



A new shortage cycle begins; Buy Mengniu and Yili

Raw milk shortage leads to faster market share gains for Mengniu and Yili

We expect the dairy sector to enter an undersupply cycle from 2018. In this new cycle, competition will switch from price to raw milk sourcing. Helped by their closer relationship with dairy farms, Mengniu and Yili should be able to gain market share faster in the next three years. Meanwhile, rising raw milk cost could be mostly offset by lower selling expenses and price increases, as we have seen in past cycles. We expect continued re-ratings for Mengniu and Yili within the new cycle and we reiterate Buy on both.

The undersupply and oversupply cycles of the past six years

The dairy sector experienced an undersupply cycle in 2011-13 and an oversupply cycle in 2014-16. **During the undersupply cycle**, Mengniu and Yili posted 13% and 17% sales CAGR, driven by market share gains, as smaller players had to source raw milk at a higher price. Yet operating margins for both companies expanded during the period, helped by lower selling expense and price hike in 2013. **During the oversupply cycle**, both companies' sales growth slowed down to high-single digit CAGR, because oversupply resulted in increasing competition at the retail end, as the smaller players can source milk at a much lower price. For Mengniu and Yili, the cost savings at a lower milk price are mostly offset by rising selling expenses.

Entering a new undersupply cycle in 2017-19

After three years' capacity reduction on upstream from 2H14, the sector's supply is rebalancing with demand from 2017. Given it takes two years for a calf to grow up to be a milkable cow, we expect the shortage cycle to continue in 2018-19. Similar to the previous shortage cycle in 2011-13, we expect both Mengniu and Yili to gain more market share in 2017-19. Actually, Mengniu/Yili's sales growth recovered to double digits in 3Q17, faster than industry's mid-single-digit growth. Meanwhile, we expect Mengniu's and Yili's margins to expand in 2018-19, as the rising raw milk price will be fully offset by lower selling expense, fewer price discounts and potential ex-factory price hikes.

The cycle is just beginning; reiterating Buy on Mengniu and Yili

Mengniu and Yili have rallied 44% and 74% YTD, driven by the early signs of industry recovery. We think the recovery is a structural trend for the next three years and expect the two names to continue to deliver sustained sales growth. We raise our target price for Mengniu to HK\$26.8 and our target price for Yili to RMB35.0 based on DCF method (factoring in 3.9% RFR, 5.6% ERP, 1.0 beta, debt-free structure and 2% terminal growth). The next catalyst will be their result reporting dates. Downside risks: food safety, and oversupply.

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Key Changes

Company	Target Price	Rating
600887.SS	31.60 to 35.00(CNY)	-
2319.HK	23.60 to 26.80(HKD)	-

Source: Deutsche Bank

Top picks

Yili (600887.SS),CNY30.28	Buy
China Mengniu Dairy (2319.HK),HKD21.70	Buy

Source: Deutsche Bank

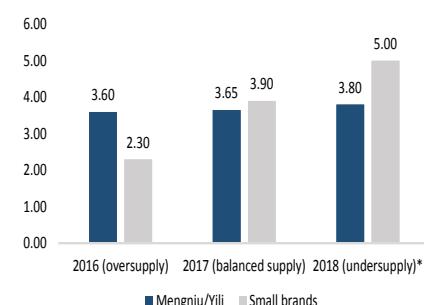
Companies Featured

Yili (600887.SS),CNY30.28	Buy
2016A	2017E
P/E (x)	17.3 28.4
EV/EBITDA (x)	11.9 18.5
Price/book (x)	4.6 7.2
	2018E
	24.0 15.8
	6.5

China Mengniu Dairy (2319.HK),HKD21.70	Buy
2016A	2017E
P/E (x)	29.5 29.4
EV/EBITDA (x)	13.1 13.5
Price/book (x)	2.4 3.2
	21.3 11.2

Source: Deutsche Bank

A dairy farm's raw milk prices in different cycles



Source: Deutsche Bank; based on channel check in a north dairy farming company with >10,000 herd size. 2018 number was based on estimated for illustration purpose.



Investment summary

Mengniu and Yili's sales growths are recovering from 2017 after two years' weak growth. The market generally believes this is due to a recovery in dairy demand. **However, we believe this is more because of changing raw milk supply cycles.** We expect the dairy sector to switch from an oversupply cycle to an undersupply cycle from 2017. In the new cycle, small brands will face increasing raw milk cost and losing market share to large brands. We expect the undersupply cycle to be sustained into 2018-19, which should lead to faster market share gains for Mengniu and Yili.

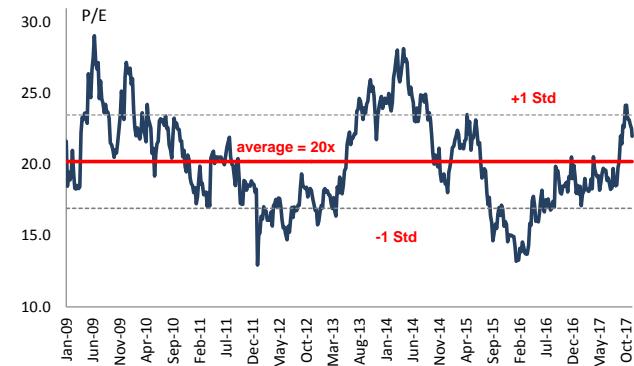
We are raising our earnings forecasts for Mengniu and Yili, and **lifting our target price for Mengniu to HK\$26.8 and our target price for Yili to RMB35, both based on DCF approach.** We reiterate Buy on the two stocks.

