

## Company Report

China Merchants Securities (HK) Co., Ltd.  
Hong Kong Equity Research

### China Mengniu Dairy (2319 HK)

#### Sales likely affected by rebound in COVID

- Revenues likely affected by rebound in COVID
- Margins were also likely affected
- Maintain BUY. New TP of HKD42.2

#### Rebound in COVID likely to negatively affect Mengniu

We believe that the recent rebound in COVID should affect Mengniu's operations in a similar manner to that of 2Q22. While we believe demand for Mengniu's products in areas under COVID lockdown should still be strong, we should expect logistics bottlenecks, higher discounting and possibly suboptimal product sales mix due to limitations in the choices of products available for purchase in some affected areas.

#### Margins may also be affected

COVID lockdowns may have caused the sales mix to shift towards lower end products. Combined with some product discounting and logistic bottlenecks, Mengniu's gross margins could be negatively affected. That said, we should expect the company to reduce its marketing expenses to a certain extent to minimize these negative effects.

#### 1H23 earnings could rebound if COVID restrictions ease

Assuming that COVID restrictions start to ease in 1H23, we should expect Mengniu's sales mix to improve as consumer could switch back to high-end products, as we expect underlying demand to remain strong. At such time, logistic issues would be resolved and stable raw milk prices, margins should rebound.

#### Maintain BUY and reduce TP to HKD42.2

We cut our FY22/23/24 EPS forecasts for Mengniu by -5.5%, -7.1% and -2.0% respectively due to the negative effected expected from the recent rebound in COVID restrictions. We also cut our TP from HKD48.8 to HKD42.2 due to the revision in earnings forecasts and the depreciation of the RMB since our previous report. Our new TP if HKD42.2 is based on a target multiple of 26.0x on our rolling 12 months forward EPS (previous 26.0x) As we believe fundamentals should improve in FY23 with relaxation, 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.

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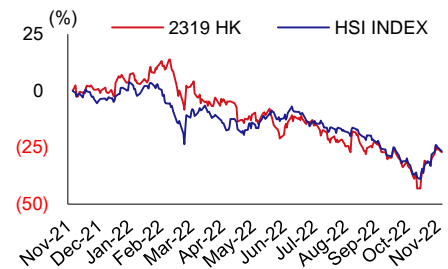
#### WHAT'S NEW

Likely affected by recent rebound in COVID; Maintain BUY. New TP of HKD42.2

### BUY

Previous	BUY
Price (Nov 22, 2022)	HKD 31.50
12-month Target Price (Potential up/downside)	HKD 42.2 (+34.0%)
Previous	HKD 48.8

#### Price Performance



Source: Bloomberg; share price as of Nov 22, 2022

%	1m	6m	12m
2319 HK	8.2	(20.2)	(30.7)
HSI	7.5	(15.9)	(30.2)

#### Sector: Consumer

Hang Seng Index (Nov 22, 2022)	17,424
HSCEI (Nov 22, 2022)	5,901

#### Key Data

52-week range (HKD)	24.7 - 50.711
Market cap (HKD mn)	124,588
Avg. daily volume (mn)	12.39
BVPS (RMB)	9.83

#### Shareholding Structure

COFCO	23.14%
Others	0.08%
No. of shares outstanding (mn)	3,951
Free float	76.78%

Source: Bloomberg

## Financials

Year ended 31 Dec (RMB mn)	2020	2021	2022E	2023E	2024E
Revenue	76,035	88,141	94,910	112,027	132,209
yoy growth	-3.8%	15.9%	7.7%	18.0%	18.0%
Attributable net profit	3,525	5,026	6,039	6,553	7,936
Adj. EPS (RMB)	0.89	1.27	1.52	1.65	2.00
yoy growth	-14.7%	42.0%	20.1%	8.5%	21.1%
P/E	32.4x	22.8x	19.0x	17.5x	14.4x
ROE	10.0%	12.7%	14.0%	14.0%	15.3%
Net debt (cash)/ equity	20.3%	28.2%	38.8%	31.7%	24.2%

