

Mengniu (2319 HK)

2H20E guidance reaffirmed

MN reported 42% NP decline to RMB1,212mn in 1H20, beating its profit alert range of 45-60% decline on strong Jun sales and CMD results. Mgmt. maintained its 2H20E guidance of not less than low-teens revenue and 0.3-0.5ppt OPM expansion. 3Q20-to-date revenue growth was on track. Maintain Buy because growth momentum resumed to pre-epidemic period, evidenced by strong recovery in 2Q20. 3Q20-to-date revenue growth was on track. Our TP is lifted from HK\$37.90 to HK\$42.00, representing 28.0x FY21E P/E (vs 28.0x sum of 2HFY20E and 1HFY21E EPS previously).

- **Strong recovery seen in 2Q20.** Revenue fell 6% to RMB37,534mn in 1H20. If excluding Junlebao's disposal and Bellamy's acquisition in 2H19, organic revenue increased by 9% to RMB36,888mn in 1H20. In 1Q20, organic revenue growth was flat and MN recorded net loss of RMB127mn because of donation, extra expenses for marketing and epidemic-related. The business strongly recovered in 2Q20 with 19% organic revenue growth (channel restocking and more milk consumption to improve immunity) and 86% surge of NP on operating leverage (Figure 1).
- **Focus on high-end products to improve margins. (1) Milk Deluxe:** It achieved 19% growth in 1H20. It launched an upgraded version of 3.8g protein in May. Brand sales growth accelerated to 30%+ in 2Q20. High-margin "DreamCap" sales mix increased to 25% from high-teens in FY19. **(2) Chilled fresh milk:** Sales up 98% in 1H20 though Wuhan market was hit by COVID-19. High-margin "Shiny Meadow" sales mix rose 10ppt to 35%. **(3) IMF:** Yashili optimized its product portfolio in 1Q20 and focused on Reeborn new products. 2Q20 revenue +25% (vs -6% in 1H) with NPM improvement. Management targets 20-25% growth in 2H20E. Bellamy's launched super high-end organic cow and goat milk IMF in Australia in 2Q20 and launched Chinese version organic IMF this month. **(4) Profitability of ice-cream and cheese** increased significantly YoY in 1H20 due to improved product mix and products upgrade.
- **Control selling expenses ratio.** The Company will adopt build RTM strength (promote Smart Network system to distributors and channel penetration into town and villages), digitalization (facilitate precise communication with consumers) and consumer-centric full chain cost savings (product innovation and design led by consumer insights, cross-BU cost-cutting project team) to improve efficiency.
- **Maintain Buy.** We fine tuned our FY20/21/22E NP estimates by +2%/1%/1% as we raised FY20/21/22E revenue estimates by 3%/2%/2%. **Catalysts:** better-than-expected revenue and margins; **Risks:** slower-than-expected recovery and food safety issues.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	68,977	79,030	76,734	86,875	97,263
YoY growth (%)	15	15	(3)	13	12
Net profit (RMB mn)	3,043	4,105	3,232	5,300	6,402
Adj. net profit (RMB mn)	2,942	3,867	3,232	5,300	6,402
Adjusted EPS (RMB)	0.754	0.988	0.821	1.346	1.626
YoY growth (%)	43	31	(17)	64	21
Consensus EPS (RMB)	na	na	0.847	1.270	1.522
Adjusted P/E (x)	39.8	32.2	38.8	23.7	19.6
P/B (x)	4.7	4.3	4.0	3.5	3.0
Yield (%)	0.6	0.6	0.6	1.0	1.2

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$42.00
(Previous TP)	HK\$37.90
Up/Downside	+18%
Current Price	HK\$30.80

China F&B Sector

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Stock Data

Mkt Cap (HK\$ mn)	140,060
Avg 3 mths t/o (HK\$ mn)	372.94
52w High/Low (HK\$)	38.10/ 24.19
Total Issued Shares (mn)	3,935.0
Source: Bloomberg	

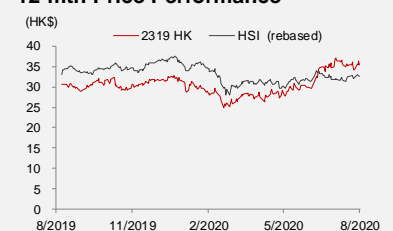
Shareholding Structure

COFCO	16.3%
Danone	9.9%
Arla	5.3%
Source: HKEx	

Share Performance

	Absolute	Relative
1-mth	5.2%	1.9%
3-mth	25.0%	14.7%
6-mth	28.3%	34.4%
Source: Bloomberg		

