

# Mengniu (2319 HK)

## GPM impressively widened in 2H20

MN reported 14% drop of NP to RMB3,525mn in FY20, 6%/9% above consensus/our est. due to comparable business OPM beat in 2H20 and profit of associate companies. MN targets to achieve 12%+ revenue growth and 0.5ppt+ OPM improvement in FY21E vs. its comparable business in FY19. MN proposed an incentive scheme to incentivize key employees to achieve its Five-year Plan, which sets revenue to grow at 15% CAGR in FY20-25E. Our TP was lifted from HK\$42.00 to HK\$50.10.

- **GPM expanded in 2H20 despite rising raw milk price.** Excluding Junlebao and Bellamy's, comparable business' revenue rose 12% YoY in 2H20, in-line with guidance. OPM improved 0.6ppt to 5.4%, beating guidance of 0.3-0.5ppt improvement. GPM widened 0.2ppt to 36.2% in 2H20 led by reducing discount and product mix improvement (vs Yili -1.3ppt in 3Q20). Revenue of high-margin Milk Deluxe and chilled fresh milk rose 19% and doubled respectively in FY20.
- **FY21E guidance.** MN targets to achieve higher than 12% revenue growth and not less than 0.5ppt OPM expansion versus 5.5% OPM of comparable business in FY19. Amid rising raw material prices, OPM expansion would mainly come from decline of selling expenses ratio. To keep a stable GPM in FY21E, MN had raised prices of certain room temperature products and chilled yogurt. It would further enhance product mix and reduce discount. According to our channel in Hunan KA channel, retail price of Milk Deluxe (250mL\*12) has been RMB58.8 in Mar (higher than RMB49.9 during period most of 2H20). Further product price hikes could be considered if raw milk cost pressure aggravates.
- **Five-year Plan.** MN laid down a five-year plan called "Creating a new Mengniu by 2025" to serve 2bn target customers. Management targets to double its revenue and net profit in five years which implies a 15% CAGR of revenue (same as growth rate in FY18 and FY19). The growth would be driven by accelerating growth of new businesses (each of chilled fresh milk, milk powder and cheese reach RMB10bn), continuing market share gain of room temperature products and developing Southeast Asia market.
- **Incentive scheme.** MN announced an incentive share for selective employees to subscribe certain financial products, whose return is derived from performance of a proposed CB (5-year RMB4bn CB, 3.5% of issued shares when converted) and share price performance. The scheme would cover >400 senior management. The scheme would incentivize these employees to achieve 2025 strategic target.
- **Maintain Buy.** We raised FY22E adj. NP est. by 2% to factor in higher revenue assumptions. We lifted our TP from HK\$42.00 to HK\$50.10, based on 28x average FY21E and FY22E adj. EPS. **Catalysts:** better-than-expected revenue and margins; **Risks:** cost pressure, keen competition and food safety issues.

### Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	79,030	76,035	87,469	99,503	111,881
YoY growth (%)	15	(4)	15	14	12
Net profit (RMB mn)	4,105	3,525	5,308	6,535	7,885
Adj. net profit (RMB mn)	3,867	3,525	5,308	6,535	7,885
Adjusted EPS (RMB)	0.988	0.897	1.344	1.655	1.997
YoY growth (%)	31	(9)	50	23	21
Consensus EPS (RMB)	na	na	1.311	1.560	1.887
Adjusted P/E (x)	38.8	43.1	27.1	22.0	18.3
P/B (x)	5.2	4.6	3.9	3.4	3.0
Yield (%)	0.5	0.7	1.1	1.4	1.6

Source: Company data, Bloomberg, CMBIS estimates

### BUY (Maintain)

Target Price	HK\$50.10
(Previous TP	HK\$42.00)
Up/Downside	+15%
Current Price	HK\$43.50

### China F&B Sector

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### Stock Data

Mkt Cap (HK\$ mn)	171,746
Avg 3 mths t/o (HK\$ mn)	668.66
52w High/Low (HK\$)	53.85/ 24.89
Total Issued Shares (mn)	3,938.6
Source: Bloomberg	

