

China Feihe (6186 HK)

Accelerate development of kids and adult milk powder

FY20 adj. NP soared 48% to RMB6,045mn, 7%/3% above consensus/our estimates due to higher GPM and lower SG&A expense ratio. Feihe further extended its lead in China's IMF market with market share rising from 12.3% in 2019 to 15.6% in 2020. It will accelerate development of functional kids and adult milk powder and upgrade its super-premium portfolio. The further product segmentation and premiumization should help Feihe to achieve its revenue target of RMB35bn in 2023E. Furthermore, the new food national standards (become effective in Feb 2023) would raise the requirements of infant foods, which should accelerate sector consolidation. Our TP was lifted from HK\$24.00 to HK\$27.10.

- **Set long-term growth targets.** Feihe targets to grow its revenue to RMB35bn in 2023E (23% CAGR in FY20-23E) and achieve revenue CAGR of 15% from 2024E to 2028E based on China's IMF market and future pipeline products. Amid China's declining number of newborns, Feihe will accelerate its development in functional kids (Stage 4 milk powder) and adult milk powder and continue to gain market share to keep its revenue growth.
- **Stage 4 milk powder a sensible move.** Its Stage 3 milk powder, which accounted for 53% of its IMF sales, is the largest IMF category. Stage 4 milk powder could extend IMF product life-cycle. Also, China's number of new borns peaked in 2016, and 2017 brings opportunity for Stage 4 milk powder. Management said that market size of Stage 4 milk powder was RMB13bn and it is estimated to grow by >40% this year. Through in-depth cooperation with maternity and baby stores (MBS), Feihe could educate parents about the advantages of Stage 4 milk powder.
- **Launch premium adult milk powder in 2H21.** Feihe will launch two new products (produced domestically and made in Canada) in 2H21 to capture opportunities from aging population. Management said that market size of adult milk was RMB20bn and it is expected to grow at 10% YoY.
- **New product pipeline.** Apart from kids and adult milk products, Feihe will launch a super-premium plus Astrobaby Platinum in Aug 2021. Also, it will upgrade the formula of Zhenzhi Organic in 1H21 and launch a super-premium goat milk IMF in Jan 2022 (Figure 2).
- **Maintain Buy.** We lift FY21/22E adj. NP by 2% to factor in better GPM and SG&A expenses ratio. Our TP was lifted from HK\$24.00 to HK\$27.10, which is based on 26.1x FY21E P/E, at 50% premium (vs 40% before) on Chinese IMF peers' average of 17.4x P/E in FY21E. Feihe will develop kids and adult milk powder to accelerate its growth. We think Feihe deserves a higher valuation premium over peers because of stronger revenue growth (26% CAGR in FY20-22E vs peers' 9%). **Key risks:** (1) weaker-than-expected sales; (2) slump of China's newborns; (3) keen competition and (4) food safety issues.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	13,722	18,592	23,941	29,459	34,473
YoY growth (%)	32	35	29	23	17
Net profit (RMB mn)	3,935	7,436	7,692	9,444	11,127
Adj. net profit (RMB mn)	4,072	6,045	7,762	9,484	11,127
Adj. EPS (RMB)	0.456	0.677	0.869	1.062	1.246
YoY growth (%)	na	48	28	22	17
Consensus EPS (RMB)	na	na	0.830	1.013	1.265
Adj. P/E (x)	42.6	28.9	21.2	17.4	14.8
P/B (x)	13.3	9.8	7.2	5.7	4.6
Yield (%)	0.9	1.3	1.9	2.3	2.7
Net cash (RMB mn)	11,718	15,234	21,265	28,079	35,781

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **HK\$27.10**
 (Previous TP **HK\$24.00**)
 Up/Downside **+23%**
 Current Price **HK\$22.00**

China Dairy Sector

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Stock Data

Mkt Cap (HK\$ mn)	196,533
Avg 3 mths t/o (HK\$ mn)	653.54
52w High/Low (HK\$)	25.70/ 10.28
Total Issued Shares (mn)	8,933.3

Source: Bloomberg

Shareholding Structure

Leng Youbin	49.90%
Morgan Stanley	10.72%

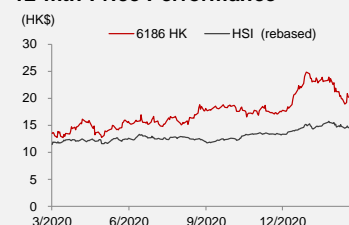
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-6.3%	-2.5%
3-mth	25.7%	13.3%
6-mth	16.4%	-3.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