Figure 1: Forecast changes

RMBm	New			Old			Change		
	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Mengniu									
Sales									
Sales	58,283	64,009	69,793	58,283	63,810	68,848	0.0%	0.3%	1.4%
Operating profit	3,434	4,174	4,883	3,434	4,123	4,749	0.0%	1.2%	2.8%
Net profit	2,448	3,378	4,172	2,448	3,339	4,066	0.0%	1.2%	2.6%
Yili									
Sales	68,674	76,409	83,497	68,012	75,694	82,731	1.0%	0.9%	0.9%
Operating profit	7,696	8,897	10,206	7,554	8,629	9,911	1.9%	3.1%	3.0%
Net profit	6,474	7,647	8,780	6,354	7,418	8,527	1.9%	3.1%	3.0%

Source: Deutsche Bank

Figure 2: Mengniu P/E Chart



Source: Deutsche Bank, Bloomberg Finance LP

Figure 3: Yili P/E Chart



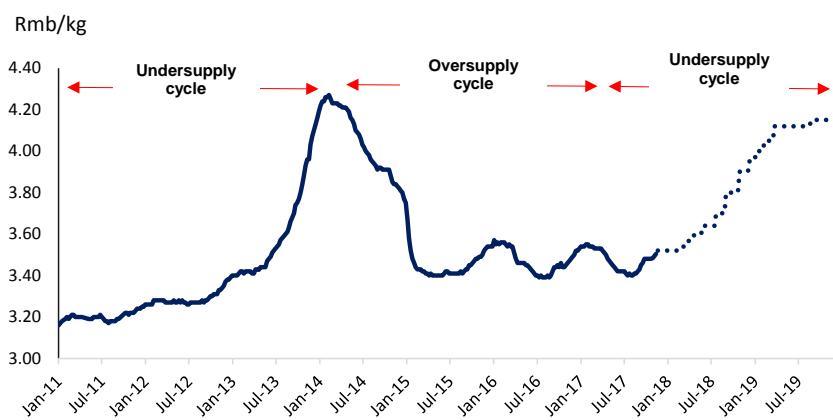
Source: Deutsche Bank, Bloomberg Finance LP



The historical milk supply cycles

Unlike most other staples segments, dairy names' operations are highly affected by the supply situation of the upstream dairy farms. Raw milk, the major raw material of the dairy sector, is cyclical in supply and has a very short shelf life. Meanwhile, an oversupply or an undersupply cycle normally lasts for two to three years, because it takes two years for a newborn calf to grow up to become a milkable cow. China experienced undersupply in 2011-1H14 and oversupply in 2H14-2016.

Figure 4: China's raw milk supply cycle



Source: Deutsche Bank, moa.gov.cn; future raw milk prices are DB forecast.

In an undersupply cycle, the competition arises mainly in raw milk sourcing, and large brands (Mengniu and Yili) are better positioned than smaller brands, because large dairy names generally have long-term contracts and closer relationships with upstream dairy farms. For example, Mengniu signed a 10-year contract with China Modern Dairy in 2008. Meanwhile, large brands have a national raw milk sourcing network and can ship more milk from production regions (north China) to consumption regions (south and east China). Large brands tend to gain more share in the cycle.

During the 2011-1H14 undersupply cycle, Mengniu and Yili recorded sales growth of 13%/17% in 2011-13 helped by market share gains (Figure 6). Meanwhile, though Yili's and Mengniu's gross margins declined during the period due to rising raw milk price, their core OP margins expanded from 1.9%/4.4% in 2010 to 8.5%/5.9% in 2014, as the rising raw milk cost was fully offset by fewer price promotions, mix upgrade, and a 5-17% price hike in 2013.

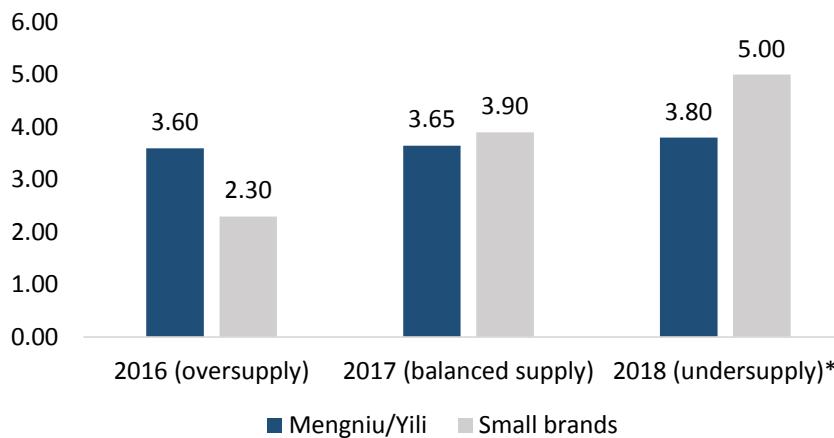
In an oversupply cycle, the competition switches back to sales and marketing, and small brands are better positioned. It is easier for small local brands to source milk at a much lower price, because dairy farms have strong incentives to sell out all extra milk. Dairy farms also sell milk directly to retail ends. This leads to heavy price competition at the retail end. However, due to their closer relationships and long-term contracts with large dairy farms, large brands cannot cut procurement volume immediately and revise down sourcing price too aggressively.



For example, in 2016, a dairy farm we visited supplied Mengniu/Yili at RMB3.5-3.8/kg, but supplied its extra milk to smaller local brands at RMB2/kg. Yet, from 3Q17, the dairy farm was still selling to Mengniu/Yili at RMB3.5-3.8/kg, but selling to smaller brands at RMB3.9/kg.

