



Rating
Buy

Asia
China

Consumer
Food & Beverage

Company
Yili

Reuters 600887.SS Bloomberg 600887 CH Exchange SHH Ticker 600887

Date
30 October 2017

Forecast Change

Price at 27 Oct 2017 (CNY)	30.20
Price target - 12mth (CNY)	31.60
52-week range (CNY)	30.20 - 17.30
HANG SENG INDEX	28,439

3Q17 earnings beat; reiterating Buy on continued sales recovery

Sales/net profit is 3.5%/4.4% higher than DB forecast

Yili reported 18% yoy sales growth to Rmb19.0bn and 34% net profit growth to Rmb1.6bn in 3Q17. **Net profit is 4.4% higher than DB forecast.** The earnings beat is mainly driven by better-than-expected market share gains. The strong earnings growth is driven by:

- **Strong sales growth on recovering sector growth and market share gains.** We estimate the industry retail growth recovered from low single digit in 3Q16 to high single digit in 3Q17, helped by less price discount on more balanced supply. Meanwhile, Yili's market share in Ambient/chilled products/IMF expanded from 31%/15%/5.7% to 34%/16%/6% respectively (Figure 1).
- **Selling expense/sales ratio declined 100bps yoy to 21.9%**, helped by easing of competition within a more balanced supply environment.
- **G&A expense declined 150bps yoy to 6.2% from a high base**, as Yili incurred incremental G&A for some one-off event (i.e. internal property maintenance).
- **SG&A expense savings was partly offset by 102bps yoy decline in gross margin**, due to rising raw milk and packaging prices.

Improving inventory turnover indicates that 4Q growth to remain strong

Inventory days improved from 31.9 days in 3Q16 to 30 days in 3Q17. Given the production date is an important decision factor when consumers choose brands in retail ends, the shorten inventory days indicate improving fresh level of the products, which should help to drive its sales growth in 4Q17. The improving inventory days also indicate a more balanced supply and demand market.

We expect the recovery trend to continue with an under supply environment

We believe Yili's growth recovery from 2Q is mainly driven by more balanced supply from 2017. After three years capacity reductions for upstream dairy farms from 2014, raw milk supply is becoming more balanced with demand from 2017. During the over supply environment, smaller dairy players could source raw milk at a heavy discount compared with large brands, but during the under supply

Valuation & Risks

Mark Yuan
Research Analyst
+852-2203 6181

Anne Ling
Research Analyst
+852-2203 6177

Key changes

TP	28.00 to 31.60	↑	12.9%
Sales (FYE)	67,195 to 67,495	↑	0.4%
Op prof margin (FYE)	11.0 to 11.2	↑	1.6%
Net profit (FYE)	6,225.0 to 6,353.9	↑	2.1%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	18.7	48.0	64.9
HANG SENG INDEX	2.9	4.8	22.9

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	26.2
Net debt/equity (%)	-54.4
Book value/share (CNY)	4.18
Price/book (x)	7.2
Net interest cover (x)	381.5
Operating profit margin (%)	11.2

Source: Deutsche Bank

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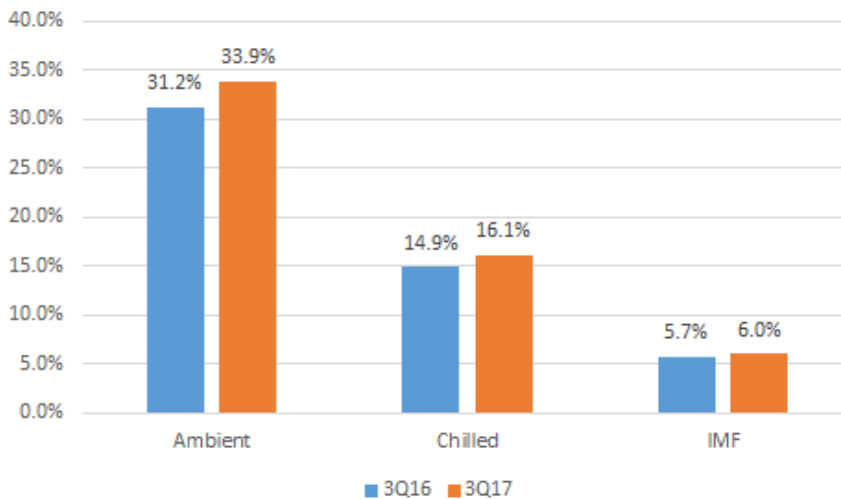


environment from 2017, smaller players need to pay a premium instead. This helps large players such as Yili and Mengniu to gain market share.