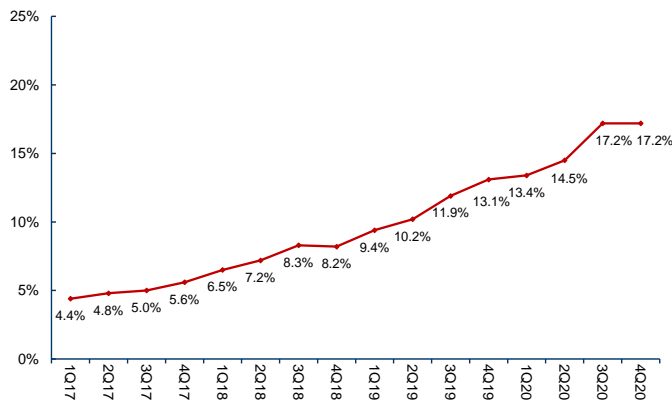
Auditor: Ernst & Young

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"China Feihe – Well positioned to gain market share" – 23 Dec 2020

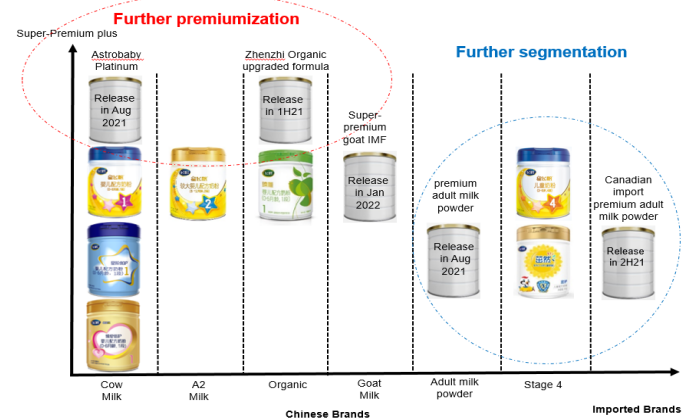
Focus Charts

Figure 1: Feihe gained more market share in 2020



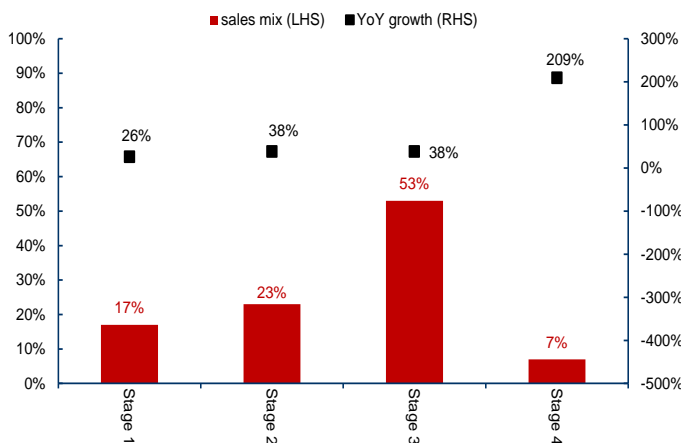
Source: Nielsen, Company

Figure 2: Further premiumization and segmentation of product portfolio



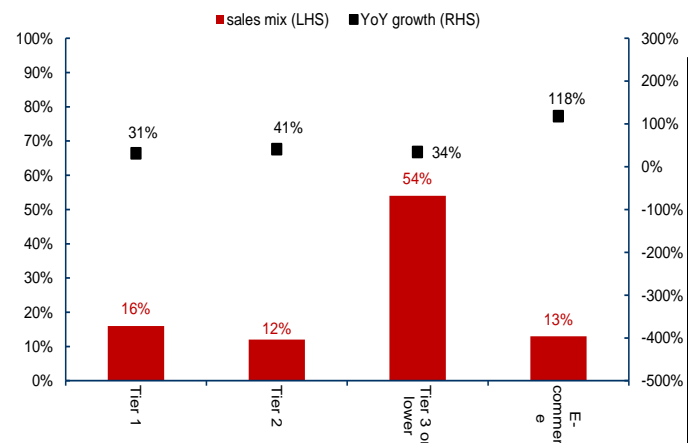
Source: Company data, CMBIS estimates
*FY18 figure

Figure 3: High stage 3 IMF sales mix supports Feihe to expand stage 4 IMF sales in FY20



