

## Company Report

### China Mengniu Dairy (2319 HK)

#### 4Q21 sales on track; Limited dilution from CB

- 4Q21 sales are on-track with full-year revenue guidance
- Limited dilution from the issuance of HKD 4.9bn CBs
- Maintain BUY and new TP of HKD53.9

#### Room temperature milk rose by 10-15% yoy in 4Q21

Our recent channel check suggests that Mengniu's room temperature milk retail sales grew by 10%-15% yoy in 4Q21, compared to our 2H21 revenue growth forecast of 10.8% yoy for Mengniu. The distributor claims that Mengniu outpaced Yili, as Yili has a higher comparison base. Overall, the distributor confirmed our view that Mengniu and Yili will continue to take market share from smaller brands. Mengniu and Yili both set growth targets of 10%+ yoy for this distributor.

#### There could be another round of price hike in 1H22

Future retail sales growth is expected to come from consumption upgrades (especially in under-penetrated rural areas), improving sales mix and price hikes. Mengniu increased its prices in Jun 2021 (mainly in white milk products) where ex-factory and retail prices increased by 3%-5%. Mengniu also cut promotion budget for distributors, which lifted the ex-factory prices. The distributor has not yet heard of more price hikes so far but expects another round of price hike in 1H22.

#### Cheese is expected to continue to grow quickly

The distributor expects large brand's cheese to grow by 50%+. So far Milkground (600882 CH, NR) has been growing faster than its peers and has been the first to market for room temperature cheese. Its new SKUs have just been introduced in Nov and Dec.

#### Limited dilution effect from the HKD4.9bn CB issuance

Mengniu finalized its 5-year, HKD 4.9bn convertible bonds (initial conversion price of HKD34.73) for its employee incentive program. Conversion would be limited to 10% of the CBs in year 1 and increase by 5% per year thereafter. Upon full conversion, the new shares would represent 4.2% of the existing share capital and 3.4% of the enlarged capital. The use of proceeds will be 1) 55% for raw milk supply, 2) 30% for raw materials, 3) 10% for wages and salaries, and 4) 5% for taxes.

#### Maintain BUY rating and TP at HKD53.9

We cut our FY21E/22E/23E revenue forecasts by 1.6%, 2.1% and 2.1% to reflect slightly more conservative sales assumptions. We further lower our FY21E/22E/23E diluted EPS by 0.8%, 3.4% and 4.3% due to the CB issuance. We lower our TP to HKD53.9 based on a FY22 PE of 28.9x (previously 28.9x). Maintain BUY.

**Catalysts:** Significant sales increase in its high-end products; larger-than-expected margin expansion; potential M&A;

**Risks:** Larger-than-expected impact from rising raw milk costs.

#### Financials

Year ended 31 Dec (RMB mn)	2019	2020	2021E	2022E	2023E
Revenue	79,030	76,035	88,565	100,783	114,891
yoy growth	14.6%	-3.8%	16.5%	13.8%	14.0%
Attributable net profit	4,105	3,525	5,121	6,062	7,287
Adj. EPS (RMB)	1.05	0.89	1.29	1.53	1.83
yoy growth	34.4%	-14.7%	45.0%	18.2%	19.7%
P/E	34.1x	40.0x	27.6x	23.3x	19.5x
PEG	n.m.	n.m.	0.6x	0.8x	0.7x
ROE	12.9%	10.0%	13.2%	14.3%	15.5%
Net debt (cash)/ equity	51.0%	20.3%	20.3%	12.3%	3.8%

Sources: Company data, CMS (HK) estimates; share price as of November 30, 2021

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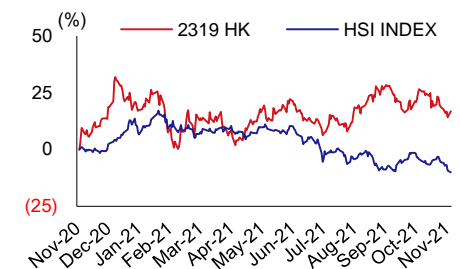
#### WHAT'S NEW

HKD 4.9bn convertible bond issuance for management incentives. Limited dilution effect. Maintain BUY and lower TP to HKD 53.9