Reiterating Buy

We are revising up our earnings forecast by 2-4% in 2017-19E, mainly to factor in higher-than-expected sales driven by Yili's market share gains. We revise up our TP by 13% to Rmb31.6 based on a DCF approach, factoring in a 9.5% WACC (3.9% RFR, 5.6% ERP, 1.0 beta, debt-free structure) 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: Market share gain



Source: Deutsche Bank



Model updated: 30 October 2017

Running the numbers

Asia

China

Food & Beverage

Yili

Reuters: 600887.SS Bloomberg: 600887 CH

Buy

Price (27 Oct 17) CNY 30.20

Target Price CNY 31.60

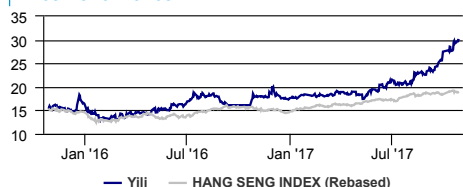
52 Week range CNY 17.30 - 30.20

Market cap (m) CNYm 183,157
USDm 27,542

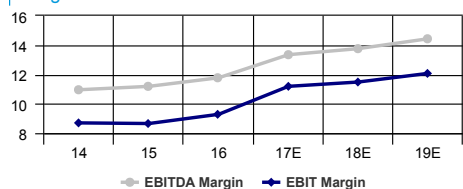
Company Profile

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.

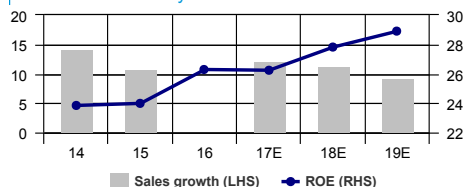
Price Performance



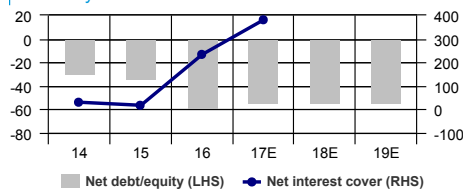
Margin Trends



Growth & Profitability



Solvency



Mark Yuan

+852 2203 6181

mark.yuan@db.com

Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.68	0.76	0.93	1.05	1.22	1.41
Reported EPS (CNY)	0.68	0.76	0.93	1.05	1.22	1.41
DPS (CNY)	0.43	0.46	0.67	0.79	0.91	1.02
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	183,157	183,157	183,157
Enterprise value (CNYm)	67,528	93,123	84,047	169,275	167,654	166,175

Valuation Metrics

P/E (DB) (x)	17.6	21.6	17.3	28.8	24.7	21.5
P/E (Reported) (x)	17.6	21.6	17.3	28.8	24.7	21.5
P/BV (x)	4.62	4.98	4.62	7.23	6.55	5.91
FCF Yield (%)	0.4	4.9	9.4	2.4	3.4	3.7
Dividend Yield (%)	3.6	2.8	4.2	2.6	3.0	3.4
EV/Sales (x)	1.2	1.5	1.4	2.5	2.2	2.0
EV/EBITDA (x)	11.4	13.8	11.9	18.8	16.2	14.0
EV/EBIT (x)	14.3	17.9	15.0	22.4	19.4	16.8

Income Statement (CNYm)

Sales revenue	54,251	60,109	60,189	67,495	75,133	82,090
Gross profit	17,851	21,733	22,762	25,343	27,481	29,895
EBITDA	5,946	6,727	7,088	9,008	10,337	11,846
Depreciation	1,204	1,497	1,473	1,428	1,679	1,905
Amortisation	20	25	25	26	29	31
EBIT	4,721	5,205	5,590	7,554	8,629	9,911
Net interest income/(expense)	-155	-297	-24	-20	153	178
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	7,467	8,717	10,021
Income tax expense	619	869	963	1,105	1,290	1,483
Minorities	22	23	7	8	9	11
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	4,144	4,632	5,662	6,354	7,418	8,527
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	4,144	4,632	5,662	6,354	7,418	8,527

Cash Flow (CNYm)

Cash flow from operations	4,216	8,591	12,563	8,243	9,795	10,946
Net Capex	-3,946	-3,652	-3,419	-3,921	-3,549	-4,151
Free cash flow	269	4,939	9,144	4,322	6,246	6,794
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-1,807	-2,659	-2,776	-4,093	-4,779	-5,493
Net inc/(dec) in borrowings	4,690	-2,586	-6,038	0	0	0
Other investing/financing cash flows	2,948	-869	175	-20	153	178
Net cash flow	6,099	-1,174	505	209	1,621	1,479
Change in working capital	-1,201	1,298	893	336	129	-1

Balance Sheet (CNYm)