12-mth Price Performance



Source: Bloomberg

Auditor: EY

Related reports

1. "Mengniu – Profit warning removes overhang; recovery ahead of guidance" – 10 Jun 2020
2. "Mengniu – Sales recovery ahead of expectation" – 22 May 2020
3. "Mengniu – Resume double-digit revenue growth in 2H20E" – 27 Mar 2020
4. "Mengniu – Acquisition to access raw milk supply and become regional player" – 26 Nov 2019

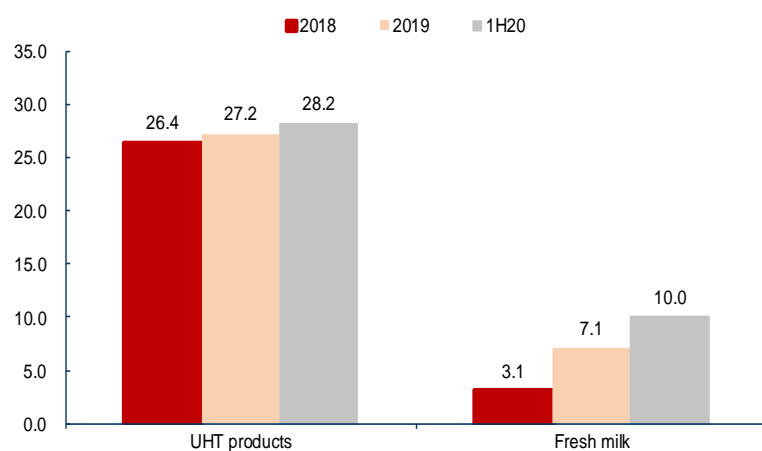
Figure 1: 1H20 results review

Y/E Dec (RMB mn)	Comparable business		%	Actual		%	Remarks
	1H20	1H19		1H20	1H19		
Revenue	36,888	33,714	9%	37,533	39,857	-6%	organic revenue +9% led by Milk Deluxe +19%, MN plain milk +25%, Fruit Milk Drink +11%. While UHT milk saw strong growth as consumers sought to increase immunity, UHT yogurt sales dropped
Cost of sales	(22,531)	(20,490)	10%	(22,881)	(24,279)	-6%	
Gross profit	14,357	13,224	9%	14,652	15,579	-6%	
Other income and gains	na	na	na	296	293	1%	additional marketing expenses to destock channel inventory
S&D expenses *	(11,500)	(9,533)	21%	(11,500)	(11,318)	2%	
Administrative expenses *	(1,439)	(1,367)	5%	(1,439)	(1,586)	-9%	
Other expenses	na	na	na	(1,054)	(664)	59%	donation exp jumped from RMB9mn to RMB446mn
Operating profit	na	na	na	956	2,304	-58%	
Finance income	na	na	na	564	511	10%	China Modern Dairy NP +77%
Finance costs	na	na	na	(324)	(322)	1%	
Associates/JV	na	na	na	206	103	100%	
Profit before tax	na	na	na	1,402	2,596	-46%	Around RMB1.8bn one-off and inventory destocking and epidemic-related expenses in 1H20
Tax expense	na	na	na	(268)	(435)	-39%	
Profit after tax	na	na	na	1,135	2,161	-47%	Junlebao business disposed in 2H19
Non-controlling interests	na	na	na	77	(84)	-192%	
Net profit	1,158	2,002	-42%	1,212	2,077	-42%	Junlebao contributed RMB77mn NP in 1H19; Bellamy's contributed RMB53mn NP in 1H20
Margin & Ratio (%)							
Gross margin	38.9	39.2	(0.3)	39.0	39.1	(0.1)	
Operating margin	na	na	na	2.5	5.8	(3.3)	
SG&A expenses ratio	35.1	32.3	2.8	34.5	32.4	2.1	
A&P expenses ratio	na	na	na	12.2	12.2	0.0	
Staff expenses ratio	na	na	na	7.9	8.6	(0.7)	
Net margin	3.1	5.9	(2.8)	3.2	5.2	(2.0)	
	1H20	1H19	change	1H20	1H19	change	
Inventory days	na	29	na	36	31	5	
A/C receivables days	na	18	na	19	17	2	
A/C payable days	na	55	na	59	59	0	

Source: Company data, CMBIS

Comparable business excluded Junlebao/Bellamy's businesses in 1H19/1H20

* 1H20 S&D and admin exp of comparable business included Bellamy's

Figure 2: Increasing market shares

Source: Nielsen

Figure 3: Retail price of Milk Deluxe (250mL*12) was RMB49.9 in a supermarket in Hunan in mid-Aug