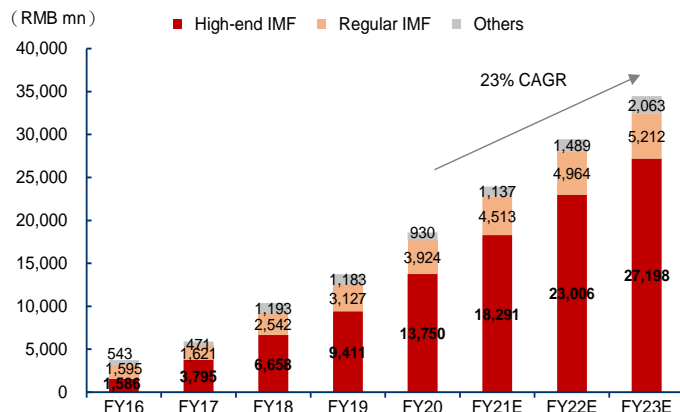
Source: Company data, CMBIS estimates

Figure 4: Sales breakdown by tier of cities and E-commerce in FY20



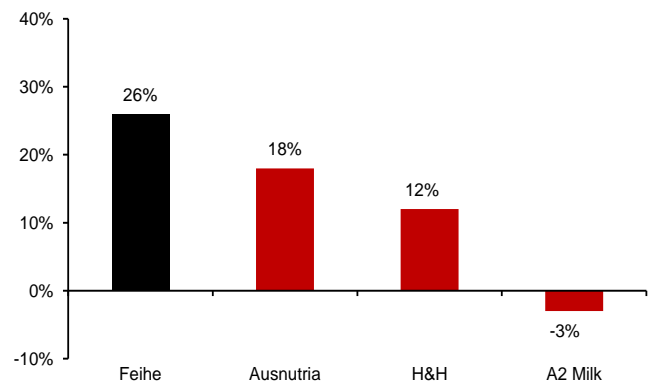
Source: Company, Tmall, CMBIS

Figure 5: 23% CAGR of revenue in FY20-23E



Source: Company data, CMBIS estimates

Figure 6: Feihe's 26% adj. EPS CAGR in FY20-22E was greater than peers



Source: Company data, Bloomberg estimates, CMBIS estimates

Results highlights

Revenue jumped 35% to RMB18,592mn despite further decline of newborns in China. IMF sales jumped 41% to RMB17,674mn led by 46% growth in high-end and 25% growth in regular. According to Nielsen, Feihe further extended its lead in China's IMF market with market share rising from 12.3% in 2019 to 15.6% in 2020. The spread between the No.2 increased by 4.8ppt to 6.2ppt. Management thinks its market share in super-premium IMF was >40% and it took market share from foreign brands.

GPM widened by 2.5ppt to 72.5%, led by 1.7ppt GPM expansion of IMF to 74.1% and 3.8ppt GPM expansion of other dairy products to 38.5%. By product, GPM of Astrobaby was largely stable at 79%. GPM of Zhenzhi Organic/premium/regular rose to 69.4%/71.2%/65.4%, according to management.

Selling expense increased 37% with expenses ratio advanced 0.3ppt to 28.3%. Number of seminars held increased from 500,000 in FY19 to 700,000 in FY20.

Administrative expenses climbed 27% with expenses ratio narrowed 0.5ppt to 6.2%. The growth was led by 55% growth of R&D expenses. Feihe will build Feihe Research Institute with more innovative and leading capacity, build a higher-level scientific research platform, carry out in-depth research and exploration on nutrition and health in the whole life-cycle.

