

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

Albert Yip
 (852) 3900 0838
 albertyip@cmbi.com.hk

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%

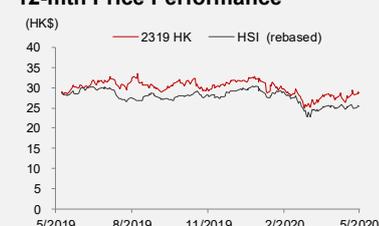
Source: HKEx

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

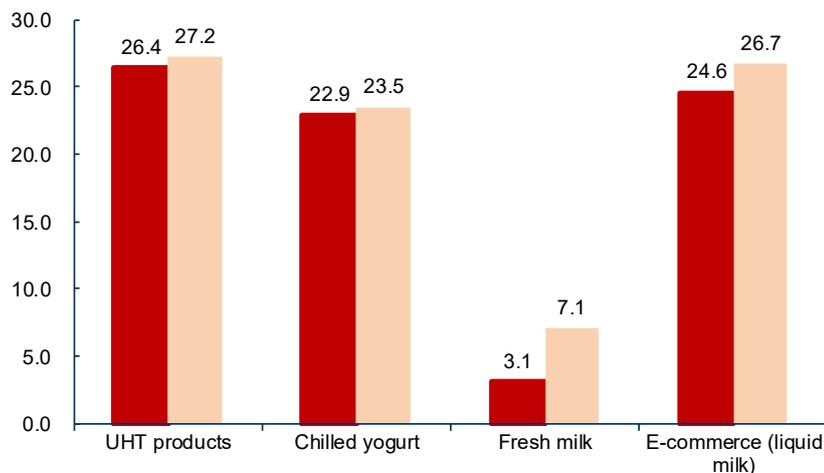


Source: Bloomberg

Auditor: EY

Related reports

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

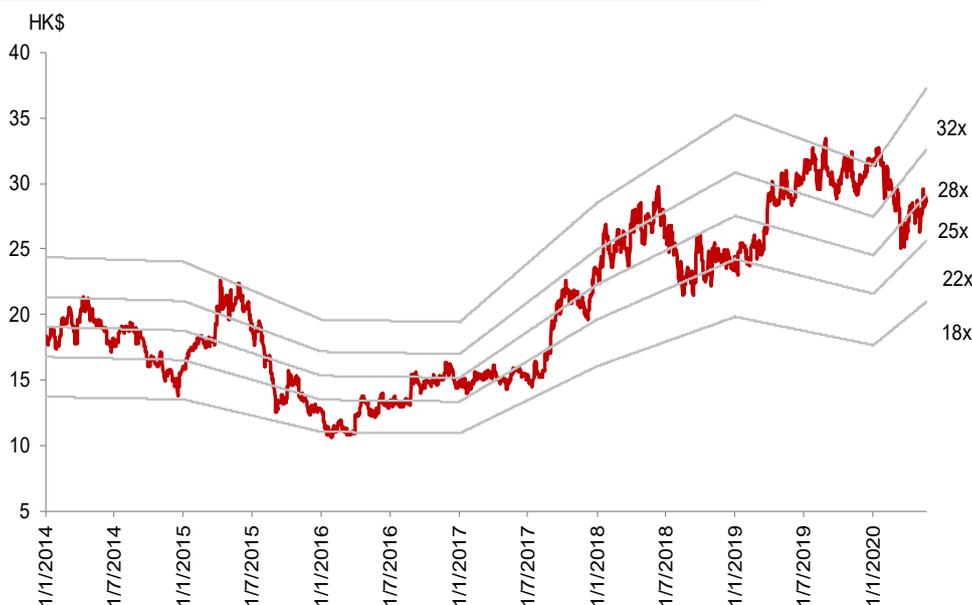
Figure 1: Increasing market shares in 2019

