

Feb 29, 2016  
Company Report  
Rating: HOLD  
TP: HK\$ 11.44

Share price (HK\$) 11.18  
Est. share price return 0.38%  
Est. dividend yield 1.67%  
Est. total return 2.06%

Previous Rating HOLD  
Previous TP HK\$ 15.14

Analyst: Paul Pan  
Tel: (852) 2147 8829  
Email: paulpan@abci.com.hk

#### Key Data

52Wk H/L(HK\$) 25.5/10.5  
Outstanding shares (mn) 3,920.71  
Market cap (HK\$ mn) 43,833.53  
3-mth avg daily turnover (HK\$ mn) 134.13  
Major shareholder(s) (%):  
COFCO Dairy Investment Ltd. 23.92  
Commonwealth Bank of Australia 14.03  
Prominent Achiever Ltd. 7.55  
JP Morgan Chase & Co. 6.99  
Source(s): Bloomberg, ABCI Securities

#### Revenue contribution of business

##### segments

(%)	FY15	FY14
Liquid milk	87.72	85.99
- UHT milk	43.58	47.36
- Milk beverage	24.83	23.82
- Yogurt	19.31	14.81
Ice cream	5.30	5.43
Milk formula	6.03	7.91
Other revenue	0.95	0.67

Source(s): The Group, ABCI Securities estimates

#### Share price performance (%)

	Absolute	Relative*
1-mth	4.10	6.96
3-mth	(9.40)	3.67
6-mth	(17.49)	(6.56)

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

#### Stock performance



Source(s): Bloomberg, ABCI Securities

## Mengniu (2319 HK)

FY15 result preview; maintain HOLD, TP revised to HKD 11.44

- Recent changes in management team and strategic consolidation into China Foods would not affect Mengniu's operation and business strategy
- We maintain our previous view on the industry, as recently news on milk dumping and refusal to collect milk by major dairy manufacturers show that the industry environment is still challenging
- We slightly adjust our previous forecast for the Group; we project that in FY15, sales, gross profit and net profit would grow by 1.18% YoY, 2.44% YoY and 5.32% YoY; GPM, OPM, and NPM would be 31.22%, 5.53%, and 4.89%; ROAA, ROAE, and ROIC would reach 5.09%, 11.08%, and 10.12%
- TP revise to HK\$ 11.44 to reflect recent market change; maintain HOLD

**Recent change of management is a strategic move of COFCO.** The Group recently announced major changes in its management team. Mr. Ning Gaoning resigned from the Group's non-executive director and the chairman of the board, and was replaced by Mr. Ma Jianping. We believe these management changes are in line with the recent strategic moves of COFCO to consolidate subsidiaries, such as incorporating Mengniu into its China Foods platform. The management and organizational changes may leave the business strategy of Mengniu intact, but we believe that the consolidation would bring in more synergies among these subsidiaries, which would ultimately benefit Mengniu.

**Maintain our less-than-sanguine view on the industry.** Significant price discounts offered by smaller brands, aggressive promotional activities by major brands, reports of milk dumping incidents and refusal to collect milk by major dairy manufacturers spark concerns on the excess production capacity in China and the less than expected growth in downstream demand. We expect the dairy sector to experience a tough 4Q15.

**Slight adjustment to our previous forecast.** Although the business environment is still challenging, downstream dairy players would fare better than the integrated dairy players. We project the Group's sales, gross profit, and net profit would edge up by 1.18% YoY, 2.44% YoY and 5.32% YoY, much lower than those in FY14; GPM, OPM, and NPM would be 31.22%, 5.53%, and 4.89%, which would be similar to those in FY14; ROAA, ROAE, and ROIC would reach 5.09%, 11.08%, and 10.12%.

**Maintain HOLD, TP revise to HKD 11.4.** In Feb, Mengniu recorded an increase of 4.10% while HSI Index decreased by 2.56%. We believe the market is paying more attention to the big players in the dairy sector due to the relatively cheap valuation. To better reflect recent market changes and our projection for the Group, we revise the Group's TP to HK\$ 11.44, which represents 14.35x FY15E P/E and 1.88x FY15E P/B, or 12.05x FY16E P/E and 1.68x FY16E P/B. Maintain HOLD. The Group's valuation had come down substantially and was lower than its competitor, Yili, which was trading at 17x~ FY15E P/E as of Feb 26.

**Risk factors:** 1) Product quality and food safety risks; 2) Regulatory risk, 3) Domestic economic growth risk; 4) Risks related to cooperation with new business partners; 5) New product and sales strategy implementation risk; 6) Political risk.

