

# Mengniu (2319 HK)

## Profit warning removes overhang; recovery ahead of guidance

Mengniu announced 1H20E NP to fall by 45-60%, which we think is largely priced in. Organic revenue growth accelerated from flat in 1Q20 to double-digit growth in Apr and May, ahead of previous guidance of slight revenue decline YoY in 1H20E. We maintain our Buy rating because uncertainty on 1H20 NP is removed and sales recovery is ahead of guidance.

- **45-60% NP decline in 1H20E.** The reasons for the NP decline include (1) additional marketing expenses were incurred to reduce channel inventories; (2) additional expenses on epidemic prevention and control to safeguard health of employees and ensure resumption of work and production; and (3) cash and supply donations (~RMB740mn) were made to fulfill social responsibilities. Such reasons are fully expected by the market.
- **Sales recovering strongly.** After a flat organic revenue growth in 1Q20, organic revenue recorded a double-digit growth YoY in Apr and May 2020. We think 1H20E organic revenue growth should beat guidance of slight YoY decline.
- **Channel inventory level is improved.** According to our source of channel checks in Hunan, retail price of Milk Deluxe (250mL \* 12 packs) in KA channel increases to ~RMB49.9 currently from RMB44.9 in late May. Marketing expenses in the channel could be reduced, which will improve Mengniu's profitability. Channel inventories were mainly manufactured in Apr and May, at a normal level.
- **Overhang is removed.** Management maintained its 2H20E guidance of low-teens organic revenue growth and 30-50bps OPM expansion YoY. Based on 45-60% NP decline in 1H20, a low-teens organic revenue growth and a 0.5ppt YoY expansion of adjusted NPM in 2H20E, we estimate FY20E NP to be RMB2.9-3.2bn, which is below our previous estimate of RMB3.5bn but in the high-end of consensus' lowest to mean estimate (RMB2.5-3.4bn). Hence, we think the 45-60% NP decline in 1H20E is largely priced in.
- **Maintain Buy.** We revised our FY20/21/22E NP estimates by -8%/2%/1% as we raised FY20/21/22E revenue estimates by 4%/3%/2%. Our TP is lifted from HK\$34.20 to HK\$37.90, representing 28.0x sum of 2HFY20E and 1HFY21E EPS (vs 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	74,513	85,337	95,293
YoY growth (%)	15	15	(6)	15	12
Net profit (RMB mn)	3,043	4,105	3,184	5,247	6,348
Adj. net profit (RMB mn)	2,942	3,867	3,184	5,247	6,348
Adjusted EPS (RMB)	0.754	0.988	0.809	1.333	1.613
YoY growth (%)	43	31	(18)	65	21
Consensus EPS (RMB)	na	na	0.875	1.264	1.508
Adjusted P/E (x)	34.5	28.0	34.2	20.7	17.1
P/B (x)	4.1	3.7	3.4	3.0	2.6
Yield (%)	0.7	0.7	0.7	1.1	1.3

Source: Company data, Bloomberg, CMBIS estimates

### BUY (Maintain)

Target Price	HK\$37.90
(Previous TP	HK\$34.20)
Up/Downside	+23%
Current Price	HK\$30.80

### China F&B Sector

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### Stock Data

Mkt Cap (HK\$ mn)	121,229
Avg 3 mths t/o (HK\$ mn)	379.89
52w High/Low (HK\$)	34.37/ 24.19
Total Issued Shares (mn)	3,935.0

Source: Bloomberg

### Shareholding Structure

COFCO	16.3%
Danone	9.9%
Arla	5.3%

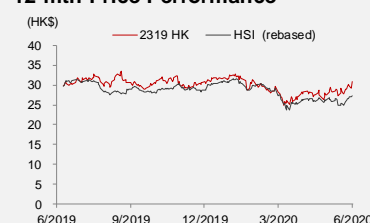
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	5.8%	3.5%
3-mth	-0.2%	5.3%
6-mth	-4.6%	2.1%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: EY

### Related reports

1. "Mengniu – Sales recovery ahead of expectation" – 22 May 2020
2. "Mengniu – Resume double-digit revenue growth in 2H20E" – 27 Mar 2020
3. "Mengniu – Acquisition to access raw milk supply and become regional player" – 26 Nov 2019

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**Figure 1: Retail price of Milk Deluxe (250mL\*12) is RMB49.9 in a supermarket in Hunan**



Source: CMBIS

**Figure 2: Retail price of Milk Deluxe (250mL\*12) was RMB44.9 in a supermarket in Hunan in late May**



Source: CMBIS

**Figure 3: Earnings revision**

US\$ mn	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	74,513	85,337	95,293	71,615	83,179	93,327	4%	3%	2%
Gross Profit	27,758	32,263	36,172	26,798	31,293	35,256	4%	3%	3%
Operating Profit	3,182	5,418	6,521	3,381	5,221	6,310	-6%	4%	3%
Adjusted Net Profit	3,184	5,247	6,348	3,464	5,152	6,282	-8%	2%	1%
Gross Margin	37.3%	37.8%	38.0%	37.4%	37.6%	37.8%	-0.1ppt	+0.2ppt	+0.2ppt
Operating Margin	4.3%	6.3%	6.8%	4.7%	6.3%	6.8%	-0.5ppt	flat	flat
Adjusted Net Margin	4.3%	6.1%	6.7%	4.8%	6.2%	6.7%	-0.6ppt	-0.1ppt	flat