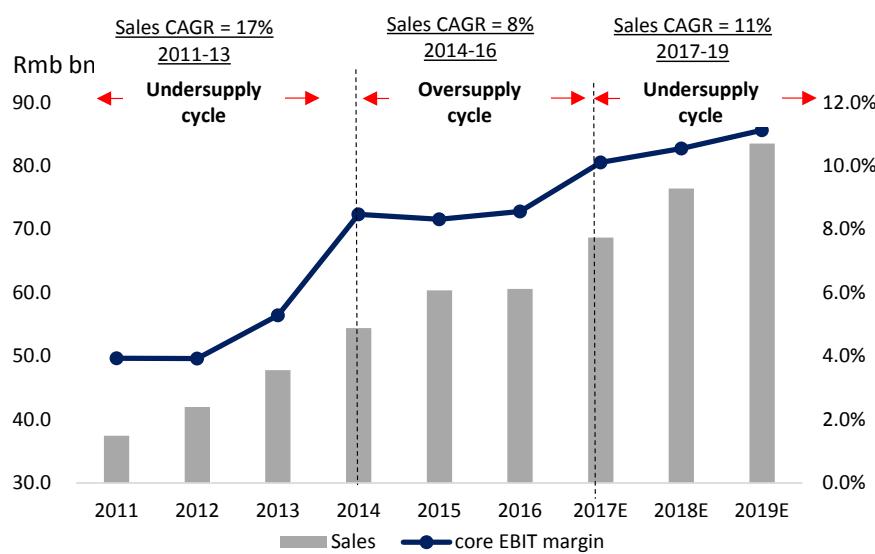
During the 2H14-2016 oversupply cycle, Yili and Mengniu saw a slowdown in sales to 8%/7% CAGR in 2014-16, due to increasing competition from small local players. Though the gross margins of both companies expanded, helped by declining raw milk price and product mix upgrade, Yili and Mengniu's core OP margins changed by 10bps/-260bps in 2014-2016, due to heavy price competition and increasing A&P expense.

Figure 5: A dairy farm's raw milk prices in different cycles



Source: Deutsche Bank; based on channel check in a north dairy farming company with >10,000 herd size. 2018 number was based on estimates for illustration purpose.

Figure 6: Yili's growth and margin in different cycles



Source: Deutsche Bank; company annual reports

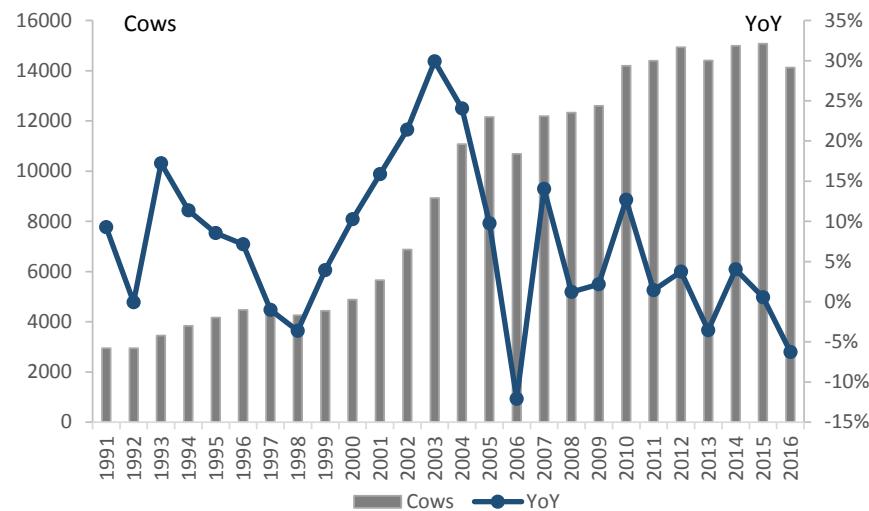


Entering a new undersupply cycle

We expect raw milk supply to rebalance again from 2H17

National raw milk price has recovered from RMB3.4 in 2Q to RMB3.5 in 3Q17. According to "cow" magazine's survey, all of the 21 dairy farms in its survey either have the same or a higher price in October compared to September, and none of those farms limited production in October. We believe this is a result of capacity reduction from 2014.

Figure 7: Number of cows and yoy change



Source: Deutsche Bank, wind

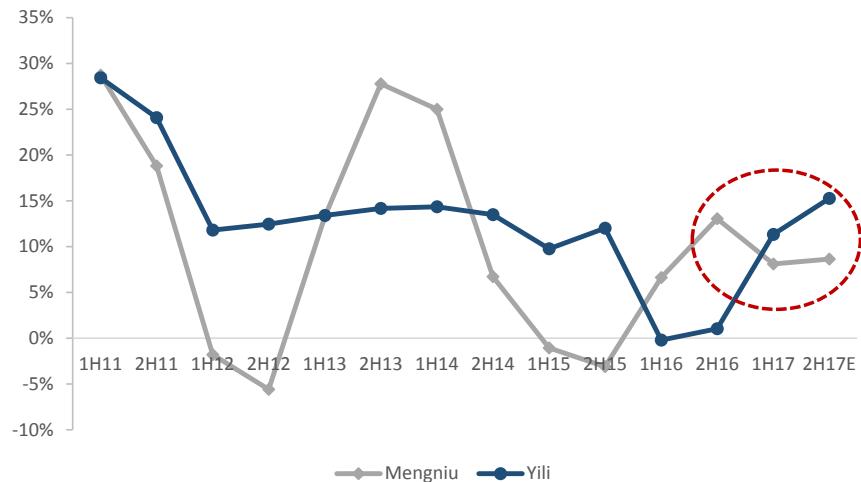
What will happen in the new shortage cycle?

