

Mengniu (2319 HK)

Resume double-digit revenue growth in 2H20E

FY19 adj. NP (excl. one-off disposal gain of Junlebao and impairment loss of Yashili) rose 31% to RMB3,867mn, in line with our estimates and consensus. FY19 Adj. OPM +0.4ppt (vs +0.5ppt in 1H19) though raw milk cost growth rose 8% YoY in 2H19. We cut FY20/21E adj. net profit by 25%/9% to reflect COVID-19 impact. Our TP is adjusted from HK\$37.00 to HK\$34.20, based on 28.0x average FY20E and FY21E EPS. MN would benefit from continuing sector consolidation. 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.

- FY19 results in line.** Revenue rose 15%, led by liquid milk (+14%), milk powder (+45%). Key products achieved strong growth (Milk Deluxe +24%, Just Yoghurt >20%). Chilled yogurt and probiotics beverages achieved high single-digit sales growth, beat industry's low single-digit decline. Fresh milk sales reached RMB700mn. Shiny Meadow became No.1 high-end fresh milk brand. If excluding Junlebao's contribution, MN achieved 14% revenue growth and 0.4ppt EBIT margin improvement for its organic business.
- COVID-19 impact.** COVID-19 outbreak mainly affected sales in Feb and Mar, especially UHT milk. Chilled milk and fresh milk is expected to resume normal growth beginning Apr. Because of extra marketing expenses for inventory destocking in channels, expenses for epidemic prevention as well as cash and supplies donation (~RMB740mn), we expect 1H20E net profit to be affected.
- Enhance brand equity.** Mengniu's donation amount ranked No.1 in FMCG sector. It also initiated a campaign with National Association of Healthy Industry and Enterprise Management to propose drinking milk everyday to strengthen immunity. Such investments should enhance consumers' recognition of MN's brand and its sales.
- FY20E outlook.** Management expects revenue to drop slightly in 1H20E and then resume YoY low-teens growth and OPM improvement in 2H20E, excluding contribution from Bellamy's Organic and Lion Dairy. Management also targets to achieve double-digit revenue CAGR next five years.

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	1.057	1.321	1.730
Adjusted P/E (x)	29.8	24.2	27.1	18.2	15.0
P/B (x)	3.5	3.2	2.9	2.6	2.3
Yield (%)	0.8	0.8	0.8	1.3	1.5

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$34.20
(Previous TP)	HK\$37.00)
Up/Downside	+29%
Current Price	HK\$26.60

China F&B Sector

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

Stock Data

Mkt Cap (HK\$ mn)	104,689
Avg 3 mths t/o (HK\$ mn)	292.36
52w High/Low (HK\$)	34.60/ 24.35
Total Issued Shares (mn)	3,927.4

Source: Bloomberg

Shareholding Structure

COFCO	16.3%
Danone	9.9%
Arla	5.3%

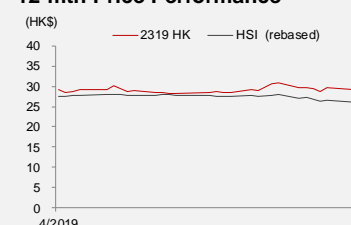
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-6.6%	6.8%
3-mth	-14.2%	1.6%
6-mth	-6.7%	2.8%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: EY