#### BUY

Previous	BUY
Price (Nov 30, 2021)	HKD 43.5
12-month Target Price (Potential up/downside)	HKD53.9 (+23.8%)
Previous	HKD55.7

#### Price Performance



Source: Bloomberg; share price as of Nov 30, 2021

%	1m	6m	12m
2319 HK	(12.2)	(6.9)	11.8
HSI	(7.5)	(19.5)	(10.9)

#### Sector: Consumer

Hang Seng Index (November 30, 2021)	23,475
HSCEI (November 30, 2021)	8,368

#### Key Data

52-week range (HKD)	38,516 - 53,456
Market cap (HKD mn)	171,958
Avg. daily volume (mn)	10.44
BVPS (RMB)	10.2

#### Shareholding Structure

COFCO	23.18%
Others	0.12%
No. of shares outstanding (mn)	3,960
Free float	76.7%

Source: Bloomberg

#### Related Research

- China Mengniu Dairy (2319 HK) - A positive read-across from Yili's 3Q21 results (BUY) (Nov 1, 2021)
- China Mengniu Dairy (2319 HK) - 1H21 results beat: Strong growth across all segments (BUY) (Aug 26, 2021)

**Figure 1: Convertible bond offering details**

Convertible bond (HK\$)	
Aggregate Principal (HK\$ mn)	4,862
Conversion price (HK\$)	34.73
Number of shares (mn)	140
Annual coupon rate	3.08%
Frequency	Semi-annual
Maturity	5 yrs
Issue date	11/26/2021
Expiry date	11/26/2026
Agreed conversion rules	The CB could be converted by 5 times. Conversion would be limited to 10% of the CBs in year 1 and increase by 5% per year thereafter. (Yr 1: 10%; Yr 2: 15%; Yr 3: 20%; Yr 4: 25%; Yr 5: 30%)

Sources: Company data, mgmt. interview, CMS (HK) estimates

**Figure 2: use of proceeds**

Use of proceeds	% of total
Payment of raw milk supply	55%
Payment of raw materials costs	30%
Payment of wages and salaries	10%
Payment of tax expenses	5%
Total	100%
Total net proceeds (HK\$ mn)	4,797

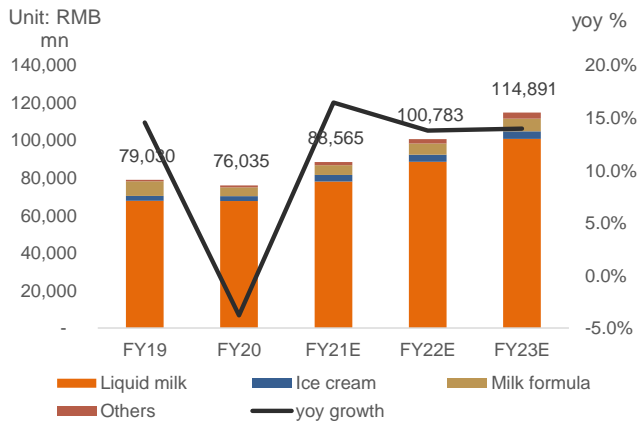
Sources: Company data, CMS (HK) estimates

**Figure 3: earnings forecast change table**

Unit: RMB mn	2021			2022			2023		
	Original	New	Diff %	Original	New	Diff %	Original	New	Diff %
Revenue	89,972	88,565	-1.6%	102,961	100,783	-2.1%	117,353	114,891	-2.1%
Gross profit	33,417	32,910	-1.5%	38,486	37,697	-2.0%	44,050	43,157	-2.0%
GPM	37.1%	37.2%	0.0ppt	37.4%	37.4%	0.0ppt	37.5%	37.6%	0.0ppt
Operating profit	5,179	5,104	-1.4%	6,438	6,316	-1.9%	7,652	7,509	-1.9%
OPM	5.8%	5.8%	0.0ppt	6.3%	6.3%	0.0ppt	6.5%	6.5%	0.0ppt
Attributable net profit	5,165	5,121	-0.8%	6,269	6,062	-3.3%	7,571	7,287	-3.8%
NPM	5.7%	5.8%	0.0ppt	6.1%	6.0%	-0.1ppt	6.5%	6.3%	-0.1ppt
EPS (RMB)	1.30	1.29	-0.8%	1.58	1.53	-3.4%	1.91	1.83	-4.3%
<b>Revenue breakdown</b>									
Liquid milk	79,560	78,152	-1.8%	90,892	88,714	-2.4%	103,389	100,927	-2.4%
Ice cream	3,439	3,439	0.0%	3,710	3,710	0.0%	3,983	3,983	0.0%
Milk powder	5,231	5,231	0.0%	6,006	6,006	0.0%	6,804	6,804	0.0%
Others	1,743	1,743	0.0%	2,353	2,353	0.0%	3,177	3,177	0.0%
<b>Overall</b>	<b>89,972</b>	<b>88,565</b>	<b>-1.6%</b>	<b>102,961</b>	<b>100,783</b>	<b>-2.1%</b>	<b>117,353</b>	<b>114,891</b>	<b>-2.1%</b>

