

Hong Kong
ADD

Consensus ratings*: Buy 27 Hold 5 Sell 2

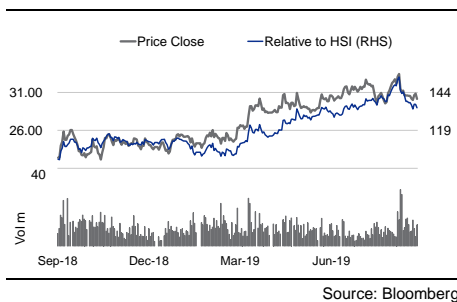
Current price:	HK\$30.15
Target price:	HK\$36.80
Previous target:	HK\$36.80
Up/downside:	22.1%
CGI / Consensus:	8.7%

Reuters:	2319.HK
Bloomberg:	2319 HK
Market cap:	US\$15,152m
	HK\$118,563m
Average daily turnover:	US\$35.17m
	HK\$276.7m
Current shares o/s:	3,927m
Free float:	68.7%

*Source: Bloomberg

Key changes in this note

➤ N/A



Price performance	1M	3M	12M
Absolute (%)	-2.4	-0.3	31.9
Relative (%)	-7.8	-0.3	32.5

Major shareholders	% held
COFCO	16.3
Danone	9.9
Arla	5.3

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China Mengniu Dairy

Mengniu announces a proposal to acquire Bellamy

- Mengniu announced a proposal to acquire Australian organic IMF producer Bellamy.
- We view the proposed deal as strategically positive for Mengniu, as Bellamy will help Mengniu enlarge its IMF products and enhance its brand mix.
- The deal is valued at 33.7x/66.0x FY18/19 PER, which doesn't look cheap to us.
- However, by leveraging Mengniu's resources and distribution network, we believe Bellamy can generate long-term synergy with Mengniu.
- We maintain our Add rating for Mengniu with a DCF-based TP of HK\$36.8.

Mengniu has proposed the acquisition of Bellamy

On 16 Sep 2019, Mengniu announced its proposal to acquire 100% of the shares of Bellamy's Australia Limited (Bellamy), an Australia-listed organic IMF and baby food producer, focusing on the super-premium segment. The consideration is AUD12.65/share in cash, and the total consideration payable by Mengniu is up to AUD1.46 bn. Mengniu plans to finance the deal with 60% of its own cash and 40% from bank financing. We believe the deal structure is reasonable, as Mengniu had Rmb5.2bn in net cash on hand as at end-Jun 2019, and it received Rmb4.6bn in cash by disposing of its stake in Junlebao in Jul 2019. Management expects the deal to be completed by late-Dec.

The valuation is not cheap based on FY2019 PER

Bellamy reported a net profit of AUD22.1m in FY2019 (ended 30 Jun), c.3.0% of Mengniu's total earnings for the 12m ended 30 Jun 2019. It was down 49% yoy as its revenue was down 22% yoy, since Bellamy's Chinese business was negatively impacted by the central government's infant milk formula (IMF) registration process. Based on this profit level, the deal is valued at 33.7x/66.0x FY18/19 PER and 31.7x FY19 EV/EBITDA, which doesn't look cheap to us in the short term. Bellamy had revenue of AUD266.2m in FY19, accounting for 1.7% of Mengniu's total revenue for the 12m ended 30 June 2019.

Bellamy will enhance Mengniu's product mix

Bellamy focuses on the super-premium segment and has a strong presence in Southeast Asia and China, as 29%/26% of its revenue in FY18/19 came from exports. Before it lost market share in China due to IMF registration, it had solid business in China's Tier 1 & 2 cities and in cross-border e-commerce channels. By acquiring Bellamy, Mengniu will enlarge its IMF business and upgrade its product mix in the long run.

Synergy plans are under way

After acquiring Bellamy, Mengniu will help it obtain the IMF registration license from the Chinese government by leveraging Mengniu's resources. Currently, Bellamy's China revenue comes mainly from cross-border e-commerce. Management's long-term target sales split between online and offline channels is 60:40 when Bellamy obtains the registration license. After the acquisition, Mengniu will keep most of Bellamy's existing management team, and Bellamy and Yashili will still be run separately. But Mengniu plans to achieve synergy between Bellamy and Yashili by sharing supply-chain operations and manufacturing facilities.

Maintain Add for Mengniu with a DCF-based TP of HK\$36.8

We maintain our Add rating for Mengniu, with DCF-based TP of HK\$36.8. We view the deal as strategically positive for Mengniu, as Bellamy will help Mengniu enlarge its IMF products and enhance its brand mix. Although the deal valuation is not cheap in the short term, based on FY19 PER, we expect Mengniu to help Bellamy improve its China business and ROE in the long term by obtaining the IMF registration license and strengthening its sales team and distribution. Positive catalysts will be 1) strong synergy from the acquisition of Bellamy, and 2) higher top-line growth. Downside risks include 1) higher-than-expected raw milk prices, and 2) more severe price competition.