Related reports

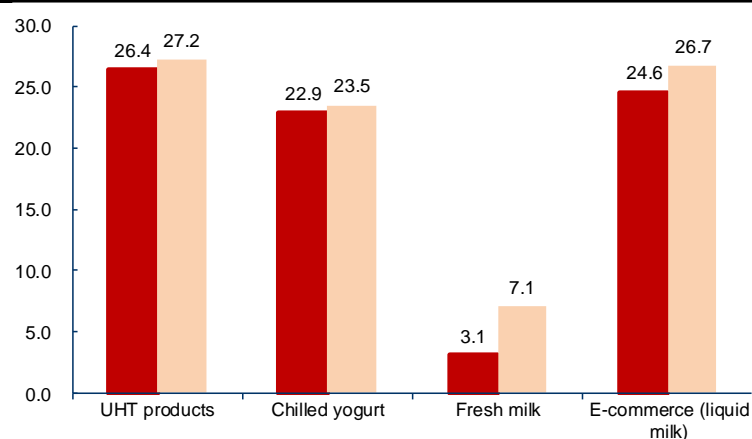
- "Mengniu – Acquisition to access raw milk supply and become regional player" – 26 Nov 2019
- "China Dairy Sector - Multiple growth drivers ahead; sector consolidation to continue" – 19 Nov 2019

- **Bellamy's Organic performed well.** The business was consolidated into P&L in Dec 19. Revenue growth in Jan and Feb 20 beat management's expectation. Management expects to receive formula registration approval and launch offline business by Jul 20, and targets 20% revenue growth in FY20E.
- **Maintain Buy.** Our TP is adjusted from HK\$37.00 to HK\$34.20, based on 28.0x average FY20E and FY21E EPS (high-end of 18-30x 1-yr forward P/E range since Mengniu's revenue restored to double-digit growth in FY16). Our target P/E multiple is unchanged as we expect MN to resume double-digit revenue growth beginning 2H20E. **Catalysts:** better-than-expected revenue and margins. **Risks:** recovery slower-than-expected, raw milk cost pressure, food safety issues.

Figure 1: FY19 results review

Y/E Dec (RMB mn)	FY19	FY18	% change	Remarks
Revenue	79,030	68,977	15%	Liquid milk +14%, milk formula +31%, ice-cream -6%
Cost of sales	(49,351)	(43,193)	14%	
Gross profit	29,679	25,784	15%	
Other income and gains/(losses)	769	635	21%	
Selling and distribution expenses	(21,536)	(18,833)	14%	Excluding Junlebao, selling exp ratio fell 0.3ppt
Administrative expenses	(3,319)	(2,915)	14%	
Other expenses	(1,482)	(936)	58%	
Operating profit	4,110	3,734	10%	
Adj. OP	4,346	3,544	23%	GP + other income - SG&A exp - tax surcharges
Finance income	1,105	868	27%	
Finance costs	(644)	(551)	17%	
One-off items	860	101	na	Gain from Junlebao disposal RMB3.3bn; impairment of Yashili investment RMB2.5bn
Share of profit from associates/JV	175	(300)	-158%	China Modern Dairy (1117 HK) turnaround in FY19
Profit before tax	5,605	3,853	45%	
Tax expense	(1,310)	(649)	102%	impairment losses are non-deductible
Profit after tax	4,296	3,204	34%	
Non-controlling interests	(190)	(161)	19%	
Net profit	4,105	3,043	35%	
Adjusted net profit	3,867	2,942	31%	
Dividend per share (RMB)	0.18	0.18	0%	
Margin & Ratio (%)				
Gross margin	37.6	37.4	0.2	GPM +0.5ppt YoY in 2H19, better than our estimate of flat
Operating margin	5.2	5.4	(0.2)	
Adj. OPM	5.5	5.1	0.4	
SG&A expenses ratio	31.5	31.5	0.0	
A&P expenses ratio	10.8	10.2	0.6	
Staff expenses ratio	9.0	9.1	(0.1)	
Adjusted net margin	4.9	4.3	0.6	
Payout ratio	17.3	23.2	(5.9)	
	FY19	FY18	change	
Inventory days	35	33	2	
A/C receivables days	15	15	0	
A/C payable days	51	56	(5)	