Sources: Company data, CMS (HK) estimates; share price as of November 22, 2022

#### Related Research

- China Mengniu Dairy (2319 HK) - 1H22 result in line; Sales should rebound in 2H (BUY) (Aug 25, 2022)

Figure 1: Key forecast change table

Unit: RMB mn	2022E			2023E			2024E		
	Original	New	Diff %	Original	New	Diff %	Original	New	Diff %
<b>Revenue</b>	<b>96,207</b>	<b>94,910</b>	<b>-1.3%</b>	<b>112,820</b>	<b>112,027</b>	<b>-0.7%</b>	<b>132,414</b>	<b>132,209</b>	<b>-0.2%</b>
<b>Gross profit</b>	<b>34,637</b>	<b>33,941</b>	<b>-2.0%</b>	<b>41,031</b>	<b>40,626</b>	<b>-1.0%</b>	<b>48,436</b>	<b>48,204</b>	<b>-0.5%</b>
GPM	36.0%	35.8%	-0.2ppt	36.4%	36.3%	-0.1ppt	36.6%	36.5%	-0.1ppt
<b>Operating profit</b>	<b>6,071</b>	<b>5,626</b>	<b>-7.3%</b>	<b>6,404</b>	<b>6,100</b>	<b>-4.8%</b>	<b>7,808</b>	<b>7,477</b>	<b>-4.2%</b>
OPM	6.3%	5.9%	-0.4ppt	5.7%	5.4%	-0.2ppt	5.9%	5.7%	-0.2ppt
<b>Attributable net profit</b>	<b>6,391</b>	<b>6,039</b>	<b>-5.5%</b>	<b>7,051</b>	<b>6,553</b>	<b>-7.1%</b>	<b>8,097</b>	<b>7,936</b>	<b>-2.0%</b>
NPM	6.6%	6.4%	-0.3ppt	6.2%	5.8%	-0.4ppt	6.1%	6.0%	-0.1ppt
<b>EPS (RMB)</b>	<b>1.61</b>	<b>1.52</b>	<b>-5.5%</b>	<b>1.78</b>	<b>1.65</b>	<b>-7.1%</b>	<b>2.04</b>	<b>2.00</b>	<b>-2.0%</b>
<b>Revenue breakdown</b>									
Liquid milk	81,180	79,882	-1.6%	91,677	90,884	-0.9%	103,606	103,401	-0.2%
Ice cream	5,288	5,288	0.0%	6,235	6,235	0.0%	6,952	6,952	0.0%
Milk powder	4,416	4,416	0.0%	5,326	5,326	0.0%	6,046	6,046	0.0%
Others	5,323	5,323	0.0%	9,582	9,582	0.0%	15,810	15,810	0.0%
<b>Overall</b>	<b>96,207</b>	<b>94,910</b>	<b>-1.3%</b>	<b>112,820</b>	<b>112,027</b>	<b>-0.7%</b>	<b>132,414</b>	<b>132,209</b>	<b>-0.2%</b>

Sources: Company data, CMS (HK) estimates

Figure 2: Target price and valuation table

<b>Stock price</b>	31.50			
<b>HKD/RMB</b>	0.9164			
<b>Price date</b>	11/22/2022			
	<b>FY21</b>	<b>FY22E</b>	<b>FY23E</b>	<b>FY24E</b>
<b>EPS (RMB)</b>	1.27	1.52	1.65	2.00
<b>P/E</b>	<b>22.8x</b>	<b>19.0x</b>	<b>17.5x</b>	<b>14.4x</b>
<b>EPS yoy</b>	42.0%	20.1%	8.5%	21.1%
<b>PEG</b>	<b>0.5x</b>	<b>0.9x</b>	<b>2.0x</b>	<b>0.7x</b>
<b>Target price calculation</b>				
<b>Target P/E</b>		<b>26.0x</b>		
<b>Fwd 12-month EPS (RMB)</b>		1.49		
<b>Target price (HKD)</b>		<b>42.2</b>		
<b>Upside</b>		<b>34.0%</b>		