Cash and other liquid assets	14,273	13,084	13,824	14,032	15,653	17,132
Tangible fixed assets	14,080	15,342	14,533	16,890	18,684	20,848
Goodwill/intangible assets	930	956	991	1,100	1,147	1,199
Associates/investments	848	1,107	2,243	2,243	2,243	2,243
Other assets	9,353	9,131	7,661	8,441	9,340	10,112
Total assets	39,484	39,620	39,252	42,707	47,068	51,535
Interest bearing debt	8,776	6,190	150	150	150	150
Other liabilities	11,897	13,295	15,876	17,063	18,776	20,198
Total liabilities	20,673	19,485	16,026	17,213	18,926	20,348
Shareholders' equity	18,634	19,984	23,082	25,342	27,981	31,015
Minorities	188	162	154	162	172	183
Total shareholders' equity	18,822	20,146	23,236	25,504	28,153	31,198
Net debt	-5,497	-6,893	-13,673	-13,882	-15,503	-16,982

Key Company Metrics

Sales growth (%)	14.1	10.8	0.1	12.1	11.3	9.3
DB EPS growth (%)	24.4	12.0	23.3	12.2	16.7	15.0
EBITDA Margin (%)	11.0	11.2	11.8	13.3	13.8	14.4
EBIT Margin (%)	8.7	8.7	9.3	11.2	11.5	12.1
Payout ratio (%)	64.2	60.5	72.3	75.2	74.1	72.8
ROE (%)	23.8	24.0	26.3	26.2	27.8	28.9
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	-54.4	-55.1	-54.4
Net interest cover (x)	30.5	17.5	234.1	381.5	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	30.36 (CNY) 30 Oct 2017	NA

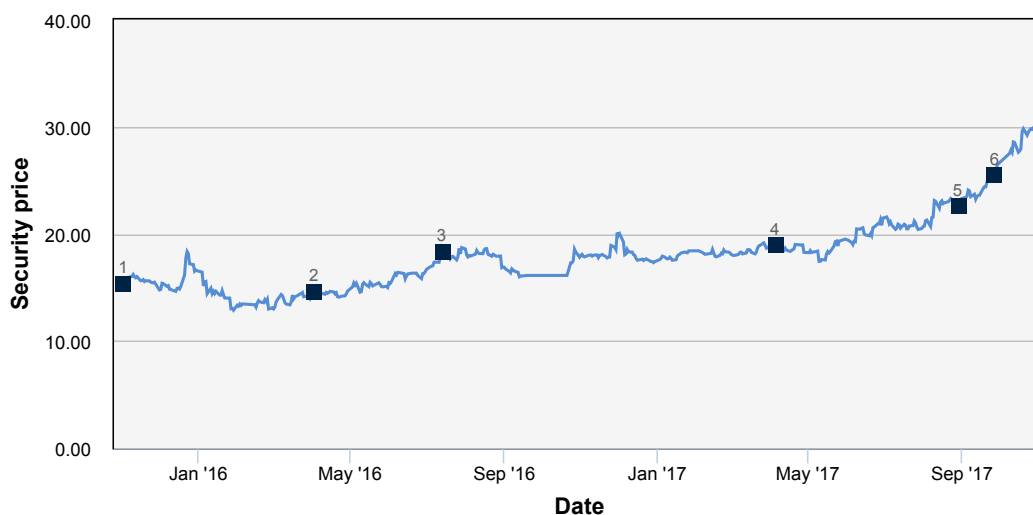
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Historical recommendations and target price. Yili (600887.SS)

(as of 10/30/2017)



Current Recommendations

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

** Analyst is no longer at Deutsche Bank

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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	6.	09/28/2017	Buy, Target Price Change CNY 28,00	Mark Yuan



Equity Rating Key

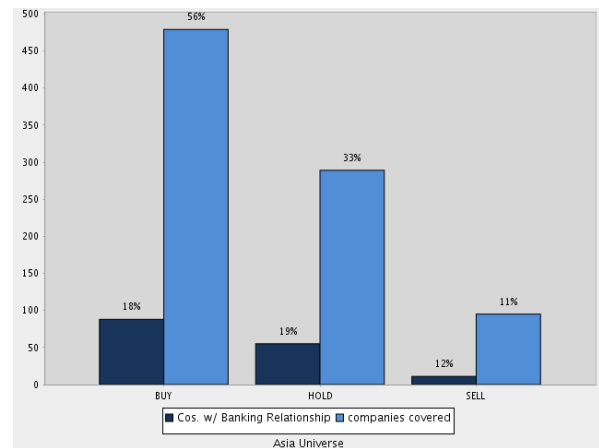
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

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

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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Raj Hindocha
Global Chief Operating Officer
Research

Michael Spencer
Head of APAC Research
Global Head of Economics

Steve Pollard
Head of Americas Research
Global Head of Equity Research

Anthony Klarman
Global Head of
Debt Research

Paul Reynolds
Head of EMEA
Equity Research

Dave Clark
Head of APAC
Equity Research

Pam Finelli
Global Head of
Equity Derivatives Research

Andreas Neubauer
Head of Research - Germany

Spyros Mesomeris
Global Head of Quantitative
and QIS Research

International locations

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

Deutsche Securities Inc.

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
