Mengniu (2319 HK)
Better operating cost efficiency to boost margins in FY22E

- 2H22 revenue growth to accelerate as COVID resurgence alleviates and economy improves; 1H22 revenue of the milk powder segment will weigh on overall growth
- GPM would continue to suffer from elevated raw material costs, especially raw milk prices, in 2H22, but lower SG&A/revenue ratio would help boost OPM in FY22E; certain one-time non-operating gain would bump up FY22E net margin
- Maintain **BUY**; current TP implies 25.05x/24.62x 22E/23E P/E, or 4.27x/3.82x 22E/23E P/B

Revenue growth to pick up in 2H22. COVID resurgence in 2Q22 resulted in overall revenue growth of 4.0% YoY in 1H22 vs. 22.3% YoY in 1H21; milk powder segment suffered additionally from the declining number of newborns and its 1H22 revenue decline by 25.6% YoY. The ice-cream segment, which achieved 1H22 revenue growth of 29.9% YoY, benefited from new product launches and the hot weather. We believe improving economy and COVID containment in 2H22 would boost growth, but demographic shifts would continue to weigh on the milk powder segment. We expect total revenue to grow 12.1% YoY for FY22E, among which the liquid milk and ice cream segments would expand 11.0% YoY and 21.5% YoY, while the milk powder segment would decline 9.2% YoY. Based on these projections, 2H22 total revenue growth would be 21.0% YoY; revenue of liquid milk and milk powder segments would increase 22.1% YoY and 8.2% YoY, while revenue of ice-cream segment in 2H22 would be similar to the level in 2H21. FY21-24E revenue CAGR would be 11.8%, and that of liquid milk, ice cream, and milk powder segment would be 11.4%, 16.8%, and 5.9%.

Margins to be impacted by high raw milk price and better operating cost efficiency. 1H22 GPM, OPM, and NPM (to shareholders of the Company) were 36.6%, 5.3%, and 7.9% in 1H22 vs. 38.2%, 6.1%, and 6.4% in 1H21. Rising raw material cost has slashed GPM and OPM, while net margin improved mainly due to net fair value gain on other financial liabilities and gain on disposal of a subsidiary amounting in total to RMB 1,015.4mn. We expect raw material costs, especially raw milk price, would remain high in 2H22, and GPM would suffer in FY22E; FY22E OPM would still improve due to SG&A/revenue ratio declining from 30.6% in FY21 to 30.4% in FY22E. We estimate GPM, OPM, and NPM (to shareholders of the Company) would be 36.6%, 5.7%, and 6.9% for FY22E. In addition, the higher FY22E NPM is caused by the one-time non-operational gain. Based on current projections, 2H22 GPM, OPM, and NPM (to shareholders of the Company) would be 36.7%, 6.0%, and 6.1%.

Maintain BUY; TP at HK$ 49.0. By our estimates, FY22E basic EPS growth and FY21-24E EPS CAGR would be 35.1%/14.8%. Maintain **BUY** on stable growth outlook and better operating efficiency. We raise our DCF-derived TP to reflect the higher profit estimates. Current TP represents 25.05x/24.62x 22E/23E P/E, or 4.27x/3.82x 22E/23E P/B.

Risk factors: 1) Macroeconomic risk; 2) Prolonged COVID-19 outbreak; 3) Commodity price risk; 4) Regulation risk; 5) Food safety risk; 6) Business acquisition risk; 7) Product concentration risk; 8) Changing consumer taste in China; 9) Fluctuation in EPS growth due to non-operating gain.

Results and Valuation

FY ended Dec 31	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	76,035	88,141	98,838	110,579	123,254
Chg (%,YoY)	(3.8)	15.9	12.1	11.9	11.5
Net Profit (RMB mn)	3,525	5,026	6,806	6,926	7,614
Chg (%,YoY)	(14.1)	42.6	35.4	1.8	9.9
Basic EPS (RMB)	0.90	1.27	1.72	1.75	1.92
Chg (% YoY)	(14.5)	42.0	35.1	1.8	9.9
P/E (x)	34.97	24.62	18.23	17.91	16.30
BVPS (RMB)	8.38	9.32	10.09	11.30	12.62
P/B (x)	3.74	3.37	3.11	2.78	2.48
DPS(RMB)	0.27	0.38	0.51	0.52	0.57
Yield (%)	0.9	1.2	1.6	1.6	1.8
ROAA (%)	4.4	5.6	6.4	6.1	6.4
ROAE (%)	11.4	14.4	17.7	16.4	16.1

Source(s): Bloomberg, ABCI Securities estimates

Company Report
Sep 1, 2022
Rating: BUY
TP: HK$ 49.0

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

Share price (HK$)	35.65
52Wk H/L(HK$)	50.71/31.5
Est. share price return	37.4%
Est. dividend yield	1.6%
Est. total return	39.0%
Previous Rating &TP	BUY; HK$48.1
Previous report date	Apr 4, 2022