Within the undersupply cycle, we expect a similar trend to the previous shortage cycle to happen in 2018-19:

- First, as large dairy players, Yili's and Mengniu's sales growth will accelerate, driven by faster market share gains. This is because small brands' raw milk sourcing capability is weaker in this cycle. Actually, Yili and Mengniu have shown such recovery from 2017 – Yili's sales growth accelerated from 0.4% in 2016 to 14% sales growth in 9M17, and we expect Mengniu's sales growth to accelerate to double-digit in 3Q17. We forecast Mengniu/Yili's sales to grow at 9%/11% in 2017-19.
- Secondly, while gross margin will be under pressure due to rising raw milk price, most of this pressures could be passed on to consumers through reducing price discounts at an early stage, and raising prices at a later stage. For example, a Shanghai distributor indicated that Yili and Mengniu have raised the supply price of chilled yoghurt from 3Q.
- Thirdly, the selling expense ratio will decline on easing competition. Yili's and Mengniu's financial results in 9M17 also show this trend. Thanks to easing off of competition and lower SG&A expense, Yili's and Mengniu's core operating margins expanded 120bps in 9M17 and 190bps yoy in 1H17, respectively. We expect Mengniu/Yili's core EBIT margins to expand by 400bps/260 bps from 2017 to 2019.



Figure 8: Mengniu's and Yili's sales growth recover from 2017



Source: Deutsche Bank, company data; E=Deutsche Bank forecast.

Mengniu: market underestimates its margin recovery potential; reiterating Buy

We forecast the dairy sector to register an 8% sales CAGR in 2017-19, driven by 4% volume growth and 4% price increase each year. Further, helped by its stronger position in raw milk sourcing, we expect Mengniu's market share to expand by 2-4% from 2017 to 2019.

Meanwhile, we expect Mengniu to narrow its profitability gap with Yili, helped by recovering efficiency after the company's organizational restructuring in 2016 and improving IMF operations helped by industry recovery. (Refer to our note "[Can Mengniu catch up with Yili?](#)" for more details.) We forecast Mengniu's recurring EBIT margin to expand from 6.1% in 1H17 to 7.0% in 2019.

We increase our earnings forecasts by 1-3% and expect a 31% recurring earnings CAGR in 2017-19. We raise our target price to HK\$26.8 based on a DCF approach (factoring in 3.9% risk-free rate, 5.6% equity premium, 1.0 beta and 2% terminal growth). Our earnings forecasts are 1-6% higher than market consensus. In our view, the market is still underestimating the potential of its margin recovery. **We reiterate Buy.** The annual results announcement in March will be next catalyst.



Figure 9: Mengniu: forecast changes

RMBm	New			Old			Change		
	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Sales	58,283	64,009	69,793	58,283	63,810	68,848	0.0%	0.3%	1.4%
Gross profit	20,336	22,352	24,285	20,336	22,373	24,164	0.0%	-0.1%	0.5%
SG&A	(16,611)	(17,987)	(19,263)	(16,611)	(18,058)	(19,278)	0.0%	-0.4%	-0.1%
Operating profit	3,434	4,174	4,883	3,434	4,123	4,749	0.0%	1.2%	2.8%
Associate income	(398)	115	247	(398)	115	247	0.0%	0.0%	0.0%
Net profit	2,448	3,378	4,172	2,448	3,339	4,066	0.0%	1.2%	2.6%
GP margin	34.9%	34.9%	34.8%	34.9%	35.1%	35.1%	0.0%	-0.1%	-0.3%
OP margin	5.9%	6.5%	7.0%	5.9%	6.5%	6.9%	0.0%	0.1%	0.1%
Net margin	4.2%	5.3%	6.0%	4.2%	5.2%	5.9%	0.0%	0.0%	0.1%
Operating cash flow	3,974	5,779	6,165	3,974	5,707	5,995	0.0%	1.3%	2.8%
Capex	(2,662)	(2,688)	(2,722)	(2,662)	(2,680)	(2,685)	0.0%	0.3%	1.4%
Free cash flow	1,312	3,091	3,443	1,312	3,027	3,310	0.0%	2.1%	4.0%

Source: Deutsche Bank estimates

Yili: well positioned in shortage cycle; reiterating Buy

In the near term, we expect Yili's market share in ambient/chilled products to expand from 34%/16% in 3Q17 to 38%/20%, respectively, in 2019, helped by its strong capability in raw milk sourcing. Meanwhile, we forecast its OP margin will expand from 11.5% in 9M17 to 12.2% in 2019, helped by easing competition and product mix upgrade.

In the long term, we expect Yili to be an industry consolidator in the staples sector, helped by its stable and experienced management team, strong distribution network, and good track record in new product launches. We expect it to deliver secular growth through market share gains, category expansion, and M&A.

We raise our earnings forecasts by 1-3% and forecast a 16% earnings CAGR in 2017-19. We increase our target price to RMB35 based on a DCF approach (factoring in 3.9% RFR, 5.6% ERP, 1.0 beta, debt-free structure and 2% terminal growth). Downside risks: higher-than-expected raw material price increases, food safety incidents, and worse-than-expected competition.

Figure 10: Yili: forecast changes

RMBm	New			Old			Change		
	2017E	2018E	2019E	2017E	2018E	2019E	2017E	2018E	2019E
Sales	68,674	76,409	83,497	68,012	75,694	82,731	1.0%	0.9%	0.9%
Gross profit	25,319	27,862	30,307	25,343	27,481	29,895	-0.1%	1.4%	1.4%
EBIT	7,696	8,897	10,206	7,554	8,629	9,911	1.9%	3.1%	3.0%
Net profit	6,474	7,647	8,780	6,354	7,418	8,527	1.9%	3.1%	3.0%
Recurring net profit	6,532	7,702	8,837	6,411	7,473	8,585	1.9%	3.1%	2.9%
GPM	36.9%	36.5%	36.3%	37.3%	36.3%	36.1%	-0.4%	0.2%	0.2%
EBIT margin	11.2%	11.6%	12.2%	11.1%	11.4%	12.0%	0.1%	0.2%	0.2%
Net margin	9.4%	10.0%	10.5%	9.3%	9.8%	10.3%	0.1%	0.2%	0.2%