### Shareholding Structure

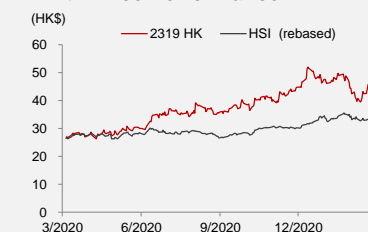
COFCO	16.3%
Danone	9.9%
Arla	5.3%
Source: HKEx	

### Share Performance

	Absolute	Relative
1-mth	-5.8%	0.2%
3-mth	-6.6%	-11.7%
6-mth	17.7%	-1.7%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: EY

### Related reports

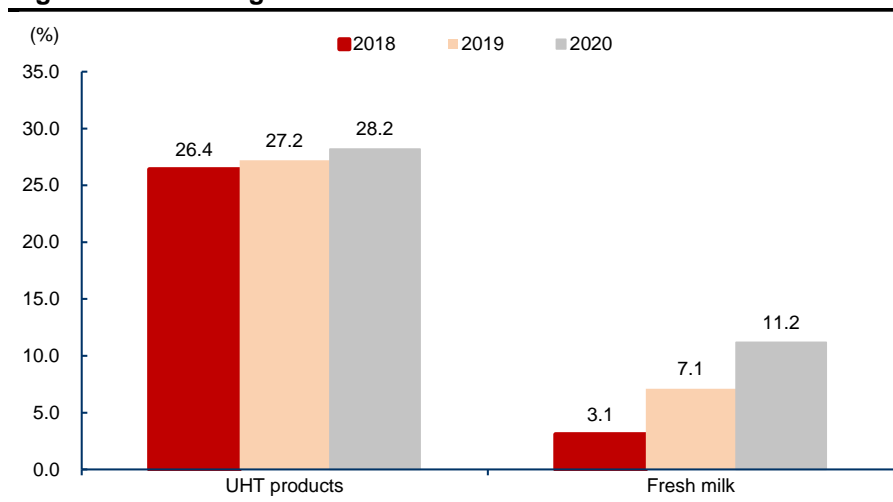
1. "Mengniu – 2H20E guidance reaffirmed – 28 Aug 2020"
2. "Mengniu - Profit warning removes overhang; recovery ahead of guidance" – 10 Jun 2020
3. "Mengniu – Sales recovery ahead of expectation" – 22 May 2020
4. "Mengniu – Resume double-digit revenue growth in 2H20E" – 27 Mar 2020
5. "Mengniu – Acquisition to access raw milk supply and become regional player" – 26 Nov 2019

**Figure 1: FY20 results review**

Y/E Dec (RMB mn)	Actual			% Comparable business			% Comparable business		
	FY20	FY19	change	FY20	FY19	change	2H20	2H19	change
<b>Revenue</b>	<b>76,035</b>	<b>79,030</b>	<b>-4%</b>	<b>75,003</b>	<b>67,817</b>	<b>11%</b>	<b>38,115</b>	<b>34,103</b>	<b>12%</b>
Cost of sales	(47,406)	(49,351)	-4%	(46,848)	(42,318)	11%	(24,317)	(21,828)	11%
Gross profit	28,629	29,679	-4%	28,155	25,500	10%	13,798	12,275	12%
Other income and gains	1,205	727	66%	na	na	na	na	na	na
S&D expenses	(21,541)	(21,536)	0%	na	na	na	na	na	na
Administrative expenses	(3,133)	(3,319)	-6%	na	na	na	na	na	na
Other expenses	(1,542)	(1,404)	10%	na	na	na	na	(1,125)	na
Operating profit	3,618	4,146	-13%	3,470	3,756	-8%	2,060	1,643	25%
Finance income	1,085	1,105	-2%	na	na	na	na	na	na
Finance costs	(572)	(644)	-11%	na	na	na	na	na	na
One-off items	0	824	na	na	na	na	na	na	na
Associates/JV	426	175	143%	na	na	na	na	na	na
Profit before tax	4,557	5,605	-19%	na	na	na	na	na	na
Tax expense	(653)	(1,310)	-50%	na	na	na	na	na	na
Profit after tax	3,904	4,296	-9%	na	na	na	na	na	na
Non-controlling interests	23	(190)	-112%	na	na	na	na	na	na
<b>Net profit</b>	<b>3,927</b>	<b>4,105</b>	<b>-4%</b>	<b>3,547</b>	<b>3,913</b>	<b>-9%</b>	<b>2,389</b>	<b>1,912</b>	<b>25%</b>
<b>Margin &amp; Ratio (%)</b>									
Gross margin	37.7	37.6	0.1	37.5	37.6	(0.1)	36.2	36.0	0.2
Operating margin	4.8	5.2	(0.5)	4.6	5.5	(0.9)	5.4	4.8	0.6
Net margin	5.2	5.2	(0.0)	4.7	5.8	(1.0)	6.3	5.6	0.7