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						Cash flow summary					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	68,977	79,030	71,615	83,179	93,327	Profit before tax	3,853	5,605	4,147	6,189	7,551
Liquid milk	59,389	67,878	63,887	74,419	83,505	Associates & JV	300	(175)	(246)	(321)	(408)
Ice-cream	2,723	2,561	2,305	2,444	2,492	D&A	1,838	2,260	1,779	1,972	2,108
Milk powder	6,017	7,870	4,567	5,232	5,949	Change in working capital	1,653	452	308	944	823
Others	848	721	856	1,084	1,380	Others	(1,280)	(1,835)	(1,989)	(2,450)	(2,853)
Cost of sales	(43,193)	(49,351)	(44,817)	(51,886)	(58,071)	Operating cash flow	6,363	6,307	3,999	6,334	7,221
Gross profit	25,784	29,679	26,798	31,293	35,256	Capex	(3,149)	(4,318)	(4,000)	(3,000)	(3,000)
Other income and gains	635	769	348	411	456	Acquisitions	(309)	(6,686)	(458)	0	0
Selling expenses	(18,833)	(21,536)	(19,837)	(22,458)	(24,918)	Others	(773)	(6,525)	725	1,453	1,639
Administration expenses	(2,915)	(3,319)	(2,721)	(3,161)	(3,546)	Investing cash flow	(4,232)	(17,530)	(3,733)	(1,547)	(1,361)
Other expenses	(936)	(1,482)	(1,206)	(863)	(938)	Change of borrowing	(383)	11,791	0	0	0
EBIT	3,734	4,110	3,381	5,221	6,310	Dividend paid	(526)	(1,374)	(712)	(797)	(1,185)
Finance income, net	318	461	521	647	833	Others	8	197	0	0	0
Others	101	860	0	0	0	Financing cash flow	(900)	10,614	(712)	(797)	(1,185)
JV & associates	(300)	184	246	321	408	Net change in cash	1,231	(608)	(446)	3,990	4,675
Pre-tax profit	3,853	5,615	4,147	6,189	7,551	Cash at the beginning	3,129	4,370	3,549	3,103	7,092
Income tax	(649)	(1,310)	(663)	(998)	(1,214)	Forex effect	10	36	0	0	0
Less: Minority interests	(161)	(190)	(20)	(39)	(54)	Cash at disposal groups	0	0	0	0	0
Net profit	3,043	4,115	3,464	5,152	6,282	Cash at the end	4,370	3,798	3,103	7,092	11,767
Adjusted net profit	2,942	3,867	3,464	5,152	6,282	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						Key ratios					
YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E	YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	36,716	41,052	44,577	45,926	47,226	Sales mix (%)					
PPE	14,734	11,103	13,027	14,134	15,175	Liquid milk	86.1	85.9	89.2	89.5	89.5
Goodwill and intangible assets	6,980	12,302	12,235	12,168	12,101	Ice-cream	3.9	3.2	3.2	2.9	2.7
JV & associates	7,202	7,492	8,196	8,516	8,924	Milk powder	8.7	10.0	6.4	6.3	6.4
Others	7,800	10,155	11,119	11,108	11,026	Others	1.2	0.9	1.2	1.3	1.5
Current assets	29,741	37,486	37,657	43,616	50,016	P&L ratios (%)					
Cash	7,298	6,476	6,030	10,020	14,695	Gross margin	37.4	37.6	37.4	37.6	37.8
Pledged deposit	623	74	74	74	74	EBIT margin	5.4	5.2	4.7	6.3	6.8
Inventory	4,282	5,090	5,358	6,203	6,943	Net margin	4.4	5.2	4.8	6.2	6.7
Trade receivables	2,892	3,587	3,776	4,386	4,921	Adjusted net margin	4.3	4.9	4.8	6.2	6.7
Others	14,646	22,259	22,418	22,933	23,384	Payout ratio	23.2	17.3	23.0	23.0	23.0
Current liabilities	25,109	31,734	32,659	35,572	38,121	Balance sheet ratios					
Borrowings	6,523	13,838	13,838	13,838	13,838	Current ratio (x)	1.2	1.2	1.2	1.2	1.3
Trade payables	7,022	6,739	7,094	8,213	9,192	A/C receivables days	15	15	19	18	18
Other payables	10,889	10,808	11,377	13,172	14,742	A/C payables days	56	51	56	54	55
Others	675	349	349	349	349	Inventory days	33	35	43	41	41
Non-current liabilities	10,884	13,456	13,456	13,456	13,456	Asset turnover (x)	1.0	1.0	0.9	0.9	1.0
Borrowings	8,192	9,635	9,635	9,635	9,635	Net gearing ratio (%)	22	51	48	33	19
Deferred revenue	856	279	279	279	279	Returns (%)					
Others	1,835	3,542	3,542	3,542	3,542	Adjusted ROE	12.3	14.2	11.4	15.1	16.2
Total net assets	30,464	33,347	36,119	40,514	45,665	Adjusted ROA	4.7	5.3	4.3	6.0	6.7
Shareholders' equity	25,212	29,132	31,884	36,240	41,337	Per share					
Non-controlling interests	5,252	4,215	4,235	4,274	4,328	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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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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