China Feihe (6186 HK)

Well positioned to gain market share

Feihe is the No.1 IMF market player in China with 18% market share in Sep 2020. We think its effective marketing strategies, flattened and in-depth distribution system and product freshness are key reasons for it to keep gaining market share. We believe Feihe will diversity its product offerings and introduce more super-premium products to capture the premiumization trend. We forecast Feihe to post 32% adj. EPS CAGR from FY19 to FY22E led by 38% CAGR of high-end IMF sales, higher than peers' average of 15%. We initiate coverage of Feihe with Buy rating and TP of HK$24.00 based on 23.7x FY21E P/E.

- **Effective marketing initiatives.** The Company perceives itself as the pioneer in IMF market to position its brand as "Most suitable for Chinese Babies". It has a nationwide sales team of >2,000 ppl organizing and participating in online and offline seminars to educate consumers on Feihe products. Through training program, conversion rate of seminars reaches 20-30%. Such high conversion rate justifies further spending on more events. According to the Company, the second player only organized around 50,000 seminars in 2019, just one-tenth of the Company's.
- **Flattened and in-depth distribution system.** Feihe operates a single-layer distribution system which allows it to effectively monitor channel sales and inventory and react quicker than competitors adopting multi-layer system. Distributors' profitability of single-layer system could be higher and better incentivized too. In addition, Feihe has an in-depth network of over 1,900 offline customers covering 119,000+ retail POS, which cannot be matched by many competitors.
- **Target 30% market share in 2023.** The Company expects to further gain market share from int'l brands in tier 1-2 cities and from small brands in lower-tier cities. It will extend its product offerings to fast-growing A2 milk and goat milk and introduce more super-premium products to capture the premiumization trend.
- **Initiate at Buy.** Our TP HK$24.00 is based on 23.7x FY21E P/E, at 40% premium on Chinese IMF peers' average of 16.9x P/E in FY21E. We think such valuation is justified because (1) Feihe is the sector leader which is gaining market share; (2) its 32% adj. EPS CAGR from FY19 to FY22E is the highest among peers. **Key risks:** (1) weaker-than-expected sales; (2) slump of China's new borns; (3) keen competition and (4) food safety issues.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	10,392	13,722	19,186	24,801	30,200
YoY growth (%)	77	32	40	29	22
Net profit (RMB mn)	2,242	3,935	5,883	7,603	9,284
Adj. net profit (RMB mn)	2,244	4,000	5,883	7,603	9,284
Adj. EPS (RMB)	na	0.448	0.659	0.851	1.039
YoY growth (%)	na	na	47	29	22
Consensus EPS (RMB)	na	na	0.648	0.832	1.021
Adj. P/E (x)	na	34.5	23.5	17.2	14.1
P/B (x)	na	10.6	7.8	5.8	4.5
Yield (%)	na	1.1	1.5	2.0	2.5
Net cash (RMB mn)	4,966	11,718	13,257	18,540	24,875

Source: Company data, Bloomberg, CMBIS estimates

BUY (Initiation)

Target Price	**HK$24.00**
Up/Downside	**+37%**
Current Price	**HK$17.50**

China Dairy Sector

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Stock Data

Mkt Cap (HK$ mn)	156,333
Avg 3 mths t/o (HK$ mn)	395.54
52w High/Low (HK$)	19.48/ 8.08
Total Issued Shares (mn)	8,933.3

Source: Bloomberg

Shareholding Structure

Leng Youbin	49.90%
Morgan Stanley	10.72%

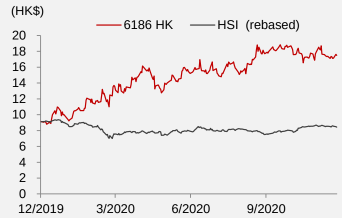
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-0.9%	-0.4%
3-mth	-0.5%	-9.4%
6-mth	10.3%	3.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

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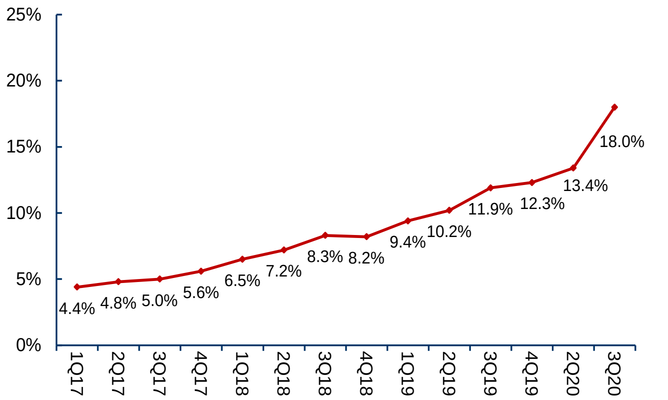
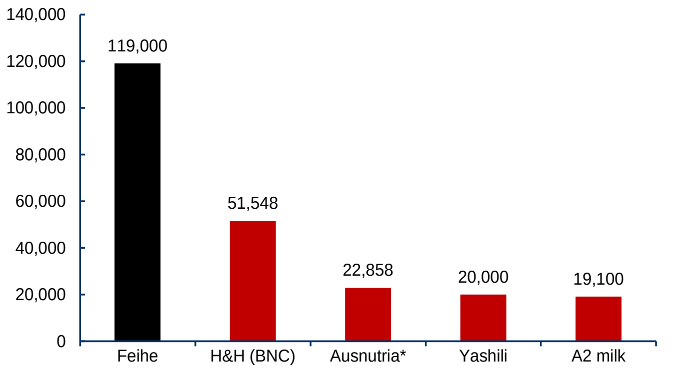


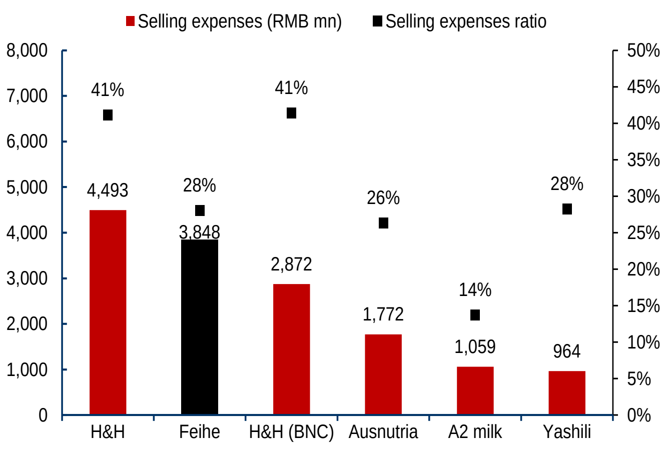
Source: Nielsen (market share for the past twelve months)

Figure 2: Feihe's in-depth POS penetration is unrivalled



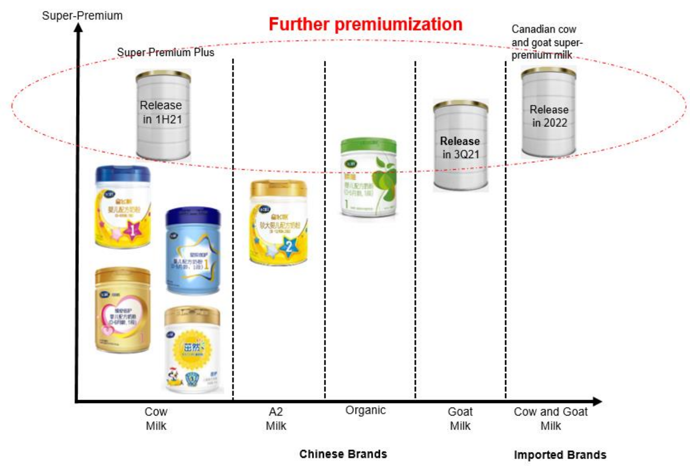
Source: Company data, CMBIS estimates
*FY18 figure

Figure 3: Feihe's selling expenses greater than peers in FY19



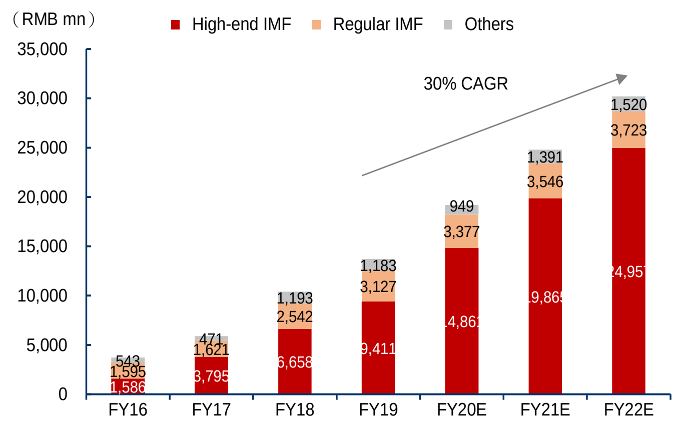
Source: Company data, CMBIS estimates

Figure 4: Diversify and upgrade product portfolio



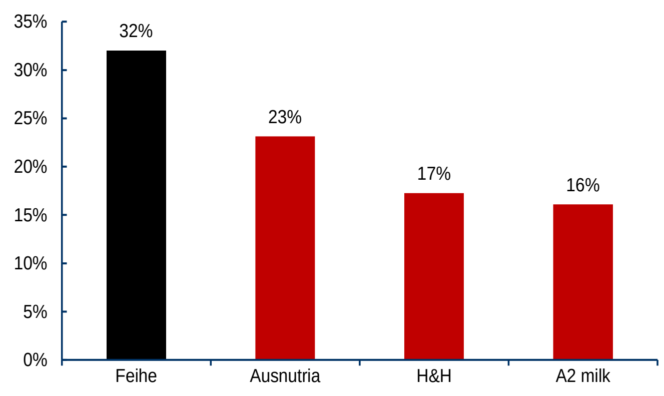
Source: Company data, Tmall, CMBIS

Figure 5: Revenue to grow at 30% CAGR in 2019-2023E



Source: Company data, CMBIS estimates

Figure 6: Feihe's 32% adj. EPS CAGR in FY19-22E was greater than peers



Source: Company data, Bloomberg estimates, CMBIS estimates

Company Overview

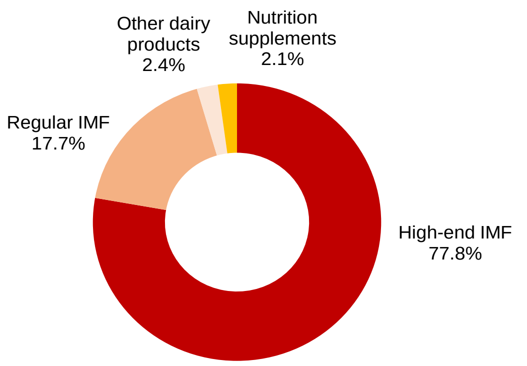
Feihe is the largest IMF company in China with 18.0% market share in terms of retail sales value as of 30 Sep 2020 according to Nielsen. It also ranked the first among domestic and international brands in terms of brand recognition by Chinese consumers. According to Frost & Sullivan ("F&S"), the Company is one of the few IMF players in China to use fresh milk as the main ingredient, in contrary to major brands sold in China, which generally use imported milk powder as the primary raw material. Since 2015, the Company has been focusing to develop and market high-end products by positioning its brand as the "More Suitable for Chinese Babies" (更适合中国宝宝体质). It has established strong brand association with this message.