#### Results and Valuation

FY ended Dec 31	FY13A	FY14A	FY15E	FY16E	FY17E
Revenue (RMB mn)	43,356.91	50,049.24	50,639.43	56,682.77	63,280.05
Chg (% YoY)	20.44	15.44	1.18	11.93	11.64
Net Income (RMB mn)	1,861.99	2,690.65	2,817.17	3,371.60	4,276.40
Chg (% YoY)	25.16	44.14	5.32	19.28	26.86
Basic EPS (RMB cent)	0.45	0.62	0.64	0.76	0.96
P/E (x)	19.29	14.38	14.03	11.77	9.22
BVPS (RMB)	2.76	4.38	4.87	5.44	6.16
P/B (x)	3.17	2.04	1.84	1.64	1.44
DPS (RMB cent)	0.14	0.18	0.19	0.22	0.28
Yield (%)	1.22	1.61	1.67	2.00	2.52
ROAA (%)	5.33	5.38	5.09	5.59	6.43
ROAE (%)	11.71	12.76	11.08	12.20	14.17

Source(s): The Group, Bloomberg, ABCI Securities estimates

## Appendix: Financial Statements of the Group

### Consolidated income statement (FY13A-FY17E)

FY ends at Dec 31 (RMB mn, excl. EPS)	FY13A	FY14A	FY15E	FY16E	FY17E	1H14A	1H15A
<b>Revenue</b>	<b>43,356.91</b>	<b>50,049.24</b>	<b>50,639.43</b>	<b>56,682.77</b>	<b>63,280.05</b>	<b>25,835.83</b>	<b>25,564.41</b>
- Liquid milk	37,902.83	43,036.16	44,422.05	49,525.55	55,300.72	21,764.84	21,940.95
- Ice cream	3,023.37	2,716.10	2,683.76	2,979.70	3,170.05	1,988.38	1,644.27
- Milk formula	2,177.25	3,960.96	3,053.10	3,515.42	3,879.73	1,933.84	1,783.49
- Other revenue	253.45	336.02	480.51	662.10	929.55	148.77	195.71
COGS	(31,659.66)	(34,615.63)	(34,829.80)	(38,697.32)	(42,739.35)	(17,454.02)	(17,421.60)
<b>Gross profit</b>	<b>11,697.25</b>	<b>15,433.61</b>	<b>15,809.63</b>	<b>17,985.44</b>	<b>20,540.70</b>	<b>8,381.82</b>	<b>8,142.81</b>
Other income	288.63	449.07	385.82	427.54	487.12	250.87	177.61
SG&A	(9,774.03)	(12,504.93)	(13,080.08)	(15,016.97)	(16,751.92)	(6,859.18)	(6,658.93)
Other expenses	(360.13)	(713.21)	(315.81)	(343.63)	(399.22)	(556.20)	(182.84)
<b>EBIT</b>	<b>1,851.72</b>	<b>2,664.55</b>	<b>2,799.56</b>	<b>3,052.39</b>	<b>3,876.69</b>	<b>1,220.66</b>	<b>1,471.75</b>
Net interest expense(-)/income(+)	198.92	207.73	359.54	700.35	886.11	77.62	139.15
Income from associate/JV	153.86	277.73	160.07	231.62	269.92	183.18	143.31
Profit before tax	2,204.50	3,150.01	3,319.17	3,984.36	5,032.72	1,481.46	1,754.20
Tax	(366.71)	(459.29)	(502.00)	(612.76)	(756.32)	(252.50)	(321.34)
Profit from discontinued operation	24.20	(0.06)	-	-	-	(0.02)	(0.01)
<b>Total net profit</b>	<b>1,861.99</b>	<b>2,690.65</b>	<b>2,817.17</b>	<b>3,371.60</b>	<b>4,276.40</b>	<b>1,228.93</b>	<b>1,432.85</b>
- Profit to shareholders	1,630.93	2,350.80	2,475.89	2,953.28	3,746.54	1,048.61	1,338.67
- Minority interest	231.06	339.85	341.28	418.32	529.86	180.33	94.18
<b>EPS (RMB)</b>							
- Basic	0.45	0.62	0.64	0.76	0.96	0.28	0.34
- Diluted	0.45	0.62	0.64	0.76	0.96	0.28	0.34
<b>DPS</b>	<b>0.14</b>	<b>0.18</b>	<b>0.19</b>	<b>0.22</b>	<b>0.28</b>	<b>0.00</b>	<b>0.00</b>