Source: Company, CMBIS

Figure 2: Increasing market shares

Source: Nielsen

Figure 3: Earnings revision

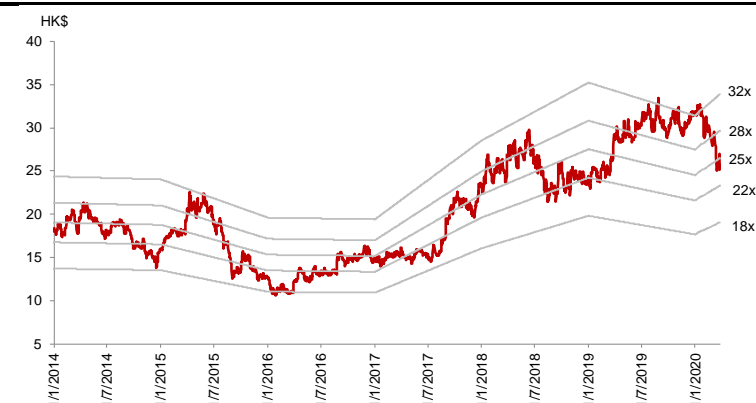
US\$ mn	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	71,615	83,179	93,327	78,057	87,348	na	-8%	-5%	na
Gross Profit	26,798	31,293	35,256	29,564	33,343	na	-9%	-6%	na
Operating Profit	3,382	5,222	6,311	4,694	5,717	na	-28%	-9%	na
Adjusted Net Profit	3,463	5,148	6,278	4,641	5,637	na	-25%	-9%	na
Gross Margin	37.4%	37.6%	37.8%	37.9%	38.2%	na	-0.5ppt	-0.6ppt	na
Operating Margin	4.7%	6.3%	6.8%	6.0%	6.5%	na	-1.3ppt	-0.2ppt	na
Adjusted Net Margin	4.8%	6.2%	6.7%	5.9%	6.5%	na	-1.1ppt	-0.3ppt	na

Source: Company data, CMBIS estimates

Figure 4: 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	80,013	90,378	86,899	-10%	-8%	7%
Gross Profit	26,798	31,293	35,256	29,858	33,838	34,151	-10%	-8%	3%
Operating Profit	3,382	5,222	6,311	4,547	5,790	7,379	-26%	-10%	-14%
Net profit	3,463	5,148	6,278	4,228	5,220	6,776	-18%	-1%	-7%
Gross Margin	37.4%	37.6%	37.8%	37.3%	37.4%	39.3%	+0.1ppt	+0.2ppt	-0.5ppt
Operating Margin	4.7%	6.3%	6.8%	5.7%	6.4%	8.5%	-1.0ppt	-0.1ppt	-1.7ppt
Net Margin	4.8%	6.2%	6.7%	5.3%	5.8%	7.8%	-0.5ppt	+0.4ppt	-1.1ppt

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
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	8,315	4,147	6,189	7,551
Associates & JV	300	(185)	(246)	(321)	(408)
D&A	1,838	2,161	1,779	1,972	2,108
Change in working capital	1,653	1,618	308	944	823
Others	(1,280)	(6,171)	(1,989)	(2,450)	(2,853)
Operating cash flow	6,363	5,740	3,999	6,334	7,221
Capex	(3,149)	(3,800)	(4,000)	(3,000)	(3,000)
Acquisitions	(309)	0	(458)	0	0
Others	(773)	4,272	725	1,453	1,639
Investing cash flow	(4,232)	472	(3,733)	(1,547)	(1,361)
Change of borrowing	(383)	245	0	0	0
Dividend paid	(526)	(711)	(712)	(797)	(1,185)
Others	8	52	0	0	0
Financing cash flow	(900)	(414)	(712)	(797)	(1,185)
Net change in cash	1,231	5,798	(446)	3,990	4,675
Cash at the beginning	3,129	4,370	3,549	3,103	7,092
Forex effect	10	0	0	0	0
Cash at disposal groups	0	0	0	0	0
Cash at the end	4,370	10,168	3,103	7,092	11,767
Time deposit	2,927	2,927	2,927	2,927	2,927
Cash and cash equivalent	7,298	13,096	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

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIS Ratings

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIS

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Securities Limited

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

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.