

# Mengniu Dairy (2319 HK)

## Subpar growth target but good corporate governance practice could stabilize shareholders' return

- 2023 outlook.** Management guided for mid-to-high single digit revenue growth ex Milkground (Mengniu holds 35% of the latter and has started consolidation from Dec 2022). This came in slightly below our expectation, as the expected recovery now looks lack of steam. Alternatively, we argue that the milk powder business remains a drag to Mengniu, despite small, and we still look for a HSD revenue decline. Accordingly, this will imply 7%/25%+ revenue growth for the remaining liquid milk/ ice cream businesses. Separately, when the aggregate of input prices unlikely to significantly come down, and when product mix upgrade decelerates, we see little ground for GPM to meaningfully expand. The major catalyst to sustain a 0.5pp recurring EBIT margins expansion, in our view, falls on operation cost savings, when we forecast administrative cost ratio to normalize to that in the pre-COVID era. Nevertheless, the merit will be partially offset by a higher selling expense, which management expects it to come in at 24-26% of 2023E revenue.
- Share buyback.** Management reinstates its intention to buy back shares whenever they feel appropriate. When current production capacity is sufficient to sustain a volume expansion for the next 3-5 years, in our view, Mengniu's capex cycle looks to have peaked-out. Considering also a 10% increase in OCF to RMB8.3bn in 2022, we see grounds for management to take on further initiatives to improve shareholders' return.
- Earnings change.** To reflect the actual 2H results, we cut our 2023/24E revenue by 2%/ 2.7%, respectively, along with a 1.1pp trim in GPM, and these lead to an 11% cut in our net profits estimates for both years. Our current forecasts fall within the range of management guidance and are 9% below consensus.
- Valuation.** Upon our earnings changes, our new TP is based on 22.0x (from 26.0x) end-23E P/E, which now represents -1sd below long-term average (from long-term average). To Mengniu, we believe its decelerating growth trajectory should command a lower valuation range relative to its F&B peers, which share higher sensitivity to China's reopening. Comparably, we applied the [same methodology to Feihe](#). Despite this, when shares are trading at historical low, we think the negatives are partially priced-in, and a good corporate governance practice could hopefully stabilize shareholders' return. Maintain BUY.

### Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	76,035	88,141	92,593	100,354	111,018
YoY growth (%)	(3.8)	15.9	5.1	8.4	10.6
Net income (RMB mn)	3,525	5,026	5,303	6,022	7,108
EPS (RMB)	0.9	1.3	1.3	1.5	1.8
YoY growth (%)	(7.6)	42.0	5.5	13.6	18.0
Consensus EPS (RMB)	n.a	n.a	1.5	1.8	2.1
P/E (x)	n.a	n.a	20.3	17.9	15.2
P/B (x)	n.a	n.a	2.7	2.4	2.2
Div yield (%)	n.a	n.a	1.5	1.7	2.0
ROE (%)	9.5	12.0	10.6	11.1	12.0
Net gearing (%)	19.4	28.2	44.8	37.4	25.3

Source: Company data, Bloomberg, CMBIGM estimates

**BUY (maintain)**

Target Price **HK\$40.0**  
 (Previous TP **HK\$52.0**)  
 Up/Downside **+22.7%**  
 Current Price **HK\$32.6**

**China Consumer –**  
 Food and Beverage

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#### Stock Data

Mkt Cap (HK\$ mn)	128,850
Avg 3 mths t/o (HK\$ mn)	324.96
52w High/Low (HK\$)	43.9/ 24.7
Total Issued Shares (mn)	3,952

Source: Wind

#### Shareholding Structure

COFCO Dairy Investment Co.	13.92%
Gendar Ltd	7.49%
Brown Brothers Harri. & Co.	7.29%