The retail sales value of IMF in China is projected to grow by a CAGR of 6.9% from 2018 to 2023, according to F&S. High-end segment is forecasted to increase at 16.6% CAGR of 16.6% from 2018 to 2023 led by rising disposable income, urbanization rate and consumers' increasing health consciousness. The Company is the market leader in high-end IMF. Revenue of the Company's high-end IMF grew at 81% CAGR from FY16 to FY19. The Company's growth in this segment has been primarily driven by its star product series, Astrobaby (114% CAGR). The Company also rolled out an organic infant milk formula product, Organic Zhenzhi (臻稚有机), to capture the shift in consumer taste towards natural and organic foods.

The Company's dairy products are primarily sold through an extensive distribution network nationwide of over 1,900 offline customers with more than 119,000 retail points of sale as of 30 Jun 2020. To capture the rapid growth from e-commerce sales in China, particularly among younger generations of consumers, its products are also sold directly on some of the largest e-commerce platforms, such as Tmall, JD.com, and Suning.com, in addition to its own website and mobile application, such as WeChat. Online sales accounted for 13% of revenue in 1H20.

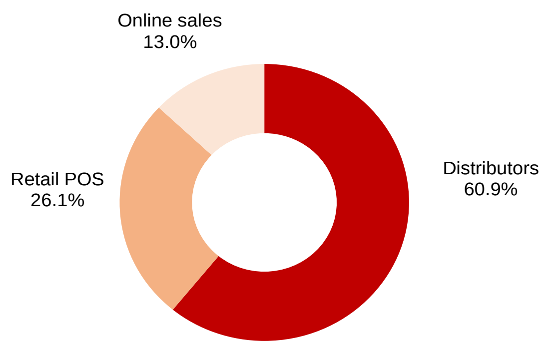
In early 2018, the Company acquired Vitamin World, which engages in the retailing of vitamins, minerals and other supplements. It operated 62 specialty stores in US and cooperated with 190 distributors, covering 860 POS in China as of 30 Jun 2020.

Figure 7: Revenue breakdown by segment in 1H20



Source: Company data, CMBIS

Figure 8: Revenue breakdown by channel in 1H20



Source: Company data, CMBIS

Competitive Advantages

Leading brand with fast-growing super-premium products

Feihe is the largest IMF company in China with 18.0% market share in terms of retail sales value as of 30 Sep 2020 according to Nielsen. Since 2016, the Company has focused its strategy on building its brand awareness and increasing penetration in lower-tier cities through a ramp-up in targeted and innovative sales and marketing initiatives. According to F&S, lower-tier cities in China accounted for 53.8% of IMF sales in China. Such proportion is forecast to reach 55.5% in 2023E underpinned by its large population and increasing urbanization and wealthy.

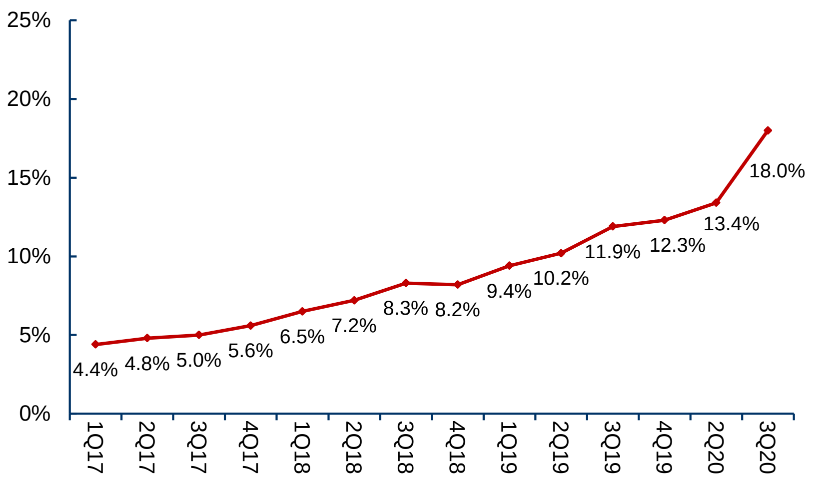
Feihe began to accelerate expansion in tier 1-2 cities in 2017. Tier 1-2 cities just accounted for 2-3% of revenue in FY17 and such proportion increased to 25% of revenue in 1H20. According to the Company, Feihe became market leader in all provinces in 1H20 except Shanghai.

The Company has established high customer loyalty, evident through a brand research conducted by Nielsen, which indicated that as of 1H20, Feihe ranked first among domestic and international brands in terms of brand recognition by Chinese consumers. The strong brand recognition the Company has gained has led to its competitive advantage over other brands, such as the first IMF domestic brand in mind and strong association as the brand that is "More Suitable for Chinese Babies" (更适合中国宝宝).

Recognizing the continued premiumization in the Chinese IMF market, the Company has repositioned its product offering towards high-end (consisting of super-premium and premium) products in recent years. The premiumization trend is supported by increasing child expenditure over the medium term, greater focus on product quality and safety, as well as growing number of educated parents towards demand for premium quality IMF.

Revenue of high-end IMF grew at 81% CAGR from FY16 to FY19. The Company is the market leader in high-end IMF. The Company's growth in this segment has been primarily driven by its star product series, Astrobaby (114% CAGR). The Company also rolled out an organic infant milk formula product, Organic Zhenzhi (臻稚有机), to capture the shift in consumer taste towards natural and organic foods.

Figure 9: Feihe has been gaining market share in China



Source: Nielsen, CMBIS

Effective marketing initiatives

Through 58 years of dedicated operation in the IMF market in China as well as effective and innovative, online and offline marketing techniques, Feihe has become one of the most widely recognized brands among Chinese consumers. Since 2015, the Company has been focusing to develop and market high-end products by positioning its brand as the "More Suitable for Chinese Babies" (更适合中国宝宝体质). It has established strong brand association with this message. Its marketing strategy consists of three key components:

1) Effective and innovative face-to-face seminars

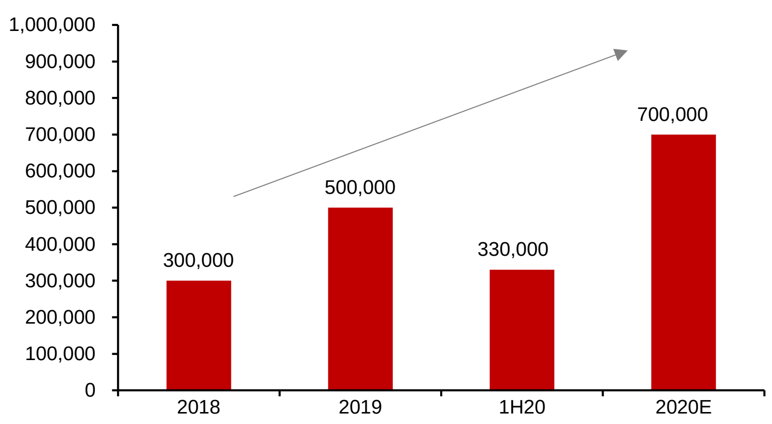
The Company organizes three types of face-to-face seminars including:

- Mother's Love (妈妈的爱) seminars introduced in August 2016 to provide free information to consumers on topics related to pregnancy and childrearing;
- Carnival (嘉年华), to introduce its products in regions where the Company has low brand presence, and involve several areas of interactions including early education on pregnancy and childrearing, nutritional information, and games;
- Shows (秀), in which sales representatives set up booths with a recreational area to educate parents about its products while their children engage in recreational activities.

According to the Company, the spending on these offline events contributed 8% of revenue in FY19. The Company has sales team of >2,000 people which is spread across the country. Our channel checks find that the Company prepares event proposals for distributors to choose and bears the events expenses. Distributors work with maternity specialty stores to invite potential customers to join the events. The Company's sales staffs attend these events and educate potential customers on Feihe products. The conversion rate of these events is around 20-30% now (vs 1-2% in the beginning) thanks to training program. Only high conversion rate can guarantee return and justify further increase of offline events. Number of events organized by the second player was just around 50,000 in 2019, much less than the Company's 500,000.

Amid lockdowns in 1H20, the Company swiftly organized online seminars after the pandemic outbreak. In 1H20, more than 330,000 face-to-face seminars were held, including more than 144,000 online seminars and 186,000 offline seminars. The Company targets to organize 700,000 seminars in 2020E.

Figure 10: Feihe expects to organize 700,000 seminars in 2020E



Source: Company, CMBIS

2) Maximize online interactivity with consumers

The Company has created user-oriented virtual communities on its WeChat accounts to serve its members whereby the Company publishes customized articles and information to them based on their pregnancy stage or child's age. Moreover, its online membership system grants member access to consultancy services provided by nutritionists, doctors and other experts, as well as providing special promotional offers to consumers.

3) Targeted and results-driven exposure on media

The Company engages in traditional media advertising on major television networks to spread its message to a wider audience of viewers. For example, the Company requires certain of its advertisers, such as Hunan Province Cable TV's Happy Camp (快乐大本营) television program, to actively promote its brand. The Company also places advertisements in MTR station, bus, etc.

The appointment of international celebrity, Zhang Ziyi (章子怡) as its brand ambassador, whom herself is a mother, has also enhanced its brand image in the local and international markets.