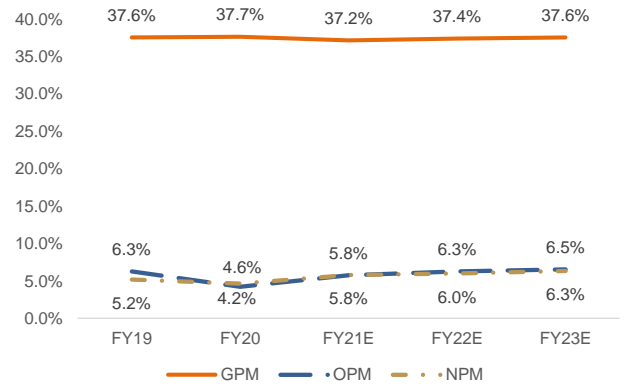
Sources: Company data, CMS (HK) estimates

Figure 4: revenue forecast breakdown (Mengniu)



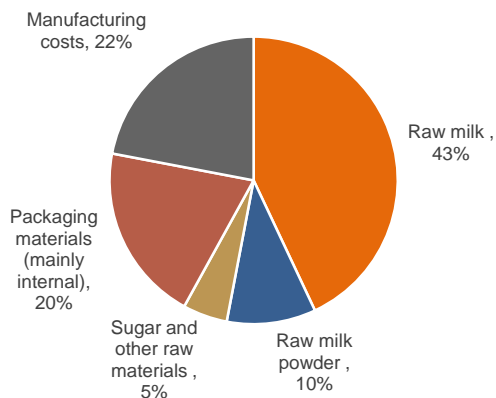
Sources: Company data, CMS (HK) estimates  
 Note: excluding the impact from Junlebao and Bellamy, the comparable revenue grew by 10.6% yoy in FY20

Figure 5: key margin assumptions (Mengniu)



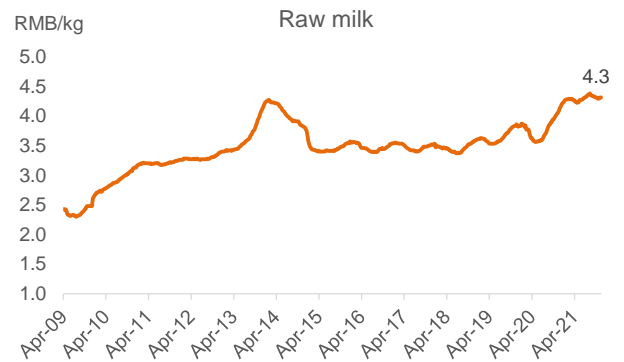
Sources: Company data, CMS (HK) estimates

Figure 6: Mengniu COGS breakdown



Sources: news report, channel check, CMS (HK) estimates

Figure 7: Raw milk price stabilized at historical high



Sources: Wind, CMS (HK) estimates

Figure 8: Target price and valuation table

Valuation - Mengniu				
Stock price		43.5		
HKD/RMB		0.82		
Price date		30/11/2021		
		<b>FY20</b>	<b>FY21E</b>	<b>FY22E</b>
EPS (RMB)		0.89	1.29	1.53
P/E		<b>40.0x</b>	<b>27.6x</b>	<b>23.3x</b>
EPS CAGR (since FY20)			45%	30.9%
PEG			<b>0.6x</b>	<b>0.8x</b>
EPS, yoy growth		-14.7%	45.0%	18.2%
				19.7%
Target price calculation				
Target PEG		<b>0.9x</b>		
Target P/E		<b>28.9x</b>		
FY22E EPS (RMB)		1.53		
Target price (HKD)		<b>53.9</b>		
Upside		<b>23.8%</b>		
Div yield		1.1%		
Total return		<b>24.9%</b>		