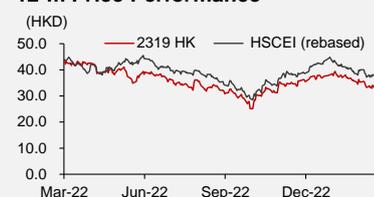
Source: Wind

#### Share Performance

	Absolute	Relative
1-mth	-5.5%	-10.2%
3-mth	-7.9%	-10.8%
6-mth	4.7%	-10.6%

Source: Wind

#### 12-m Price Performance



Source: BBG

**Auditor: KPMG**

#### Related Reports

- [Nongfu Spring \(9633 HK\) – Mid-teen top-line growth and a 90% dividend payout sustain the valuation premium over peers](#) – 30 Mar 2023
- [Shenzhen Pagoda \(2411 HK\) – An ensuring 2022: and we remain positive for 2023](#) – 30 Mar 2023

Figure 1: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	92,593	100,354	111,018	92,802	102,393	114,048	-0.2%	-2.0%	-2.7%
Gross Profit	32,690	35,726	40,078	33,130	37,066	41,856	-1.3%	-3.6%	-4.2%
Recurring EBIT	6,378	7,141	8,455	6,205	7,460	8,880	2.8%	-4.3%	-4.8%
Net profit	5,303	6,022	7,108	5,898	6,771	7,938	-10.1%	-11.1%	-10.5%
Gross Margin	35.3%	35.6%	36.1%	35.7%	36.2%	36.7%	-0.4ppt	-0.6ppt	-0.6ppt
EBIT Margin	6.9%	7.1%	7.6%	6.7%	7.3%	7.8%	0.2ppt	-0.2ppt	-0.2ppt
Net Margin	5.7%	6.0%	6.4%	6.4%	6.6%	7.0%	-0.6ppt	-0.6ppt	-0.6ppt

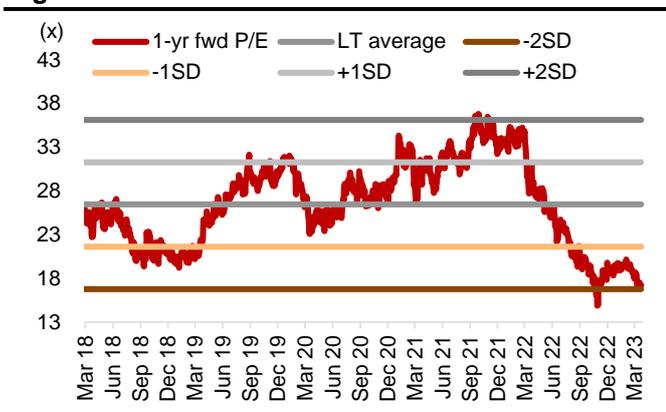
Source: Company data, CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	92,593	100,354	111,018	93,531	106,576	116,048	-1.0%	-5.8%	-4.3%
Gross Profit	32,690	35,726	40,078	34,135	39,258	42,906	-4.2%	-9.0%	-6.6%
Recurring EBIT	6,378	7,141	8,455	6,390	7,654	9,105	-0.2%	-6.7%	-7.1%
Net profit	5,303	6,022	7,108	5,826	6,612	7,815	-9.0%	-8.9%	-9.1%
Gross Margin	35.3%	35.6%	36.1%	36.5%	36.8%	37.0%	-1.2ppt	-1.2ppt	-0.9ppt
EBIT Margin	6.9%	7.1%	7.6%	6.8%	7.2%	7.8%	0.1ppt	-0.1ppt	-0.2ppt
Net Margin	5.7%	6.0%	6.4%	6.2%	6.2%	6.7%	-0.5ppt	-0.2ppt	-0.3ppt

