

Yili Industrial (600887 CH)

Promotional expense on Winter Olympics could weigh on 4Q results

We trim our 2021E net profits by 1.5% to RMB8,902mn subsequent to our incorporation of a 0.9pp higher opex ratio (of 28.7%) for 4Q21 due to any promotional expense for the Winter Olympics. In other words, we lowered our 4Q21E net profit estimate to RMB958mn which is now about 2% below consensus. Meanwhile, we leave our 2021E top line largely unchanged, as we expect 4Q shipment growth (+11.6% YoY) to sequentially improve from 8.6% in 3Q. We extrapolated our revised forecasts, and as such we cut ~4% of our 2022E net profits which explained our lowered TP of RMB46.5 (from RMB50.0). We are buy-rated, but we prefer CR Beer (291HK, Buy) and Mengniu (2319HK, Buy) within our China Consumer Staples coverage universe for a potentially lower earnings volatility into the result seasons.

- **A steady 4Q top line.** Sales in liquid milk improved vs 3Q21 when IMF continued to track strongly. Based on Nielsen data, Yili's market share in IMF expanded 1.6ppt YoY to 7.1% in Nov 2021, despite regional outbreaks in the country during the quarter. Low temp milk recorded steady top line growth in the quarter but has not yet broken even, which is a common situation faced by the sector at the current stage, given still limited scale, high cold chain logistic cost, and the need of time to grow consumer habits.
- **4Q21 margins still under pressure.** 4Q21 margins went under relatively high pressure compared to 3Q21, due to a still-high raw milk price and a higher selling expense ratio, largely due to increased advertising campaigns including those for Winter Olympics. It is unlikely, in our view, to see significant reduction in selling expense ratio in the near term as the company plans to keep investing in emerging categories such as IMF, low temp milk, cheese. Management expected full-year NPM to improve by about 0.5ppt YoY.
- **Valuation.** Our TP is based on an updated 28.5x (from 29.0x) end-22E P/E which still represents +1sd above its 3-year average. In our view, our methodology reflects Yili's solid growth roadmap which likely manifests into a guided approximately 0.5ppt margins expansion per annum.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	90,223	96,886	110,813	125,929	140,856
YoY growth (%)	13.4	7.4	14.4	13.6	11.9
Net income (RMB mn)	6,934	7,078	8,902	10,648	12,734
EPS (RMB)	1.1	1.2	1.5	1.6	2.0
YoY growth (%)	11.6	2.0	25.8	11.7	19.7
Consensus EPS (RMB)	n.a	n.a	1.5	1.6	2.0
P/E (x)	n.a	n.a	27.0	24.1	20.2
P/B (x)	n.a	n.a	7.3	6.6	6.0
Yield (%)	n.a	n.a	2.8	3.1	3.7
ROE (%)	24.9	22.0	27.3	29.1	32.0
Net gearing (%)	net cash	1.3	7.6	5.7	2.5

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **RMB46.5**
 (Previous TP **RMB50.0**)
 Up/Downside **+18.0%**
 Current Price **RMB39.4**

China Consumer Staples

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Stock Data

Mkt Cap (RMB mn)	252,165
Avg 3 mths t/o (RMB mn)	2,530
52w High/Low (RMB)	48.9/ 30.9
Total Issued Shares (mn)	6,400

Source: Bloomberg

Shareholding Structure

HKSCC	12.3%
Huhe Haote Investment	8.9%
Pan Gang	4.7%

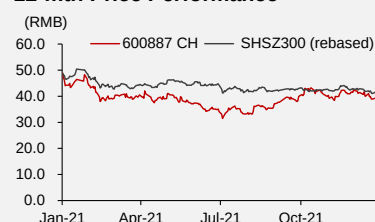
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-7.0%	-4.4%
3-mth	-1.2%	2.3%
6-mth	15.5%	22.8%