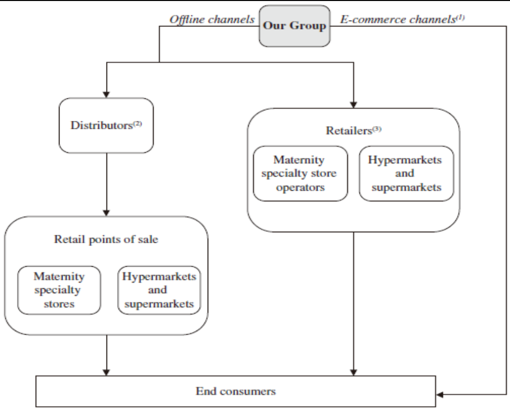
Figure 11: Unique customer experience and creative marketing initiatives

Source: Company

Flattened and in-depth distribution network

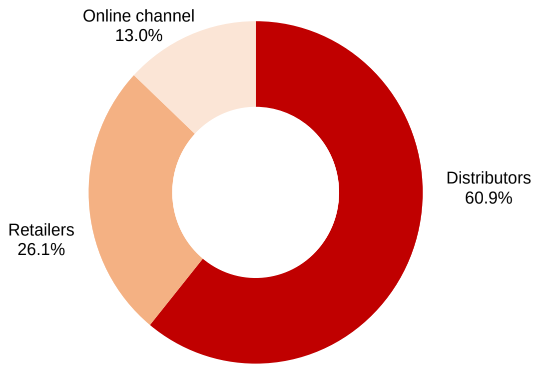
The Company primarily sold its products through an extensive nationwide distribution network of over 1,900 offline customers with more than 119,000 retail points of sale as of 30 Jun 2020. Offline customers are distributors who sell products to maternity stores, supermarkets and hypermarkets. The Company also sells directly to certain large maternity specialty stores as well as supermarket and hypermarket chains. Revenue generated from sales to offline channel accounted for 87.0% of total revenue from dairy products for the six months ended 30 Jun 2020.

Figure 12: Distribution channels of the Company



Source: Company
(1) Including company's website, mobile applications, third-party e-commerce platforms. (2) The Company also sold to educational bureaus and schools. (3) The Company's retail customers do not overlap with distributors' customers.

Figure 13: Dairy product revenue breakdown by channel in 1H20



Source: Company data, CMBIS

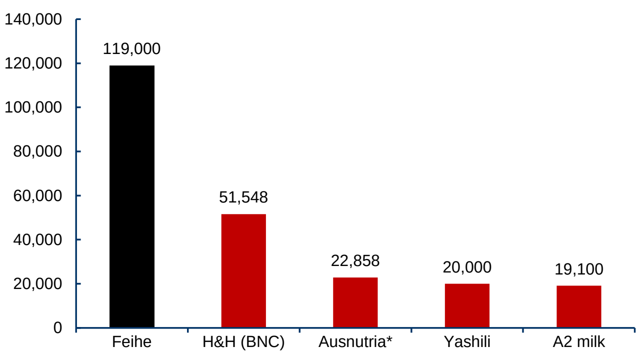
The Company operates a single-layer distribution system so its distributors sell products to retail POS directly. The single-layer distribution system allows the Company to effectively monitor channel inventory level, control product sales at POS level and gain feedback from distributors in a timely manner. To further enhance monitoring and control of inventory, the Company launched a barcode scanning function in its DRP system and required distributors to adopt barcode scanning function in 2H16. Compared to multi-layer distributor system, the Company could react more quickly than its competitors and its distributors are incentivized to distribute the Company's products given that single-layer distributors' profitability could be higher multi-layer distributors in general.

Figure 14: Distribution system of certain peers

Feihe	Yili	Biostime	Ausnutria	Meadjohnson
single-layer	two-layer	multi-layer	single-layer	two-layer
Have distributors in cities and counties. All order directly from Company	First layer is at city level and second layer is at county level	Chief distributor at provincial level. Have second and third layer in regions cannot be covered by chief distributor	Have distributors in cities and counties. All order directly from Company	First layer is at city level and second layer is at county level

Source: Company, channel checks

Figure 15: Feihe's in-depth POS penetration is unrivalled



Source: Company data, CMBIS estimates
*FY18 figure

Produced by quality fresh milk

One of few players to produce by high quality fresh milk. According to F&S, the Company is one of the few IMF players in China to use fresh milk as the main ingredient, in contrary to major brands sold in China, which generally use imported milk powder as the primary raw material. By using fresh milk, the Company avoids 1-2 month shipping time of imported milk powder. Also, the close proximity of production facilities to raw milk suppliers ensures product freshness.

The Company's fresh milk is mainly sourced from YST Group, one of the leading dairy farm operators in China in terms of herd size and production volume, in which the Company has a longstanding partnership since 2010. All fresh milk sourced from its suppliers are required to meet a series of nutritional and safety standards that are higher than the benchmarks in China and Europe.

Figure 16: Consistent commitment to high quality raw materials

Fresh milk main content	Feihe's standards 飞鹤	China standards	European standards
Protein content	**≥3.4%**	≥2.8%	≥3.2%
Fat content	**≥4.2%**	≥3.1%	≥3.7%
Aerobic plate count (/mL)	**≤10,000**	≤2,000,000	≤100,000
Somatic cell count (/mL)	**≤200,000**	N/A	≤400,000

Source: Company data, CMBIS
Note: Fat content, protein content, aerobic plate count, and somatic cell count are the four major measuring standards of fresh milk. Generally a higher protein and fat content indicates higher quality. Aerobic plate count and somatic cell count are two major indicators used to determine safety quality of fresh milk, and generally a lower aerobic plate count indicates improved sanitation and a lower somatic cell count indicates better animal health.

No artificial flavoring. The Company does not use artificial flavoring in its products as the use of locally-sourced fresh milk enables its products to retain the natural and fresh taste and aroma of milk. Moreover, the Company does not use certain lower-cost ingredients such as sucrose or maltodextrin as the main carbohydrate source and sweetener, but rather use lactose in its products, a naturally-occurring sugar in breast milk that aids in the absorption of other minerals, which the Company believes benefits the physical development of infants.

Resembling Chinese mothers' breast milk and more suitable for Chinese babies. According to F&S, the Company is one of the first infant milk formula providers in China to successfully complete in-depth research on babies. Prior to launching its Astrobaby product series in 2010, the Company worked with the Hunan Provincial Center for Disease Prevention and Control (湖南省疾病预防控制中心) to conduct in-depth research over three months to study the health benefits to infants by adding OPO structured fats for the specific growth and development needs, and to promote the digestive health of Chinese babies.

Development of breast milk database. The Company has conducted clinical studies in collaboration with national research institutions and continued to contribute to the establishment of a comprehensive Chinese breast milk database. The Company's ongoing participation in this effort allows it to continue its extensive research on the breast milk composition of Chinese mothers across different regions, with the aim of improving its infant milk formula to meet the nutritional needs of infants in China.

The infant milk formula market in China

Industry consolidation driven by favorable policies

The Administrative Measures for the Registration of Product Formulas of Infant Formula Milk Powder (“婴幼儿配方乳粉产品配方注册管理办法”) was promulgated by the CFDA on 6 Jun 2016 and became effective on 1 Oct 2016. According to the Measures, the product formulas of the infant formula milk powder produced, sold and imported to China shall be approved and registered with CFDA. If the same enterprise applies for the registration of two or more product formulas for the same age group, there shall be a significant difference between the product formulas and the difference shall be scientifically proved.

The Measures requires IMF companies to provide details of the product formula, safety standard of raw materials, production technologies, product quality inspection report, proof of capabilities of R&D, production and quality inspection etc. In addition, each licensed factory is limited to three approved recipes. Given such limitations, licensed factories would only keep top three approved recipes in terms of sales and terminate the production of remaining recipes, we expect the Measures will accelerate the rising of market concentration ratio. Before the Measures took effect, there were more than 3,000 brands (domestic and foreign manufacturers). As at 30 Jun 2019, 423 brands and 1,253 recipes were totally approved, according to Euromonitor and CITIC Agricultural Fund.

Major IMF brands can lift their investment in raw milk sources and R&D to expand their number of approved recipes and strengthen marketing initiatives and channel penetration to increase sales, further squeezing the market shares of smaller IMF players.

The NDRC published the Action Plan for the Promotion of Domestic IMF (“国产婴幼儿配方乳粉提升行动方案”) in May 2019, targeting to improve the quality of domestic IMF brands and keep self-sufficiency ratio at >60%, enhance market shares of domestic IMF brands and promote industry consolidation. The Plan will strictly review the attributes of new IMF manufacturers and encourage enterprises to merge or acquire outdated production capacities, accelerate the upgrade of production technologies and facilities of enterprises whose annual production capacities less than 1,000 tonnes or annual sales less than RMB50mn for three consecutive years.

Growth drivers of IMF market in China

The following are key market drivers and trends of the infant milk formula market in China:

- **Increase in consumer confidence of domestic IMF brands**

With the enhancement in the quality management regime of China’s dairy industry and the increased competitiveness of domestic IMF brands, consumers’ confidence and preference for domestic IMF brands continued to increase.

- **Growth of the high-end infant milk formula segment**

Due to increasing urbanization, rising disposable income and growing health awareness, the demand for high-end infant milk formula products, particularly super-premium products, is expected to be the driving force of the overall infant milk formula industry in China.

- **Increasing urbanization and rising disposable income**

The increase in the urbanization rate and the per capita annual disposable income of Chinese residents will enhance the purchasing power of consumers, allowing them to purchase more infant milk formula products, especially high-end products. Lower-tier cities as well as rural areas in China are becoming more urbanized and wealthy, and families in such regions are increasingly able to afford higher-quality infant milk formula. In general, these regions have larger populations and therefore higher potential for consumption growth.

- **Low level of exclusive breastfeeding rate**

The rate of infants that are fed exclusively with breast milk for the first six months after birth was 29% in 2019. The increasing resemblance of infant milk formula to breast milk, availability of infant milk formula and inconvenience of breastfeeding for working mothers are among the primary factors that have influenced a mother's choice of whether or not to breastfeed her baby. With China's continued economic growth and urbanization process, breastfeeding rates are expected to remain at low levels, creating more demand for infant milk formula.

Entry barriers of IMF market in China

The following are main entry barriers of the infant milk formula market in China:

- **Established brand recognition and reputation for quality and safety**

The melamine incident in 2008 eroded consumers' confidence in domestically produced infant milk formula brands. As brand reputation is a very valuable asset for a company, many leading domestic brands have devoted significant time, financial resources and marketing efforts towards promoting the safety of their products. New market players and competitors without the necessary resources or time investment may face challenges in establishing brand presence and reputation.

- **Extensive policies, laws and regulations**

Following the melamine incident in 2008, the PRC Government strengthened the supervision of the infant milk formula market by implementing more stringent policies and regulations on the quality and safety of infant milk formula products and the raw materials used in such products. These policies and regulations have created major entry barriers for new market players, including (i) high qualification standards that companies must meet to produce infant milk formula products and (ii) high safety requirements that necessitate strong production and quality control management as well as operating experience.

- **Strong sales network**

The success of infant milk formula players is largely dependent on the ability to build a strong sales network and coverage. Market players that have established sales channels and close relationships with distributors, retailers and emerging e-commerce platforms are better positioned to capture greater market share while also reducing marketing costs.

