



Rating
Buy

Asia
China

Consumer
Food & Beverage

Company
Yili

Reuters 600887.SS Bloomberg 600887 CH Exchange SHH Ticker 600887

Date
28 September 2017

Forecast Change

Price at 27 Sep 2017 (CNY)	25.44
Price target - 12mth (CNY)	28.00
52-week range (CNY)	25.79 - 16.11
HANG SENG INDEX	27,513

3Q preview: strong growth to continue; reiterating Buy

Expecting a strong 3Q result driven by industry recovery and market share gain
We forecast Yili to report 14% sales growth, 28% recurring EBIT (before other income) growth and 14% net profit growth in 3Q17, which should beat consensus' full year forecast at 10% sales/earnings growth for FY17. Particularly, the strong growth is driven by:

- Industry recovery and market share gains through high-end products.**
We expect the liquid milk industry to grow by 6% in 3Q17 (vs. 7% in 1H17) and Yili's market share in liquid milk to increase from 33.6% in June to 34% in September. High-end products, including UHT yoghurt, high-end yoghurt and pro biotic drinks, are the key sales drivers. Meanwhile, we expect the lower tier region and special channel to deliver higher sales growth helped by Yili's increasing penetrations.
- Our recent channel check indicates that its sales growth remains strong in 3Q.** The Shanghai distributor indicated that its room temperate products grew at 8% in both 1H17 and 3Q; the Shenzhen distributor indicated its sales grew at higher than 10% YTD. Meanwhile, we find that Mengniu and Yili are revising up ex-factory price and retail price from July, implying that industry competition continues to ease down.
- 90bps yoy expansion of recurring EBIT margin.** Our recent channel check indicates the price competition is stabilizing. We believe the more balanced supply/demand in upstream should also lead to a stable competition environment. Accordingly, we forecast a yoy flattish selling expense/sales ratio in 3Q17. The yoy EBIT margin expansion is mainly helped by lower G&A/sales from a high base in 3Q16, while partly offset by lower gross margin on rising packaging cost and milk powder price.

Sales growth to accelerate in 2017-19

Liquid milk growth is recovering from low single digits in 2016 to high single digits in 2017. Firstly, we think this is mainly helped by more balanced supply from 2017, and we expect raw milk cycle to turn from over-supply in 2014-16 to under-supply in 2018-19. Secondly, the recovery is also helped by trading up demand from low-end milk beverage to pure milk and yoghurt. Thirdly, this is helped by Yili's increasing penetration in lower tier regions and special channels. We believe these drivers are sustainable. We forecast Yili's sales CAGR to improve from 8% in 2014-16 to 11% in 2017-18E.

Valuation & Risks

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Key changes

TP	24.80 to 28.00	↑	12.9%
Sales (FYE)	66,917 to 67,195	↑	0.4%
Op prof margin (FYE)	10.2 to 11.0	↑	8.3%
Net profit (FYE)	6,414.8 to 6,225.0	↓	-3.0%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	11.3	19.4	57.9
HANG SENG INDEX	-1.2	6.5	16.7

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	25.7
Net debt/equity (%)	-54.2
Book value/share (CNY)	4.17
Price/book (x)	6.1
Net interest cover (x)	373.8
Operating profit margin (%)	11.0

Source: Deutsche Bank



Raising TP to Rmb28.0; reiterating Buy on the industry recovery cycle.

We revised up Yili's earnings by 4-9% in 2018-19E, mainly to factor in the higher sales growth on industry recovery and Yili's market share gain. We are raising our TP by 13% to Rmb28 based on our DCF approach (factoring in 9.5% WACC and 2% terminal growth). We reiterate Yili as our top pick among our A share coverage. Downside risks: higher-than-expected raw material price increase, food safety incidents and worse-than-expected competition.