Source(s): The Group, ABCI Securities estimates

### Consolidated balance sheet (2013A-2017E)

FY ends at Dec 31 (RMB mn)	FY13A	FY14A	FY15E	FY16E	FY17E	1H14A	1H15A
Cash and equivalent	7,102	4,650	9,733	13,625	14,381	8,677	8,607
Accounts receivables	754	1,148	1,651	1,446	2,025	1,262	1,864
Inventory	2,577	4,342	4,034	4,504	5,377	4,460	4,289
Other current assets	5,888	10,193	6,695	5,950	7,214	5,294	7,797
<b>Total current assets</b>	<b>16,321</b>	<b>20,333</b>	<b>22,113</b>	<b>25,526</b>	<b>28,997</b>	<b>19,693</b>	<b>22,557</b>
PP&E and construction in progress	10,522	11,697	12,155	13,197	14,517	10,962	11,776
Land use rights	1,049	1,051	1,104	1,209	1,297	1,095	1,096
Goodwill & intangibles	7,307	7,458	7,452	7,445	7,437	7,301	7,454
Other non-current assets	5,140	6,542	7,447	8,004	8,946	7,211	7,222
<b>Total non-current assets</b>	<b>24,018</b>	<b>26,748</b>	<b>28,158</b>	<b>29,855</b>	<b>32,197</b>	<b>26,568</b>	<b>27,548</b>
<b>Total assets</b>	<b>40,339</b>	<b>47,081</b>	<b>50,271</b>	<b>55,381</b>	<b>61,194</b>	<b>46,261</b>	<b>50,105</b>
Accounts payables	4,761	4,992	5,294	5,371	6,752	5,121	5,161
Short-term debt	8,462	4,361	5,869	6,807	7,951	5,169	5,052
Other current liabilities	4,841	4,999	4,845	6,410	6,301	5,888	5,451
<b>Total current liabilities</b>	<b>18,063</b>	<b>14,351</b>	<b>16,007</b>	<b>18,587</b>	<b>21,004</b>	<b>16,178</b>	<b>15,664</b>
Long-term debt	3,236	5,464	4,982	4,976	4,969	4,816	5,417
Other non-current liabilities	1,029	2,773	2,892	3,203	3,839	2,036	2,790
<b>Total non-current liabilities</b>	<b>4,265</b>	<b>8,237</b>	<b>7,874</b>	<b>8,179</b>	<b>8,808</b>	<b>6,852</b>	<b>8,206</b>
<b>Total liabilities</b>	<b>22,328</b>	<b>22,588</b>	<b>23,881</b>	<b>26,767</b>	<b>29,811</b>	<b>23,030</b>	<b>23,871</b>
Equity attributable to shareholders	15,361	21,489	23,206	25,204	27,691	20,274	21,419
Minority interest	2,650	3,003	3,184	3,410	3,691	2,957	4,815
<b>Equities</b>	<b>18,011</b>	<b>24,493</b>	<b>26,390</b>	<b>28,614</b>	<b>31,383</b>	<b>23,230</b>	<b>26,234</b>
<b>Total liabilities and equity</b>	<b>40,339</b>	<b>47,081</b>	<b>50,271</b>	<b>55,381</b>	<b>61,194</b>	<b>46,261</b>	<b>50,105</b>

Source(s): The Group, ABCI Securities estimates

**Consolidated cash flow statement (2013A-2017E)**

<b>FY ends at Dec 31 (RMB mn)</b>	<b>FY13A</b>	<b>FY14A</b>	<b>FY15E</b>	<b>FY16E</b>	<b>FY17E</b>	<b>1H14A</b>	<b>1H15A</b>
Profit before tax	2,229	3,150	3,319	3,984	5,033	1,481	1,754
Depreciation and amortization	1,218	1,342	1,532	1,691	1,902	638	701
Change in working capital	517	(478)	1,093	224	809	(221)	456
Others	(679)	(934)	(1,388)	(2,022)	(2,460)	(352)	(803)
<b>Total cash flow from operation</b>	<b>3,284</b>	<b>3,080</b>	<b>4,557</b>	<b>3,877</b>	<b>5,284</b>	<b>1,547</b>	<b>2,107</b>
CapEx	(12,597)	(3,278)	(2,424)	(3,400)	(4,082)	(1,485)	(1,440)
Others	(2,672)	(3,137)	(2,727)	(2,372)	(2,146)	(1,756)	2,286
<b>Total Cash Flow From investing</b>	<b>(15,269)</b>	<b>(6,415)</b>	<b>(5,151)</b>	<b>(5,772)</b>	<b>(6,228)</b>	<b>(3,241)</b>	<b>846</b>
Change in debt	7,840	(1,946)	1,026	933	1,136	(1,818)	512
Dividend paid	(385)	(491)	(680)	(728)	(872)	(463)	(642)
Others	4,876	6,055	(583)	(840)	(1,258)	5,605	853
<b>Total Cash Flow From Financing</b>	<b>12,331</b>	<b>3,619</b>	<b>(238)</b>	<b>(635)</b>	<b>(993)</b>	<b>3,323</b>	<b>723</b>
<b>Net change in cash</b>	<b>346</b>	<b>283</b>	<b>(832)</b>	<b>(2,530)</b>	<b>(1,937)</b>	<b>1,629</b>	<b>3,677</b>
<b>Cash and cash equivalent at beg</b>	<b>2,918</b>	<b>3,355</b>	<b>3,607</b>	<b>2,813</b>	<b>202</b>	<b>3,355</b>	<b>3,607</b>
ForEx change	148	(31)	38	(81)	(27)	25	208
<b>Cash and cash equivalent at end</b>	<b>3,355</b>	<b>3,607</b>	<b>2,813</b>	<b>202</b>	<b>(1,762)</b>	<b>5,009</b>	<b>7,492</b>
Time deposit - maturity longer than three months	3,747	1,043	6,920	13,424	16,143	3,668	1,115
<b>Cash and cash equivalent on Balance Sheet</b>	<b>7,102</b>	<b>4,650</b>	<b>9,733</b>	<b>13,625</b>	<b>14,381</b>	<b>8,677</b>	<b>8,607</b>

