

Mengniu (2319 HK)

Sales recovery ahead of expectation

We hosted investors meeting with management recently. Key interested topics are sales recovery pace, margin trend, channel inventory level and 2H outlook. Excluding Junlebao and Bellamy's, MN saw flat revenue growth in 1Q20 and positive revenue growth in Apr. We think its 1H20E organic revenue growth could beat guidance of slight YoY decline. MN would benefit from continuing sector consolidation. Going forward, we expect MN to deliver OPM expansion thanks to continuing momentum of high-margin products (Milk Deluxe and Just Yoghurt) and improvement of non-A&P selling expenses ratio. Maintain BUY.

- **Sales recovery ahead of expectation.** Organic revenue growth was flat in 1Q20 (vs -11% of Yili (600887 CH)) and turned positive in Apr. By category, UHT milk sales did not see decline in 1Q20 but milk beverage, UHT yoghurt and Yashili were relatively weaker. Management attributed the recovery to rapid and effective responses to COVID-19 impact such as promoting sales by keeping sales promoters in KA channel during CNY holidays, allocating more inventory to e-commerce channel and setting up >70,000 wechat groups for group purchases.
- **Channel inventory notably improved.** After clearing channel inventories manufactured last year and Jan 2020, both channel inventory and price levels notably improved from end of 1Q20 to end of Apr 2020, which is in line with our channel checks.
- **2H20E guidance maintained.** NP would drop in 1H20E due to (1) weakened sales; (2) selling expenses spent for channel inventory destocking especially in Feb and Mar; (3) donation and expenses for epidemic prevention; (4) converting unused raw milk into milk powder would increase production cost of beverage, adult milk powder and ice-cream because such conversion cost is higher than import price of milk powder. That said, as both revenue growth and promotion discount improve QoQ in 2Q20E, we expect 2Q20E NPM would notably improve QoQ. Management maintained its 2H20E guidance of low-teens organic revenue growth and 30-50bps OPM expansion YoY.
- **Maintain Buy.** Our TP of HK\$34.20 represents 28.0x average FY20E and FY21E EPS. **Catalysts:** better-than-expected revenue and margins; **Risks:** slower-than-expected recovery and food safety issues.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	68,977	79,030	71,615	83,179	93,327
YoY growth (%)	15	15	(9)	16	12
Net profit (RMB mn)	3,043	4,105	3,464	5,152	6,282
Adj. net profit (RMB mn)	2,942	3,867	3,464	5,152	6,282
Adjusted EPS (RMB)	0.754	0.988	0.880	1.309	1.597
YoY growth (%)	43	31	(11)	49	22
Consensus EPS (RMB)	na	na	0.905	1.275	1.512
Adjusted P/E (x)	32.1	26.0	29.2	19.6	16.1
P/B (x)	3.8	3.5	3.2	2.8	2.4
Yield (%)	0.7	0.7	0.8	1.2	1.4

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$34.20
(Previous TP	HK\$34.20)
Up/Downside	+19%
Current Price	HK\$28.65

China F&B Sector

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Stock Data

Mkt Cap (HK\$ mn)	112,759
Avg 3 mths t/o (HK\$ mn)	332.13
52w High/Low (HK\$)	34.60/ 24.35
Total Issued Shares (mn)	3,935.0
Source: Bloomberg	

Shareholding Structure

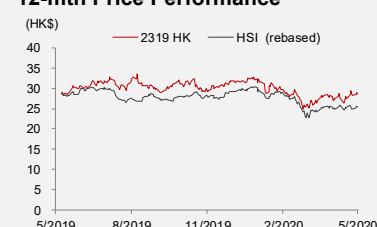
COFCO	16.3%
Danone	9.9%
Arla	5.3%
Source: HKEx	