Source: Deutsche Bank estimates



Figure 11: Valuation comp

Company	Ticker	Rec	Listing Curr	Price	Mkt Cap US\$mn	PE (x)			PB (x)			EV/EBITDA			Div Yield (%)		
						Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y	Hist	FY1Y	FY2Y
A share F&B companies																	
Yili Dairy	600887.SS	Buy	CNY	30.7	28,123	17.3	28.8	24.3	4.6	7.3	6.6	11.9	18.8	16.1	4.3	2.6	3.0
Bright Dairy	600597.SS	Hold	CNY	14.8	2,748	28.4	29.3	26.8	3.2	3.4	3.1	7.6	9.1	8.6	1.2	1.2	1.3
Beijing Sanyuan	600429.SS	NR	CNY	6.8	1,529	111.5	52.1	42.3	2.5	NM	NM	101.4	NM	NM	NM	NM	NM
Henan Shuanghui	000895.SZ	NR	CNY	28.0	13,931	15.7	19.9	17.9	4.9	6.5	6.2	10.8	13.6	12.3	4.3	4.9	5.5
Foshan Haitian	603288.SS	NR	CNY	53.6	21,849	27.9	41.5	35.2	7.9	12.6	10.6	19.6	31.4	26.7	1.3	1.5	1.8
Average						40.2	34.3	29.3	4.6	7.5	6.6	30.2	18.2	15.9	2.8	2.5	2.9
HK F&B companies																	
Mengniu Dairy	2319.HK	Buy	HKD	21.6	10,847	NM	29.1	21.1	2.4	3.2	2.8	13.1	13.4	11.1	0.8	0.8	1.1
Biostime	1112.HK	Hold	HKD	41.6	3,386	13.2	26.4	22.0	4.1	5.4	4.5	9.2	14.5	11.3	0.0	0.0	1.8
Want Want	0151.HK	Hold	HKD	6.6	10,501	16.1	20.7	19.9	4.7	5.1	4.3	9.6	12.7	11.9	0.0	0.0	0.0
Tingyi	0322.HK	Sell	HKD	12.4	8,880	33.8	36.1	34.3	2.5	3.1	2.9	7.6	9.4	9.0	1.5	1.4	1.5
UPC	0220.HK	Hold	HKD	6.9	3,820	36.0	31.4	28.7	1.7	2.0	1.9	10.5	9.7	8.7	0.6	1.0	1.0
CRB	0291.HK	Hold	HKD	22.6	9,398	62.0	30.8	25.6	2.2	2.9	2.7	12.1	16.1	13.7	0.6	0.7	0.8
Dali	3799.HK	Buy	HKD	6.0	10,479	16.0	20.6	17.4	3.5	4.6	4.2	8.9	11.8	9.8	4.4	3.4	4.0
Vitasoy	345.HK	NR	HKD	18.8	2,541	28.4	35.7	31.5	6.9	7.5	6.8	19.1	20.8	18.2	1.6	1.7	1.8
Average						29.4	28.8	25.1	3.5	4.2	3.8	11.3	13.6	11.7	1.2	1.1	1.5
Global dairy/IMF companies																	
Meiji Holdings	2269.T	Buy	JPY	9,370	12,539	20.5	23.1	20.2	3.3	3.0	2.7	11.1	10.7	9.6	1.0	1.2	1.2
Dean Foods	DF	NR	USD	9.3	846	13.7	11.8	11.0	3.2	1.3	1.2	6.4	4.9	4.8	3.9	4.0	4.1
Danone SA	DANO.PA	Sell	EUR	70.7	54,979	22.6	22.4	20.1	2.8	3.1	2.9	11.3	13.2	11.9	2.7	2.7	3.0
Nestle SA	NESN.S	Buy	CHF	84.7	263,129	26.7	26.2	23.8	3.5	4.0	4.1	14.2	15.5	14.7	3.1	2.8	2.9
Fonterra	FCG.NZ	NR	NZD	6.3	7,015	11.2	12.0	10.8	1.3	1.4	1.3	7.8	8.5	8.0	6.3	6.1	6.6
Saputo	SAP.TO	NR	CAD	45.0	13,632	26.5	22.6	20.1	4.1	3.9	3.6	15.7	13.7	12.1	1.4	1.4	1.5
Vietnam Dairy	VNM.HM	NR	VND	158,000	10,067	21.5	23.0	20.9	8.2	9.5	8.7	14.8	16.2	14.7	2.5	3.7	3.8
Average						20.4	20.2	18.1	3.8	3.8	3.5	11.6	11.8	10.8	3.0	3.1	3.3

Source: Deutsche Bank, Bloomberg Finance LP. Prices as of 6 Nov 2017. We use DB forecasts for those companies we covered and Bloomberg Finance LP consensus for other companies.



Model updated: 06 November 2017

Running the numbers

Asia

China

Food & Beverage

China Mengniu Dairy

Reuters: 2319.HK

Bloomberg: 2319 HK

Buy

Price (7 Nov 17) HKD 21.70

Target Price HKD 26.80

52 Week range HKD 14.00 - 22.55

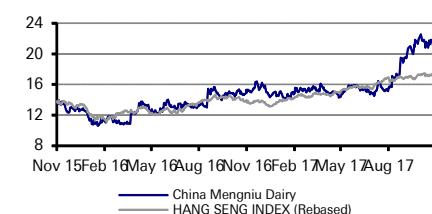
Market Cap (m) HKDm 85,150

USDm 10,912

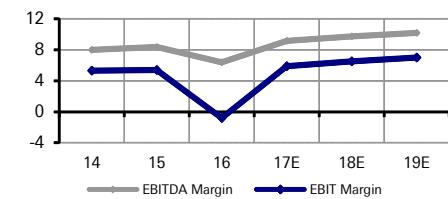
Company Profile

China Mengniu is one of the leading dairy product manufacturers in China. There are 3 principal product categories (1) liquid milk (comprising UHT milk, milk beverage and yoghurt), (2) ice cream and (3) milk powder; and (4) other products such as plant-based protein, cheese, milk tablets, etc.