Figure 7: FY20 results review

Y/E Dec (RMB mn)	FY20	FY19	% change	Remarks
Revenue	18,592	13,722	35%	IMF revenue +41%
Cost of sales	(5,112)	(4,112)	24%	
Gross profit	13,480	9,610	40%	
Other income and gains/(losses)	1,077	814	32%	government grant +38% to RMB998mn
Selling and distribution expenses	(5,263)	(3,848)	37%	
Administrative expenses	(1,161)	(913)	27%	R&D exp +55% to RMB265mn
Other expenses	(231)	(70)	231%	
EBIT	7,901	5,592	41%	
Finance income	338	163	107%	
Finance costs	(50)	(73)	-31%	
Others	1,717	na	na	Acquisition of YST recorded RMB1.7bn gain on bargain purchase
Associate	(6)	na	na	
Profit before tax	9,900	5,683	74%	
Tax expense	(2,464)	(1,748)	41%	
Net profit	7,437	3,935	89%	
Adj. net profit	6,045	4,072	48%	
Adj. EPS (RMB)	0.68	0.46	48%	
Margin & Ratio (%)				
Gross margin	72.5	70.0	2.5	led by 1.7ppt/3.8ppt GPM expansion of IMF/other dairy products
EBIT margin	42.5	40.8	1.7	
SG&A expenses ratio	34.6	34.7	(0.1)	
Adj. net margin	32.5	29.7	2.8	
Effective tax rate	24.9	30.8	(5.9)	
Payout ratio	37.8	38.7	(0.8)	
	FY20	FY19	change	
Inventory days	70	60	10	
A/C receivables days	6	11	(5)	
A/C payable days	78	83	(5)	
Net cash (RMBmn)	15,234	11,718	30%	

Source: Company data, CMBIS

Earnings Revision

Figure 8: Earnings revision

RMB mn	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	23,941	29,459	34,473	24,801	30,200	na	-3%	-2%	na
Gross Profit	17,873	22,051	25,895	18,222	22,372	na	-2%	-1%	na
EBIT	10,615	13,022	15,312	10,547	12,873	na	1%	1%	na
Adj. Net profit	7,762	9,484	11,127	7,603	9,284	na	2%	2%	na
Gross Margin	74.7%	74.9%	75.1%	73.5%	74.1%	na	+1.2ppt	+0.8ppt	na
EBIT Margin	44.3%	44.2%	44.4%	42.5%	42.6%	na	+0.8ppt	+1.6ppt	na
Adj. Net Margin	32.4%	32.2%	32.3%	30.7%	30.7%	na	+1.7ppt	+1.5ppt	na

Source: CMBIS estimates

Figure 9: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	23,941	29,459	34,473	24,326	29,989	33,230	-2%	-2%	4%
Gross Profit	17,873	22,051	25,895	17,512	21,675	23,992	2%	2%	8%
EBIT	10,615	13,022	15,312	10,153	12,473	14,951	5%	4%	2%
Adj. Net profit	7,762	9,484	11,127	7,335	9,080	10,928	6%	4%	2%
Gross Margin	74.7%	74.9%	75.1%	72.0%	72.3%	72.2%	+2.7ppt	+2.6ppt	+2.9ppt
EBIT Margin	44.3%	44.2%	44.4%	41.7%	41.6%	45.0%	+1.6ppt	+2.8ppt	-0.6ppt
Adj. Net Margin	32.4%	32.2%	32.3%	30.2%	30.3%	32.9%	+2.2ppt	+1.9ppt	-0.6ppt

