

Company Report

China Mengniu Dairy (2319 HK)

Sales was affected in 2Q but may rebound in 2H

- Demand remained strong but sales was affected by COVID in 2Q
- 2H22 sales could rebound as COVID lockdown policies ease
- Maintain BUY and lift TP to HKD48.8

Strong demand but sales likely still affected

Our recent channel checks suggest that while demand for Mengniu's products in 2Q22 in areas under COVID lockdown was still strong, the company's sales would still have been negatively affected to some degree. Logistics bottlenecks meant some delivery delays to areas where retailers were still opened. While Mengniu was still able to sell to end-consumers through community group purchase channels, these channels tend to limit the choices of products available for purchase (ie no fresh milk or a lack of high end products), meaning that the product sales mix may be shifted towards lower-end products and therefore suboptimal.

Margins may also be slightly affected

As COVID lockdowns may have caused the sales mix to shift towards lower end products, Mengniu's gross margins could also be negatively affected. Furthermore, logistics bottlenecks and increases in fuel costs may have also increased transportation costs. While raw milk prices have started to come off yoy in 2Q22, packaging costs have continued to increase. Hence, we believe that overall GPM may have slightly contracted in 1H22. That said, we expect that Mengniu may also have reduced its spending in 1H22 to maintain OPM flattish yoy.

2H22 could rebound as COVID lockdown policies ease

Assuming there will be no large scale COVID lockdowns in China in 2H22, we should expect Mengniu's sales mix to improve as consumer could switch back to high-end products, given that demand should still be strong. While fuel costs and packaging costs are likely to remain high in 2H22, lower raw milk costs and the positive shift in sales mix could lead to an improvement in GPM.

Maintain BUY and raise TP to HKD48.8

We cut our FY22/23/24 EPS for Mengniu by -7.0%, -4.2% and -4.4% respectively due to the COVID lockdowns in 2Q22. Our new TP is HKD48.8 (previously HKD47.9) based on a target multiple of 26.5x on our rolling 12 months forward EPS (2H22+1H23, vs previously FY22). As we believe 2H22 should improve and that Mengniu's share price has sufficiently discounted the hiccups in 2Q22, we maintain BUY rating.

Catalysts: Significant sales increase in its high-end products; larger-than-expected margin expansion in 2H22; potential M&A;

Risks: Rebound in COVID leading to large scale lockdowns. Higher than expected increase in costs.

Financials

Year ended 31 Dec (RMB mn)	2020	2021	2022E	2023E	2024E
Revenue	76,035	88,141	94,660	110,083	125,809
yoy growth	-3.8%	15.9%	7.4%	16.3%	14.3%
Attributable net profit	3,525	5,026	5,474	6,887	7,725
Adj. EPS (RMB)	0.89	1.27	1.38	1.74	1.95
yoy growth	-14.7%	42.0%	8.9%	25.8%	12.2%
P/E	37.0x	26.1x	24.0x	19.0x	17.0x
ROE	10.0%	12.7%	12.5%	14.3%	14.4%
Net debt (cash)/ equity	20.3%	28.2%	6.7%	-2.3%	-11.0%

Sources: Company data, CMS (HK) estimates; share price as of July 18, 2022

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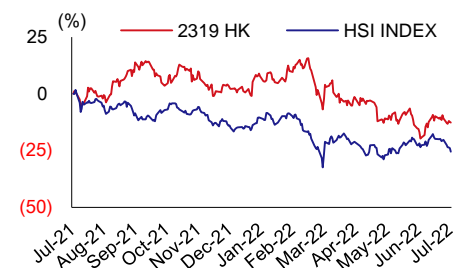
WHAT'S NEW

2H22 sales could rebound as COVID lockdown policies gradually ease; Maintain BUY and lift TP to HKD48.8

BUY

Previous	BUY
Price (Jul 18, 2022)	HKD 38.5
12-month Target Price (Potential up/downside)	HKD 48.8 (+27.0%)
Previous	HKD 47.9

Price Performance



Source: Bloomberg; share price as of Jul 18, 2022

%	1m	6m	12m
2319 HK	9.7	(15.9)	(11.5)
HSI	(1.1)	(13.5)	(25.6)