Sources: Company data, Bloomberg, CMS (HK) estimates

## Comparable valuation – dairy sector

	Rating	Price	CMS PT	Upside	Mcap (USD mn)	Trading vol (USD mn)	EV/EBITDA (x)		P/E (x)		PEG (x)	ROE (%)		EPS CAGR (%)	Div Yield (%)	
							2021E	2022E	2021E	2022E	2022E	2021E	2022E	19-22E	2021E	
<b>Dairy - China</b>																
Mengniu Dairy	2319 HK	BUY	43.5	53.9	23.8%	22,048	586	69.7	69.0	27.6	23.3	0.8	13.2	14.3	27.1	1.1
Yili-A	600887 CH	NR	39.2	n.a.	n.a.	37,397	2,906	19.1	16.0	26.5	22.5	1.1	26.4	27.0	18.7	2.5
Bright Dairy - A	600597 CH	NR	13.8	n.a.	n.a.	2,658	308	10.5	8.8	25.4	22.4	2.2	10.0	10.6	11.0	1.2
China Modern Dairy	1117 HK	NR	1.3	n.a.	n.a.	1,330	33	4.9	4.0	6.9	4.8	0.1	13.5	15.7	29.5	0.7
<b>Median</b>						<b>12,353</b>	<b>447</b>	<b>14.8</b>	<b>12.4</b>	<b>26.0</b>	<b>22.4</b>	<b>0.9</b>	<b>13.4</b>	<b>15.0</b>	<b>22.9</b>	<b>1.1</b>
<b>IMF - China</b>																
Feihe	6186 HK	NR	10.4	n.a.	n.a.	11,865	217	6.8	5.6	10.3	8.4	0.4	36.7	35.3	20.7	4.3
H&H	1112 HK	NR	14.3	n.a.	n.a.	1,181	15	5.4	4.7	6.7	5.9	1.2	16.7	17.5	9.3	5.9
Ausnutria	1717 HK	NR	8.9	n.a.	n.a.	1,963	37	6.9	5.7	10.1	8.4	0.4	21.5	26.2	19.1	3.6
Yashili	1230 HK	NR	0.5	n.a.	n.a.	329	1	4.1	3.3	12.6	9.4	0.2	3.2	3.5	35.7	2.3
<b>Median</b>						<b>1,572</b>	<b>26</b>	<b>6.1</b>	<b>5.2</b>	<b>10.2</b>	<b>8.4</b>	<b>0.4</b>	<b>19.1</b>	<b>21.9</b>	<b>19.9</b>	<b>3.9</b>
<b>Dairy &amp; IMF - Global</b>																
Nestle	NESN SW	NR	120.1	n.a.	n.a.	365,652	355	20.3	19.2	26.9	25.0	3.3	27.9	31.0	7.4	2.4
Danone	BN FP	NR	54.3	n.a.	n.a.	42,099	83	11.5	10.8	16.5	15.7	n.a.	12.7	12.9	(0.1)	3.7
Meiji	2269 JP	NR	6,660.0	n.a.	n.a.	9,013	3,368	7.2	7.1	11.9	14.5	-8.9	12.3	9.8	(1.2)	2.4
Fonterra	FSF NZ	NR	3.7	n.a.	n.a.	4,006	0	6.7	6.2	10.7	9.4	0.8	7.8	8.5	9.6	4.9
A2 Milk	A2M AU	NR	6.0	n.a.	n.a.	3,175	41	19.1	14.9	40.0	30.8	n.a.	9.9	12.0	n.a.	-
<b>Median</b>						<b>9,013</b>	<b>83</b>	<b>11.5</b>	<b>10.8</b>	<b>16.5</b>	<b>15.7</b>	<b>0.8</b>	<b>12.3</b>	<b>12.0</b>	<b>3.7</b>	<b>2.4</b>

Sources: Bloomberg, company data, CMS (HK) estimates

Note 1: A/H shares are based on the closing price on November 30, 2021. Oversea stocks are based on the closing price on November 29, 2021.