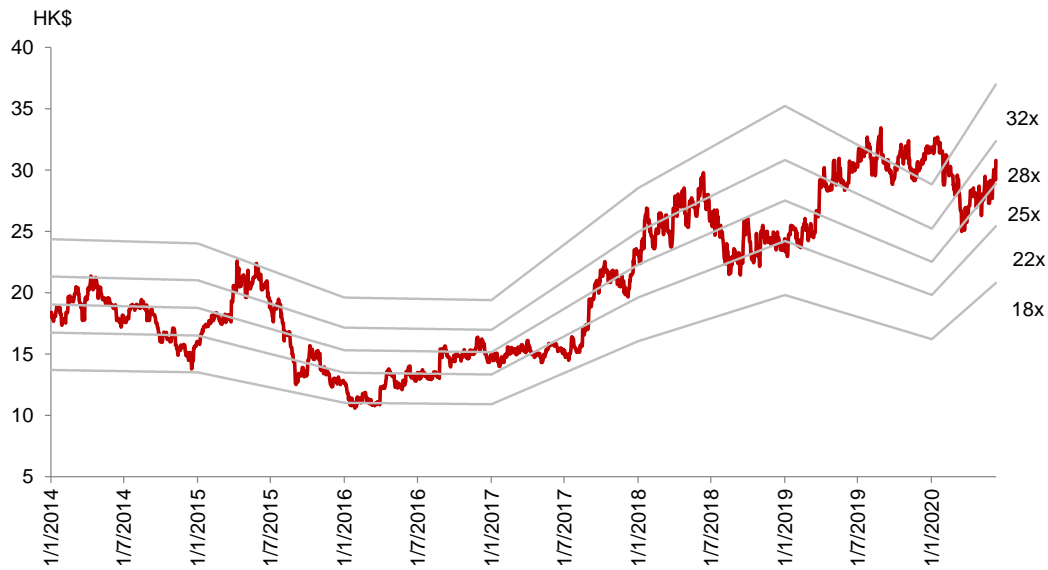
Source: Company data, CMBIS estimates

**Figure 4: CMBIS estimates vs consensus**

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	74,513	85,337	95,293	74,786	86,184	95,086	0%	-1%	0%
Gross Profit	27,758	32,263	36,172	27,960	32,815	36,448	-1%	-2%	-1%
Operating Profit	3,182	5,418	6,521	3,636	5,548	6,563	-12%	-2%	-1%
Adj. Net profit	3,184	5,247	6,348	3,399	4,907	5,871	-6%	7%	8%
Gross Margin	37.3%	37.8%	38.0%	37.4%	38.1%	38.3%	-0.1ppt	-0.3ppt	-0.3ppt
Operating Margin	4.3%	6.3%	6.8%	4.9%	6.4%	6.9%	-0.6ppt	-0.1ppt	-0.1ppt
Adj. Net Margin	4.3%	6.1%	6.7%	4.5%	5.7%	6.2%	-0.2ppt	+0.4ppt	+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)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>68,977</b>	<b>79,030</b>	<b>74,513</b>	<b>85,337</b>	<b>95,293</b>
Liquid milk	59,389	67,878	66,956	76,770	85,685
Ice-cream	2,723	2,561	2,305	2,444	2,492
Milk powder	6,017	7,870	4,396	5,039	5,735
Others	848	721	856	1,084	1,380
Cost of sales	(43,193)	(49,351)	(46,755)	(53,074)	(59,121)
Gross profit	25,784	29,679	27,758	32,263	36,172
Other income and gains	635	769	339	413	459
Selling expenses	(18,833)	(21,536)	(20,789)	(23,138)	(25,539)
Administration expenses	(2,915)	(3,319)	(2,906)	(3,243)	(3,621)
Other expenses	(936)	(1,482)	(1,221)	(878)	(951)
EBIT	3,734	4,110	3,182	5,418	6,521
Finance income, net	318	461	377	553	731
Others	101	860	0	0	0
JV & associates	(300)	184	246	321	408
Pre-tax profit	3,853	5,615	3,805	6,292	7,660
Income tax	(649)	(1,310)	(605)	(1,015)	(1,233)
Less: Minority interests	(161)	(190)	(16)	(30)	(79)
<b>Net profit</b>	<b>3,043</b>	<b>4,115</b>	<b>3,184</b>	<b>5,247</b>	<b>6,348</b>
<b>Adjusted net profit</b>	<b>2,942</b>	<b>3,867</b>	<b>3,184</b>	<b>5,247</b>	<b>6,348</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Profit before tax</b>	<b>3,853</b>	<b>5,605</b>	<b>3,805</b>	<b>6,292</b>	<b>7,660</b>
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	557	792	797
Others	(1,280)	(1,835)	(1,863)	(2,327)	(2,723)
<b>Operating cash flow</b>	<b>6,363</b>	<b>6,307</b>	<b>4,032</b>	<b>6,407</b>	<b>7,433</b>
Capex	(3,149)	(4,318)	(4,000)	(3,000)	(3,000)
Acquisitions	(309)	(6,686)	(458)	0	0
Others	(773)	(6,525)	2,657	(688)	(510)
<b>Investing cash flow</b>	<b>(4,232)</b>	<b>(17,530)</b>	<b>(1,801)</b>	<b>(3,688)</b>	<b>(3,510)</b>
Change of borrowing	(383)	11,791	(1,383)	0	0
Dividend paid	(526)	(1,374)	(712)	(732)	(1,207)
Others	8	197	0	0	0
<b>Financing cash flow</b>	<b>(900)</b>	<b>10,614</b>	<b>(2,095)</b>	<b>(732)</b>	<b>(1,207)</b>
<b>Net change in cash</b>	<b>1,231</b>	<b>(608)</b>	<b>136</b>	<b>1,987</b>	<b>2,717</b>
Cash at the beginning	3,129	4,370	3,798	3,934	5,920
Forex effect	10	36	0	0	0
Cash at disposal groups	0	0	0	0	0
<b>Cash at the end</b>	<b>4,370</b>	<b>3,798</b>	<b>3,934</b>	<b>5,920</b>	<b>8,637</b>
Time deposit	2,927	2,678	2,678	2,678	2,678
Cash and cash equivalent	7,298	6,476	6,612	8,599	11,315

