,984	23,182	26,031	28,532	30,631	11,819	12,910
- Core gross profit	21,387	22,813	25,402	27,566	29,193	11,613	12,692
- Liquid milk	16,069	17,808	20,070	21,970	23,382	8,739	9,517
- Chilled product	1,489	1,806	2,021	1,917	1,804	1,279	1,424
- Milk formula	3,609	3,065	3,276	3,642	3,967	1,483	1,724
- Others	221	134	35	37	39	111	27
- Non-core gross profit	100	72	91	122	155	45	27
- Gross profit on interest income	496	297	538	844	1,283	161	192
Business tax and levies	(251)	(420)	(438)	(478)	(507)	(176)	(273)
S&D expenses	(13,258)	(14,114)	(15,071)	(16,638)	(18,012)	(7,076)	(7,648)
Admin expenses	(3,456)	(3,457)	(4,278)	(4,754)	(5,068)	(1,533)	(1,290)
Operating profit	5,019	5,191	6,244	6,662	7,045	3,033	3,699
Asset impairment expense	(14)	(46)	(74)	(81)	(90)	(42)	(37)
Investment income	186	399	435	498	554	318	68
Non-operating profit/(loss)	629	1,112	1,129	1,200	1,280	541	(55)
Net finance income/expense	(297)	(24)	(61)	(160)	(174)	(18)	(28)
Pretax profit	5,524	6,632	7,672	8,119	8,615	3,832	3,648
Tax	(869)	(963)	(1,279)	(1,191)	(1,297)	(585)	(631)
Net profit	4,654	5,669	6,393	6,928	7,318	3,247	3,017
- Profit attributable to shareholders	4,632	5,662	6,385	6,919	7,309	3,211	3,364
- Minority interest	23	7	8	9	9	11	4
Cash dividend	2,729	3,647	4,038	4,413	4,662	0	0
EPS (RMB)							
- Basic	0.76	0.93	1.05	1.14	1.20	1	0.55
- Diluted	0.76	0.93	1.05	1.14	1.20	1	0.55
Cash DPS (RMB)	0.45	0.60	0.66	0.73	0.77	0	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	1H16	1H17
Cash and cash equivalent	13,084	13,824	34,410	38,908	43,736	10,879	18,628
Trade and bills receivable	719	686	691	736	845	133	1,210
Inventory	4,663	4,326	4,620	4,847	5,446	3,738	4,286
Others	1,320	1,357	1,262	1,314	1,616	2,145	1,865
Total current assets	19,786	20,193	40,984	45,806	51,642	16,895	25,990
PP&E	14,559	13,137	12,589	11,694	11,027	12,892	12,978
Biological assets	1,299	0	0	0	0	0	0
Goodwill	11	11	11	11	11	11	11
AFS investment	985	612	674	741	815	613	605
LT equity investment	122	1,631	1,865	2,150	2,497	1,546	1,669
Others	2,870	3,678	7,789	9,098	10,914	2,697	3,132
Total non-current assets	19,845	19,070	22,928	23,693	25,264	17,758	18,394
Total assets	39,631	39,262	63,911	69,499	76,906	34,654	44,384
Trade and bills payable	6,642	7,091	7,089	7,759	8,291	287	7,624
ST borrowings	6,190	150	11,234	12,267	14,448	790	6,870
Others	5,370	7,667	9,305	9,269	9,018	11,862	6,635
Total current liabilities	18,202	14,907	27,628	29,294	31,757	12,939	21,129
LT Borrowings	0	0	287	373	530	0	0
Others	1,283	1,119	951	923	944	1,140	352
Total non-current liabilities	1,283	1,119	1,238	1,296	1,474	1,140	352
Shareholders' equity	19,984	23,082	34,764	38,597	43,325	20,403	22,754
Minority interest	162	154	281	312	350	172	148
Total equity	20,146	23,236	35,045	38,908	43,675	20,575	22,902
Total liabilities and equity	39,631	39,262	63,911	69,499	76,906	34,654	44,384

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2015A-2019E)

FY ends at Dec 31 (RMB mn)	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Net profit	4,654	5,669	6,393	6,928	7,318	3,222	3,368
Depreciation and amortization	1,794	1,657	1,604	1,651	1,725	964	891
Change in working capital	2,898	5,849	224	440	(1,234)	3,572	(1,436)
Others	190	(359)	439	(76)	(14)	(257)	6
Cash flow from operating activities	9,536	12,817	8,660	8,944	7,795	7,502	2,829
Change in PP&E, intangible assets, and other non-current assets	(3,626)	(3,396)	(5,229)	(6,058)	(7,218)	(1,553)	(1,519)
Others	139	153	62	109	63	221	224
Cash flow from investing activities	(3,487)	(3,243)	(5,167)	(5,949)	(7,155)	(1,331)	(1,294)
Change in borrowings	(2,586)	(6,038)	11,370	1,119	2,339	(5,400)	6,720
Cash flow related to dividend payment, interest payment, or profit distribution	(2,659)	(2,776)	(4,422)	(3,058)	(4,160)	(2,756)	(3,701)
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)	15,947	(1,939)	(1,821)	(8,156)	3,237
Net change in cash	(229)	760	19,441	1,055	(1,180)	(1,986)	4,771
ForEx effect	(14)	235	54	69	86	39	(142)
Cash and cash equivalent - end	12,217	13,211	32,706	33,830	32,735	10,269	17,840