Source: CMBIS estimates, Bloomberg estimates

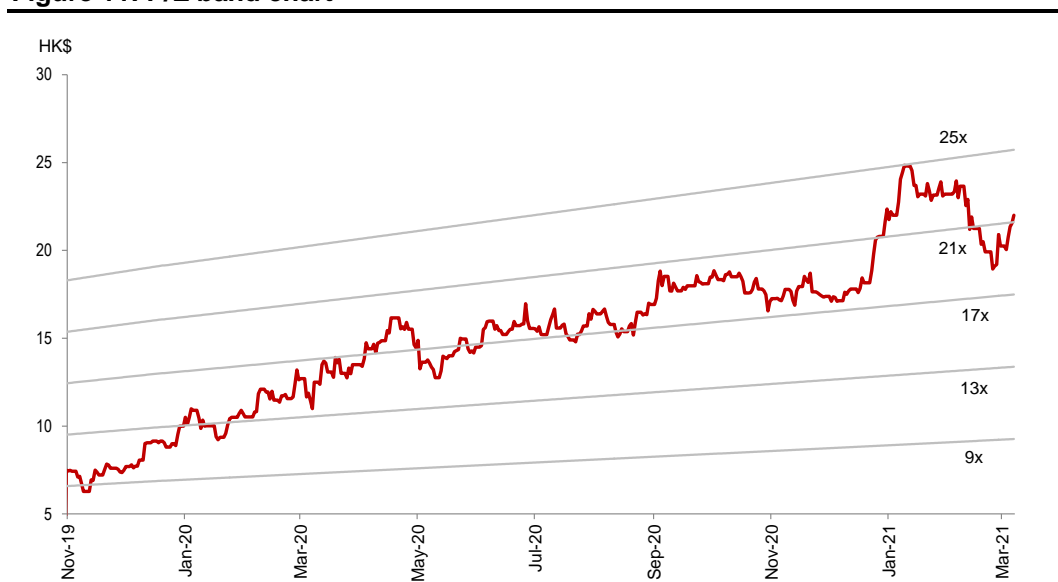
Valuation

Figure 10: Peers valuation table

	Stock code	Rating	Price	Mkt cap (LC/US\$mn)	Y/E	P/E (x)			EPS growth (%)			P/B (x)	ROAE (%)	FY0-3 EPS cagr	FY2 PEG	FY0-2 rev cagr
Feihe	6186 HK	Buy	22.00	196,533	Dec-19	28.9	21.2	17.4	51	28	22	7.2	38.2	32.6	0.7	26
A2 Milk	A2M AU	NR	8.45	6,282	Jun-19	16.8	28.8	24.2	33	(40)	19	5.8	40.2	-2.0	(14.7)	(3)
Ausnutria	1717 HK	NR	11.00	18,876	Dec-19	15.3	11.8	9.6	12	19	23	2.9	21.9	17.8	0.7	18
H&H	1112 HK	NR	29.85	19,239	Dec-19	14.2	11.8	10.0	5	21	17	2.3	20.0	14.3	0.8	12
Chinese IMF						18.8	18.4	15.3	25	7	20	4.6	30.0	15.7	(3.1)	14
Chinese IMF - excluding Feihe						15.4	17.4	14.6	16	(0)	20	3.7	27.3	10.0	(4.4)	9
Yili	600887 CH	Buy	38.96	236,979	Dec-19	32.0	27.1	23.5	6	18	15	8.3	27.1	13.0	2.1	11
Mengniu	2319 HK	Buy	44.35	175,102	Dec-19	47.7	29.1	24.1	(17)	64	21	4.9	10.6	18.1	1.6	13
Bright Dairy	600597 CH	NR	17.07	20,902	Dec-19	39.0	33.1	28.1	7	18	18	3.6	8.7	14.0	2.4	4
Chinese Dairy						39.6	29.8	25.2	(1)	33	18	5.6	15.5	15.0	2.0	9
Nestle	NESN SW	NR	102.80	318,699	Dec-19	24.3	23.4	22.0	(3)	4	7	6.0	26.3	2.6	9.1	1
RB	RB/ LN	NR	63.14	62,491	Dec-19	19.3	20.6	18.7	(4)	(6)	10	4.3	23.8	(0.4)	(53.8)	(0)
Abbott	ABT US	NR	120.25	213,026	Dec-19	33.8	23.8	22.4	42	42	7	5.3	19.1	29.1	0.8	11
Danone	BN FP	NR	59.02	48,261	Dec-19	18.2	17.8	16.2	(11)	2	10	2.1	11.6	0.1	139.3	2
Fonterra	FSF NZ	NR	5.05	5,844	Jul-19	50.5	16.6	14.8	(79)	204	13	1.1	11.0	(10.1)	(1.7)	2
Meiji	2269 JP	NR	7160.00	10,041	Mar-20	15.6	15.2	14.7	(1)	3	3	1.7	11.4	1.5	10.0	2
Int'l IMF						26.9	19.6	18.1	(9)	41	8	3.4	17.2	3.8	17.3	3
Int'l IMF sector - excluding outliers														11.1	6.7	5

Source: Bloomberg estimates, CMBIS estimates

Figure 11: P/E band chart



Source: Company data, Bloomberg, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	13,722	18,592	23,941	29,459	34,473
High-end IMF	9,411	13,750	18,291	23,006	27,198
Regular IMF	3,127	3,924	4,513	4,964	5,212
Others	1,183	930	1,137	1,489	2,063
Cost of sales	(4,112)	(5,112)	(6,068)	(7,408)	(8,578)
Gross profit	9,610	13,480	17,873	22,051	25,895
Other income	814	1,077	858	840	748
Selling expenses	(3,848)	(5,263)	(6,680)	(8,190)	(9,446)
Admin expenses	(913)	(1,161)	(1,436)	(1,680)	(1,886)
Other expenses	(70)	(231)	(85)	(85)	(85)
EBIT	5,592	7,901	10,530	12,937	15,227
Finance income	163	338	391	469	556
Finance costs	(73)	(50)	(35)	(40)	(40)
Gain on bargain purchase	0	1,730	0	0	0
FV change of biological assets	0	(12)	0	0	0
JV & associates	0	(6)	(6)	(6)	(6)
Profit before tax	5,683	9,900	10,881	13,360	15,737
Income tax expense	(1,748)	(2,464)	(3,174)	(3,879)	(4,558)
Non-controlling interests	0	(0)	(101)	(122)	(136)
Net profit	3,935	7,436	7,692	9,444	11,127
Adj. net profit	4,072	6,045	7,762	9,484	11,127