Financial Summary	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue (Rmbm)	60,156	68,977	77,569	85,491	94,040
Operating EBITDA (Rmbm)	4,185	5,179	6,664	7,913	9,147
Net Profit (Rmbm)	2,048	3,043	3,806	4,661	5,491
Core EPS (Rmb)	0.53	0.77	0.97	1.19	1.40
Core EPS Growth		47.4%	25.1%	22.4%	17.8%
FD Core P/E (x)	51.88	35.20	28.14	22.98	19.51
DPS (Rmb)	0.12	0.18	0.29	0.36	0.42
Dividend Yield	0.44%	0.66%	1.07%	1.31%	1.54%
EV/EBITDA (x)	26.66	21.74	16.36	13.27	10.95
P/FCFE (x)	NA	41.0	131.5	19.4	16.2
Net Gearing	29.6%	24.4%	10.7%	(2.1%)	(14.3%)
P/BV (x)	4.70	4.25	3.78	3.37	2.98
ROE	9.4%	12.7%	14.2%	15.5%	16.2%
% Change In Core EPS Estimates					
CGI/consensus EPS (x)			0.85	1.00	1.00

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

Mengniu announces a proposal to acquire Bellamy

Figure 1: Historical Financials of Bellamy's Australia Limited

Year ended 31 March (Unit: AUD million)	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019
Revenue	48.90	125.30	234.08	240.18	328.70	266.24
COGS	-32.51	-84.10	-132.86	-148.66	-199.83	-150.37
Gross Profit	16.39	41.21	101.23	91.52	128.87	115.87
SG&A	-14.26	-28.60	-47.14	-90.39	-64.89	-81.95
Net Finance Income (Expense)	-0.18	0.70	0.59	-1.27	0.93	1.75
Others, Net	-0.08	-0.32	0.22	-0.54	-3.72	-4.31
Earnings before Taxes	1.88	12.98	54.89	-0.68	61.20	31.36
Tax	-0.61	-3.91	-16.57	-0.13	-18.38	-9.69
Net Profit	1.27	9.07	38.33	-0.81	43.27	22.11
Minority Interest	0.00	0.00	0.00	0.00	0.45	0.45
Gross Profit Margin	33.5%	32.9%	43.2%	38.1%	39.2%	43.5%
Net Profit Margin	2.6%	7.2%	16.4%	-0.3%	13.2%	8.3%
EBITDA	2.40	13.05	54.40	1.92	68.28	39.24
EBITDA - yoy change	62.8%	442.8%	316.8%	-96.5%	3458.3%	-42.5%
Net Profit	1.27	9.07	38.33	-0.81	43.27	22.11
Net Profit - yoy change	-21.0%	616.7%	322.4%	N/A	N/A	-48.9%

SOURCES: CGIS RESEARCH, COMPANY DATA, CAPITAL IQ

Figure 2: Bellamy vs Mengniu

	Bellamy	Bellamy	Mengniu	Bellamy as % of Mengniu
Jul 2018 - Jun 2019	AUD million	Rmb Million	Rmb Million	
Revenue	266	1,299	74,332	1.7%
COGS	(150)	(734)	(45,231)	1.6%
Gross Profit	116	565	29,101	1.9%
SG&A	(82)	(400)	(24,852)	1.6%
Operating Profit	34	166	4,249	3.9%
Net Finance Income (Expense)	2	9	361	2.4%
Others, Net	(4)	(21)	3	-800.9%
Earnings before Taxes	31	153	4,613	3.3%
Tax	(10)	(47)	(974)	4.9%
Net Profit	22	108	3,639	3.0%
Minority Interest	0	2	(180)	-1.2%
Gross Profit Margin	43.5%	43.5%	39.2%	
Net Profit Margin	8.3%	8.3%	4.9%	
EBITDA	39	191	5,169	3.7%
Net Profit	22	108	3,639	3.0%