Price Performance



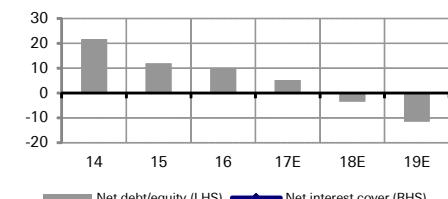
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

	2014	2015	2016	2017E	2018E	2019E
Financial Summary						
DB EPS (CNY)	0.60	0.61	0.39	0.63	0.87	1.07
Reported EPS (CNY)	0.60	0.61	-0.19	0.63	0.87	1.07
DPS (CNY)	0.07	0.14	0.09	0.14	0.20	0.25
BVPS (CNY)	5.5	5.6	5.3	5.8	6.5	7.3
Weighted average shares (m)	3,884	3,889	3,886	3,886	3,886	3,886
Average market cap (CNYm)	55,078	53,402	44,392	72,406	72,406	72,406
Enterprise value (CNYm)	57,645	54,533	44,994	72,352	69,848	66,854

	2014	2015	2016	2017E	2018E	2019E
Valuation Metrics						
P/E (DB) (x)	23.6	22.6	29.5	29.4	21.3	17.2
P/E (Reported) (x)	23.6	22.6	nm	29.4	21.3	17.2
P/BV (x)	2.30	1.82	2.41	3.19	2.86	2.54
FCF Yield (%)	0.3	nm	1.7	1.8	4.3	4.8
Dividend Yield (%)	0.5	1.0	0.8	0.8	1.1	1.3
EV/Sales (x)	1.2	1.1	0.8	1.2	1.1	1.0
EV/EBITDA (x)	14.4	13.3	13.1	13.5	11.2	9.4
EV/EBIT (x)	21.6	20.6	nm	21.1	16.7	13.7

	2014	2015	2016	2017E	2018E	2019E
Income Statement (CNYm)						
Sales revenue	50,049	49,027	53,779	58,283	64,009	69,793
Gross profit	15,434	15,375	17,635	20,336	22,352	24,285
EBITDA	4,006	4,092	3,435	5,343	6,238	7,104
Depreciation	1,342	1,444	1,602	1,910	2,065	2,221
Amortisation	0	0	2,254	0	0	0
EBIT	2,665	2,648	-420	3,434	4,174	4,883
Net interest income(expense)	208	245	184	89	47	248
Associates/affiliates	278	138	-225	-398	115	247
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0	0
Profit before tax	3,150	3,030	-461	3,125	4,335	5,378
Income tax expense	459	510	351	613	885	1,138
Minorities	340	153	-62	64	73	68
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	2,351	2,367	-751	2,448	3,378	4,172
DB adjustments (including dilution)	0	0	2,254	0	0	0
DB Net profit	2,351	2,367	1,503	2,448	3,378	4,172

	2014	2015	2016	2017E	2018E	2019E
Cash Flow (CNYm)						
Cash flow from operations	3,080	1,909	5,114	3,974	5,779	6,165
Net Capex	-2,931	-3,278	-4,352	-2,662	-2,688	-2,722
Free cash flow	148	-1,369	761	1,312	3,091	3,443
Equity raised/bought back	4,074	0	0	0	0	0
Dividends paid	-491	-655	-349	-284	-676	-876
Net inc/(dec) in borrowings	-1,485	519	-2,457	0	0	0
Other investing/financing cash flows	-1,994	4,733	184	89	47	248
Net cash flow	252	3,228	-1,861	1,117	2,461	2,815
Change in working capital	-470	-928	2,040	-983	230	193

	2014	2015	2016	2017E	2018E	2019E
Balance Sheet (CNYm)						
Cash and other liquid assets	4,650	7,931	6,070	7,187	9,649	12,463
Tangible fixed assets	11,801	12,559	14,038	14,838	15,508	16,054
Goodwill/intangible assets	8,508	8,470	7,598	7,550	7,503	7,458
Associates/investments	5,735	6,514	6,628	6,230	6,344	6,592
Other assets	16,387	15,178	14,791	15,275	16,206	17,227
Total assets	47,081	50,653	49,124	51,079	55,211	59,794
Interest bearing debt	9,948	11,097	8,640	8,640	8,640	8,640
Other liabilities	12,640	12,940	14,981	14,992	16,457	17,768
Total liabilities	22,588	24,037	23,621	23,632	25,097	26,408
Shareholders' equity	21,489	22,136	20,845	22,725	25,319	28,522
Minorities	3,003	4,479	4,659	4,723	4,795	4,863
Total shareholders' equity	24,493	26,615	25,504	27,447	30,114	33,386
Net debt	5,298	3,166	2,570	1,453	-1,008	-3,823

	2014	2015	2016	2017E	2018E	2019E
Key Company Metrics						
Sales growth (%)	15.4	-2.0	9.7	8.4	9.8	9.0
DB EPS growth (%)	34.2	1.0	-36.3	62.6	38.0	23.5
EBITDA Margin (%)	8.0	8.3	6.4	9.2	9.7	10.2
EBIT Margin (%)	5.3	5.4	-0.8	5.9	6.5	7.0
Payout ratio (%)	11.6	23.0	nm	23.0	23.0	23.0
ROE (%)	12.8	10.9	-3.5	11.2	14.1	15.5
Capex/sales (%)	5.9	6.7	8.1	4.6	4.2	3.9
Capex/depreciation (x)	2.2	2.3	2.7	1.4	1.3	1.2
Net debt/equity (%)	21.6	11.9	10.1	5.3	-3.3	-11.5
Net interest cover (x)	nm	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates

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Model updated: 06 November 2017

Running the numbers

Asia

China

Food & Beverage

Yili

Reuters: 600887.SS Bloomberg: 600887 CH

Buy

Price (7 Nov 17) CNY 30.28

Target Price CNY 35.00

52 Week range CNY 17.30 - 30.70

Market Cap (m) CNYm 183,642

USDm 27,677

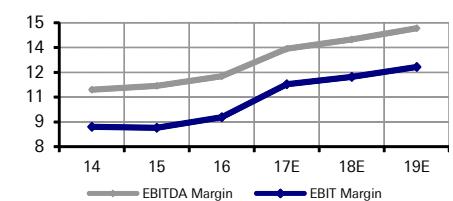
Company Profile

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.