- **Continued investment in research and development**

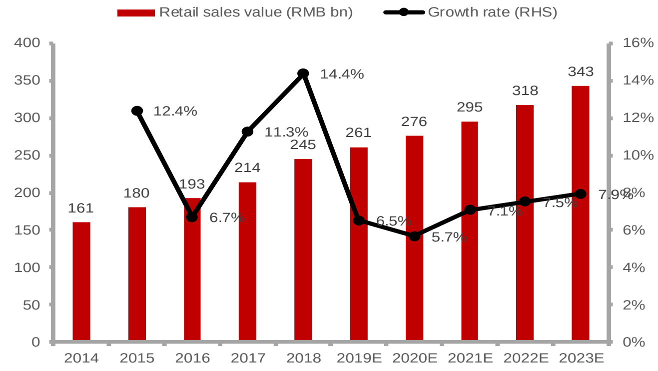
Unlike the manufacture of other dairy products, the production of infant milk formula involves substantial scientific research, often over extended periods of time, and requires the use of a significant amount of technology and know-how, stringent quality control procedures, as well as highly specialized personnel and skilled workers. Market players that have robust research and development capacity and ability to invest in such efforts, or that are able to collaborate with leading research institutions to develop new products and technologies are in a better position to capture greater market share.

Retail sales value by domestic brands and international brands

The infant milk formula market in China represents infant milk formula products sold by domestic and international brands in China, excluding cross-border purchases by Chinese consumers. According to F&S, the retail sales value of China's infant milk formula market increased from RMB 160.5bn in 2014 to RMB 245.0bn in 2018, representing a CAGR of 11.2%.

China's infant milk formula market is expected to grow at a CAGR of 6.9% to RMB 342.7bn in 2023, driven by the growth of the high-end market supported by positive factors such as an increasing focus on product quality and safety, appreciation for nutrients of infant milk formulas, as well as China's implementation of the "Universal Two-Child Policy" in 2015.

Figure 17: Retail sales value of infant milk formula market (China), 2014-2023E

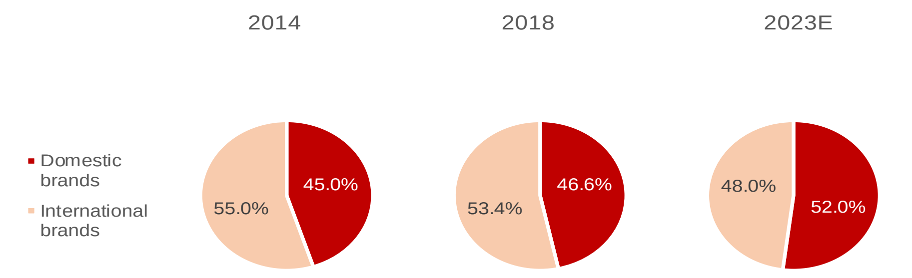


Source: F&S, CMBIS

Prior to the melamine incident in 2008, domestic brands of China's infant milk formula held a relatively larger proportion of market share in comparison to international brands. Following the incident, consumers' confidence in domestic infant milk formula has been negatively impacted, which led to international brands taking up market share. Nevertheless, over the years it was evident that the market share of domestic brands has gradually rebounded.

According to F&S, in 2014 and 2018, international brands collectively held 55.0% and 53.4%, respectively, of the infant milk formula market in terms of the retail sales value. While domestic brands collectively held 45.0% and 46.6% of the infant milk formula market in the same years, respectively. Over the last five years, domestic brands have occupied a growing share of infant milk formula market through their continued investment in brand promotion as well as research and development of high-end products. By the end of 2023, the market share held by domestic brands is expected to increase to over half of the entire market.

Figure 18: Retail sales value of infant milk formula by domestic brand and international brand (China), 2014 vs. 2018 vs. 2023E



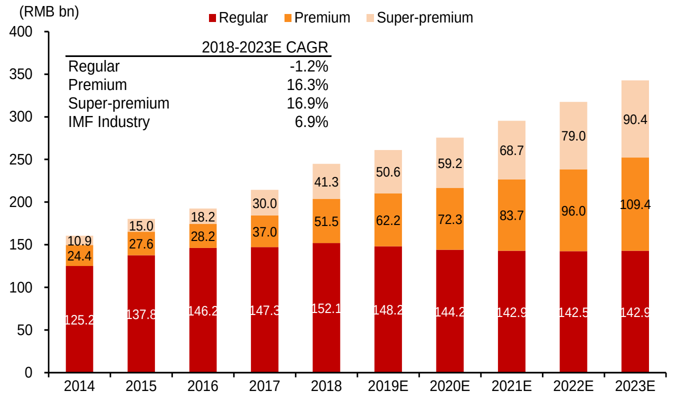
Source: F&S, Company data, CMBIS

Growth driven by premiumization

After the dividend of two-child policy was fully released, China's number of babies born dropped from 17.23mn in 2017 to 15.23mn in 2018. Growth of retail sales volume of IMF is forecast to slow from 8.4% in 2014-2018 to 3.8% in 2018-2023E, according to F&S. However, driven by consumers' growing health awareness, increasing income level and urbanization, retail sales value of premium and super-premium IMF are estimated to grow at CAGR of 16.3% and 17.0%, respectively, in 2018-2023E.

We think organic IMF and goat milk are two fast-growing categories that could benefit from consumption upgrade. According to Nielsen, sales of organic IMF jumped 42.4% in 2018. Goat milk IMF, which has been proven to be more easily digested and has lower allergic reactions than cow milk IMF, also saw imported volume growth of around 30% in 2018 according to The General Administration of Customs of PRC. The growth rates of these two categories were faster than China IMF industry's 14% retail sales growth (F&S data) in 2018.

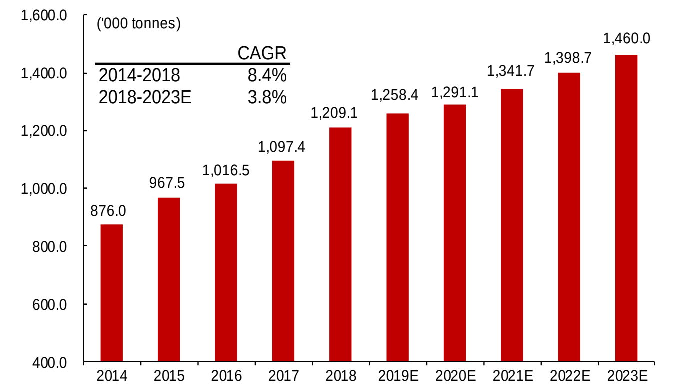
Figure 19: China's IMF industry is forecast to grow by 6.9% from 2018 to 2023E, led by premium and super-premium IMF



Source: F&S

Super-premium/premium/regular IMF products are priced at or above RMB450 per kg/from RMB350-449 per kg/below RMB350 per kg for average retail price of Stage 1 to Stage 3, respectively

Figure 20: China's IMF retail sales volume CAGR is expected to moderate to 3.8% CAGR from 2018 to 2023E

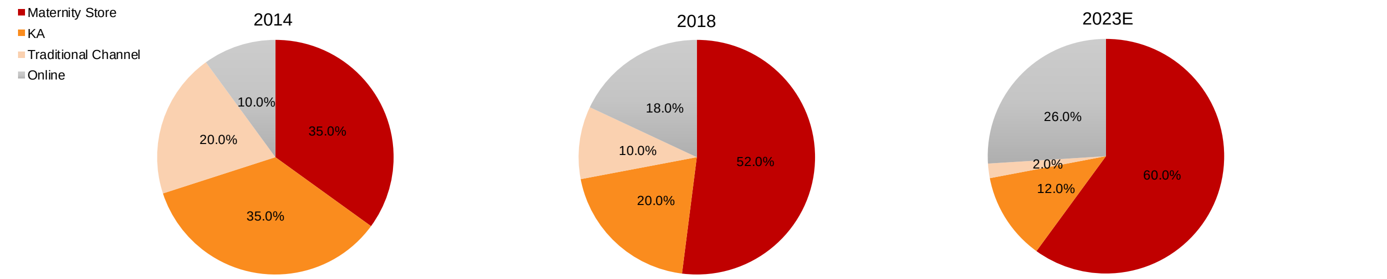


Source: F&S

Maternity specialty stores and e-commerce channels gaining market share from traditional and KA channels

There are four major distribution channels for consumers to purchase IMF, namely maternity specialty stores, e-commerce, KA (hypermarket & supermarket) and traditional channel. In 2018, baby & maternity stores accounted for 52% of retail sales value of IMF industry. Such proportion is expected to reach 60% in 2023E. Market share of e-commerce's market increased significantly from 10% in 2014 to 18% in 2018, and is estimated to climb to 26% in 2023E, according to F&S. On the contrary, market share of KA and traditional channel dropped from 35% and 20% in 2014 to 20% and 10% in 2018, respectively. Their market share is estimated to fall further to 12% and 2% in 2023E, respectively.

Figure 21: Baby & maternity stores and e-commerce channels are expected to gain market share of IMF retail sales

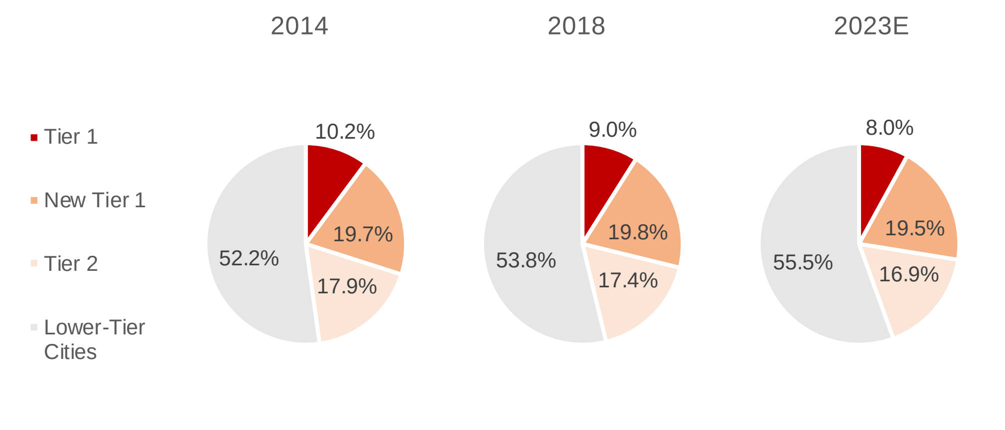


Source: F&S

Lower-tier cities to gain market share

The infant milk formula market in lower-tier cities accounted for the majority of the whole market in terms of the retail sales value, and the retail sales value in lower-tier cities also experienced rapid growth from 2014 to 2018. With the increase of China's urbanization rate is driven by lower-tier cities and consumers in lower-tier cities become more wealthy, the proportion of IMF retail sales value in lower-tier cities is expected to increase from 53.8% in 2018 to 55.5% in 2023E.

