



Rating
Hold

Asia
China

Consumer
Food & Beverage

Company
Bright Dairy

Reuters 600597.SS Bloomberg 600597 CH Exchange SHH Ticker 600597

Date
29 August 2017

Results

Price at 25 Aug 2017 (CNY)	12.54
Price target - 12mth (CNY)	14.00
52-week range (CNY)	14.71 - 11.45
HANG SENG INDEX	27,848

2Q17 recurring profit in line; maintaining Hold on fair valuation

Strong earnings growth on lower marketing expense and income tax savings

Bright reported 2Q17 results with a 5.3% yoy increase in sales to RMB5,557m and 46.2% yoy increase in net profit to RMB179m. Sales and operating profit were in line with our forecasts, while net profit was 14% higher than our forecast due to a lower effective tax rate at 10.5% (vs. 26% in 2Q16), helped by a one-off income tax refund. On a semi-annual basis, sales increased 6.4% yoy and net profit increased 52.2% yoy in 1H17. Specifically,

- **Sales** increased 6% yoy in 1H17 (5% yoy in 2Q17), mainly driven by a 39% yoy sales increase from its New Zealand subsidiary Synlait in 1H17. Its room temperature business declined by double digits in 1H17, while partly offset by incremental sales from the pasteurized milk segment.
- **Gross margin** declined 670bps in 1H17 to 34.1% (down 780bps in 2Q17), mainly due to a declining gross margin in the room temperature segment on increasing competition and a less favorite product mix.
- **SG&A/sales** ratio declined 730bps yoy to 28.1% in 1H17 (decline 840bps in 2Q17), helped by lower advertisement and promotion expenses.

Increasing investment in distribution network

Bright's room temperature sales declined by double digits in 1H17, even though it launched a few new products in this category from 2017, as its distribution network is weaker than that of lead players such as Yili and Mengniu. The company indicated that it is investing in the channels to increase penetration rate and POS sales. We think this could help to improve room temperature business sales.

Implication on dairy sector: easing competition within cost inflation environment

We estimate that both pasteurized milk and room temperature gross margin declined in 1H17, due mainly to rising packaging material cost in 1H17, while raw milk price in Shanghai is flattish at Rmb3.78/liter. Within the cost inflating environment, the company cut its advertisement expense and promotion expense by 36% and 19% yoy in 1H17, indicating an easing competition environment (also partly because of a higher base in 1H17 due to Olympic Games).

Maintaining Hold on fair valuation

We maintain our TP unchanged at Rmb14 based on a DCF approach (factoring in 3.9% RFR, 5.6% equity premium, 1.0 beta and 2% TG). Near-term, we expect

Valuation & Risks

Mark Yuan
Research Analyst
+852-2203 6181

Anne Ling
Research Analyst
+852-2203 6177

Price/price relative



Performance (%)	1m	3m	12m
Absolute	2.8	7.6	-15.0
HANG SENG INDEX	3.7	8.7	22.1

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	12.0
Net debt/equity (%)	-33.7
Book value/share (CNY)	4.41
Price/book (x)	2.8
Net interest cover (x)	22.1
Operating profit margin (%)	5.3

Source: Deutsche Bank



Bright's growth to be under pressure due to its weaker distribution network in the room temperature segment. The stock is trading at 23x 2017E P/E, which is fair compared to the peer average of 20x. Upside risk: successful new product launches. Downside risk: increasing competition.

Figure 1: 1H17 results

RMBm	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	1H16	2H16	1H17	2Q17	1H17	YoY Change
Sales	4,994	5,276	5,197	4,740	5,366	5,557	10,270	9,937	10,923	5.3%	6.4%	
Gross profit	2,008	2,190	2,020	1,479	1,855	1,874	4,198	3,499	3,729	-14.4%	-11.2%	
SG&A	1,709	1,926	1,720	1,036	1,504	1,560	3,635	2,756	3,064	-19.0%	-15.7%	
EBIT	300	263	301	443	352	330	563	744	682	25.2%	21.0%	
Net profit	118	123	185	138	187	179	241	322	366	46.2%	52.2%	
GPM	40.2%	41.5%	38.9%	31.2%	34.6%	33.7%	40.9%	35.2%	34.1%	-7.8%	-6.7%	
SG&A/Sales	34.2%	36.5%	33.1%	21.9%	28.0%	28.1%	35.4%	27.7%	28.1%	-8.4%	-7.3%	
EBITM	6.0%	5.0%	5.8%	9.3%	6.6%	5.9%	5.5%	7.5%	6.2%	0.9%	0.8%	
NPM	2.4%	2.3%	3.6%	2.9%	3.5%	3.2%	2.3%	3.2%	3.4%	0.9%	1.0%	