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>36,716</b>	<b>41,052</b>	<b>44,577</b>	<b>45,926</b>	<b>47,226</b>
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
<b>Current assets</b>	<b>29,741</b>	<b>37,486</b>	<b>36,737</b>	<b>42,529</b>	<b>48,935</b>
Cash	7,298	6,476	6,612	8,599	11,315
Pledged deposit	623	74	74	74	74
Inventory	4,282	5,090	5,575	6,329	7,050
Trade receivables	2,892	3,587	3,929	4,499	5,024
Others	14,646	22,259	20,547	23,029	25,472
<b>Current liabilities</b>	<b>25,109</b>	<b>31,734</b>	<b>33,406</b>	<b>36,003</b>	<b>38,489</b>
Borrowings	6,523	13,838	13,838	13,838	13,838
Trade payables	7,022	6,739	7,381	8,378	9,333
Other payables	10,889	10,808	11,838	13,437	14,968
Others	675	349	349	349	349
<b>Non-current liabilities</b>	<b>10,884</b>	<b>13,456</b>	<b>12,073</b>	<b>12,073</b>	<b>12,073</b>
Borrowings	8,192	9,635	8,252	8,252	8,252
Deferred revenue	856	279	279	279	279
Others	1,835	3,542	3,542	3,542	3,542
<b>Total net assets</b>	<b>30,464</b>	<b>33,347</b>	<b>35,835</b>	<b>40,379</b>	<b>45,599</b>
<b>Shareholders' equity</b>	<b>25,212</b>	<b>29,132</b>	<b>31,604</b>	<b>36,118</b>	<b>41,259</b>
<b>Non-controlling interests</b>	<b>5,252</b>	<b>4,215</b>	<b>4,231</b>	<b>4,260</b>	<b>4,339</b>

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Liquid milk	86.1	85.9	89.9	90.0	89.9
Ice-cream	3.9	3.2	3.1	2.9	2.6
Milk powder	8.7	10.0	5.9	5.9	6.0
Others	1.2	0.9	1.1	1.3	1.4
<b>P&amp;L ratios (%)</b>					
Gross margin	37.4	37.6	37.3	37.8	38.0
EBIT margin	5.4	5.2	4.3	6.3	6.8
Net margin	4.4	5.2	4.3	6.1	6.7
Adjusted net margin	4.3	4.9	4.3	6.1	6.7
Payout ratio	23.2	17.3	23.0	23.0	23.0
<b>Balance sheet ratios</b>					
Current ratio (x)	1.2	1.2	1.1	1.2	1.3
A/C receivables days	15	15	18	18	18
A/C payables days	56	51	55	54	55
Inventory days	33	35	42	41	41
Asset turnover (x)	1.0	1.0	0.9	1.0	1.0
Net cash (RMB mn)	4,410	3,808	3,327	7,314	12,030
<b>Returns (%)</b>					
Adjusted ROE	12.3	14.2	10.5	15.5	16.4
Adjusted ROA	4.7	5.3	4.0	6.2	6.9
<b>Per share</b>					
EPS (RMB)	0.75	0.99	0.81	1.33	1.61
DPS (RMB)	0.18	0.18	0.19	0.31	0.37
BVPS (RMB)	6.42	7.40	8.03	9.18	10.48

Source: Company data, CMBIS estimates



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