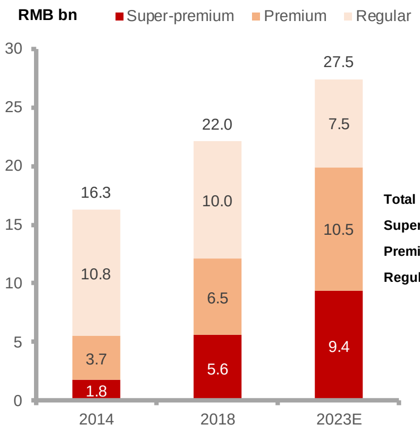
Figure 22: Retail sales value of infant milk formula by city tier (China), 2014, 2018, 2023E



Source: F&S, Company data, CMBIS

In 2018, the Tier 1 cities, New Tier 1 cities, Tier 2 cities and lower-tier cities accounted for 9.0%, 19.8%, 17.4% and 53.8% of the total infant milk formula market in terms of retails sales value, respectively.

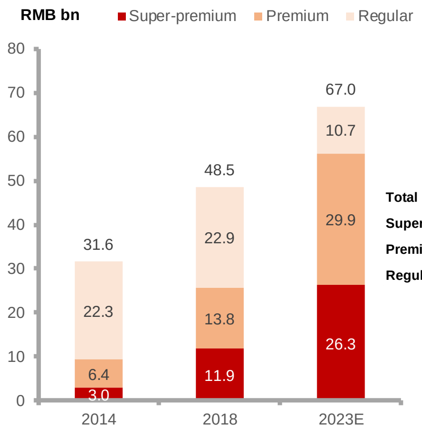
Figure 23: Tier 1 cities infant milk formula market by super-premium, premium and regular infant milk formula (China), 2014, 2018, 2023E



	CAGR (2014-2018)	CAGR (2018-2023E)
Total	7.7%	4.5%
Super-premium	33.0%	11.1%
Premium	14.8%	10.2%
Regular	-2.1%	-5.5%

Source: F&S, Company data, CMBIS

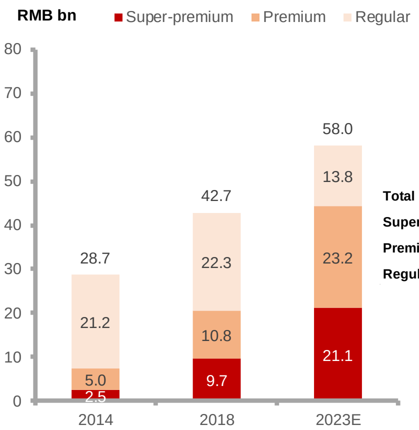
Figure 24: New tier 1 cities infant milk formula market by super-premium, premium and regular infant milk formula (China), 2014, 2018, 2023E



	CAGR (2014-2018)	CAGR (2018-2023E)
Total	11.3%	6.7%
Super-premium	41.0%	17.3%
Premium	21.3%	16.8%
Regular	0.7%	-14.1%

Source: F&S, Company data, CMBIS

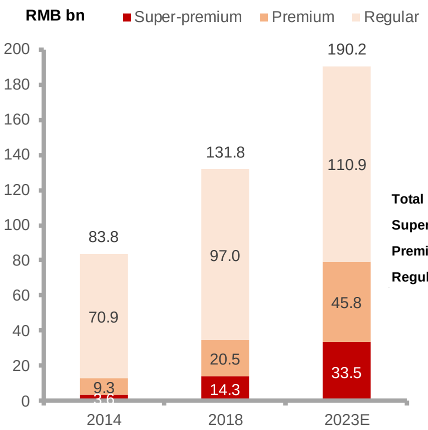
Figure 25: Tier 2 cities infant milk formula market by super-premium, premium and regular infant milk formula (China), 2014, 2018, 2023E



	CAGR (2014-2018)	CAGR (2018-2023E)
Total	10.4%	6.3%
Super-premium	39.8%	17.0%
Premium	21.0%	16.6%
Regular	1.3%	-9.2%

Source: F&S, Company data, CMBIS

Figure 26: Lower-tier cities infant milk formula market by super-premium, premium and regular infant milk formula (China), 2014, 2018, 2023E



	CAGR (2014-2018)	CAGR (2018-2023E)
Total	12.0%	7.6%
Super-premium	41.1%	18.6%
Premium	21.9%	17.4%
Regular	8.2%	2.7%

Source: F&S, Company data, CMBIS

Growth drivers

The Company has set an ambitious target of reaching 30% market share in 2023E. By tier of cities, the Company expects to reach 20-30% market share in tier 1-2 cities and 40-45% market share in lower-tier cities. We expect the Company to gain market share in tier 1-2 cities and lower-tier cities from international brands and small domestic brands, respectively. Apart from IMF, the Company will give more details about its new product category development plan in 2021.

Further gain market share in tier 1-2 cities and Southern China

- **Good track record in becoming market leader in upper-tier cities**

International brands generally have higher market share in tier 1-2 cities. However, the Company had good track record in breaking into upper-tier cities. For example, the Company recorded 80% CAGR of revenue in Beijing from 2016 to 2018 and now becomes the No. 1 brand. The Company firstly entered into the outer region market of Beijing and established close partnerships with key local retailers like Wumart, Lijia Baby and Leyou. It cooperated with them on promotions and precise marketing initiatives to enhance brand awareness, dedicated resources into recruiting qualified sales managers in the regions and increasing sales representatives coverage at POS and provided them with continuous training about IMF knowledge. Such efforts differentiate Feihe brand image and services from international brands.

- **International brands are losing market share**

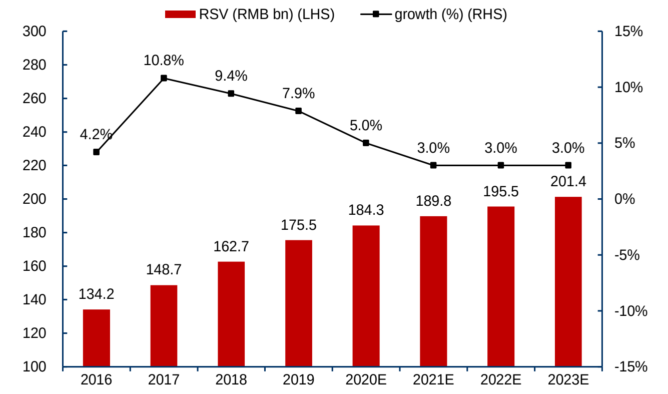
According to our channel checks, although international brands generally have high brand recognition, we think they have the following shortcomings that let Feihe and other domestic brands to gain market share:

- Fewer advertising and promotion activities;
- Lower profitability for distributors;
- Small maternity specialty stores are not willing to sell international brands because their retail prices at online channels are low and volatile.

- **Strategies in upper-tier cities**

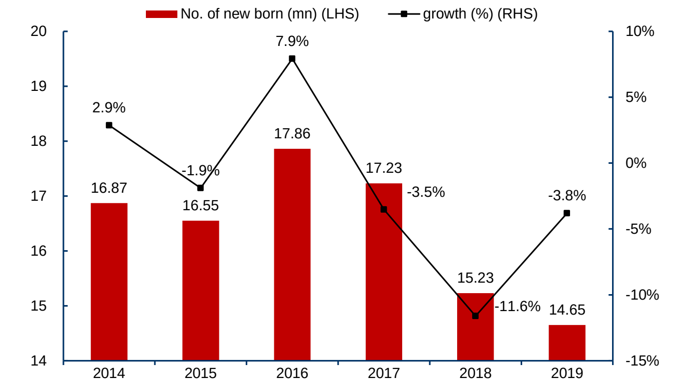
The Company will spend more from its A&P expenses in tier 1-2 cities to promote its brand. At the same time, the Company would allow distributors in tier 1-2 cities to have better profit margin than those in lower-tier cities to incentivize them.

Figure 27: We forecast China's IMF market to grow at 3.5% CAGR in 2019-2023E



Source: Euromonitor, CMBIS estimates

Figure 28: The decline of new born in China moderated in 2019



Source: National Statistics Bureau, CMBIS

Increase market share in lower-tier cities

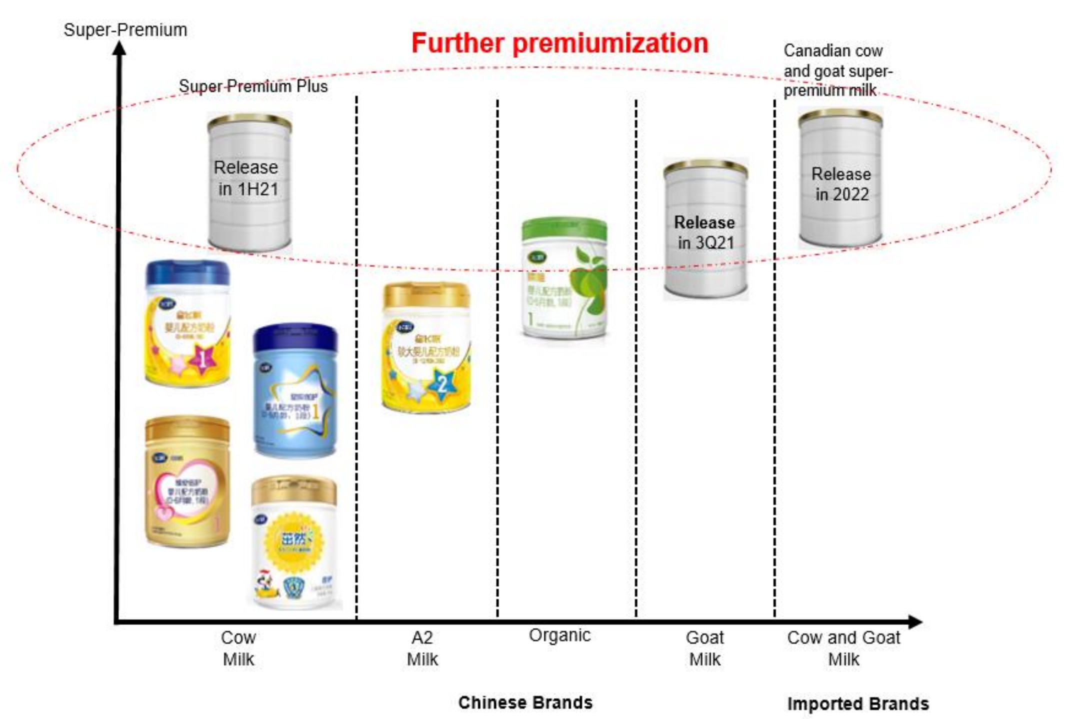
According to Nielsen, top ten players already took 72.3% market share in 1H20. There is still room for leading players to take market share from small players. According to the Company, Feihe had 50-60% market share in stronghold market like Heilongjing. We believe the competitors in lower-tier cities are mainly domestic brands and small players. Given the Company's strong brand recognition, in-depth distribution system and economies of scale, we think the Company could further take market share from small players.