Sector: Consumer

Hang Seng Index (July 18, 2022)	20,846
HSCEI (July 18, 2022)	7,169

Key Data

52-week range (HKD)	34.45 - 50.711
Market cap (HKD mn)	152,058
Avg. daily volume (mn)	7.25
BVPS (RMB)	10.6

Shareholding Structure

COFCO	23.14%
Others	0.08%
No. of shares outstanding (mn)	3,968
Free float	76.78%

Source: Bloomberg

Related Research

1. China Food & Beverage Sector - 2H22 Outlook: Recovery from COVID lockdowns (OVERWEIGHT) (July 8, 2022)
2. China Food & Beverage Sector - Expecting a strong sales rebound in June (OVERWEIGHT) (June 8, 2022)

Figure 1: Key forecast change table

Unit: RMB mn	2022E			2023E			2024E		
	Original	New	Diff %	Original	New	Diff %	Original	New	Diff %
Revenue	98,564	94,660	-4.0%	112,724	110,083	-2.3%	128,817	125,809	-2.3%
Gross profit	36,426	34,640	-4.9%	41,893	40,646	-3.0%	48,136	46,708	-3.0%
<i>GPM</i>	37.0%	36.6%	-0.4ppt	37.2%	36.9%	-0.2ppt	37.4%	37.1%	-0.2ppt
Operating profit	5,892	5,388	-8.6%	6,983	6,628	-5.1%	8,253	7,842	-5.0%
<i>OPM</i>	6.0%	5.7%	-0.3ppt	6.2%	6.0%	-0.2ppt	6.4%	6.2%	-0.2ppt
Attributable net profit	5,887	5,474	-7.0%	7,187	6,887	-4.2%	8,077	7,725	-4.4%
<i>NPM</i>	6.0%	5.8%	-0.2ppt	6.4%	6.3%	-0.1ppt	6.3%	6.1%	-0.1ppt
EPS (RMB)	1.48	1.38	-7.0%	1.81	1.74	-4.2%	2.04	1.95	-4.4%
Revenue breakdown									
Liquid milk	84,955	81,404	-4.2%	96,662	94,425	-2.3%	109,734	107,184	-2.3%
Ice cream	4,749	4,569	-3.8%	5,420	5,213	-3.8%	6,039	5,807	-3.8%
Milk powder	5,569	5,396	-3.1%	6,199	6,002	-3.2%	7,046	6,820	-3.2%
Others	3,291	3,291	0.0%	4,443	4,443	0.0%	5,998	5,998	0.0%
Overall	98,564	94,660	-4.0%	112,724	110,083	-2.3%	128,817	125,809	-2.3%

Sources: Company data, CMS (HK) estimates

Figure 2: Target price and valuation table

Valuation - Mengniu

Stock price	38.5
HKD/RMB	0.86
Price date	18/7/2022

	FY21	FY22E	FY23E	FY24E
EPS (RMB)	1.27	1.38	1.74	1.95
P/E	26.1x	24.0x	19.0x	17.0x
EPS yoy	42.0%	8.9%	25.8%	12.2%
PEG	0.6x	2.7x	0.7x	1.4x

Target price calculation

Target P/E	26.5x
Fwd 12-month EPS (RMB)	1.59
Target price (HKD)	48.8
Upside	27.0%
<i>Div yield</i>	1.3%
Total return	28.3%