Share Performance

	Absolute	Relative
1-mth	3.6%	3.3%
3-mth	-2.2%	10.7%
6-mth	-1.9%	8.2%

Source: Bloomberg

12-mth Price Performance

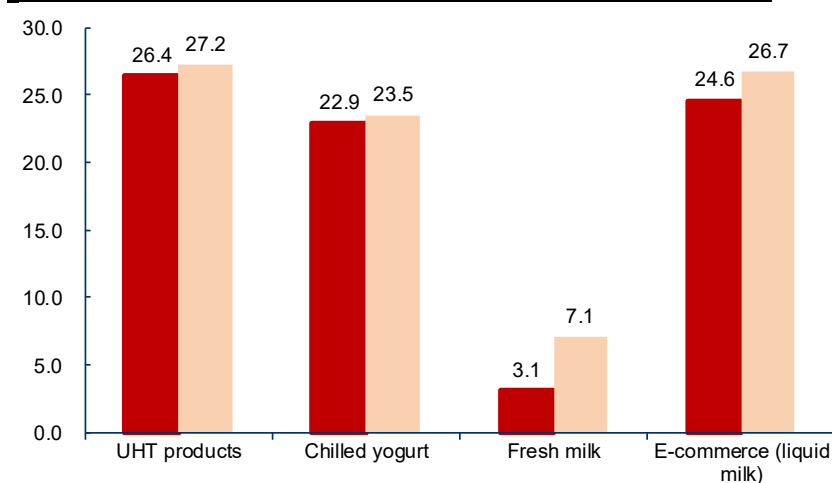


Source: Bloomberg

Auditor: EY

Related reports

1. "Mengniu – Resume double-digit revenue growth in 2H20E" – 27 Mar 2020
2. "Mengniu – Acquisition to access raw milk supply and become regional player" – 26 Nov 2019
3. "China Dairy Sector - Multiple growth drivers ahead; sector consolidation to continue" – 19 Nov 2019

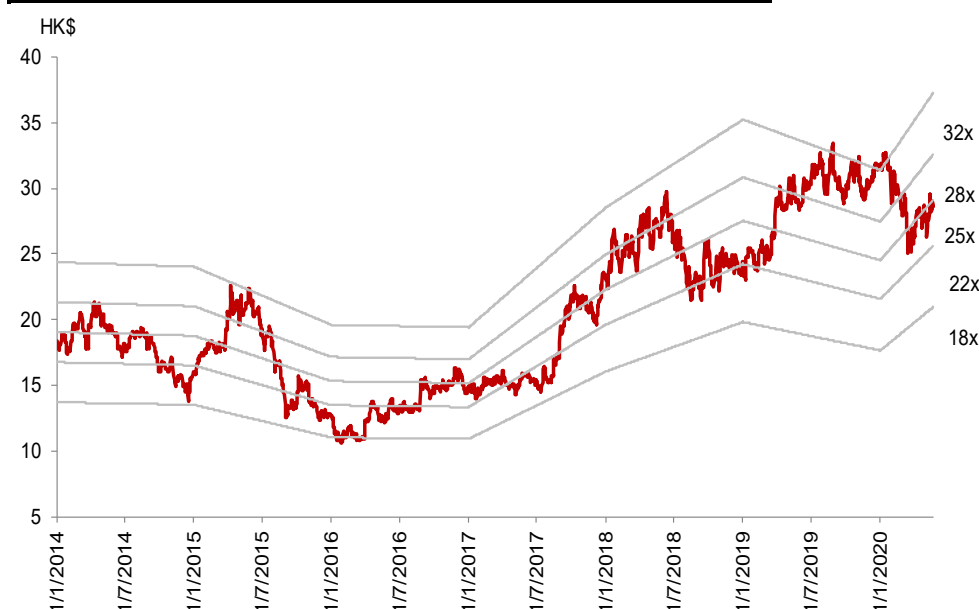
Figure 1: Increasing market shares in 2019

Source: Nielsen

Figure 2: CMBI estimates vs consensus

US\$ mn	CMBI			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	71,615	83,179	93,327	75,314	86,658	95,148	-5%	-4%	-2%
Gross Profit	26,798	31,293	35,256	28,253	33,054	36,467	-5%	-5%	-3%
Operating Profit	3,381	5,221	6,310	4,072	5,775	6,713	-17%	-10%	-6%
Adj. Net profit	3,464	5,152	6,282	3,517	4,957	5,906	-1%	4%	6%
Gross Margin	37.4%	37.6%	37.8%	37.5%	38.1%	38.3%	-0.1ppt	-0.5ppt	-0.6ppt
Operating Margin	4.7%	6.3%	6.8%	5.4%	6.7%	7.1%	-0.7ppt	-0.4ppt	-0.3ppt
Adj. Net Margin	4.8%	6.2%	6.7%	4.7%	5.7%	6.2%	+0.1ppt	+0.5ppt	+0.5ppt

Source: Bloomberg, CMBIS estimates

Figure 3: P/E band chart

Source: CMBIS estimates, Bloomberg, Company data

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	68,977	79,030	71,615	83,179	93,327
Liquid milk	59,389	67,878	63,887	74,419	83,505
Ice-cream	2,723	2,561	2,305	2,444	2,492
Milk powder	6,017	7,870	4,567	5,232	5,949
Others	848	721	856	1,084	1,380
Cost of sales	(43,193)	(49,351)	(44,817)	(51,886)	(58,071)
Gross profit	25,784	29,679	26,798	31,293	35,256
Other income and gains	635	769	348	411	456
Selling expenses	(18,833)	(21,536)	(19,837)	(22,458)	(24,918)
Administration expenses	(2,915)	(3,319)	(2,721)	(3,161)	(3,546)
Other expenses	(936)	(1,482)	(1,206)	(863)	(938)
EBIT	3,734	4,110	3,381	5,221	6,310
Finance income, net	318	461	521	647	833
Others	101	860	0	0	0
JV & associates	(300)	184	246	321	408
Pre-tax profit	3,853	5,615	4,147	6,189	7,551
Income tax	(649)	(1,310)	(663)	(998)	(1,214)
Less: Minority interests	(161)	(190)	(20)	(39)	(54)
Net profit	3,043	4,115	3,464	5,152	6,282
Adjusted net profit	2,942	3,867	3,464	5,152	6,282