Source: Deutsche Bank, company data

Forecasts and ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	19,277.5	20,088.1	21,397.0	22,708.7	23,954.3
EBITDA (CNYm)	1,257.8	1,865.9	1,766.0	1,835.0	1,956.1
Reported NPAT (CNYm)	418.3	563.2	623.4	681.0	743.2
Reported EPS FD(CNY)	0.34	0.46	0.51	0.55	0.60
DB EPS FD (CNY)	0.35	0.48	0.54	0.59	0.64
DB EPS growth (%)	-37.4	37.3	12.0	9.0	8.7
PER (x)	51.8	27.1	23.3	21.4	19.7
EV/EBITDA (x)	17.1	7.6	7.5	7.0	6.3
DPS (net) (CNY)	0.12	0.15	0.18	0.20	0.22
Yield (net) (%)	0.7	1.2	1.4	1.6	1.7

Source: Deutsche Bank estimates, company data



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Bright Dairy	600597.SS	12.64 (CNY) 28 Aug 2017	NA

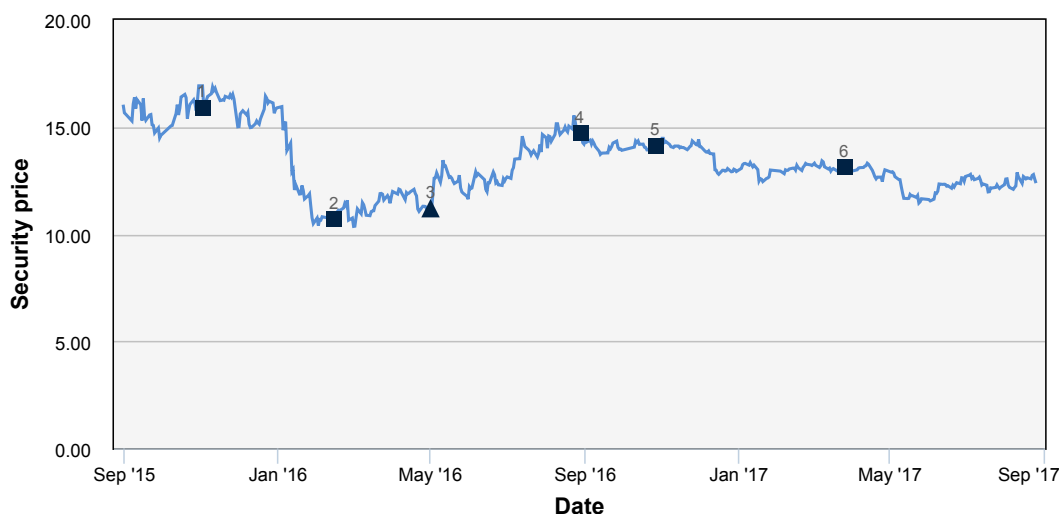
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Historical recommendations and target price. Bright Dairy (600597.SS)

(as of 08/25/2017)



Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

** Analyst is no longer at Deutsche Bank

1.	11/03/2015	Sell, Target Price Change CNY 11,00 Mark Yuan	4.	08/29/2016	Hold, Target Price Change CNY 12,40 Mark Yuan
2.	02/15/2016	Sell, Target Price Change CNY 9,80 Mark Yuan	5.	10/28/2016	Hold, Target Price Change CNY 13,60 Mark Yuan
3.	05/02/2016	Upgraded to Hold, Target Price Change CNY 11,00 Mark Yuan	6.	03/27/2017	Hold, Target Price Change CNY 14,00 Mark Yuan



Equity Rating Key

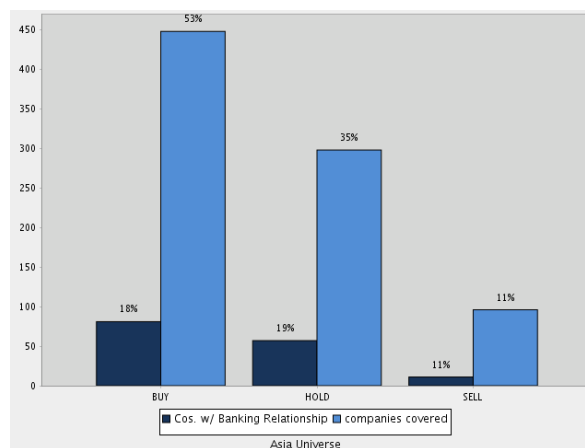
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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Raj Hindocha
Global Chief Operating Officer
Research

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Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Mainzer Landstrasse 11-17
60329 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

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2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500