SOURCES: CGIS RESEARCH, COMPANY DATA, CAPITAL IQ

Figure 3: Deal Summary

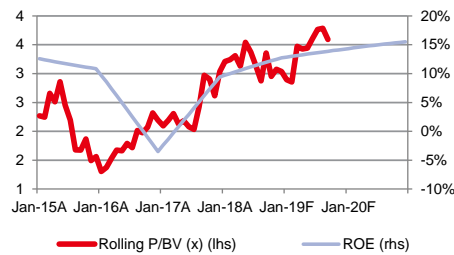
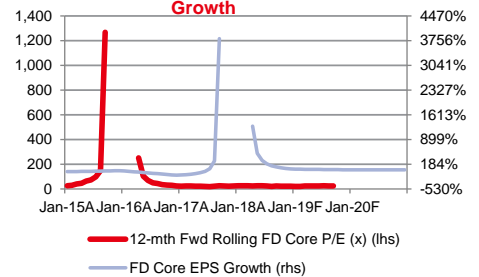
	FY2018	FY2019
Target	100% equity interest in Bellamy's Australia	
Cash consideration	AUD12.65/share	
Total shares outstanding (m, including options)	115.35	
Total consideration (AUD m)	1,459	
Net profit (AUD m)	43.27	22.11
Implied PER	33.7x	66.0x
Enterprise value implied by the consideration (AUD m)	1,458.80	1,458.80
EBITDA (AUD m)	68.28	39.24
Implied EV/EBITDA	21.4x	37.2x

SOURCES: CGIS RESEARCH, COMPANY DATA, CAPITAL IQ

Figure 4: Peer comparison

Company	Ticker	Recom.	Price	TP	Mkt cap	P/E (x)			3-year	P/BV (x)		EV/EBITDA (x)		Dividend yield (x)	
			(LC\$)	(LC\$)	(US\$)	CY19F	CY20F	CY21F	CAGR (%)	CY19F	CY20F	CY19F	CY20F	CY19F	CY20F
Mengniu	2319 HK	Add	30.15	31.50	15,161	23.8	22.9	19.4	26.8%	3.6	3.2	16.0	13.5	1.1%	1.3%
China Modern Dairy	1117 HK	Add	1.14	1.50	894	13.0	10.7	7.9	N/A	0.9	0.9	7.7	7.4	0.0%	0.0%
Yili	600887 CH	Add	29.32	34.0	25,310	25.8	23.1	19.9	6.2%	5.8	5.3	18.5	16.4	2.5%	2.7%
Yashili	1230 HK	Non Rated	0.94	na	570	32.6	32.6	22.3	N/A	0.7	0.7	9.7	9.6	0.0%	0.6%
Bright Dairy	600597 CH	Non Rated	11.06	na	1,917	29.2	26.3	22.9	-7.3%	2.4	2.2	8.7	8.0	1.2%	1.3%
Health and Happiness	1112 HK	Non Rated	33.30	na	2,733	14.3	12.1	10.6	20.1%	3.3	2.7	9.3	8.2	1.6%	1.9%
Beingmate	002570 CH	Non Rated	5.70	na	825	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.0%	0.0%

SOURCES: CGIS RESEARCH, BLOOMBERG

BY THE NUMBERS
P/BV vs ROE

12-mth Fwd FD Core P/E vs FD Core EPS Growth

Profit & Loss

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Net Revenues	60,156	68,977	77,569	85,491	94,040
Gross Profit	21,183	25,784	29,089	32,268	35,896
Operating EBITDA	4,185	5,179	6,664	7,913	9,147
Depreciation And Amortisation	(1,212)	(1,344)	(1,939)	(2,157)	(2,343)
Operating EBIT	2,972	3,835	4,726	5,757	6,803
Financial Income/(Expense)	347	386	311	406	422
Pretax Income/(Loss) from Assoc.	(695)	(369)	61	110	153
Non-Operating Income/(Expense)	0	0	0	0	0
Profit Before Tax (pre-EI)	2,625	3,853	5,098	6,273	7,379
Exceptional Items					
Pre-tax Profit	2,625	3,853	5,098	6,273	7,379
Taxation	(594)	(649)	(1,103)	(1,355)	(1,588)
Exceptional Income - post-tax					
Profit After Tax	2,031	3,204	3,995	4,918	5,790
Minority Interests	17	(161)	(189)	(257)	(300)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	2,048	3,043	3,806	4,661	5,491
Recurring Net Profit	2,048	3,043	3,806	4,661	5,491
Fully Diluted Recurring Net Profit	2,048	3,043	3,806	4,661	5,491