Note 2: The companies rated "NR" uses Bloomberg consensus estimates

## Financial statement

### Balance Sheet

RMB mn	2019	2020	2021E	2022E	2023E
PP&E	11,103	12,547	13,776	14,896	15,916
Right of use assets	1,698	1,848	1,985	1,985	1,985
Goodwill	4,719	4,883	5,258	5,258	5,258
Other intangible assets	7,583	7,717	8,420	8,420	8,420
Investments in associates	7,351	9,020	9,241	9,241	9,241
Other non-current assets	8,598	12,624	12,887	14,084	15,500
<b>Non-current assets</b>	<b>41,052</b>	<b>48,640</b>	<b>51,567</b>	<b>53,884</b>	<b>56,320</b>
Inventories	5,090	5,512	5,236	5,873	6,649
Trade receivables	3,587	2,988	3,273	3,682	4,175
Prepayment and other receivables	3,027	3,605	5,143	5,786	6,561
Bank Balances and Cash	6,476	11,397	12,218	11,505	11,699
Other current assets	19,306	8,004	6,659	6,659	6,659
<b>Current assets</b>	<b>37,486</b>	<b>31,507</b>	<b>32,528</b>	<b>33,507</b>	<b>35,744</b>
<b>Total assets</b>	<b>78,537</b>	<b>80,146</b>	<b>84,096</b>	<b>87,391</b>	<b>92,064</b>
Account payable	6,739	7,969	7,929	8,894	10,069
Other payables and accruals	10,808	11,466	10,325	11,581	13,111
Bank Borrowings	13,838	4,924	5,122	4,122	3,122
Other current liabilities	349	1,785	2,401	2,564	2,751
<b>Current liabilities</b>	<b>31,734</b>	<b>26,144</b>	<b>25,776</b>	<b>27,162</b>	<b>29,054</b>
Deferred Tax Liabilities	1,942	2,280	2,189	2,189	2,189
Deferred income	279	420	498	498	498
Bank Borrowing	9,635	14,020	15,240	12,840	10,440
Other non-current liabilities	1,600	35	194	218	247
<b>Non-current liabilities</b>	<b>13,456</b>	<b>16,754</b>	<b>18,120</b>	<b>15,744</b>	<b>13,373</b>
<b>Total liabilities</b>	<b>45,190</b>	<b>42,899</b>	<b>43,897</b>	<b>42,906</b>	<b>42,427</b>
Share capital and other reserves	12,667	13,256	12,026	12,026	12,026
Retained earnings	16,465	19,727	23,311	27,555	32,656
Non-controlling interests	4,215	4,265	4,862	4,905	4,956
<b>Total equity</b>	<b>33,347</b>	<b>37,248</b>	<b>40,199</b>	<b>44,485</b>	<b>49,638</b>
<b>Total equity and liabilities</b>	<b>78,537</b>	<b>80,146</b>	<b>84,096</b>	<b>87,391</b>	<b>92,064</b>

### Cashflow

RMB mn	2019	2020	2021E	2022E	2023E
Profit before tax	5,605	4,155	6,134	7,632	9,173
Finance Costs	-461	-512	-369	-297	-419
D&A	2,260	2,137	2,204	2,229	2,402
Changes in OWC	569	954	684	531	661
Income tax paid	-990	-753	-1,072	-1,526	-1,835
Others	-677	-633	573	297	419
<b>CF from operating activities</b>	<b>6,307</b>	<b>5,348</b>	<b>8,155</b>	<b>8,865</b>	<b>10,402</b>
Capital expenditure	-1,112	-611	-1,212	-1,128	-1,214
Disposal of subsidiaries	2,885	15	0	0	0
Changes of investment deposits	-7,372	9,356	1,244	0	0
Others	-11,931	-3,938	-6,174	-3,418	-3,624
<b>CF from investing activities</b>	<b>-17,530</b>	<b>4,822</b>	<b>-6,142</b>	<b>-4,546</b>	<b>-4,838</b>
Dividend paid	-1,374	-785	-2,608	-1,819	-2,186
Debt financing (repaid)	11,791	-3,926	1,591	-3,400	-3,400
Others	197	141	-304	187	216
<b>CF from financing activities</b>	<b>10,614</b>	<b>-4,571</b>	<b>-1,321</b>	<b>-5,031</b>	<b>-5,370</b>
<b>Net cash flow</b>	<b>-608</b>	<b>5,599</b>	<b>692</b>	<b>-713</b>	<b>193</b>