Figure 1: Forecast change

	New			Old			Diff		
	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Sales	67,713	75,260	82,108	67,388	74,685	81,541	0.5%	0.8%	0.7%
Gross profit	25,412	27,578	30,019	25,722	27,678	29,748	-1.2%	-0.4%	0.9%
EBIT	7,403	8,343	9,555	6,809	7,333	8,058	8.7%	13.8%	18.6%
Net profit	6,225	7,173	8,222	6,415	6,884	7,541	-3.0%	4.2%	9.0%
GPM	37.5%	36.6%	36.6%	38.2%	37.1%	36.5%	-0.6%	-0.4%	0.1%
EBIT margin	10.9%	11.1%	11.6%	10.1%	9.8%	9.9%	0.8%	1.3%	1.8%
Net margin	9.2%	9.5%	10.0%	9.5%	9.2%	9.2%	-0.3%	0.3%	0.8%

Source: Deutsche Bank

Forecasts and ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Sales (CNYm)	60,108.8	60,189.1	67,194.5	74,697.1	81,464.1
EBITDA (CNYm)	6,726.8	7,087.9	8,856.6	10,049.7	11,487.6
Reported NPAT (CNYm)	4,631.8	5,661.8	6,225.0	7,172.9	8,222.3
Reported EPS FD(CNY)	0.76	0.93	1.03	1.18	1.36
DB EPS FD (CNY)	0.76	0.93	1.03	1.18	1.36
OLD DB EPS FD (CNY)	0.76	0.93	1.06	1.14	1.24
% Change	0.0%	0.0%	-3.0%	4.2%	9.0%
DB EPS growth (%)	12.0	23.3	9.9	15.2	14.6
PER (x)	21.6	17.3	24.8	21.5	18.8
EV/EBITDA (x)	13.8	11.9	15.9	13.8	12.0
DPS (net) (CNY)	0.46	0.66	0.76	0.87	0.99
Yield (net) (%)	2.8	4.1	3.0	3.4	3.9

Source: Deutsche Bank estimates, company data



Model updated: 27 September 2017

Running the numbers

Asia

China

Food & Beverage

Yili

Reuters: 600887.SS Bloomberg: 600887 CH

Buy

Price (27 Sep 17) CNY 25.44

Target Price CNY 28.00

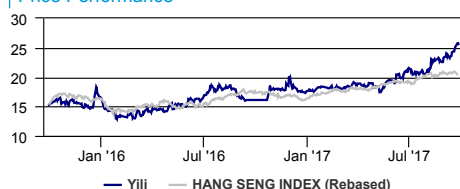
52 Week range CNY 16.11 - 25.79

Market cap (m) CNYm 154,289
USDm 23,267

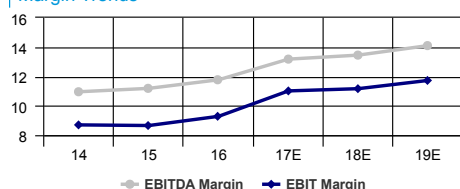
Company Profile

Yili mainly operates four business divisions, producing such consumables as liquid milk, ice cream, and milk powder, via nearly 100 subsidiaries and has more than 1,000 SKUs. In 2014, Yili's total revenue was Rmb54.4bn, and net profits were Rmb4.2bn. Both the total revenue and net profits ranked No.1 in the dairy industry in China. Yili was listed on the Shanghai Stock Exchange in 1996.

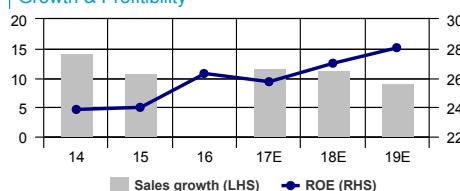
Price Performance



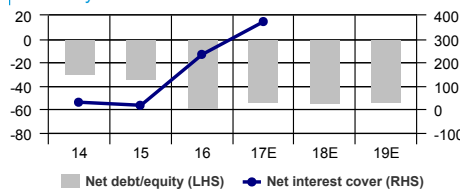
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.68	0.76	0.93	1.03	1.18	1.36
Reported EPS (CNY)	0.68	0.76	0.93	1.03	1.18	1.36
DPS (CNY)	0.43	0.46	0.66	0.76	0.87	0.99
BVPS (CNY)	3.0	3.3	3.8	4.2	4.6	5.1
Weighted average shares (m)	6,129	6,118	6,065	6,065	6,065	6,065
Average market cap (CNYm)	73,025	100,016	97,720	154,289	154,289	154,289
Enterprise value (CNYm)	67,528	93,123	84,047	140,487	138,959	137,586