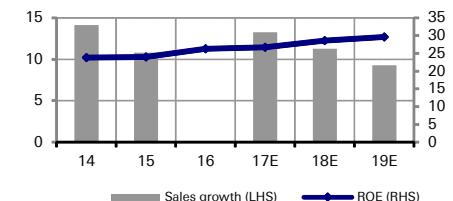
Price Performance



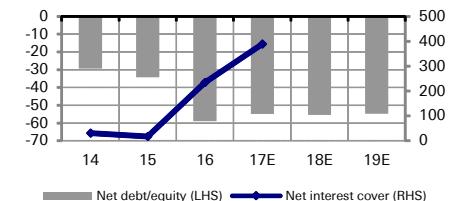
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

	2014	2015	2016	2017E	2018E	2019E
Financial Summary						
DB EPS (CNY)	0.68	0.76	0.93	1.07	1.26	1.45
Reported EPS (CNY)	0.68	0.76	0.93	1.07	1.26	1.45
DPS (CNY)	0.43	0.46	0.69	0.81	0.93	1.09
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	183,642	183,642	183,642
Enterprise value (CNYm)	67,528	93,123	84,047	169,666	168,019	166,479

Valuation Metrics

P/E (DB) (x)	17.6	21.6	17.3	28.4	24.0	20.9
P/E (Reported) (x)	17.6	21.6	17.3	28.4	24.0	20.9
P/BV (x)	4.62	4.98	4.62	7.23	6.53	5.88
FCF Yield (%)	0.4	4.9	9.4	2.4	3.5	3.8
Dividend Yield (%)	3.6	2.8	4.3	2.7	3.1	3.6
EV/Sales (x)	1.2	1.5	1.4	2.5	2.2	2.0
EV/EBITDA (x)	11.4	13.8	11.9	18.5	15.8	13.7
EV/EBIT (x)	14.3	17.9	15.0	22.0	18.9	16.3

Income Statement (CNYm)

Sales revenue	54,251	60,109	60,189	68,157	75,841	82,847
Gross profit	17,851	21,733	22,762	25,319	27,862	30,307
EBITDA	5,946	6,727	7,088	9,150	10,608	12,147
Depreciation	1,204	1,497	1,473	1,428	1,682	1,910
Amortisation	20	25	25	26	29	31
EBIT	4,721	5,205	5,590	7,696	8,897	10,206
Net interest income(expense)	-155	-297	-24	-20	154	180
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	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	7,609	8,987	10,318
Income tax expense	619	869	963	1,126	1,330	1,527
Minorities	22	23	7	8	10	11
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	4,144	4,632	5,662	6,474	7,647	8,780
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	4,144	4,632	5,662	6,474	7,647	8,780

Cash Flow (CNYm)

Cash flow from operations	4,216	8,591	12,563	8,468	10,002	11,207
Net Capex	-3,946	-3,652	-3,419	-3,974	-3,583	-4,190
Free cash flow	269	4,939	9,144	4,494	6,419	7,016
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-1,807	-2,659	-2,776	-4,171	-4,926	-5,656
Net inc/(dec) in borrowings	4,690	-2,586	-6,038	0	0	0
Other investing/financing cash flows	2,948	-869	175	-20	154	180
Net cash flow	6,099	-1,174	505	303	1,647	1,540
Change in working capital	-1,201	1,298	893	389	94	-2

Balance Sheet (CNYm)

Cash and other liquid assets	14,273	13,084	13,824	14,126	15,773	17,313
Tangible fixed assets	14,080	15,342	14,533	16,942	18,767	20,964
Goodwill/intangible assets	930	956	991	1,102	1,149	1,202
Associates/investments	848	1,107	2,243	2,243	2,243	2,243
Other assets	9,353	9,131	7,661	8,538	9,392	10,167
Total assets	39,484	39,620	39,252	42,951	47,324	51,889
Interest bearing debt	8,776	6,190	150	150	150	150
Other liabilities	11,897	13,295	15,876	17,265	18,907	20,337
Total liabilities	20,673	19,485	16,026	17,415	19,057	20,487
Shareholders' equity	18,634	19,984	23,082	25,385	28,106	31,229
Minorities	188	162	154	162	172	183
Total shareholders' equity	18,822	20,146	23,236	25,547	28,278	31,413
Net debt	-5,497	-6,893	-13,673	-13,976	-15,623	-17,163

Key Company Metrics

Sales growth (%)	14.1	10.8	0.1	13.2	11.3	9.2
DB EPS growth (%)	24.4	12.0	23.3	14.4	18.1	14.8
EBITDA Margin (%)	11.0	11.2	11.8	13.4	14.0	14.7
EBIT Margin (%)	8.7	8.7	9.3	11.3	11.7	12.3
Payout ratio (%)	64.2	60.5	73.7	76.1	74.0	75.1
ROE (%)	23.8	24.0	26.3	26.7	28.6	29.6
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	2.2
Net debt/equity (%)	-29.2	-34.2	-58.8	-54.7	-55.2	-54.6
Net interest cover (x)	30.5	17.5	234.1	388.6	nm	nm

Source: Company data, Deutsche Bank estimates



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist			
Company	Ticker	Recent price*	Disclosure
Yili	600887.SS	30.28 (CNY) 7 Nov 17	NA
China Mengniu Dairy	2319.HK	21.70 (HKD) 7 Nov 17	7,13,14,15