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 (%)	
							2022E	2023E	2022E	2023E		2024E	2022E			2023E
Dairy - China																
Mengniu Dairy	2319 HK	BUY	38.5	48.8	27.0%	19,370	56	15.7	13.8	24.0	19.0	1.1	12.5	14.3	24.0	1.3
Yili-A	600887 CH	NR	36.1	n.a.	n.a.	34,215	287	12.4	10.7	21.5	18.3	0.9	20.7	21.5	17.0	3.2
Bright Dairy - A	600597 CH	NR	11.5	n.a.	n.a.	2,355	25	8.0	6.9	22.9	19.9	1.1	8.6	8.9	16.6	1.2
China Modern Dairy	1117 HK	NR	1.1	n.a.	n.a.	1,089	3	3.6	1.4	5.2	4.0	0.1	12.5	13.9	23.3	3.4
Median						10,863	40	10.2	8.8	22.2	18.7	1.0	12.5	14.1	20.1	2.2
IMF - China																
Feihe	6186 HK	NR	8.3	n.a.	n.a.	9,426	19	5.0	4.5	8.8	7.6	0.6	30.0	30.3	10.8	4.9
H&H	1112 HK	NR	9.5	n.a.	n.a.	777	1	6.0	5.8	6.1	5.3	0.4	14.5	14.5	10.9	6.1
Ausnutria	1717 HK	NR	6.8	n.a.	n.a.	1,569	1	5.4	4.7	11.6	9.1	1.1	15.6	17.0	6.9	2.9
Yashili	1230 HK	NR	1.1	n.a.	n.a.	641	1	8.6	7.8	30.4	30.4	1.5	2.3	2.3	20.1	n.a.
Median						1,173	1	5.7	5.3	10.2	8.3	0.9	15.0	15.8	10.8	4.9
Dairy & IMF - Global																
Nestle	NESN SW	NR	114.9	n.a.	n.a.	323,758	433	16.8	15.9	24.5	22.6	-2.7	25.3	28.6	(7.6)	2.6
Danone	BN FP	NR	53.5	n.a.	n.a.	36,772	91	10.2	9.5	16.6	15.3	-3.8	11.3	12.2	(3.7)	3.7
A2 Milk	A2M AU	NR	4.4	n.a.	n.a.	2,236	13	12.8	10.3	31.6	24.9	n.a.	9.8	11.3	n.a.	-
Median						19,969	30	11.5	9.9	20.6	19.0	-2.7	9.8	11.3	(3.8)	2.6

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

Note: share prices are based on the closing price on July 18, 2022.

Financial statement

Balance Sheet

RMB mn	2020	2021	2022E	2023E	2024E
PP&E	12,547	17,335	17,675	18,025	18,386
Right of use assets	1,848	2,142	2,142	2,142	2,142
Goodwill	4,883	4,858	4,858	4,858	4,858
Other intangible assets	7,717	7,999	7,999	7,999	7,999
Investments in associates	9,020	15,794	15,794	15,794	15,794
Other non-current assets	12,624	18,953	12,224	13,667	15,057
Non-current assets	48,640	67,081	60,692	62,486	64,237
Inventories	5,512	6,485	6,452	7,319	8,322
Trade receivables	2,988	4,160	3,600	4,096	4,672
Prepayment and other receivables	3,605	4,286	5,613	6,388	7,285
Bank Balances and Cash	11,397	11,217	16,599	17,435	19,043
Other current assets	8,004	4,872	4,872	4,872	4,872
Current assets	31,507	31,020	37,135	40,110	44,194
Total assets	80,146	98,101	97,827	102,596	108,431
Account payable	7,969	8,804	8,813	9,998	11,367
Other payables and accruals	11,466	14,576	13,597	15,426	17,539
Bank Borrowings	4,924	4,265	3,265	2,265	1,265
Other current liabilities	1,785	1,426	1,493	1,559	1,597
Current liabilities	26,144	29,072	27,168	29,248	31,769
Deferred Tax Liabilities	2,280	2,456	2,456	2,456	2,456
Deferred income	420	478	478	478	478
Bank Borrowing	14,020	18,786	16,386	13,986	11,586
Other non-current liabilities	35	5,309	5,452	5,650	5,879
Non-current liabilities	16,754	27,030	24,773	22,571	20,399
Total liabilities	42,899	56,102	51,941	51,819	52,168
Share capital and other reserves	13,256	12,388	12,388	12,388	12,388
Retained earnings	19,727	24,438	28,269	33,091	38,498
Non-controlling interests	4,265	5,174	5,229	5,299	5,377
Total equity	37,248	41,999	45,886	50,777	56,263
Total equity and liabilities	80,146	98,101	97,827	102,596	108,431