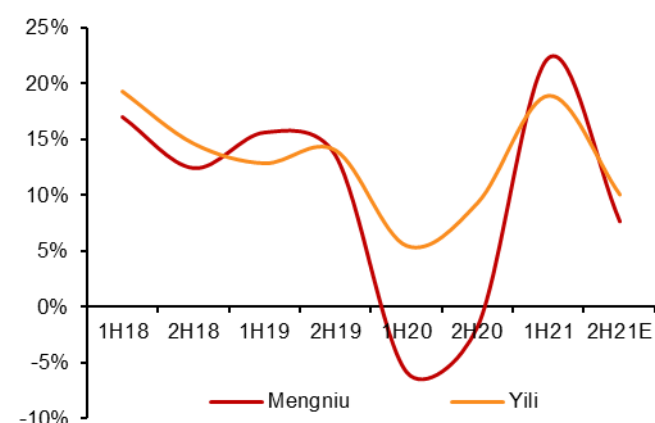
Source: Bloomberg

12-mth Price Performance

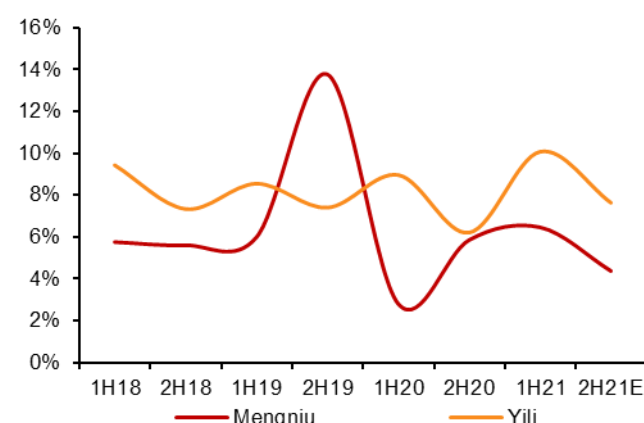


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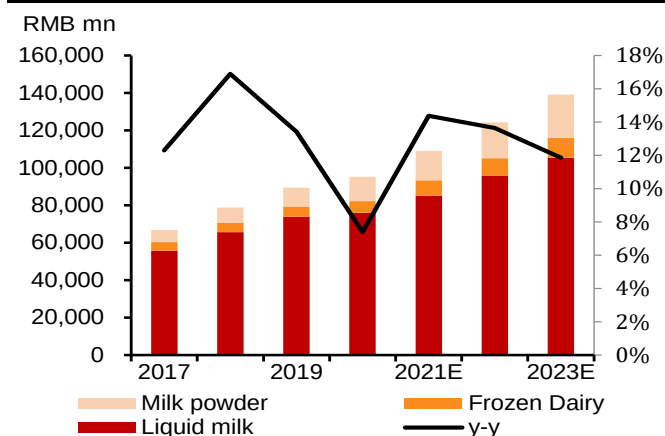
1. ["Cherry-picking amid a de-risking mentality; our top picks: CRB/ Mengniu/ Feihe"](#) – 21 Jan 2022
2. ["Marketing feedback – inflation & price hikes are key words appeared in every meeting"](#) – 23 Nov 2021
3. ["Structural merits look prominent amid transitional headwind and any stagflation expectation"](#) – 2 Nov 2021