Source(s): The Group, ABCI Securities estimates

**Key operating and financial ratios (2013A-2017E)**

<b>As of Dec 31</b>	<b>FY13A</b>	<b>FY14A</b>	<b>FY15E</b>	<b>FY16E</b>	<b>FY17E</b>	<b>1H14A</b>	<b>1H15A</b>
<b>Growth measures (%)</b>							
Sales growth	20.44	15.44	1.18	11.93	11.64	25.00	(1.05)
Liquid milk growth	17.22	13.54	3.22	11.49	11.66	19.18	0.81
- UHT milk growth	11.91	7.47	(6.88)	8.72	2.14	13.02	(13.38)
- Milk beverage growth	29.69	14.34	5.49	9.18	10.37	23.12	(2.89)
- Yogurt growth	18.12	36.69	31.88	20.71	32.53	37.99	55.95
Ice cream growth	(4.67)	(10.16)	(1.19)	11.03	6.39	1.74	(17.31)
Milk powder growth	393.09	81.92	(22.92)	15.14	10.36	390.67	(7.77)
Other product growth	94.46	32.58	43.00	37.79	40.40	161.39	31.55
Gross profit growth	30.70	31.94	2.44	13.76	14.21	51.88	(2.85)
Operating profit growth	15.17	43.90	5.07	9.03	27.01	36.54	20.57
Net profit growth	25.16	44.14	5.32	19.28	26.86	39.91	27.66
<b>Profitability ratios (%)</b>							
Gross margin	26.98	30.84	31.22	31.73	32.46	32.44	31.85
EBIT margin	4.27	5.32	5.53	5.39	6.13	4.72	5.76
EBITDA margin	7.49	8.56	8.55	8.37	9.13	7.90	9.06
Pre-tax margin	5.08	6.29	6.55	7.03	7.95	5.73	6.86
Net margin	3.76	4.70	4.89	5.21	5.92	4.06	5.24
<b>Return ratios (%)</b>							
ROAA	5.33	5.38	5.09	5.59	6.43	2.42	2.75
ROAE	11.71	12.76	11.08	12.20	14.17	5.09	5.28
ROIC	12.59	10.69	10.12	13.07	15.85	5.10	3.23
<b>Liquidity ratio (%)</b>							
Current ratio	90.36	141.68	138.14	137.33	138.06	121.73	144.00
Quick ratio	76.09	111.42	112.94	113.10	112.45	94.16	116.62
Cash ratio	42.42	34.18	62.56	74.97	70.09	54.40	57.76
<b>Cash conversion cycle (days)</b>							
Days of outstanding receivable	6.78	6.94	10.09	9.97	10.01	7.12	10.75
Days of inventory on hand	22.71	36.48	43.89	40.27	42.19	36.79	45.21
Days of outstanding payable	46.58	48.93	54.37	49.69	50.73	46.63	54.02
CCC	(17.09)	(5.51)	(0.40)	0.55	1.48	(2.72)	1.95
<b>Leverage ratios (%)</b>							
Total debt/Equity	64.94	40.11	41.78	41.86	41.82	43.53	40.57
Total debt/Total assets	29.00	20.87	21.58	21.28	21.11	21.86	21.24

Source(s): The Group, ABCI Securities estimates

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### Analyst Certification

I, Hongxing (Paul) PAN, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

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### Definition of equity rating

Rating	Definition
Buy	Stock return $\geq$ Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2010-2014

Time horizon of share price target: 12-month

### Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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**Office address: ABCI Securities Company Limited, 13/F Fairmont House,  
8 Cotton Tree Drive, Central, Hong Kong.**

**Tel: (852) 2868 2183**