Source(s): Company, ABCI Securities estimates

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

FY ends at Dec 31	2015A	2016A	2017E	2018E	2019E	1H16	1H17
Growth (YoY %)							
Revenue	10.88	0.41	5.68	6.98	6.98	(0.21)	11.32
Core revenue	9.87	1.45	4.97	6.21	5.99	0.36	11.64
- Liquid milk	11.19	5.03	5.53	6.08	5.85	4.78	12.75
- Chilled products	(4.34)	2.35	3.35	3.34	5.32	(1.98)	10.62
- Milk formula	7.21	(15.38)	9.04	9.48	7.64	(24.05)	19.95
- Others	36.21	(58.64)	(92.11)	6.21	5.99	(20.25)	(93.58)
Non-core revenue	132.85	(36.50)	34.29	29.84	29.56	(5.85)	(8.03)
Gross profit	21.89	5.45	12.29	9.61	7.36	10.69	9.23
Core gross profit	22.65	6.66	11.35	8.52	5.90	12.34	9.29
- Liquid milk	22.93	10.82	12.70	9.47	6.43	19.33	8.90
- Chilled products	(0.85)	21.31	11.91	(5.12)	(5.89)	12.47	11.30
- Milk formula	31.56	(15.07)	6.90	11.16	8.93	(14.58)	16.26
- Others	80.95	(39.46)	(73.98)	6.21	5.99	(20.50)	(75.82)
Non-core gross profit	(17.16)	(28.52)	26.79	33.68	27.70	0.29	(40.87)
Operating profit	8.79	3.43	20.28	6.71	5.74	(4.84)	21.96
EBITDA	11.62	0.04	14.27	5.90	5.45	(3.81)	15.12
Pretax Profit	15.41	20.07	15.68	5.82	6.11	20.19	(4.80)
Net profit (to owners of the Company)	11.76	22.24	12.78	8.37	5.62	20.63	4.75
Profitability ratios (%)							
GPM	36.42	38.25	40.64	41.64	41.79	39.28	38.55
Core-GPM	36.40	38.27	40.59	41.48	41.44	39.53	38.70
- Liquid milk	34.08	35.96	38.40	39.63	39.85	37.19	35.93
- Chilled products	36.32	43.05	46.62	42.80	38.25	43.65	43.92
- Milk formula	55.97	56.17	55.08	55.92	56.60	58.54	56.74
- Others	20.72	30.32	100.00	100.00	100.00	26.57	100.00
Non-core GPM	9.13	10.28	9.71	9.99	9.85	8.27	5.32
OPM	8.31	8.56	9.75	9.72	9.61	10.08	11.04
EBITDA margin	11.27	11.22	12.14	12.01	11.84	13.14	13.59
Pretax margin	9.15	10.94	11.98	11.85	11.75	12.74	10.89
NPM (to owners of the Group)	7.67	9.34	9.97	10.10	9.97	10.67	10.04
Revenue contribution (%)							
Core revenue/ total revenue	97.36	98.36	97.70	96.99	96.10	97.64	97.92
Non-core revenue/ total revenue	1.82	1.15	1.46	1.78	2.15	1.82	1.50
Interest income/ total revenue	0.82	0.49	0.84	1.23	1.75	0.54	0.57
Core revenue composition							
- Liquid milk	80.24	83.07	83.51	83.41	83.30	79.97	80.77
- Chilled products	6.97	7.04	6.93	6.74	6.70	9.98	9.88
- Milk formula	10.97	9.15	9.51	9.80	9.95	8.62	9.27
- Others	1.82	0.74	0.06	0.06	0.06	1.43	0.08
Return ratios (%)							
ROAA	11.71	14.35	12.38	10.37	9.98	17.29	14.43
ROAE	23.99	26.29	22.08	18.86	17.84	31.81	29.36
Liquidity ratio (x)							
Current ratio	1.09	1.35	1.48	1.56	1.63	1.31	1.23
Quick ratio	0.83	1.06	1.32	1.40	1.45	1.02	1.03
Cash ratio	0.72	0.93	1.25	1.33	1.38	0.84	0.88
Cash conversion cycle (days)							
Days of outstanding receivable	3	3	3	3	3	4	4
Days of inventory on hand	47	45	44	44	46	42	38
Days of outstanding payable	56	64	65	66	67	63	63
CCC	(5)	(16)	(18)	(19)	(18)	(18)	(20)
Leverage ratios (%)							
Total debt/Equity	30.73	0.65	32.87	32.49	34.30	3.84	30.00
Total debt/Total assets	15.62	0.38	18.03	18.19	19.48	2.28	15.48

Source(s): Company, ABCI Securities estimates



Disclosures

Analyst Certification

I, PAN Hongxing, Paul, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates may pursue financial interests to the companies mentioned in the report.

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.

Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

Copyright 2017 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.
Tel: 852) 2868 2183