Cash Flow

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
EBITDA	4,185	5,179	6,664	7,913	9,147
Cash Flow from Inv. & Assoc.					
Change In Working Capital	1,229	1,637	967	819	818
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	1,091	664	190	252	309
Net Interest (Paid)/Received	(361)	(454)	(583)	(515)	(527)
Tax Paid	(638)	(662)	(1,103)	(1,355)	(1,588)
Cashflow From Operations	5,505	6,363	6,136	7,113	8,159
Capex	(2,401)	(3,518)	(2,500)	(2,500)	(2,500)
Disposals Of FAs/subsidiaries	136	524	0	0	0
Acq. Of Subsidiaries/investments	(4,188)	(253)	(0)	0	0
Other Investing Cashflow	(4,997)	(122)	894	921	949
Cash Flow From Investing	(11,450)	(3,368)	(1,606)	(1,579)	(1,551)
Debt Raised/(repaid)	5,796	(383)	(3,715)	0	0
Proceeds From Issue Of Shares	24	5	0	0	0
Shares Repurchased					
Dividends Paid	(399)	(526)	(711)	(1,142)	(1,398)
Preferred Dividends					
Other Financing Cashflow	327	4	0	0	0
Cash Flow From Financing	5,748	(900)	(4,426)	(1,142)	(1,398)
Total Cash Generated	(196)	2,095	104	4,392	5,209
Free Cashflow To Equity	(148)	2,613	815	5,534	6,607
Free Cashflow To Firm	(5,584)	3,450	5,113	6,050	7,135

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

BY THE NUMBERS... cont'd

Balance Sheet

(Rmbm)	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Total Cash And Equivalents	5,959	7,298	7,402	11,794	17,003
Total Debtors	2,652	2,941	3,285	3,644	4,034
Inventories	3,510	4,282	4,377	4,879	5,409
Total Other Current Assets	13,896	15,220	15,566	15,885	16,230
Total Current Assets	26,018	29,741	30,630	36,202	42,676
Fixed Assets	14,079	16,937	17,527	17,897	18,080
Total Investments	8,839	9,408	9,348	9,277	9,192
Intangible Assets	7,783	8,100	8,002	7,904	7,808
Total Other Non-Current Assets	1,421	2,271	2,271	2,271	2,271
Total Non-current Assets	32,121	36,716	37,148	37,350	37,351
Short-term Debt	7,958	6,546	6,023	6,023	6,023
Current Portion of Long-Term Debt					
Total Creditors	6,342	7,022	7,440	8,240	9,082
Other Current Liabilities	8,266	11,542	12,876	14,073	15,314
Total Current Liabilities	22,566	25,109	26,338	28,336	30,419
Total Long-term Debt	6,015	8,192	5,000	5,000	5,000
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	2,450	2,691	2,691	2,691	2,691
Total Non-current Liabilities	8,465	10,884	7,691	7,691	7,691
Total Provisions	0	0	0	0	0
Total Liabilities	31,032	35,993	34,029	36,027	38,110
Shareholders' Equity	22,604	25,212	28,308	31,827	35,919
Minority Interests	4,503	5,252	5,441	5,698	5,998
Total Equity	27,107	30,464	33,749	37,524	41,917

Key Ratios

	Dec-17A	Dec-18A	Dec-19F	Dec-20F	Dec-21F
Revenue Growth	11.9%	14.7%	12.5%	10.2%	10.0%
Operating EBITDA Growth	267%	24%	29%	19%	16%
Operating EBITDA Margin	6.96%	7.51%	8.59%	9.26%	9.73%
Net Cash Per Share (Rmb)	(2.06)	(1.89)	(0.92)	0.20	1.52
BVPS (Rmb)	5.80	6.42	7.21	8.10	9.15
Gross Interest Cover	7.43	6.96	8.11	11.17	12.91
Effective Tax Rate	22.6%	16.8%	21.6%	21.6%	21.5%
Net Dividend Payout Ratio	17.8%	19.3%	23.3%	23.2%	23.3%
Accounts Receivables Days	15.26	14.80	14.65	14.83	14.90
Inventory Days	31.96	32.92	32.60	31.83	32.29
Accounts Payables Days	55.01	56.46	54.44	53.91	54.37
ROIC (%)	9.3%	10.8%	11.8%	14.6%	17.6%
ROCE (%)	9.9%	11.1%	12.5%	14.3%	15.3%
Return On Average Assets	4.41%	5.68%	7.23%	8.43%	9.18%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

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We are transferring the rating mechanism from "BUY, SELL, HOLD" to "ADD, REDUCE, HOLD". Please refer to the definitions below.

Explanation on Equity Ratings (Existing mechanism (will be replaced by new mechanism by 01/09/19))

- BUY : share price will increase by >20% within 12 months in absolute terms
SELL : share price will decrease by >20% within 12 months in absolute terms
HOLD : no clear catalyst, and downgraded from BUY pending clearer signal to reinstate BUY or further downgrade to outright SELL

Explanation on Equity Ratings (New mechanism)

- ADD : The stock's total return is expected to exceed 10% over the next 12 months.
REDUCE : The stock's total return is expected to fall below 0% or more over the next 12 months.
HOLD : The stock's total return is expected to be between 0% and positive 10% over the next 12 months.

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