Cashflow

RMB mn	2020	2021	2022E	2023E	2024E
Profit before tax	4,155	5,868	6,844	8,612	9,659
Finance Costs	-512	-284	-466	-583	-781
D&A	2,137	2,481	2,749	2,803	2,859
Changes in OWC	954	4,587	-1,704	874	1,007
Income tax paid	-753	-999	-1,315	-1,655	-1,856
Others	-633	-3,929	466	583	781
CF from operating activities	5,348	7,723	6,575	10,635	11,669
Capital expenditure	-611	-12,576	-3,500	-3,569	-3,640
Disposal of subsidiaries	15	0	0	0	0
Changes of investment deposits	9,356	1,244	0	0	0
Others	-3,938	-4,450	7,140	-1,028	-970
CF from investing activities	4,822	-15,783	3,640	-4,597	-4,610
Dividend paid	-785	-2,578	-1,642	-2,066	-2,317
Debt financing (repaid)	-3,926	8,262	-3,400	-3,400	-3,400
Others	141	2,067	209	265	266
CF from financing activities	-4,571	7,751	-4,833	-5,202	-5,451
Net cash flow	5,599	-309	5,382	836	1,608

Profit & Loss

RMB mn	2020	2021	2022E	2023E	2024E
Revenues	76,035	88,141	94,660	110,083	125,809
Cost of Sales	-47,406	-55,752	-60,021	-69,436	-79,101
Gross profits	28,629	32,390	34,640	40,646	46,708
Other income and gains	1,205	1,618	1,768	2,033	2,321
Selling & marketing exp	-21,541	-23,488	-25,083	-29,202	-33,377
Admin expense	-3,133	-3,524	-3,799	-4,408	-5,036
Other expenses	-1,944	-2,105	-2,137	-2,442	-2,774
Operating profits	3,216	4,891	5,388	6,628	7,842
Finance costs	512	284	466	583	781
Share of results of JV/asso.	426	693	990	1,401	1,036
Profit before tax	4,155	5,868	6,844	8,612	9,659
Income tax expense	-653	-905	-1,315	-1,655	-1,856
Net profit	3,502	4,964	5,529	6,957	7,803
Non-controlling interest	-23	-62	55	70	78
Attributable net profit	3,525	5,026	5,474	6,887	7,725
Diluted EPS (RMB)	0.89	1.27	1.38	1.74	1.95
Dividend per share (RMB)	0.27	0.38	0.41	0.52	0.58

Financial Ratio

	2020	2021	2022E	2023E	2024E
yo y growth					
Revenue	-3.8%	15.9%	7.4%	16.3%	14.3%
Gross Profit	-3.5%	13.1%	6.9%	17.3%	14.9%
Operating profit	-35.3%	52.0%	10.2%	23.0%	18.3%
Net profit	-14.1%	42.6%	8.9%	25.8%	12.2%
EPS	-14.7%	42.0%	8.9%	25.8%	12.2%
Profitability					
Gross margin	37.7%	36.7%	36.6%	36.9%	37.1%
Operating margin	4.2%	5.5%	5.7%	6.0%	6.2%
Net margin	4.6%	5.7%	5.8%	6.3%	6.1%
Liquidity					
AR days	15.8	14.8	15.0	12.8	12.7
Inventory days	40.8	39.3	39.3	36.2	36.1
AP days	56.6	54.9	53.6	49.4	49.3
Cash conversion cycle	0.0	-0.8	0.7	-0.5	-0.5
Cash flow & leverage					
Free cash low	5,355	-1,276	1,898	5,463	6,561
Net debt to equity	20.3%	28.2%	6.7%	-2.3%	-11.0%
Dividend payout ratio	30.0%	30.0%	30.0%	30.0%	30.0%
Dividend yield	0.8%	1.2%	1.3%	1.6%	1.8%
Return analysis					
ROE	10.0%	12.7%	12.5%	14.3%	14.4%
Asset turnover	1.0	1.0	1.0	1.1	1.2
Net margin	4.6%	5.7%	5.8%	6.3%	6.1%
Financial leverage	2.2	2.2	2.2	2.1	2.0
ROA	4.4%	5.6%	5.6%	6.9%	7.3%
Valuation ratios					
P/E	37.0x	26.1x	24.0x	19.0x	17.0x
P/B	3.5x	3.1x	2.9x	2.6x	2.3x

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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Hong Kong

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