Figure 1: Revenue growth, Mengniu vs Yili

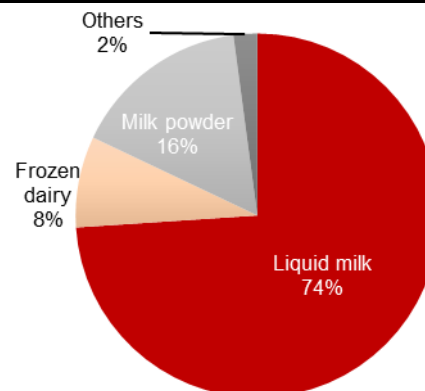
Source: Company data, CMBIS estimates

Figure 2: EBIT margins, Mengniu vs Yili

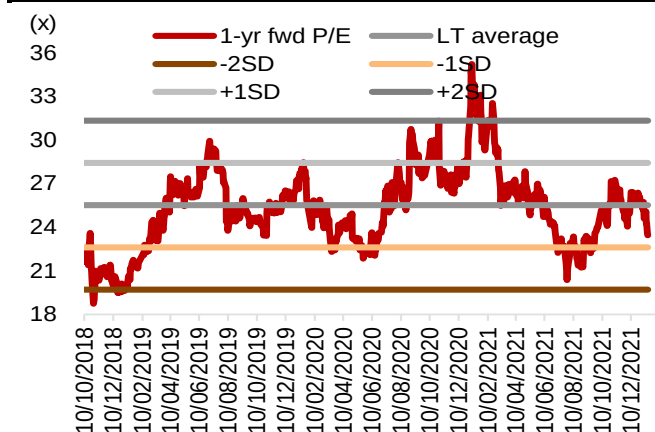
Source: Company data, CMBIS estimates

Figure 3: Revenue breakdown 2017-23E

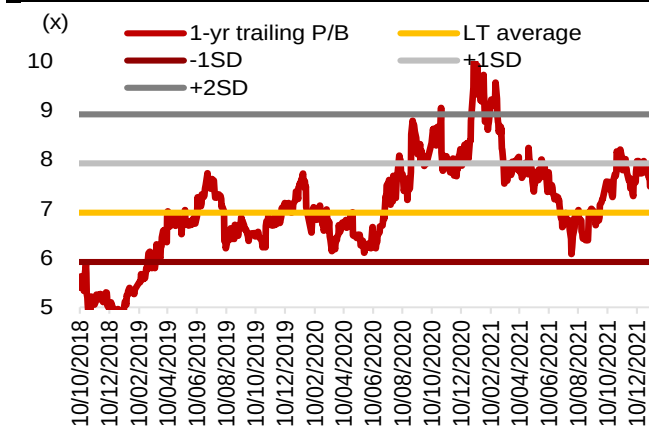
Source: Company data, CMBIS estimates

Figure 4: Gross profits breakdown by product

Source: Company data, CMBIS

Figure 5: 1-year forward P/E chart

Source: Bloomberg, CMBIS estimates

Figure 6: Trailing P/B chart

Source: Bloomberg, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	90,223	96,886	110,813	125,929	140,856
Liquid milk	73,761	76,123	85,182	95,810	105,37
Others	16,462	20,762	25,631	30,119	35,479
Gross profits	33,254	34,534	39,414	45,233	51,020
D&A	(1,958)	(2,442)	(2,821)	(3,252)	(3,688)
Selling expense	(21,070)	(21,538)	(23,603)	(26,445)	(29,298)
Administration expenses	(4,780)	(5,363)	(6,095)	(6,926)	(7,465)
Other op expense	1,734	2,286	2,821	3,252	3,688
EBIT	7,181	7,476	9,717	11,862	14,257
EBITDA	9,139	9,919	12,537	15,114	17,944
Finance costs, net	(8)	(188)	(369)	(470)	(456)
Investment gains/loss	1,108	1,270	1,350	1,460	1,516
Non-operating	(86)	(408)	(200)	(300)	(300)
Pre-tax profit	8,194	8,150	10,497	12,552	15,016
Income tax	(1,243)	(1,051)	(1,575)	(1,883)	(2,252)
Less: Minority interests	(17)	(21)	(21)	(21)	(21)
Net profit	6,934	7,078	8,902	10,648	12,743

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income	6,934	7,078	8,902	10,648	12,743
D&A	1,958	2,442	2,821	3,252	3,688
Change in working capital	(2,286)	4,684	(901)	981	963
Others	1,850	(4,353)	(429)	(539)	(595)
Net cash fr. operating act.	8,455	9,852	10,392	14,342	16,799
Capex & investments	(9,243)	(6,522)	(6,597)	(7,638)	(6,845)
Acquisition	(1,583)	22	-	-	-
Others	826	(2,543)	(900)	(900)	(900)
Net cash fr. investing act.	(9,999)	(9,043)	(7,497)	(8,538)	(7,745)
Equity raised	275	248	-	1,200	-
Change of Debts	8,986	5,122	(400)	(400)	(400)
Dividend paid	(4,913)	(4,988)	(4,988)	(6,639)	(7,942)
Others	(5,364)	(428)	-	-	-
Net cash fr. financing act.	(1,016)	(47)	(5,388)	(5,839)	(8,342)
Net change in cash	(2,560)	762	(2,493)	(36)	712
Cash at the beginning of the	13,824	11,328	11,695	9,203	9,167
Exchange difference	62	(395)	-	-	-
Cash at the end of the year	11,325	11,695	9,203	9,167	9,879
Less: pledged cash	-	-	-	-	-

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	34,755	42,774	47,900	53,746	58,419
PP&E/Fixed assets	24,461	28,768	32,282	36,340	39,455
Goodwill	1,936	1,897	2,160	2,487	2,530
Investments	2,494	3,423	4,773	6,233	7,749
Other non-current assets	5,864	8,685	8,685	8,685	8,685
Current assets	25,706	28,381	28,204	29,712	31,942
Cash	11,325	11,695	9,203	9,167	9,879
Account receivable	2,032	1,875	2,429	2,760	3,087
Inventory	7,715	7,545	9,307	10,519	11,710
Other current assets	4,634	7,266	7,266	7,266	7,266
Current liabilities	31,432	34,768	37,635	41,261	45,105
Borrowings	4,560	6,957	6,757	6,557	6,357
Account payables	13,618	17,975	19,390	21,914	24,395
Other payables	13,254	9,836	11,488	12,790	14,353
Non-current liabilities	2,755	5,853	5,653	5,453	5,253
Borrowings	1,971	5,137	4,937	4,737	4,537
Other non-current liabilities	784	716	716	716	716
Common stock	6,096	6,083	6,083	6,513	6,513
Retained earnings	21,534	23,541	25,804	28,510	31,749
Minority Interest	143	149	169	190	211
Total net assets	26,274	30,533	32,816	36,743	40,003
Shareholders' equity	26,131	30,384	32,647	36,553	39,792