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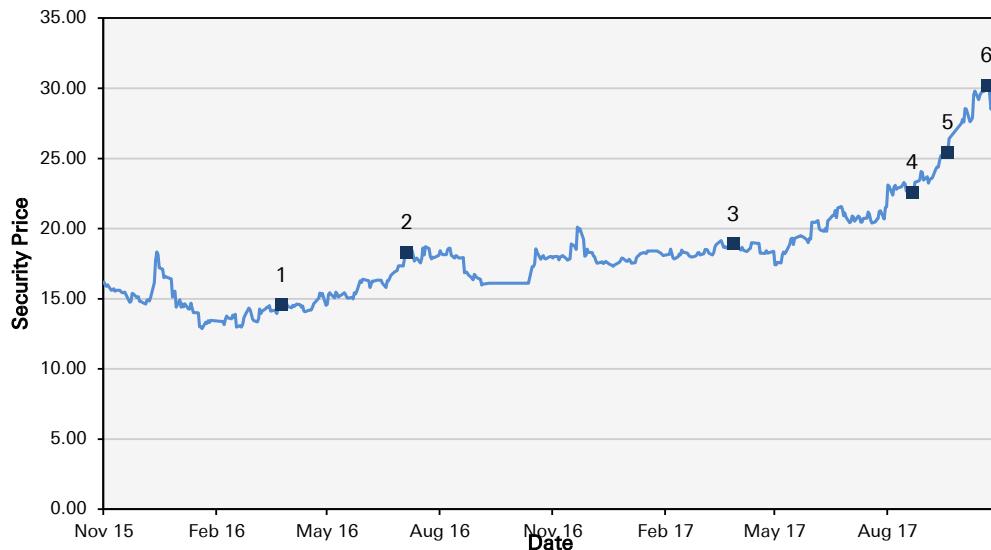
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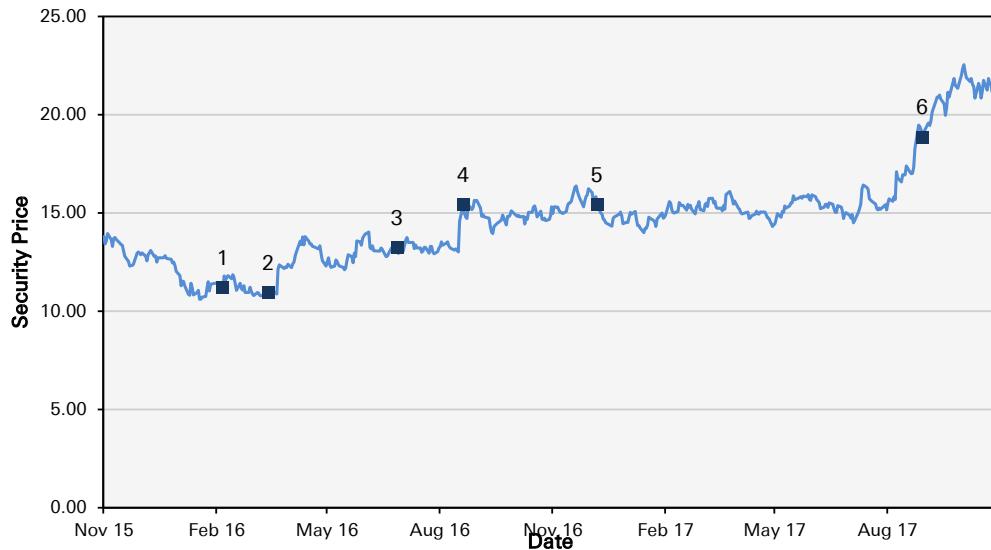


Historical recommendations and target price: Yili (600887.SS)
 (as of 11/7/2017)



1. 03/04/2016:	Buy, Target Price Change CNY18.40 Mark Yuan	4. 30/08/2017:	Buy, Target Price Change CNY24.80 Mark Yuan
2. 14/07/2016:	Buy, Target Price Change CNY20.40 Mark Yuan	5. 28/09/2017:	Buy, Target Price Change CNY28.00 Mark Yuan
3. 06/04/2017:	Buy, Target Price Change CNY22.00 Mark Yuan	6. 30/10/2017:	Buy, Target Price Change CNY31.60 Mark Yuan

Historical recommendations and target price: China Mengniu Dairy (2319.HK)
 (as of 11/7/2017)



1. 15/02/2016:	Buy, Target Price Change HKD15.00 Mark Yuan	4. 29/08/2016:	Buy, Target Price Change HKD18.00 Mark Yuan
2. 23/03/2016:	Buy, Target Price Change HKD14.10 Mark Yuan	5. 16/12/2016:	Buy, Target Price Change HKD18.20 Mark Yuan
3. 06/07/2016:	Buy, Target Price Change HKD14.50 Mark Yuan	6. 07/09/2017:	Buy, Target Price Change HKD23.60 Mark Yuan



Equity rating key

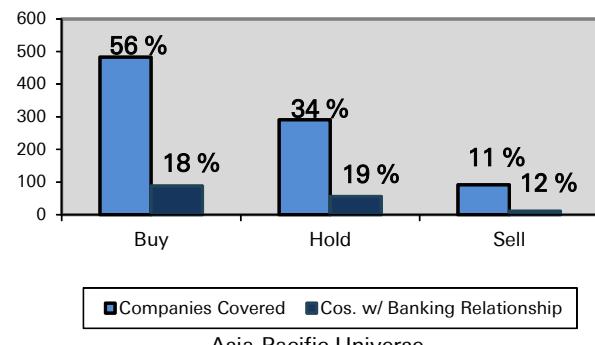
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

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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Equity rating dispersion and banking relationships





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