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

## Financial statement

### Balance Sheet

RMB mn	2020	2021	2022E	2023E	2024E
PP&E	12,547	17,335	17,337	17,677	18,028
Right of use assets	1,848	2,142	2,109	2,109	2,109
Goodwill	4,883	4,858	4,883	4,883	4,883
Other intangible assets	7,717	7,999	8,031	8,031	8,031
Investments in associates	9,020	15,794	16,685	16,685	16,685
Other non-current assets	12,624	18,953	23,719	27,594	32,139
<b>Non-current assets</b>	<b>48,640</b>	<b>67,081</b>	<b>72,764</b>	<b>76,978</b>	<b>81,874</b>
Inventories	5,512	6,485	6,454	7,535	8,904
Trade receivables	2,988	4,160	4,676	5,501	6,521
Prepayment and other receivables	3,605	4,286	3,794	4,463	5,290
Bank Balances and Cash	11,397	11,217	14,094	14,778	16,109
Other current assets	8,004	4,872	5,137	5,137	5,137
<b>Current assets</b>	<b>31,507</b>	<b>31,020</b>	<b>34,155</b>	<b>37,414</b>	<b>41,960</b>
<b>Total assets</b>	<b>80,146</b>	<b>98,101</b>	<b>106,919</b>	<b>114,393</b>	<b>123,834</b>
Account payable	7,969	8,804	9,028	10,540	12,454
Other payables and accruals	11,466	14,576	13,225	15,439	18,243
Bank Borrowings	4,924	4,265	7,136	6,136	5,136
Other current liabilities	1,785	1,426	1,398	1,462	1,512
<b>Current liabilities</b>	<b>26,144</b>	<b>29,072</b>	<b>30,787</b>	<b>33,577</b>	<b>37,345</b>
Deferred Tax Liabilities	2,280	2,456	2,498	2,498	2,498
Deferred income	420	478	620	620	620
Bank Borrowing	14,020	18,786	24,217	24,217	24,217
Other non-current liabilities	35	5,309	4,337	4,367	4,405
<b>Non-current liabilities</b>	<b>16,754</b>	<b>27,030</b>	<b>31,672</b>	<b>31,702</b>	<b>31,740</b>
<b>Total liabilities</b>	<b>42,899</b>	<b>56,102</b>	<b>62,459</b>	<b>65,279</b>	<b>69,085</b>
Share capital and other reserves	13,256	12,388	10,682	10,682	10,682
Retained earnings	19,727	24,438	28,669	33,256	38,812
Non-controlling interests	4,265	5,174	5,109	5,175	5,256
<b>Total equity</b>	<b>37,248</b>	<b>41,999</b>	<b>44,461</b>	<b>49,114</b>	<b>54,749</b>
<b>Total equity and liabilities</b>	<b>80,146</b>	<b>98,101</b>	<b>106,919</b>	<b>114,393</b>	<b>123,834</b>

### Cashflow

RMB mn	2020	2021	2022E	2023E	2024E
Profit before tax	4,155	5,868	6,899	7,975	9,658
Finance Costs	-512	-284	-463	-757	-974
D&A	2,137	2,396	2,724	2,750	2,804
Changes in OWC	954	921	-1,386	1,151	1,503
Income tax paid	-753	-903	-945	-1,356	-1,642
Others	-633	-453	-452	757	974
<b>CF from operating activities</b>	<b>5,348</b>	<b>7,545</b>	<b>6,376</b>	<b>10,520</b>	<b>12,323</b>
Capital expenditure	-611	-565	-3,599	-3,501	-3,570
Disposal of subsidiaries	15	65	0	0	0
Changes of investment deposits	9,356	3,132	0	0	0
Others	-3,938	-18,071	-3,891	-3,463	-4,130
<b>CF from investing activities</b>	<b>4,822</b>	<b>-15,440</b>	<b>-7,490</b>	<b>-6,964</b>	<b>-7,700</b>
Dividend paid	-785	-1,077	-1,812	-1,966	-2,381
Debt financing (repaid)	-3,926	8,013	8,479	-1,000	-1,000
Others	141	-163	-2,675	94	89
<b>CF from financing activities</b>	<b>4,155</b>	<b>5,868</b>	<b>6,899</b>	<b>7,975</b>	<b>9,658</b>
<b>Net cash flow</b>	<b>-512</b>	<b>-284</b>	<b>-463</b>	<b>-757</b>	<b>-974</b>