Source: CMBIS

Figure 4: Retail price of Just Yoghurt original flavour (200g*12) was RMB46.8 in a supermarket in Hunan in late Aug



Source: CMBIS

Figure 5: Earnings revision

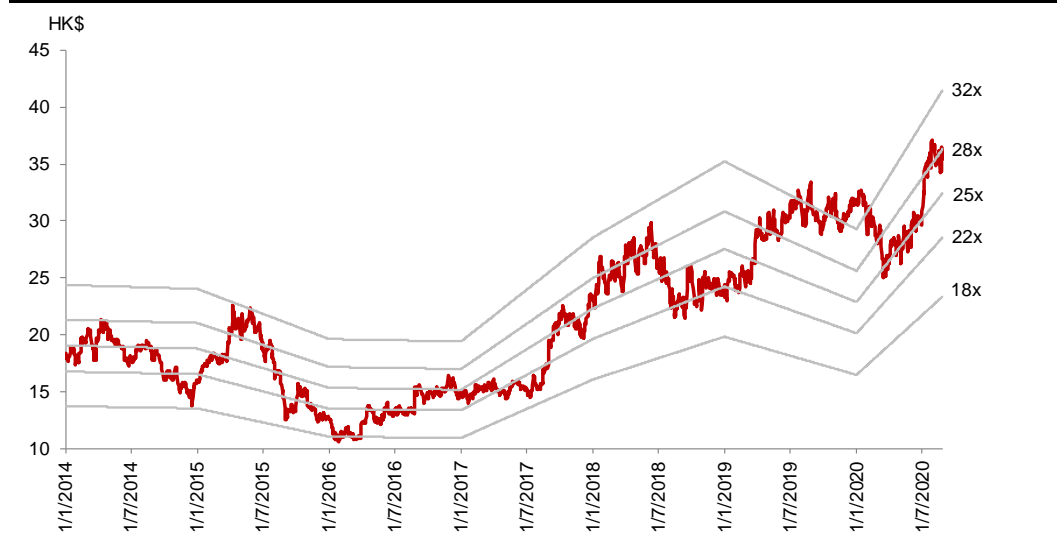
US\$ mn	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	76,734	86,875	97,263	74,513	85,337	95,293	3%	2%	2%
Gross Profit	28,910	33,258	37,418	27,758	32,263	36,172	4%	3%	3%
Operating Profit	3,202	5,370	6,447	3,182	5,418	6,521	1%	-1%	-1%
Adjusted Net Profit	3,232	5,300	6,402	3,184	5,247	6,348	2%	1%	1%
Gross Margin	37.7%	38.3%	38.5%	37.3%	37.8%	38.0%	+0.4ppt	+0.5ppt	+0.5ppt
Operating Margin	4.2%	6.2%	6.6%	4.3%	6.3%	6.8%	-0.1ppt	-0.1ppt	-0.2ppt
Adjusted Net Margin	4.2%	6.1%	6.6%	4.3%	6.1%	6.7%	-0.1ppt	flat	-0.1ppt

Source: Company data, CMBIS estimates

Figure 6: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	76,734	86,875	97,263	75,029	86,615	96,846	2%	0%	0%
Gross Profit	28,910	33,258	37,418	27,813	32,932	37,158	4%	1%	1%
Operating Profit	3,202	5,370	6,447	3,591	5,641	6,845	-11%	-5%	-6%
Adj. Net profit	3,232	5,300	6,402	3,282	4,952	5,947	-2%	7%	8%
Gross Margin	37.7%	38.3%	38.5%	37.1%	38.0%	38.4%	+0.6ppt	+0.3ppt	+0.1ppt
Operating Margin	4.2%	6.2%	6.6%	4.8%	6.5%	7.1%	-0.6ppt	-0.3ppt	-0.5ppt
Adj. Net Margin	4.2%	6.1%	6.6%	4.4%	5.7%	6.1%	-0.2ppt	+0.4ppt	+0.5ppt

Source: Bloomberg, CMBIS estimates

Figure 7: 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	76,734	86,875	97,263
Liquid milk	59,389	67,878	68,102	76,949	86,093
Ice-cream	2,723	2,561	2,613	2,743	2,798
Milk powder	6,017	7,870	5,119	6,013	6,851
Others	848	721	900	1,170	1,521
Cost of sales	(43,193)	(49,351)	(47,824)	(53,618)	(59,845)
Gross profit	25,784	29,679	28,910	33,258	37,418
Other income and gains	635	769	601	613	665
Selling expenses	(18,833)	(21,536)	(21,639)	(23,934)	(26,553)
Administration expenses	(2,915)	(3,319)	(3,223)	(3,649)	(4,085)
Other expenses	(936)	(1,482)	(1,448)	(918)	(998)
EBIT	3,734	4,110	3,202	5,370	6,447
Finance income, net	318	461	438	627	781
Others	101	860	0	0	0
JV & associates	(300)	184	296	385	493
Pre-tax profit	3,853	5,615	3,936	6,381	7,721
Income tax	(649)	(1,310)	(692)	(1,019)	(1,229)
Less: Minority interests	(161)	(190)	17	(32)	(61)
Net profit	3,043	4,115	3,262	5,330	6,432
Adjusted net profit	2,942	3,867	3,232	5,300	6,402