### Profit & Loss

RMB mn	2019	2020	2021E	2022E	2023E
<b>Revenues</b>	<b>79,030</b>	<b>76,035</b>	<b>88,565</b>	<b>100,783</b>	<b>114,891</b>
Cost of Sales	-49,351	-47,406	-55,655	-63,086	-71,735
<b>Gross profits</b>	<b>29,679</b>	<b>28,629</b>	<b>32,910</b>	<b>37,697</b>	<b>43,157</b>
Other income and gains	4,101	1,205	927	1,104	1,258
Selling & marketing exp	-21,536	-21,541	-24,065	-27,238	-30,941
Admin expense	-3,319	-3,133	-3,426	-3,895	-4,439
Other expenses	-3,954	-1,944	-1,242	-1,352	-1,526
<b>Operating profits</b>	<b>4,970</b>	<b>3,216</b>	<b>5,104</b>	<b>6,316</b>	<b>7,509</b>
Finance costs	461	512	369	297	419
Share of results of JV/asso.	175	426	661	1,018	1,244
<b>Profit before tax</b>	<b>5,605</b>	<b>4,155</b>	<b>6,134</b>	<b>7,632</b>	<b>9,173</b>
Income tax expense	-1,310	-653	-977	-1,526	-1,835
<b>Net profit</b>	<b>4,296</b>	<b>3,502</b>	<b>5,157</b>	<b>6,105</b>	<b>7,338</b>
Non-controlling interest	190	-23	36	43	51
<b>Attributable net profit</b>	<b>4,105</b>	<b>3,525</b>	<b>5,121</b>	<b>6,062</b>	<b>7,287</b>
Diluted EPS (RMB)	1.05	0.89	1.29	1.53	1.83
Dividend per share (RMB)	0.18	0.27	0.39	0.46	0.55

### Financial Ratio

	2019	2020	2021E	2022E	2023E
<b>yo y growth</b>					
Revenue	14.6%	-3.8%	16.5%	13.8%	14.0%
Gross Profit	15.1%	-3.5%	15.0%	14.5%	14.5%
Operating profit	29.6%	-35.3%	58.7%	23.7%	18.9%
Net profit	34.9%	-14.1%	45.3%	18.4%	20.2%
EPS	34.4%	-14.7%	45.0%	18.2%	19.7%
<b>Profitability</b>					
Gross margin	37.6%	37.7%	37.2%	37.4%	37.6%
Operating margin	6.3%	4.2%	5.8%	6.3%	6.5%
Net margin	5.2%	4.6%	5.8%	6.0%	6.3%
<b>Liquidity</b>					
AR days	15.0	15.8	12.9	12.6	12.5
Inventory days	34.7	40.8	35.2	32.1	31.9
AP days	50.9	56.6	52.1	48.7	48.2
Cash conversion cycle	-1.3	0.0	-4.0	-3.9	-3.9
<b>Cash flow &amp; leverage</b>					
Free cash low	5,656	5,355	6,064	6,685	7,857
Net debt to equity	51.0%	20.3%	20.3%	12.3%	3.8%
Dividend payout ratio	17.3%	30.0%	30.0%	30.0%	30.0%
Dividend yield	0.5%	0.7%	1.1%	1.3%	1.5%
<b>Return analysis</b>					
ROE	12.9%	10.0%	13.2%	14.3%	15.5%
Asset turnover	1.1	1.0	1.1	1.2	1.3
Net margin	5.2%	4.6%	5.8%	6.0%	6.3%
Financial leverage	2.3	2.2	2.1	2.0	1.9
ROA	5.7%	4.4%	6.2%	7.1%	8.1%
<b>Valuation ratios</b>					
P/E	34.1x	40.0x	27.6x	23.3x	19.5x
P/B	4.2x	3.8x	3.5x	3.2x	2.9x

Sources: Company data, CMS (HK) estimates

## Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
NEUTRAL	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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