Valuation Metrics

P/E (DB) (x)	17.6	21.6	17.3	24.8	21.5	18.8
P/E (Reported) (x)	17.6	21.6	17.3	24.8	21.5	18.8
P/BV (x)	4.62	4.98	4.62	6.10	5.54	5.01
FCF Yield (%)	0.4	4.9	9.4	2.7	3.9	4.2
Dividend Yield (%)	3.6	2.8	4.1	3.0	3.4	3.9
EV/Sales (x)	1.2	1.5	1.4	2.1	1.9	1.7
EV/EBITDA (x)	11.4	13.8	11.9	15.9	13.8	12.0
EV/EBIT (x)	14.3	17.9	15.0	19.0	16.7	14.4

Income Statement (CNYm)

Sales revenue	54,251	60,109	60,189	67,195	74,697	81,464
Gross profit	17,851	21,733	22,762	25,412	27,578	30,019
EBITDA	5,946	6,727	7,088	8,857	10,050	11,488
Depreciation	1,204	1,497	1,473	1,428	1,678	1,902
Amortisation	20	25	25	26	29	31
EBIT	4,721	5,205	5,590	7,403	8,343	9,555
Net interest income/(expense)	-155	-297	-24	-20	152	176
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	220	616	1,066	-67	-65	-68
Profit before tax	4,786	5,524	6,632	7,316	8,430	9,663
Income tax expense	619	869	963	1,083	1,248	1,430
Minorities	22	23	7	8	9	10
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	4,144	4,632	5,662	6,225	7,173	8,222
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	4,144	4,632	5,662	6,225	7,173	8,222

Cash Flow (CNYm)

Cash flow from operations	4,216	8,591	12,563	8,055	9,523	10,611
Net Capex	-3,946	-3,652	-3,419	-3,897	-3,526	-4,117
Free cash flow	269	4,939	9,144	4,159	5,996	6,494
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-1,807	-2,659	-2,776	-4,010	-4,621	-5,297
Net inc/(dec) in borrowings	4,690	-2,586	-6,038	0	0	0
Other investing/financing cash flows	2,948	-869	175	-20	152	176
Net cash flow	6,099	-1,174	505	128	1,528	1,373
Change in working capital	-1,201	1,298	893	306	119	-13

Balance Sheet (CNYm)

Cash and other liquid assets	14,273	13,084	13,824	13,952	15,479	16,852
Tangible fixed assets	14,080	15,342	14,533	16,867	18,640	20,773
Goodwill/intangible assets	930	956	991	1,100	1,146	1,197
Associates/investments	848	1,107	2,243	2,243	2,243	2,243
Other assets	9,353	9,131	7,661	8,389	9,265	10,007
Total assets	39,484	39,620	39,252	42,550	46,774	51,073
Interest bearing debt	8,776	6,190	150	150	150	150
Other liabilities	11,897	13,295	15,876	16,953	18,615	19,978
Total liabilities	20,673	19,485	16,026	17,103	18,765	20,128
Shareholders' equity	18,634	19,984	23,082	25,296	27,848	30,774
Minorities	188	162	154	162	171	182
Total shareholders' equity	18,822	20,146	23,236	25,458	28,019	30,955
Net debt	-5,497	-6,893	-13,673	-13,802	-15,329	-16,702