Source: Company data, CMBIS

Comparable business excluded Junlebao/Bellamy's businesses in FY19 and FY20

**Figure 2: Increasing market shares**

Source: Nielsen, Company data

Figure 3: Earnings revision

US\$ mn	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	87,469	99,503	111,881	86,875	97,263	na	1%	2%	na
Gross Profit	33,101	37,963	43,073	33,258	37,418	na	0%	1%	na
Operating Profit	5,344	6,571	7,932	5,370	6,447	na	0%	2%	na
Adjusted Net Profit	5,308	6,535	7,885	5,300	6,402	na	0%	2%	na
Gross Margin	37.8%	38.2%	38.5%	38.3%	38.5%	na	-0.5ppt	-0.3ppt	na
Operating Margin	6.1%	6.6%	7.1%	6.2%	6.6%	na	-0.1ppt	flat	na
Adjusted Net Margin	6.1%	6.6%	7.0%	6.1%	6.6%	na	flat	flat	na

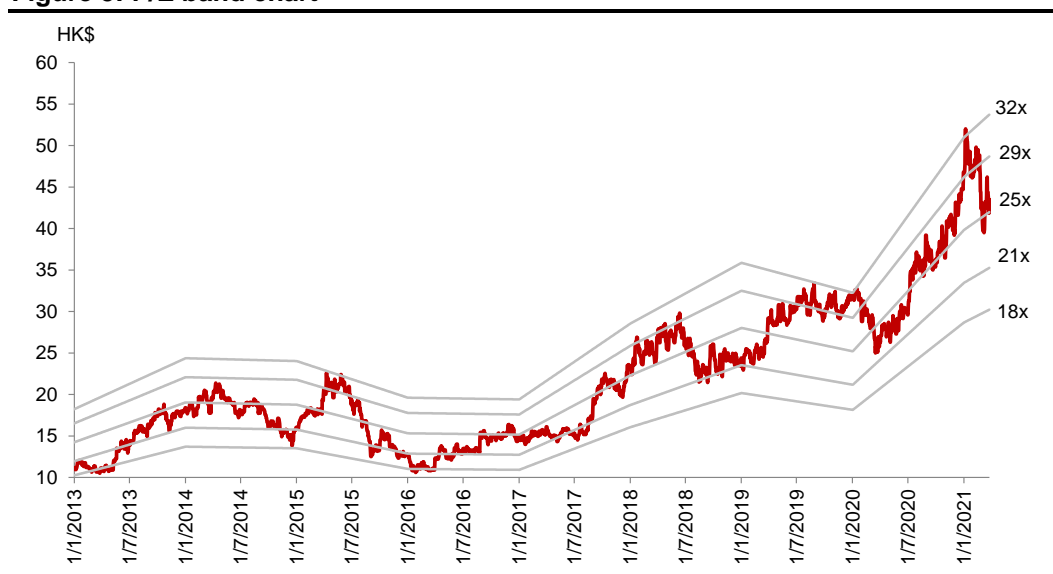
Source: Company data, CMBIS estimates

Figure 4: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	87,469	99,503	111,881	87,940	98,183	107,319	-1%	1%	4%
Gross Profit	33,101	37,963	43,073	33,329	37,535	41,200	-1%	1%	5%
Operating Profit	5,344	6,571	7,932	5,700	6,817	7,818	-6%	-4%	1%
Adj. Net profit	5,308	6,535	7,885	5,016	5,952	7,010	6%	10%	12%
Gross Margin	37.8%	38.2%	38.5%	37.9%	38.2%	38.4%	-0.1ppt	flat	+0.1ppt
Operating Margin	6.1%	6.6%	7.1%	6.5%	6.9%	7.3%	-0.4ppt	-0.3ppt	-0.2ppt
Adj. Net Margin	6.1%	6.6%	7.0%	5.7%	6.1%	6.5%	+0.4ppt	+0.5ppt	+0.5ppt

Source: Bloomberg, CMBIS estimates

Figure 5: P/E band chart



Source: CMBIS estimates, Bloomberg, Company data

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>79,030</b>	<b>76,035</b>	<b>87,469</b>	<b>99,503</b>	<b>111,881</b>
Liquid milk	67,878	67,751	77,373	86,812	96,298
Ice-cream	2,561	2,634	2,765	2,904	3,049
Milk powder	7,870	4,573	5,254	6,095	7,023
Others	721	1,077	2,077	3,693	5,511
Cost of sales	(49,351)	(47,406)	(54,368)	(61,540)	(68,808)
Gross profit	29,679	28,629	33,101	37,963	43,073
Other income and gains	727	960	686	731	780
Selling expenses	(21,536)	(21,541)	(24,054)	(27,214)	(30,487)
Administration expenses	(3,319)	(3,133)	(3,455)	(3,881)	(4,307)
Other expenses	(1,404)	(1,542)	(934)	(1,029)	(1,125)
EBIT	4,146	3,373	5,344	6,571	7,932
Finance income, net	461	512	435	562	755
Others	824	(157)	0	0	0
JV & associates	175	426	524	658	730
Pre-tax profit	5,605	4,155	6,302	7,791	9,417
Income tax	(1,310)	(668)	(982)	(1,213)	(1,477)
Less: Minority interests	(190)	17	(12)	(43)	(56)
<b>Net profit</b>	<b>4,105</b>	<b>3,504</b>	<b>5,308</b>	<b>6,535</b>	<b>7,885</b>
<b>Adjusted net profit</b>	<b>3,867</b>	<b>3,268</b>	<b>5,308</b>	<b>6,535</b>	<b>7,885</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20E	FY21E	FY22E	FY23E
<b>Profit before tax</b>	<b>5,605</b>	<b>3,919</b>	<b>6,302</b>	<b>7,791</b>	<b>9,417</b>