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
Liquid milk	81.8	78.6	76.9	76.1	74.8
Others	18.2	21.4	23.1	23.9	25.2
P&L ratios (%)					
Gross margin	36.9	35.6	35.6	35.9	36.2
Operating margin	8.0	7.7	8.8	9.4	10.1
Pre-tax margin	9.1	8.4	9.5	10.0	10.7
Net margin	7.7	7.3	8.0	8.5	9.0
Effective tax rate	(15.2)	(12.9)	(15.0)	(15.0)	(15.0)
Balance sheet analysis					
Current ratio (x)	0.4	0.4	0.3	0.3	0.3
Net receivable days	8.2	7.1	8.0	8.0	8.0
Inventory turnover days	49.9	44.6	48.0	48.0	48.0
Net payable days	88.1	106.2	100.0	100.0	100.0
Net debt to equity (%)	net cash	1.3	7.6	5.8	2.5
Returns (%)					
ROE	24.9	22.0	27.3	29.1	32.0
Dividend yield	n.a	n.a	2.8	3.1	3.7
Per share					
EPS (RMB)	1.1	1.2	1.5	1.6	2.0
DPS (RMB)	0.8	0.8	1.1	1.2	1.5
BVPS (RMB)	4.3	5.0	5.4	6.0	6.5
EV/ EBITDA (x)	n.a	n.a	19.3	17.1	14.4

Source: Company data, CMBIS estimates

Yili Industrial (600887 CH) NDR key takeaways

Yili management joined our NDR and shared with us the company's recent business developments. We summarized below the key updates on the company's 4Q21 and Jan 2022-to-date performance and some topics of major market interest.

- **A steady 4Q top line. Sales in liquid milk improved vs 3Q21.** IMF continued to track strongly. Based on Nielsen data, Yili's market share in IMF expanded 1.6pp YoY to 7.1% in Nov 2021, despite regional outbreaks in the country during the quarter. Low temp milk recorded steady top line growth in the quarter but has not yet broken even, which is a common situation faced by the sector at the current stage, given still limited scale, high cold chain logistic cost, and the need of time to grow consumer habits.
- **4Q21 margins still under pressure.** 4Q21 margins went under relatively high pressure compared to 3Q21, due to a still-high raw milk price and a higher selling expense ratio, largely due to increased advertising campaigns including those for Winter Olympics. It is unlikely, in our view, to see significant reduction in selling expense ratio in the near term as the company plans to keep investing in emerging categories such as IMF, low temp milk, cheese. Management expected full year NPM expected to improve by about 0.5pp YoY.
- **2022E outlook and longer-term targets.** Management guided for a healthy pace of channel stocking in Jan 2022-to-date. The company targets to achieve double-digit revenue growth in 2022E, and to rank among the top 3 players globally by 2025E, with steady growth in liquid milk, a 25%+ CAGR in IMF and high growth in smaller categories such as cheese, low temp milk. The company targets to maintain steady margin expansion so as to achieve ~9-10% NPM by 2025E. Management also expects the sector to see further consolidation going forward.
- **Cost pressure from raw milk price hike expect to ease in 2022E.** Raw milk price increase decelerated in 4Q21 QoQ, with the increase falling to LSD in Oct and Nov 2021. Management estimated raw milk price to record a HSD increase YoY for 2021, and expect the price to relatively stabilize at high levels in 2022E, which should lead to easing cost pressure for Yili. The company sounds reserved on further price hikes in 2022E, after it has increased the prices of some SKUs in Jan and end 2021.
- **Development of IMF business and the strategic investment in Ausnutria.** The IMF inventory maintained at quite healthy level in 4Q21 and Jan 2022-to-date. The company targeted to become the second largest player in IMF in 2022E and achieve a CAGR of 25%+ by 2025E before the strategic investment in Ausnutria. According to management, it could even beat the target with synergies from Ausnutria in terms of supply chain integration, product extension (to other health care products) and channels expansion. Financial impact from the merger would be reflected in 2Q22, according to management.

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