Key Company Metrics

Sales growth (%)	14.1	10.8	0.1	11.6	11.2	9.1
DB EPS growth (%)	24.4	12.0	23.3	9.9	15.2	14.6
EBITDA Margin (%)	11.0	11.2	11.8	13.2	13.5	14.1
EBIT Margin (%)	8.7	8.7	9.3	11.0	11.2	11.7
Payout ratio (%)	64.2	60.5	70.8	74.2	73.8	73.0
ROE (%)	23.8	24.0	26.3	25.7	27.0	28.1
Capex/sales (%)	7.3	6.1	5.7	5.8	4.7	5.1
Capex/depreciation (x)	3.2	2.4	2.3	2.7	2.1	2.1
Net debt/equity (%)	-29.2	-34.2	-58.8	-54.2	-54.7	-54.0
Net interest cover (x)	30.5	17.5	234.1	373.8	nm	nm

Source: Company data, Deutsche Securities estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Yili	600887.SS	25.44 (CNY) 27 Sep 2017	NA

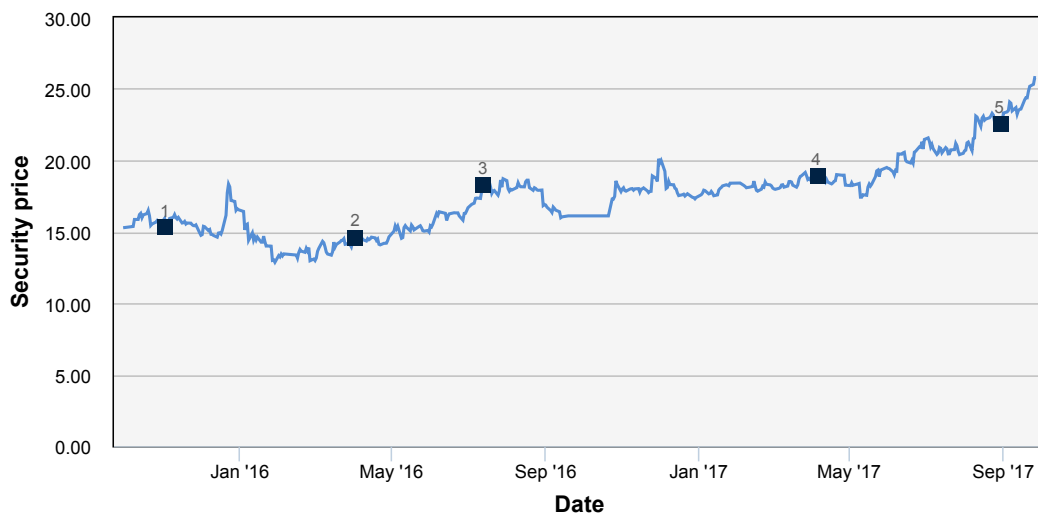
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Historical recommendations and target price. Yili (600887.SS)

(as of 09/27/2017)



Current Recommendations

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

** Analyst is no longer at Deutsche Bank

1.	11/03/2015	Buy, Target Price Change CNY 18,60	Mark Yuan	4.	04/06/2017	Buy, Target Price Change CNY 22,00	Mark Yuan
2.	04/03/2016	Buy, Target Price Change CNY 18,40	Mark Yuan	5.	08/30/2017	Buy, Target Price Change CNY 24,80	Mark Yuan
3.	07/14/2016	Buy, Target Price Change CNY 20,40	Mark Yuan				



Equity Rating Key

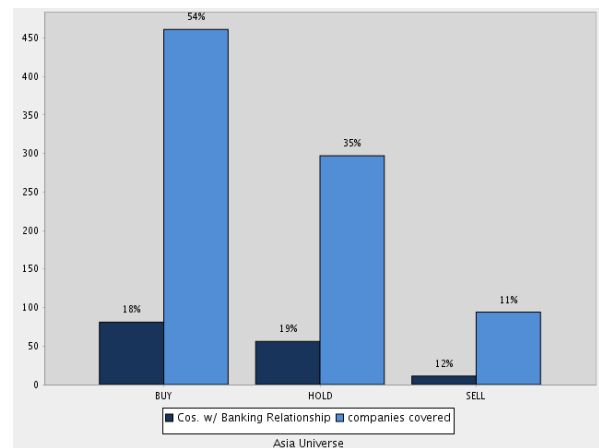
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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