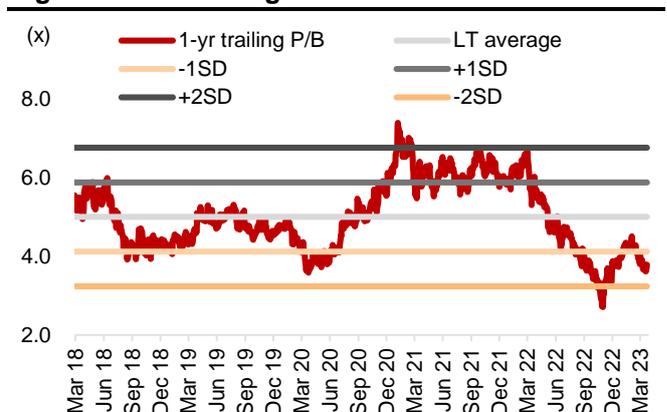
Source: Company data, CMBIGM estimate

Figure 3: 12M forward P/E band



Source: Company data, Bloomberg, CMBIGM estimates

Figure 4: 12M trailing P/B band



Source: Company data, Bloomberg, CMBIGM estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Revenue</b>	<b>76,035</b>	<b>88,141</b>	<b>92,593</b>	<b>100,35</b>	<b>111,01</b>
Liquid Milk	67,751	76,514	78,269	83,910	91,624
Others	8,284	11,627	14,324	16,445	19,394
<b>Gross profits</b>	<b>28,629</b>	<b>32,390</b>	<b>32,690</b>	<b>35,726</b>	<b>40,078</b>
D&A	(2,042)	(2,396)	(2,652)	(2,752)	(2,852)
Selling expense	(21,541)	(23,488)	(22,347)	(25,089)	(27,755)
Administration expenses	(2,915)	(3,524)	(4,442)	(4,014)	(4,441)
Other operating expenses	(1,783)	(1,629)	(1,802)	-	-
Others	3,029	3,780	4,730	2,952	3,052
<b>EBIT</b>	<b>3,377</b>	<b>5,132</b>	<b>6,177</b>	<b>6,823</b>	<b>8,082</b>
<b>EBITDA</b>	<b>5,419</b>	<b>7,529</b>	<b>8,829</b>	<b>9,576</b>	<b>10,935</b>
Finance costs, net	(572)	(743)	(1,125)	(1,125)	(1,125)
Non-operating	1,350	1,479	1,451	1,686	1,758
<b>Pre-tax profit</b>	<b>4,155</b>	<b>5,868</b>	<b>6,502</b>	<b>7,384</b>	<b>8,715</b>
Income tax	(653)	(905)	(1,318)	(1,496)	(1,766)
Less: Minority interests	23	62	118	134	158
<b>Net profit</b>	<b>3,525</b>	<b>5,026</b>	<b>5,303</b>	<b>6,022</b>	<b>7,108</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Net income</b>	<b>3,525</b>	<b>5,026</b>	<b>5,303</b>	<b>6,022</b>	<b>7,108</b>
D&A	2,042	2,396	2,652	2,752	2,852
Change in working capital	967	1,459	(3,644)	(4,024)	(577)
Others	(1,187)	(1,336)	(1,896)	(2,164)	(2,260)
<b>Net cash fr. operating act.</b>	<b>5,348</b>	<b>7,545</b>	<b>2,415</b>	<b>2,586</b>	<b>7,123</b>
Capex & investments	(611)	(565)	(640)	(640)	(640)
Acquisition	(26)	(830)	-	-	-
Others	5,459	(14,045)	657	779	779
<b>Net cash fr. investing act.</b>	<b>4,822</b>	<b>(15,440)</b>	<b>17</b>	<b>139</b>	<b>139</b>
Equity raised	-	-	-	-	-
Change of Debts	(3,926)	8,013	-	-	-
Dividend paid	(885)	(1,282)	(1,548)	(1,698)	(1,968)
Others	241	42	(81)	-	-
<b>Net cash fr. financing act.</b>	<b>(4,571)</b>	<b>6,773</b>	<b>(1,629)</b>	<b>(1,698)</b>	<b>(1,968)</b>
<b>Net change in cash</b>	<b>5,599</b>	<b>(1,123)</b>	<b>803</b>	<b>1,028</b>	<b>5,294</b>
Cash at the beginning of the	5,970	12,351	11,963	13,894	14,922
Exchange difference	(172)	(11)	-	-	-
<b>Cash at the end of the year</b>	<b>11,397</b>	<b>11,217</b>	<b>12,766</b>	<b>14,922</b>	<b>20,216</b>
Less: pledged cash	-	-	-	-	-

### Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Non-current assets</b>	<b>48,640</b>	<b>67,081</b>	<b>81,036</b>	<b>80,353</b>	<b>79,463</b>
PP&E/Fixed assets	12,547	17,335	19,653	18,716	17,099
Goodwill	4,883	4,858	8,888	8,888	8,888
Deferred tax assets	1,277	1,561	1,601	1,601	1,601
Other non-current assets	29,933	43,327	50,895	51,148	51,875
<b>Current assets</b>	<b>31,507</b>	<b>31,020</b>	<b>36,777</b>	<b>39,876</b>	<b>46,443</b>
Cash	11,397	11,217	12,766	14,922	20,216
Account receivable	2,927	4,160	3,660	3,967	4,389
Inventory	5,512	6,485	8,073	8,710	9,561
Other current assets	11,670	9,158	12,278	12,278	12,278
<b>Current liabilities</b>	<b>26,144</b>	<b>29,072</b>	<b>33,153</b>	<b>30,072</b>	<b>30,768</b>
Borrowings	4,924	4,265	9,095	9,095	9,095
Account payables	7,969	8,804	10,201	7,120	7,815
Other payables	8,326	11,737	4,763	4,763	4,763
Lease liabilities	4,924	4,265	9,095	9,095	9,095
<b>Non-current liabilities</b>	<b>16,754</b>	<b>27,030</b>	<b>34,608</b>	<b>35,914</b>	<b>35,914</b>
Borrowings	13,696	18,786	26,106	26,106	26,106
Deferred tax liabilities	2,280	2,456	3,926	3,926	3,926
Other non-current liabilities	779	5,787	4,575	5,882	5,882
<b>Minority Interest</b>	<b>4,265</b>	<b>5,174</b>	<b>9,953</b>	<b>9,819</b>	<b>9,661</b>
<b>Total net assets</b>	<b>37,248</b>	<b>41,999</b>	<b>50,052</b>	<b>54,242</b>	<b>59,223</b>
<b>Shareholders' equity</b>	<b>32,983</b>	<b>36,826</b>	<b>40,099</b>	<b>44,423</b>	<b>49,562</b>

### Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Sales mix (%)</b>					
Liquid Milk	89.1	86.8	84.5	83.6	82.5
Others	10.9	13.2	15.5	16.4	17.5
<b>P&amp;L ratios (%)</b>					
Gross margin	37.7	36.7	35.3	35.6	36.1
Operating margin	4.4	5.8	6.7	6.8	7.3
Pre-tax margin	5.5	6.7	7.0	7.4	7.9
Net margin	4.6	5.7	5.7	6.0	6.4
Effective tax rate	(15.7)	(15.4)	(20.3)	(20.3)	(20.3)
<b>Balance sheet analysis</b>					
Current ratio (x)	0.4	0.4	0.3	0.4	0.4
Net receivable days	14.1	17.2	14.4	14.4	14.4
Inventory turnover days	42.4	42.5	49.2	49.2	49.2
Net payable days	38.3	36.5	40.2	40.2	40.2
Net debt to equity (%)	19.4	28.2	44.8	37.4	25.3
<b>Returns (%)</b>					
ROE	9.5	12.0	10.6	11.1	12.0
Dividend yield	n.a	n.a	1.5	1.7	2.0
<b>Per share</b>					
EPS (RMB)	0.9	1.3	1.3	1.5	1.8
DPS (RMB)	0.3	0.4	0.4	0.5	0.5
BVPS (RMB)	8.3	9.3	10.1	11.2	12.5

Source: Company data, CMBIS estimates

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