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Profit before tax	5,683	9,900	10,966	13,445	15,822
D&A	181	-	340	369	397
Net finance cost	(90)	-	(357)	(429)	(516)
Change in working capital	562	-	1,493	1,283	1,165
Others	(1,155)	-	(2,677)	(3,336)	(3,966)
Operating cash flow	5,181	7,748	9,765	11,333	12,901
Capex	(1,401)	-	(1,000)	(1,000)	(1,000)
Acquisitions	0	-	0	0	0
Others	(4,114)	-	0	0	0
Investing cash flow	(5,515)	(3,787)	(1,000)	(1,000)	(1,000)
Change of borrowings	2,957	-	0	0	0
Dividend paid	(2,704)	-	(2,613)	(3,402)	(4,090)
Equity raised	5,918	-	0	0	0
Others	(2,049)	-	(121)	(117)	(109)
Financing cash flow	4,123	(2,543)	(2,734)	(3,519)	(4,199)
Net change in cash	3,789	1,419	6,031	6,814	7,702
Cash at the beginning	896	4,667	6,085	12,117	18,930
Exchange difference	(18)	0	0	0	0
Cash at the end	4,667	6,085	12,117	18,930	26,632

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	5,715	9,778	10,421	11,035	11,622
PPE and ROU assets	4,348	7,563	8,223	8,854	9,457
Goodwill and intangible assets	48	48	48	48	48
JV and associates	143	143	138	132	127
Bank deposits	812	0	0	0	0
Others	364	2,024	2,012	2,001	1,990
Current assets	17,289	18,544	24,594	31,763	39,778
Inventories	686	1,284	1,220	1,489	1,724
Trade and other receivable	885	846	929	1,015	1,092
Others	0	0	0	0	0
Other deposits	11,050	10,329	10,329	10,329	10,329
Cash balance	4,667	6,085	12,117	18,930	26,632
Current liabilities	7,439	7,107	8,609	10,238	11,708
Trade payables	1,042	1,133	1,345	1,642	1,901
Other payables	2,631	4,518	5,817	7,158	8,377
Bank borrowings	3,094	448	448	448	448
Others	672	1,008	999	990	982
Non-current liabilities	2,536	2,030	1,971	1,922	1,880
Borrowings	1,716	732	732	732	732
Others	262	514	455	405	364
Deferred tax liabilities	557	784	784	784	784
Total net assets	13,030	19,186	24,435	30,639	37,812
Shareholders' equity	13,030	17,747	22,895	28,978	36,015
Non-controlling interests	0	1,438	1,539	1,661	1,797

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
High-end IMF	68.6	74.0	76.4	78.1	78.9
Regular IMF	22.8	21.1	18.8	16.8	15.1
Others	8.6	5.0	4.8	5.1	6.0
P&L ratios (%)					
Gross margin	70.0	72.5	74.7	74.9	75.1
EBIT margin	40.8	42.5	44.3	44.2	44.4
Net margin	28.7	40.0	32.1	32.1	32.3
Adj. net margin	29.7	32.5	32.4	32.2	32.3
Payout ratio	38.7	37.8	40.0	40.0	40.0
Balance sheet ratios					
Current ratio (x)	2.3	2.6	2.9	3.1	3.4
Quick ratio (x)	2.2	2.4	2.7	3.0	3.3
A/C rec turnover days	11	6	5	5	5
A/C payables turnover days	83	78	75	74	75
Inventory turnover days	60	70	75	67	68
Net cash (RMB mn)	11,718	15,234	21,265	28,079	35,781
Returns (%)					
Adj. ROAE	43.3	39.3	38.2	36.6	34.2
Adj. ROAA	22.6	29.0	24.6	24.6	23.9
Per share					
Adj. EPS (RMB)	0.46	0.68	0.87	1.06	1.25
DPS (HK\$)	0.19	0.30	0.41	0.50	0.59
BVPS (RMB)	1.46	1.99	2.56	3.24	4.03

Source: Company data, CMBIS estimates

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