Expand product portfolio and further premiumization

The Company launched Zhouran in May 2020 to strengthen its portfolio in stage 4 IMF products and extend its customers' life cycle. All stage 4 products saw revenue increase of >700% YoY to reach 8% of revenue in 1H20. Going forward, the Company will diversify its production into different sub-segments and upgrade its products

- **A2 milk:** The Company launched Astrobaby A2 milk IMF in Dec 2020 to tap into this fast-growing sub-segment. A2 Milk (A2M AU) recorded NZD679mn (RMB3bn) sales China based channels (maternity stores and cross-border e-commerce channels) in FY20, representing 65% YoY growth.
- **Goat milk:** The Company plans to launch goat milk IMF in 3Q21 to enter this sub-segment. Ausnutria, the sub-segment leader, recorded 28% YoY sales growth of goat milk IMF in China in 1H20.
- **More super-premium products:** The Company plans to launch super-premium plus products in 2021. In 2022, it plans to produce Canadian-produced, cow and goat milk IMF.
- **Upgrade organic IMF:** The Company plans to upgrade the formula of Organic Zhenzhi in 2021.

Figure 29: Diversify and upgrade product portfolio



Source: Company, Tmall, CMBIS

Control upstream fresh milk source

The Company acquired 71.26% equity interest of YST (1431HK), the major fresh milk provider of the Company, by conditional offer in Dec 2020. Apart from earnings accretion to the Company, we think there are further synergies between the two companies:

- **Adjust milk source to support its sales growth.** The Company can adjust raw milk production of YST to support Feihe's growth in A2 milk and organic IMF products.
- **Close proximity of dairy farms.** The close proximity of its production facilities to its dairy milk suppliers ensures the freshness is optimally preserved. YST can set up its farms close to Feihe's production facilities.
- **Secure quality fresh milk supply.** According to the Company, around 90% of its fresh milk supply comes from YST. On the other hand, YST supplies about 70-80% of its fresh milk to Feihe with the remaining to Mengniu and Bright Dairy. Given that China's fresh milk supply is quite tight, we observe dairy product companies have been investing in upstream players to secure raw milk supply. Feihe's acquisition of YST secures stable supply of fresh milk.
- **Reduce exposure to raw milk price fluctuation.** We expect raw milk price could further increase in 2021 and 2022, the consolidation of YST could greatly minimize the impact on GPM by raw milk price fluctuation.

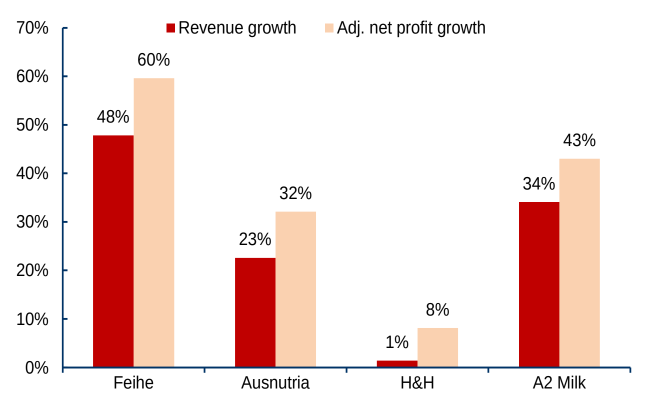
Financial forecast

Strong 1H20 results

Feihe delivered a strong set of results in 1H20 and outperformed peers. Revenue jumped 48% YoY and adj. net profit soared 60% YoY. According to Nielsen, Feihe's market share increased from 12.3% as of 31 Dec 2019 to 13.4% as of 30 Jun 2020.

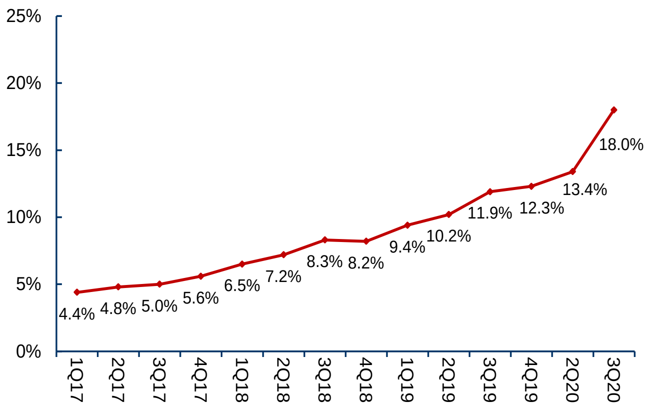
The strong revenue growth was driven by 73% growth of high-end IMF, followed by 9% growth of regular IMF. Nutrition supplement arm, Vitamin World, saw 42% drop of revenue due to pandemic in US. GPM expanded 3.4ppt to 70.9% in 1H20 driven by greater sales mix of high-margin high-end IMF by 11.3ppt to 77.8%. EBIT margin widened 3.7ppt to 45.9%, led by GPM expansion. SG&A expenses ratio maintained at 31.3% in 1H20.

Figure 30: Feihe 1H20 results outperformed peers



Source: Company data, CMBIS

Figure 31: Feihe gained more market share in 2020



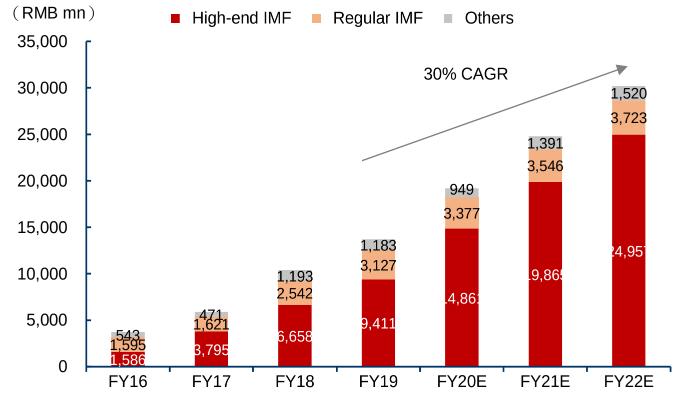
Source: Nielsen (market share for the past twelve months)

32% adj. EPS CAGR from FY19 to FY22E

We estimate revenue to grow at 30% CAGR in FY19-22E driven by continuing premiumization and consumers' increasing confidence in domestic brands. The Company's high sales mix in high-end segment (78% of revenue in 1H20), strong brand recognition by consumers, expansion into new sub-segments and further premiumization should help it capture growth opportunities in China's premium IMF market. We expect the Company to gain market share from international brands in tier 1-2 cities and small domestic brands in lower tier-cities.

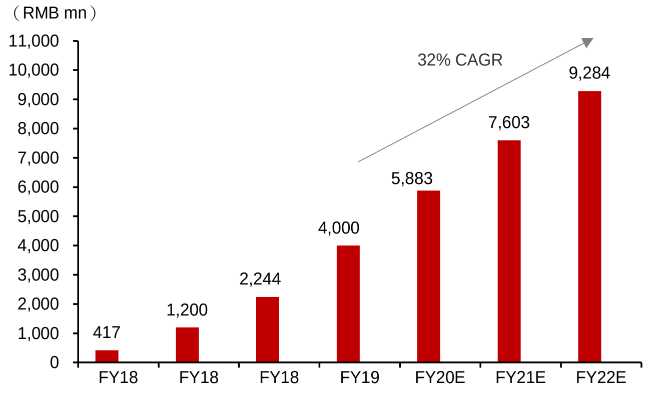
We forecast adj. EPS to grow at 32% CAGR in FY19-22E. We expect EBIT margin to increase from 40.8% in FY19 to 42.6% in FY23E. Such margin expansion is led by 4.1ppt GPM expansion (from higher sales mix in high-end segment and consolidation of YST) and operating leverage, but partly offset by decreasing government grant after 4/1/1 agreements will expire in 2020/21/22E.

Figure 32: We forecast revenue to grow at 30% CAGR in 2019-2023E



Source: Company, CMBIS estimates

Figure 33: We forecast adj. NP to grow at 32% CAGR in 2019-2023E



Source: Company, CMBIS estimates

Figure 34: P&L assumptions

(RMB mn)	FY18	FY19	FY20E	FY21E	FY22E
Revenue	**10,392**	**13,722**	**19,186**	**24,801**	**30,200**
growth (%)	*76.5%*	*32.0%*	*39.8%*	*29.3%*	*21.8%*
High-end IMF	*6,658*	*9,411*	*14,861*	*19,865*	*24,957*
growth (%)	*75.4%*	*41.4%*	*57.9%*	*33.7%*	*25.6%*
GPM (%)	*64.1%*	*68.6%*	*77.5%*	*80.1%*	*82.6%*
Regular IMF	*2,542*	*3,127*	*3,377*	*3,546*	*3,723*
growth (%)	*56.8%*	*23.0%*	*8.0%*	*5.0%*	*5.0%*
GPM (%)	*24.5%*	*22.8%*	*17.6%*	*14.3%*	*12.3%*
Others	*1,193*	*1,183*	*949*	*1,391*	*1,520*
growth (%)	*153.4%*	*-0.8%*	*-19.8%*	*46.6%*	*9.3%*
GPM (%)	*28.1%*	*44.7%*	*42.8%*	*40.4%*	*40.9%*
GPM (%)	67.5%	70.0%	71.7%	73.5%	74.1%
Other income	466	814	1,128	663	536
% rev (%)	*4.5%*	*5.9%*	*5.9%*	*2.7%*	*1.8%*
Selling expenses	3,661	3,848	5,526	6,845	8,275
% rev (%)	*35.2%*	*28.0%*	*28.8%*	*27.6%*	*27.4%*
Admin expenses	580	913	1,233	1,492	1,760
% rev (%)	*5.6%*	*6.7%*	*6.4%*	*6.0%*	*5.8%*
Other expenses	86	70	260	85	85
% rev (%)	*0.8%*	*0.5%*	*1.4%*	*0.3%*	*0.3%*
EBIT	3,157	5,592	8,134	10,547	12,873
growth (%)	*88.8%*	*77.1%*	*45.5%*	*29.7%*	*22.1%*
% of rev (%)	*30.4%*	*40.8%*	*42.4%*	*42.5%*	*42.6%*

Source: Company data, CMBIS estimates

Figure 35: CMBIS estimates vs consensus

	CMBIS			Consensus			Diff (%)		
RMB mn	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	19,186	24,801	30,200	18,884	24,191	29,709	2%	3%	2%
Gross Profit	13,765	18,222	22,372	13,477	17,372	21,387	2%	5%	5%
EBIT	8,134	10,547	12,873	7,872	10,164	12,423	3%	4%	4%
Adj. Net profit	5,883	7,603	9,284	5,668	7,264	8,923	4%	5%	4%
Gross Margin	71.7%	73.5%	74.1%	71.4%	71.8%	72.0%	+0.3ppt	+1.7ppt	+2.1ppt
EBIT Margin	42.4%	42.5%	42.6%	41.7%	42.0%	41.8%	+0.7ppt	+0.5ppt	+0.8ppt
Adj. Net Margin	30.7%	30.7%	30.7%	30.0%	30.0%	30.0%	+0.7ppt	+0.7ppt	+0.7ppt