Associates & JV	(175)	(432)	(524)	(658)	(730)
D&A	2,260	1,784	2,275	2,420	2,556
Change in working capital	452	704	996	1,055	1,054
Others	(1,835)	(1,786)	(1,901)	(2,259)	(2,716)
<b>Operating cash flow</b>	<b>6,307</b>	<b>4,190</b>	<b>7,148</b>	<b>8,350</b>	<b>9,582</b>
Capex	(4,318)	(4,000)	(4,000)	(4,000)	(3,000)
Acquisitions	(6,686)	(458)	0	0	0
Others	(6,525)	2,516	(1,534)	(954)	(761)
<b>Investing cash flow</b>	<b>(17,530)</b>	<b>(1,942)</b>	<b>(5,534)</b>	<b>(4,954)</b>	<b>(3,761)</b>
Change of borrowing	11,791	2,192	0	0	0
Dividend paid	(1,374)	(712)	(1,058)	(1,592)	(1,960)
Others	197	0	0	0	0
<b>Financing cash flow</b>	<b>10,614</b>	<b>1,480</b>	<b>(1,058)</b>	<b>(1,592)</b>	<b>(1,960)</b>
<b>Net change in cash</b>	<b>(608)</b>	<b>3,728</b>	<b>556</b>	<b>1,803</b>	<b>3,861</b>
Cash at the beginning	4,370	3,798	8,719	9,275	11,078
Forex effect	36	0	0	0	0
Cash at disposal groups	0	0	0	0	0
<b>Cash at the end</b>	<b>3,798</b>	<b>7,526</b>	<b>9,275</b>	<b>11,078</b>	<b>14,939</b>
Time deposit	2,678	2,678	2,678	2,678	2,678
<b>Cash and cash equivalent</b>	<b>6,476</b>	<b>10,204</b>	<b>11,953</b>	<b>13,756</b>	<b>17,617</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Non-current assets</b>	<b>41,052</b>	<b>48,640</b>	<b>51,342</b>	<b>53,579</b>	<b>54,753</b>
PPE	11,103	12,547	13,852	15,334	16,447
Goodwill and intangible assets	12,302	12,601	12,513	12,426	12,339
JV & associates	7,492	9,124	9,648	10,305	11,035
Others	10,155	14,369	15,329	15,514	14,932
<b>Current assets</b>	<b>37,486</b>	<b>31,507</b>	<b>35,841</b>	<b>41,518</b>	<b>49,294</b>
Cash	6,476	11,397	11,953	13,756	17,617
Pledged deposit	74	250	250	250	250
Inventory	5,090	5,512	6,299	7,130	7,972
Trade receivables	3,587	2,988	3,438	3,911	4,397
Others	22,259	11,359	13,901	16,472	19,059
<b>Current liabilities</b>	<b>31,734</b>	<b>26,144</b>	<b>28,919</b>	<b>31,848</b>	<b>34,818</b>
Borrowings	13,838	4,924	4,924	4,924	4,924
Trade payables	6,739	7,969	9,107	10,308	11,526
Other payables	10,808	11,466	13,103	14,831	16,583
Others	349	1,785	1,785	1,785	1,785
<b>Non-current liabilities</b>	<b>13,456</b>	<b>16,754</b>	<b>16,754</b>	<b>16,754</b>	<b>16,754</b>
Borrowings	9,635	14,020	14,020	14,020	14,020
Deferred revenue	279	420	420	420	420
Others	3,542	2,314	2,314	2,314	2,314
<b>Total net assets</b>	<b>33,347</b>	<b>37,248</b>	<b>41,509</b>	<b>46,495</b>	<b>52,475</b>
<b>Shareholders' equity</b>	<b>29,132</b>	<b>32,983</b>	<b>37,232</b>	<b>42,175</b>	<b>48,099</b>
<b>Non-controlling interests</b>	<b>4,215</b>	<b>4,265</b>	<b>4,277</b>	<b>4,320</b>	<b>4,376</b>

### Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Sales mix (%)</b>					
Liquid milk	85.9	89.1	88.5	87.2	86.1
Ice-cream	3.2	3.5	3.2	2.9	2.7
Milk powder	10.0	6.0	6.0	6.1	6.3
Others	0.9	1.4	2.4	3.7	4.9
<b>P&amp;L ratios (%)</b>					
Gross margin	37.6	37.7	37.8	38.2	38.5
EBIT margin	5.2	4.4	6.1	6.6	7.1
Net margin	5.2	4.6	6.1	6.6	7.0
Adjusted net margin	4.9	4.6	6.1	6.6	7.0
Payout ratio	17.3	29.9	30.0	30.0	30.0
<b>Balance sheet ratios</b>					
Current ratio (x)	1.2	1.2	1.2	1.3	1.4
A/C receivables days	17	16	13	13	14
A/C payables days	51	56	57	58	58
Inventory days	35	41	40	40	40
Asset turnover (x)	1.0	1.0	1.0	1.0	1.1
Net cash (RMB mn)	(16,922)	(7,298)	(15,387)	(6,742)	(4,939)
<b>Returns (%)</b>					
Adjusted ROE	14.2	10.5	15.1	16.5	17.5
Adjusted ROA	5.3	4.1	6.3	7.2	7.9
<b>Per share</b>					
EPS (RMB)	0.99	0.90	1.34	1.66	2.00
DPS (RMB)	0.18	0.27	0.40	0.50	0.60
BVPS (RMB)	7.40	8.35	9.43	10.68	12.18

Source: Company data, CMBIS estimates

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