### Profit & Loss

RMB mn	2020	2021	2022E	2023E	2024E
<b>Revenues</b>	<b>76,035</b>	<b>88,141</b>	<b>94,910</b>	<b>112,027</b>	<b>132,209</b>
Cost of Sales	-47,406	-55,752	-60,969	-71,401	-84,005
<b>Gross profits</b>	<b>28,629</b>	<b>32,390</b>	<b>33,941</b>	<b>40,626</b>	<b>48,204</b>
Other income and gains	1,205	1,618	1,947	1,120	1,322
Selling & marketing exp	-21,541	-23,488	-24,555	-28,985	-34,203
Admin expense	-3,133	-3,524	-4,092	-4,830	-5,701
Other expenses	-1,944	-2,105	-1,615	-1,831	-2,146
<b>Operating profits</b>	<b>3,216</b>	<b>4,891</b>	<b>5,626</b>	<b>6,100</b>	<b>7,477</b>
Finance costs	512	284	463	757	974
Share of results of JV/asso.	426	693	810	1,118	1,208
<b>Profit before tax</b>	<b>4,155</b>	<b>5,868</b>	<b>6,899</b>	<b>7,975</b>	<b>9,658</b>
Income tax expense	-653	-905	-945	-1,356	-1,642
<b>Net profit</b>	<b>3,502</b>	<b>4,964</b>	<b>5,954</b>	<b>6,619</b>	<b>8,016</b>
Non-controlling interest	-23	-62	-85	66	80
<b>Attributable net profit</b>	<b>3,525</b>	<b>5,026</b>	<b>6,039</b>	<b>6,553</b>	<b>7,936</b>
Diluted EPS (RMB)	0.89	1.27	1.52	1.65	2.00
Dividend per share (RMB)	0.27	0.38	0.46	0.50	0.60

### Financial Ratio

	2020	2021	2022E	2023E	2024E
<b>yo y growth</b>					
Revenue	-3.8%	15.9%	7.7%	18.0%	18.0%
Gross Profit	-3.5%	13.1%	4.8%	19.7%	18.7%
Operating profit	-35.3%	52.0%	15.0%	8.4%	22.6%
Net profit	-14.1%	42.6%	20.2%	8.5%	21.1%
EPS	-14.7%	42.0%	20.1%	8.5%	21.1%
<b>Profitability</b>					
Gross margin	37.7%	36.7%	35.8%	36.3%	36.5%
Operating margin	4.2%	5.5%	5.9%	5.4%	5.7%
Net margin	4.6%	5.7%	6.4%	5.8%	6.0%
<b>Liquidity</b>					
AR days	15.8	14.8	17.0	16.6	16.6
Inventory days	40.8	39.3	38.7	35.8	35.7
AP days	56.6	54.9	53.4	50.0	50.0
Cash conversion cycle	0.0	-0.8	2.3	2.3	2.4
<b>Cash flow &amp; leverage</b>					
Free cash low	5,355	7,062	2,593	5,462	6,943
Net debt to equity	20.3%	28.2%	38.8%	31.7%	24.2%
Dividend payout ratio	30.0%	30.0%	30.0%	30.0%	30.0%
Dividend yield	0.9%	1.3%	1.6%	1.7%	2.1%
<b>Return analysis</b>					
ROE	10.0%	12.7%	14.0%	14.0%	15.3%
Asset turnover	1.0	1.0	0.9	1.0	1.1
Net margin	4.6%	5.7%	6.4%	5.8%	6.0%
Financial leverage	2.2	2.2	2.4	2.4	2.3
ROA	4.4%	5.6%	5.9%	5.9%	6.7%
<b>Valuation ratios</b>					
P/E	32.4x	22.8x	19.0x	17.5x	14.4x
P/B	3.1x	2.7x	2.6x	2.3x	2.1x

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
HOLD	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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