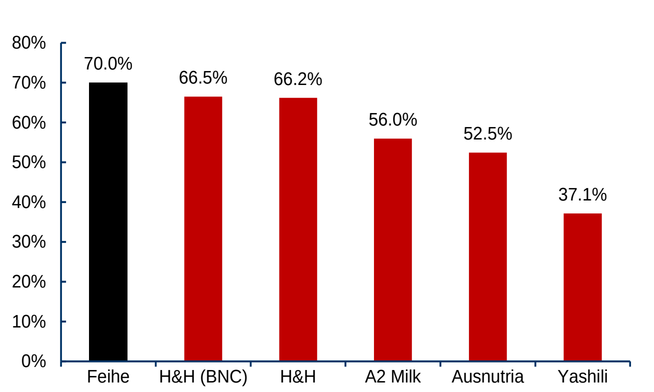
Source: CMBIS estimates, Bloomberg estimates

Peers comparison

Market leader with the highest GPM

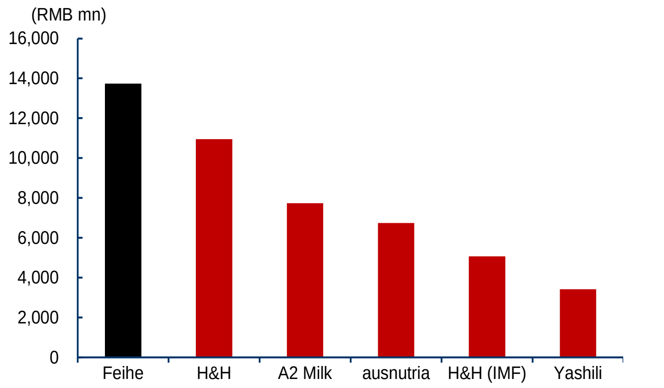
Feihe is the market leader in China's IMF market in 2019 with 12.3% market share according to Nielsen. Feihe's 70% GPM in FY19 also topped among peers because its high-end IMF sales (GPM 75.9%) contributed 69% of total revenue. H&H baby nutrition and care (BNC) segment recorded 66.5% GPM in FY19. IMF was the biggest category with GPM of 65.8%. Ausnutria's own-brand IMF reported 57.2% GPM and accounted for 89% of total revenue. A2 Milk's GPM was also less than Feihe. We think its China label ("至初") could have high GPM due to high retail price RMB488/900g, but this segment just accounted for 24% of total revenue in FY20. Most of sales (ANZ and China's cross-border e-commerce) were from overseas label whose retail price at Tmall International is just RMB240/900g.

Figure 36: Feihe's GPM the highest in FY19



Source: Company data, CMBIS

Figure 37: Feihe's revenue also the highest in FY19



Source: Company data, CMBIS estimates

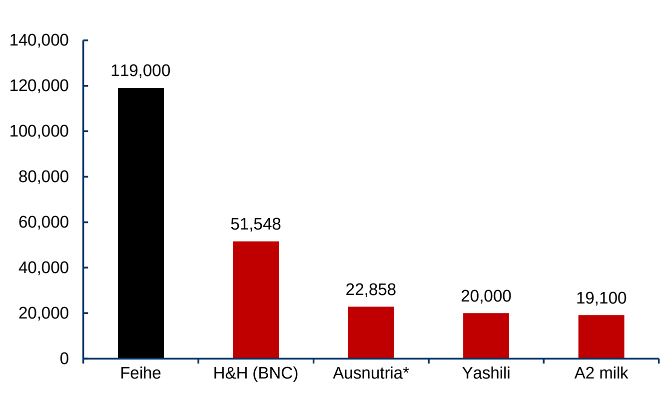
Most in-depth penetration compared to peers

Thanks to its in-depth, single-layer distribution system and a large number of distributors (~1,900 customers), Feihe covered 119,000 retail POS (maternity specialty stores and supermarkets) in 1H20. Such number was more than double of H&H's BNC segment, which covered 51,548 maternity specialty stores, supermarkets and VIP pharmacies. Other peers' POS coverage is even lower.

Effective selling expenses to promote sales

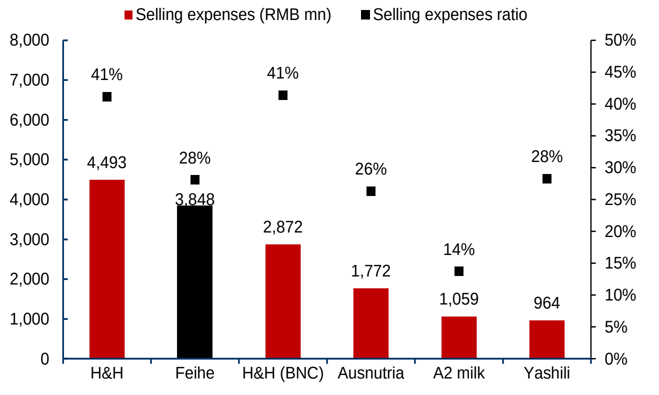
Although Feihe's selling expenses ratio (28%) was behind H&H's BNC segment (41%), it was similar to Ausnutria and Yashili. That said, its absolute amount was the greatest among peers. While Feihe organized more than 500,000 offline seminars and had a large sales team staff (3,130 people as of 30 Jun 2019, even greater than total staff number of some peers) in 2019, its selling expenses ratio was still in line with peers. We think the high conversion rate of offline seminars (20-30%) is a key reason for its low selling expenses ratio.

Figure 38: Feihe's POS penetration is unrivalled



Source: Company data, CMBIS estimates
*FY18 figure

Figure 39: Feihe's selling expenses greater than peers in FY19



Source: Company data, CMBIS estimates

Figure 40: Peer comparison

	Feihe	Ausnutria	H&H	A2 milk	Yashili
Stock code	6186 HK	1717 HK	1112 HK	A2M AU	1230 HK
Reporting currency	RMB	RMB	RMB	NZD	RMB
Operation metrics					
Financial year ended	31-Dec	31-Dec	31-Dec	30-Jun	31-Dec
Latest FY figures	FY19	FY19	FY19	FY20	FY19
Revenue (mn)	13,722	6,736	10,925	1,731	3,412
Revenue growth	32.0%	25.0%	7.8%	33.1%	13.3%
Adj. net profit (mn)	4,000	942	1,074	386	112
Adj. net profit growth	78.3%	62.0%	-18.8%	34.1%	114.9%
GPM (%)	70.0%	52.5%	66.2%	56.0%	37.1%
Selling expenses ratio	28.0%	26.3%	41.1%	13.7%	28.2%
- *A&P exp ratio*	*19.1%*	*11.6%*	*17.9%*	*11.2%*	*N/A*
- *non-A&P exp ratio*	*9.0%*	*14.7%*	*23.3%*	*2.5%*	*N/A*
G&A expenses ratio	5.5%	6.3%	5.8%	5.5%	6.5%
R&D expenses ratio	1.2%	2.0%	1.5%	0.3%	N/A
OP margin	40.8%	16.4%	17.9%	31.6%	0.5%
Tax rate (%)	30.8%	20.6%	35.8%	29.9%	N/A
Adj. NPM (%)	29.2%	14.0%	9.8%	22.3%	3.3%
ROAA	22.9%	12.4%	7.0%	31.4%	3.0%
ROAE	42.5%	25.9%	20.6%	40.2%	2.0%
Avg inventory turnover days	60	205	152	61	143
Latest number of POS *	119,000	22,858	51,548	19,100	20,000
Staff number	5,802	4,689	3,000	319	2,965

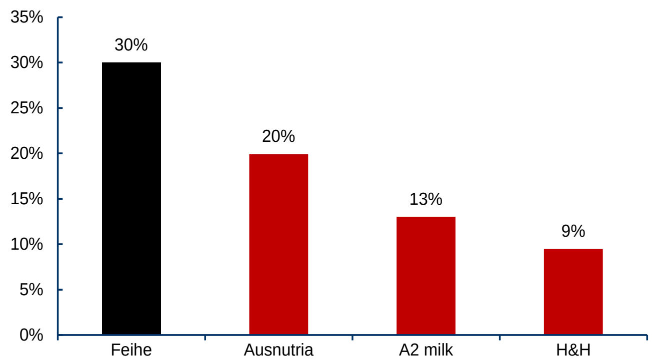
Source: Company data, CMBIS estimates
*Ausnutria's POS number was in FY18

Valuation

Stronger adj. EPS CAGR than peers in FY19-22E

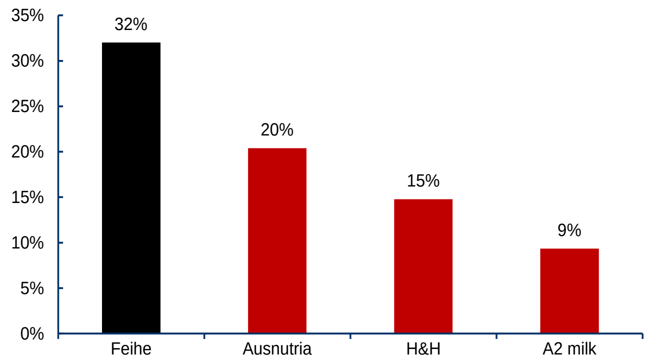
We estimate Feihe to post 32% CAGR of adj. EPS in FY19-22E, which is the highest among peers and greater than peers' average of 15%. The Company's 30% revenue CAGR is also the highest among peers.

Figure 41: Feihe's 30% revenue CAGR in FY19-22E was higher than peers



Source: Company data, Bloomberg estimates, CMBIS estimates

Figure 42: Feihe's 32% adj. EPS CAGR in FY19-22E was also greater than peers



Source: Company data, Bloomberg estimates, CMBIS estimates

Initiate at Buy with TP of HK$24.00

We set our TP of HK$24.00 based on 23.7x FY21E P/E, representing a 40% premium on Chinese IMF peers' average of 16.9x P/E in FY21E. We think Feihe is justified to trade at such premium to peers' valuation because (1) it is the Chinese IMF market leader which is gaining market share and (2) its 32% adj. EPS CAGR from FY19 to FY22E is the highest among peers.