Source(s): Bloomberg, ABCI Securities estimates

Key Data

Issued shares (bn)	3.96
Market cap (HK$ bn)	141.0
3-mth ADT (HK$ mn)	410.0

Major shareholders	(%)
COFCO	23.1
FIL Limited	7.7

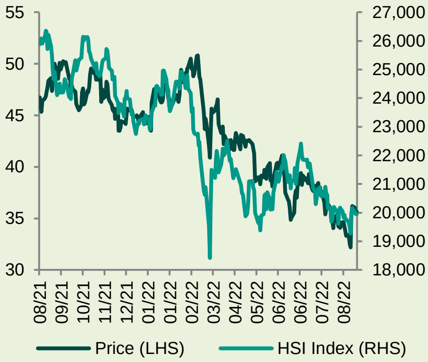
Source(s): Bloomberg, HKEX, ABCI Securities

Sector Performance (%)

	Absolute	Relative*
1-mth	(2.1)	(1.1)
3-mth	(11.5)	(4.7)
6-mth	(29.8)	(17.6)

* 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 Aug 31, 2022;
2) RMB/HKD: 1.1365

Exhibit 1: Change in assumptions, projections, and valuations

	Current report		Previous report		Rationale
FY ends at Dec 31	FY22E	FY23E	FY22E	FY23E	
Assumptions					
D/E (%)	78.3	63.2	58.3	48.5	Adjusted based on 1H22 rates
D/A (%)	31.7	27.6	25.6	22.3	
Tax rate (%)	15.3	15.3	15.5	15.5	
Valuations					
TP (HK$)	49.0		48.1		Higher TP mainly due to higher profit forecasts
P/E (x)	25.05	24.62	31.13	24.53	
P/B (x)	4.27	3.82	3.83	3.45	

Note: Previous report was published on Apr 4, 2022
Source(s): The Company, ABCI Securities estimates

Exhibit 2: Changes in major forecasts

	Current report			Previous report			Change (%)		
As of Dec 31	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue (RMB mn)	98,838	110,579	123,254	99,401	112,857	128,414	(0.6)	(2.0)	(4.0)
Net profit (to shareholders of the Company) (RMB mn)	6,806	6,926	7,614	4,965	6,300	6,922	37.1	9.9	10.0
EPS (RMB)	1.72	1.75	1.92	1.26	1.59	1.75	36.6	10.1	10.0

Source(s): ABCI Securities estimates

Financial Statements

Consolidated income statement

FY ends at Dec 31 (RMB mn, except per share data)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	**76,035**	**88,141**	**98,838**	**110,579**	**123,254**
- Liquid milk	67,751	76,514	84,933	94,784	105,811
- Ice cream	2,634	4,240	5,151	6,011	6,763
- Milk formula	4,573	4,949	4,494	5,057	5,882
- Other revenue	1,077	2,438	4,260	4,726	4,798
COGS	(47,406)	(55,752)	(62,614)	(69,580)	(77,292)
Gross profit	**28,629**	**32,390**	**36,224**	**40,999**	**45,963**
S&D expenses	(21,541)	(23,488)	(26,172)	(29,391)	(32,857)
Admin expenses	(3,133)	(3,524)	(3,904)	(4,394)	(4,884)
Other operating expenses	(473)	(516)	(549)	(624)	(701)
EBIT	**3,482**	**4,862**	**5,599**	**6,590**	**7,521**
Net interest expense /income	512	284	754	1,063	975
Other gains/(losses)	426	693	1,561	396	339
Profit before tax	**4,155**	**5,868**	**7,913**	**8,048**	**8,834**
Tax	(653)	(905)	(1,207)	(1,234)	(1,351)
Total net profit	**3,502**	**4,964**	**6,706**	**6,814**	**7,483**
- Profit to shareholders	3,525	5,026	6,806	6,926	7,614
- Minority interest	(23)	(62)	(100)	(112)	(131)
Dividend	**1,058**	**1,506**	**2,011**	**2,043**	**2,244**
EPS (RMB)					
- Basic EPS	0.90	1.27	1.72	1.75	1.92
- Diluted EPS	0.89	1.27	1.60	1.62	1.79
DPS (RMB)	**0.27**	**0.38**	**0.51**	**0.52**	**0.57**

Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet

FY ends at Dec 31 (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash and cash equivalent	11,397	11,217	24,817	19,081	20,804
Trade and bills receivable	2,988	4,160	4,473	4,923	4,447
Inventory	5,512	6,485	7,394	8,030	8,246
Others	11,609	9,158	10,743	12,511	12,811
Total current assets	**31,507**	**31,020**	**47,427**	**44,545**	**46,309**
PP&E and CIP	15,276	19,955	20,686	22,346	24,721
Goodwill	4,883	4,858	4,858	4,858	4,858
Other intangible assets	7,717	7,999	8,399	8,819	9,260
Others	20,763	34,270	29,885	33,275	36,184
Total non-current assets	**48,640**	**67,081**	**63,828**	**69,298**	**75,023**
Total assets	**80,146**	**98,101**	**111,255**	**113,843**	**121,332**
Trade and bills payable	7,969	8,804	11,999	10,756	14,228
ST borrowings	4,924	4,265	6,807	5,673	4,442
Others	13,251	16,003	16,455	19,268	21,456
Total current liabilities	**26,144**	**29,072**	**35,261**	**35,697**	**40,127**
LT Borrowings	14,020	18,786	24,290	21,555	19,164
Convertible bonds	0	3,981	4,158	4,158	4,158
Others	2,734	4,262	2,531	2,761	3,102
Total non-current liabilities	**16,754**	**27,030**	**30,980**	**28,474**	**26,424**
Shareholders' equity	32,983	36,826	39,919	44,690	49,929
Minority interest	4,265	5,174	5,094	4,982	4,851
Total equity	**37,248**	**41,999**	**45,013**	**49,672**	**54,781**
Total liabilities and equity	**80,146**	**98,101**	**111,255**	**113,843**	**121,332**

Source(s): The Group, ABCI Securities estimates

Consolidated cash flow statement

FY ends at Dec 31 (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Pretax profit	4,155	5,868	7,913	8,048	8,834
Depreciation and amortization	2,137	2,396	1,842	1,940	2,163
Change in working capital	967	1,459	1,914	578	5,625
Others	(1,911)	(2,179)	(2,214)	(2,321)	(2,493)
Cash flow from operating activities	**5,348**	**7,545**	**9,455**	**8,245**	**14,129**
Change in PP&E and CIP	(4,017)	(5,992)	(4,303)	(5,288)	(5,663)
Others	8,838	(9,448)	(6,082)	698	(3,160)
Cash flow from investing activities	**4,822**	**(15,440)**	**(10,384)**	**(4,590)**	**(8,824)**
Change in borrowings	(3,926)	8,089	8,223	(3,870)	(3,622)
Others	(645)	(1,316)	1,225	(2,860)	(1,150)
Cash flow from financing activities	**(4,571)**	**6,773**	**9,448**	**(6,730)**	**(4,772)**
Net change in cash	**5,599**	**(1,123)**	**8,519**	**(3,076)**	**533**
Forex effect	(172)	(11)	12	6	3
Cash and cash equivalent - end	**9,225**	**8,092**	**16,622**	**13,552**	**14,088**

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios

FY ends at Dec 31	FY20A	FY21A	FY22E	FY23E	FY24E
Growth (YoY %)					
Revenue	(3.8)	15.9	12.1	11.9	11.5
- Liquid milk	(0.2)	12.9	11.0	11.6	11.6
- Ice cream	2.8	61.0	21.5	16.7	12.5
- Milk powder	(41.9)	8.2	(9.2)	12.5	16.3
- Other products	49.4	126.3	74.8	10.9	1.5
Gross profit	(3.5)	13.1	11.8	13.2	12.1
Operating profit	(19.9)	39.6	15.2	17.7	14.1
Pretax profit	(25.9)	41.2	34.8	1.7	9.8
Net profit (to shareholders of the Company)	(14.1)	42.6	35.4	1.8	9.9
Profitability ratios (%)					
GPM	37.7	36.7	36.6	37.1	37.3
OPM	4.6	5.5	5.7	6.0	6.1
Pretax margin	5.5	6.7	8.0	7.3	7.2
NPM (to shareholders of the Company)	4.6	5.7	6.9	6.3	6.2
Return ratios (%)					
ROAA	4.4	5.6	6.4	6.1	6.4
ROAE	11.4	14.4	17.7	16.4	16.1
Liquidity ratio (x)					
Current ratio	1.2	1.1	1.3	1.2	1.2
Quick ratio	2.9	2.5	2.1	2.4	2.8
Cash ratio	1.9	1.7	1.7	1.8	1.8
Cash conversion cycle (days)					
Days of outstanding receivable	16	15	16	16	14
Days of inventory on hand	41	39	40	40	38
Days of outstanding payable	57	55	61	60	59
CCC	(0)	(1)	(4)	(4)	(7)
Leverage ratios (%)					
Total debt/Equity	50.9	64.4	78.3	63.2	50.7
Total debt/Total assets	23.6	27.6	31.7	27.6	22.9
Net debt/Equity	20.3	37.7	23.2	24.8	12.7
Net debt/Assets	9.4	16.1	9.4	10.8	5.7

Source(s): The Group, ABCI Securities estimates

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Rating	Definition
Buy	Stock return rate≥ Market return rate (~10%)
Hold	- Market return rate (-~10%) ≤ Stock return rate < Market return rate (+~10%)
Sell	Stock return < - Market return (-~10%)

Notes: 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 2009(For reference: HSI total return index 2009-21 averaged at 9.2%)

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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