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before tax	3,853	5,605	4,147	6,189	7,551
Associates & JV	300	(175)	(246)	(321)	(408)
D&A	1,838	2,260	1,779	1,972	2,108
Change in working capital	1,653	452	308	944	823
Others	(1,280)	(1,835)	(1,989)	(2,450)	(2,853)
Operating cash flow	6,363	6,307	3,999	6,334	7,221
Capex	(3,149)	(4,318)	(4,000)	(3,000)	(3,000)
Acquisitions	(309)	(6,686)	(458)	0	0
Others	(773)	(6,525)	725	1,453	1,639
Investing cash flow	(4,232)	(17,530)	(3,733)	(1,547)	(1,361)
Change of borrowing	(383)	11,791	0	0	0
Dividend paid	(526)	(1,374)	(712)	(797)	(1,185)
Others	8	197	0	0	0
Financing cash flow	(900)	10,614	(712)	(797)	(1,185)
Net change in cash	1,231	(608)	(446)	3,990	4,675
Cash at the beginning	3,129	4,370	3,549	3,103	7,092
Forex effect	10	36	0	0	0
Cash at disposal groups	0	0	0	0	0
Cash at the end	4,370	3,798	3,103	7,092	11,767
Time deposit	2,927	2,678	2,927	2,927	2,927
Cash and cash equivalent	7,298	6,476	6,030	10,020	14,695

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	36,716	41,052	44,577	45,926	47,226
PPE	14,734	11,103	13,027	14,134	15,175
Goodwill and intangible assets	6,980	12,302	12,235	12,168	12,101
JV & associates	7,202	7,492	8,196	8,516	8,924
Others	7,800	10,155	11,119	11,108	11,026
Current assets	29,741	37,486	37,657	43,616	50,016
Cash	7,298	6,476	6,030	10,020	14,695
Pledged deposit	623	74	74	74	74
Inventory	4,282	5,090	5,358	6,203	6,943
Trade receivables	2,892	3,587	3,776	4,386	4,921
Others	14,646	22,259	22,418	22,933	23,384
Current liabilities	25,109	31,734	32,659	35,572	38,121
Borrowings	6,523	13,838	13,838	13,838	13,838
Trade payables	7,022	6,739	7,094	8,213	9,192
Other payables	10,889	10,808	11,377	13,172	14,742
Others	675	349	349	349	349
Non-current liabilities	10,884	13,456	13,456	13,456	13,456
Borrowings	8,192	9,635	9,635	9,635	9,635
Deferred revenue	856	279	279	279	279
Others	1,835	3,542	3,542	3,542	3,542
Total net assets	30,464	33,347	36,119	40,514	45,665
Shareholders' equity	25,212	29,132	31,884	36,240	41,337
Non-controlling interests	5,252	4,215	4,235	4,274	4,328

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Liquid milk	86.1	85.9	89.2	89.5	89.5
Ice-cream	3.9	3.2	3.2	2.9	2.7
Milk powder	8.7	10.0	6.4	6.3	6.4
Others	1.2	0.9	1.2	1.3	1.5
P&L ratios (%)					
Gross margin	37.4	37.6	37.4	37.6	37.8
EBIT margin	5.4	5.2	4.7	6.3	6.8
Net margin	4.4	5.2	4.8	6.2	6.7
Adjusted net margin	4.3	4.9	4.8	6.2	6.7
Payout ratio	23.2	17.3	23.0	23.0	23.0
Balance sheet ratios					
Current ratio (x)	1.2	1.2	1.2	1.2	1.3
A/C receivables days	15	15	19	18	18
A/C payables days	56	51	56	54	55
Inventory days	33	35	43	41	41
Asset turnover (x)	1.0	1.0	0.9	0.9	1.0
Net gearing ratio (%)	22	51	48	33	19
Returns (%)					
Adjusted ROE	12.3	14.2	11.4	15.1	16.2
Adjusted ROA	4.7	5.3	4.3	6.0	6.7
Per share					
EPS (RMB)	0.75	0.99	0.88	1.31	1.60
DPS (RMB)	0.18	0.18	0.20	0.30	0.37
BVPS (RMB)	6.42	7.40	8.10	9.21	10.50

Source: Company data, CMBIS estimates

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