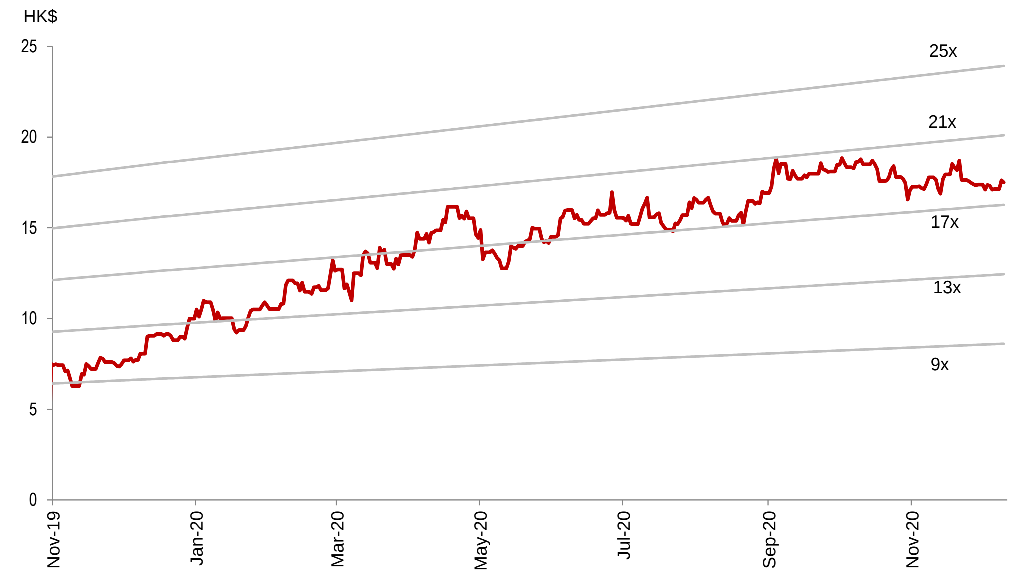
For cross-checking, our TP implied FY21E P/E is lower than A2 Milk's 26.2x P/E, whose adj. EPS CAGR is slower than Feihe. Also, our TP implied FY21E P/E is lower than dairy sector leaders' (Yili and Mengniu) P/E of 28-29x because China's number of new borns is decreasing and IMF market's customer life cycle is shorter than dairy sector. We think our TP is not aggressive.

Figure 43: Peers valuation table

	Stock code	Rating	Price	Mkt cap (LC/ US$mn)	Y/E	P/E (x) FY1	P/E (x) FY2	P/E (x) FY3	EPS growth (%) FY1	EPS growth (%) FY2	EPS growth (%) FY3	P/B (x) FY1	ROAE (%) FY1	FY0-3 EPS cagr	FY2 PEG
Feihe	6186 HK	Buy	17.50	156,333	Dec-19	23.5	18.2	14.9	47	29	22	7.8	38.4	32.4	0.6
A2 Milk	A2M AU	NR	10.77	7,998	Jun-19	21.4	26.2	22.0	33	(17)	19	7.4	40.2	9.3	2.8
Ausnutria	1717 HK	NR	12.36	21,209	Dec-19	16.0	12.4	10.2	11	29	22	3.2	22.3	20.4	0.6
H&H	1112 HK	NR	30.20	19,460	Dec-19	14.4	12.0	10.1	6	20	19	2.4	19.9	14.8	0.8
Chinese IMF						**18.8**	**17.2**	**14.3**	**24**	**15**	**21**	**5.2**	**30.2**	**19.2**	**1.2**
Chinese IMF - excluding Feihe						**17.3**	**16.9**	**14.1**	**16**	**11**	**20**	**4.3**	**27.5**	**14.8**	**1.4**
Yili	600887 CH	Buy	40.96	249,144	Dec-19	33.7	28.5	24.7	6	18	15	8.7	27.1	13.0	2.2
Mengniu	2319 HK	Buy	43.45	171,507	Dec-19	46.8	28.5	23.6	(17)	64	21	4.8	10.6	18.1	1.6
Bright Dairy	600597 CH	NR	17.09	20,926	Dec-19	39.1	33.4	27.9	7	17	20	3.6	8.9	14.3	2.3
Chinese Dairy						**39.9**	**30.2**	**25.4**	**(1)**	**33**	**19**	**5.7**	**15.5**	**15.1**	**2.0**
Nestle	NESN SW	NR	100.88	327,292	Dec-19	23.9	22.5	20.9	(3)	6	8	5.9	26.2	3.6	6.3
RB	RB/ LN	NR	65.48	62,594	Dec-19	20.1	20.6	18.8	(5)	(2)	9	4.5	22.9	0.7	30.7
Abbott	ABT US	NR	108.09	191,575	Dec-19	30.5	24.5	23.5	42	24	4	4.7	19.1	22.5	1.1
Danone	BN FP	NR	52.66	44,149	Dec-19	16.2	15.4	14.2	(11)	6	9	1.9	11.6	0.7	22.9
Fonterra	FSF NZ	NR	4.39	5,003	Jul-19	43.9	14.5	13.1	(79)	202	11	1.1	11.0	(10.8)	(1.4)
Meiji	2269 JP	NR	7190.00	10,620	Mar-20	15.2	14.6	14.1	2	4	4	1.7	11.6	3.2	4.6
Int'l IMF						**25.0**	**18.7**	**17.4**	**(9)**	**40**	**7**	**3.3**	**17.1**	**3.3**	**10.7**
Int'l IMF sector - excluding outliers														**9.8**	**4.0**

Source: Bloomberg estimates, CMBIS estimates

Figure 44: P/E band chart



Source: Company data, Bloomberg, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	**10,392**	**13,722**	**19,186**	**24,801**	**30,200**
High-end IMF	6,658	9,411	14,861	19,865	24,957
Regular IMF	2,542	3,127	3,377	3,546	3,723
Others	1,193	1,183	949	1,391	1,520
Cost of sales	(3,373)	(4,112)	(5,421)	(6,580)	(7,827)
Gross profit	7,019	9,610	13,765	18,222	22,372
Other income	466	814	1,128	663	536
Selling expenses	(3,661)	(3,848)	(5,526)	(6,845)	(8,275)
Admin expenses	(580)	(913)	(1,233)	(1,492)	(1,760)
Other expenses	(86)	(70)	(260)	(85)	(85)
EBIT	3,157	5,592	7,874	10,462	12,788
Finance income	90	163	285	300	369
Finance costs	(59)	(73)	(39)	(37)	(42)
JV & associates	0	0	(1)	(1)	(1)
Profit before tax	3,189	5,683	8,119	10,724	13,115
Income tax expense	(946)	(1,748)	(2,489)	(3,088)	(3,776)
Non-controlling interests	0	0	(8)	(119)	(140)
Net profit	2,242	3,935	5,883	7,603	9,284
Adj. net profit	2,244	4,000	5,883	7,603	9,284

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before tax	**3,189**	**5,683**	**8,379**	**10,809**	**13,200**
D&A	162	181	221	255	58
Net finance cost	(32)	(90)	(246)	(263)	(327)
Change in working capital	659	562	909	847	877
Others	(857)	(1,155)	(2,108)	(2,733)	(3,380)
Operating cash flow	**3,121**	**5,181**	**7,156**	**8,915**	**10,427**
Capex	(1,130)	(1,401)	(1,000)	(1,000)	(1,000)
Acqusitions	(176)	0	(1,848)	0	0
Others	(1,966)	(4,114)	960	0	0
Investing cash flow	**(3,272)**	**(5,515)**	**(1,887)**	**(1,000)**	**(1,000)**
Change of borrowings	752	2,957	(3,574)	0	0
Dividend paid	0	(2,704)	(2,674)	(2,556)	(3,014)
Equity raised	0	5,918	0	0	0
Others	(1,261)	(2,049)	3,193	(77)	(78)
Financing cash flow	**(509)**	**4,123**	**(3,055)**	**(2,633)**	**(3,092)**
Net change in cash	**(660)**	**3,789**	**2,214**	**5,283**	**6,335**
Cash at the beginning	1,566	896	4,667	6,881	12,163
Exchange difference	(9)	(18)	0	0	0
Cash at the end	**896**	**4,667**	**6,881**	**12,163**	**18,498**

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	**4,563**	**5,715**	**9,458**	**10,202**	**11,143**
PPE and ROU assets	2,861	4,348	5,128	5,873	6,815
Goodwill and intangible assets	48	48	48	48	48
JV and associates	143	143	148	148	147
Bank deposits	1,153	812	70	70	70
Others	358	364	4,063	4,063	4,063
Current assets	**7,295**	**17,289**	**17,836**	**23,440**	**30,107**
Inventories	660	686	904	1,098	1,306
Trade and other receivable	1,080	885	1,011	1,139	1,263
Others	1	0	1,497	1,497	1,497
Other deposits	4,658	11,050	7,543	7,543	7,543
Cash balance	896	4,667	6,881	12,163	18,498
Current liabilities	**4,860**	**7,439**	**6,500**	**7,664**	**8,869**
Trade payables	833	1,042	1,373	1,667	1,983
Other payables	2,478	2,631	3,552	4,428	5,320
Bank borrowings	1,083	3,094	345	345	345
Others	466	672	1,230	1,226	1,221
Non-current liabilities	**1,210**	**2,536**	**1,879**	**1,868**	**1,861**
Borrowings	657	1,716	892	892	892
Others	192	262	430	419	412
Deferred tax liabilities	361	557	557	557	557
Total net assets	**5,787**	**13,030**	**18,914**	**24,110**	**30,521**
Shareholders' equity	**5,787**	**13,030**	**17,636**	**22,714**	**28,984**
Non-controlling interests	**0**	**0**	**1,278**	**1,396**	**1,537**

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
High-end IMF	64.1	68.6	77.5	80.1	82.6
Regular IMF	24.5	22.8	17.6	14.3	12.3
Others	11.5	8.6	4.9	5.6	5.0
P&L ratios (%)					
Gross margin	67.5	70.0	71.7	73.5	74.1
EBIT margin	30.4	40.8	42.4	42.5	42.6
Net margin	21.6	28.7	30.7	30.7	30.7
Adj. net margin	21.6	29.2	30.7	30.7	30.7
Payout ratio	na	40.0	35.0	35.0	35.0
Balance sheet ratios					
Current ratio (x)	1.5	2.3	2.7	3.1	3.4
Quick ratio (x)	1.4	2.2	2.6	2.9	3.2
A/C rec turnover days	9	11	7	7	8
A/C payables turnover days	45	83	81	84	85
Inventory turnover days	36	60	54	56	56
Net cash (RMB mn)	4,966	11,718	13,257	18,540	24,875
Returns (%)					
Adj. ROAE	47.9	42.5	38.4	37.7	35.9
Adj. ROAA	23.8	22.9	23.4	25.3	25.2
Per share					
Adj. EPS (RMB)	na	0.45	0.66	0.85	1.04
DPS (HK$)	na	0.19	0.26	0.36	0.43
BVPS (RMB)	na	1.46	1.97	2.54	3.24

Source: Company data, CMBIS estimates

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