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before tax	3,853	5,605	3,906	6,351	7,691
Associates & JV	300	(175)	(296)	(385)	(493)
D&A	1,838	2,260	1,779	1,972	2,108
Change in working capital	1,653	452	747	716	820
Others	(1,280)	(1,835)	(1,811)	(2,243)	(2,607)
Operating cash flow	6,363	6,307	4,325	6,411	7,519
Capex	(3,149)	(4,318)	(4,000)	(3,000)	(3,000)
Acquisitions	(309)	(6,686)	(458)	0	0
Others	(773)	(6,525)	2,519	(776)	(622)
Investing cash flow	(4,232)	(17,530)	(1,939)	(3,776)	(3,622)
Change of borrowing	(383)	11,791	2,192	0	0
Dividend paid	(526)	(1,374)	(712)	(743)	(1,219)
Others	8	197	0	0	0
Financing cash flow	(900)	10,614	1,480	(743)	(1,219)
Net change in cash	1,231	(608)	3,866	1,892	2,678
Cash at the beginning	3,129	4,370	3,798	7,664	9,555
Forex effect	10	36	0	0	0
Cash at disposal groups	0	0	0	0	0
Cash at the end	4,370	3,798	7,664	9,555	12,234
Time deposit	2,927	2,678	2,678	2,678	2,678
Cash and cash equivalent	7,298	6,476	10,342	12,233	14,912

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	36,716	41,052	44,628	46,041	47,426
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	8,246	8,631	9,124
Others	7,800	10,155	11,119	11,108	11,026
Current assets	29,741	37,486	40,849	46,422	52,858
Cash	7,298	6,476	10,342	12,233	14,912
Pledged deposit	623	74	74	74	74
Inventory	4,282	5,090	5,741	6,437	7,184
Trade receivables	2,892	3,587	4,046	4,580	5,128
Others	14,646	22,259	20,646	23,097	25,559
Current liabilities	25,109	31,734	31,156	33,553	36,130
Borrowings	6,523	13,838	11,015	11,015	11,015
Trade payables	7,022	6,739	7,601	8,522	9,511
Other payables	10,889	10,808	12,190	13,667	15,255
Others	675	349	349	349	349
Non-current liabilities	10,884	13,456	18,472	18,472	18,472
Borrowings	8,192	9,635	14,650	14,650	14,650
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	35,849	40,438	45,682
Shareholders' equity	25,212	29,132	31,652	36,208	41,391
Non-controlling interests	5,252	4,215	4,198	4,230	4,291

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Liquid milk	86.1	85.9	88.8	88.6	88.5
Ice-cream	3.9	3.2	3.4	3.2	2.9
Milk powder	8.7	10.0	6.7	6.9	7.0
Others	1.2	0.9	1.2	1.3	1.6
P&L ratios (%)					
Gross margin	37.4	37.6	37.7	38.3	38.5
EBIT margin	5.4	5.2	4.2	6.2	6.6
Net margin	4.4	5.2	4.2	6.1	6.6
Adjusted net margin	4.3	4.9	4.2	6.1	6.6
Payout ratio	23.2	17.3	23.0	23.0	23.0
Balance sheet ratios					
Current ratio (x)	1.2	1.2	1.3	1.4	1.5
A/C receivables days	15	15	18	18	18
A/C payables days	56	51	55	55	55
Inventory days	33	35	41	41	42
Asset turnover (x)	1.0	1.0	0.9	0.9	1.0
Net cash (RMB mn)	4,410	3,808	3,481	7,373	12,052
Returns (%)					
Adjusted ROE	12.3	14.2	10.6	15.6	16.5
Adjusted ROA	4.7	5.3	3.9	6.0	6.6
Per share					
EPS (RMB)	0.75	0.99	0.82	1.35	1.63
DPS (RMB)	0.18	0.18	0.19	0.31	0.37
BVPS (RMB)	6.42	7.40	8.04	9.20	10.52

Source: Company data, CMBIS estimates

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