

Mengniu (2319.HK)

Acquisition of Bellamy helping milk powder business development; maintaining whole financial year's guidelines

China | Dairy | Company report

23 October 2019

Investment Summary

Mengniu announced that it intends to acquire Bellamy's Australia at a price of no more than AUD1.46 billion (HKD7.86 billion), with a planned share of AUD12.65 per share. Bellamy's net profit after tax is AUD21.7 million in FY2019. The P/E ratio is 67 times. Bellamy is Australia's first organic milk powder brand. It is listed on the ASX. It is a global recognised brand and has operations in Australia, New Zealand, China and Southeast Asia. We believe that the acquisition will be highly complementary to Mengniu's existing infant formula business, which will help Mengniu expand China and overseas markets. Organic IMF enjoys significantly faster growth and higher margins compared to the overall IMF market. Bellamy's gross profit margin of FY 2019 reached 43.5%, and the EBITDA rate reached 17.6%, both higher than Mengniu. Bellamy's FY 2018/2019 revenue fell 19% y.o.y. to AUD266 million, mainly due to the slower-than-expected approval of China's milk powder formula registration, and the e-commerce law. Mengniu said that after the acquisition, it will closely communicate with the relevant departments to assist Bellamy to accelerate the registration approval.

Mengniu's revenue in 1H of FY2019 increased by 15.6% y.o.y., if excluding Junlebao, the growth rate was 13%. Up to 9.5% of revenue growth came from sales volume growth, and the rest was the increase in ASP, mainly due to faster growth of basic products. The management team still maintains the guidance of the whole year, with low double-digit growth in revenue (including Junlebao, which will be finished disposal in 2H. Operating profit margin improved by 50 points in 1H and is expected to be maintained in 2H. Gross profit margin decreased by 0.1 ppt y.o.y. to 39.1%, while GPM was flat excluding Junlebao. Raw milk price rose by 5 to 6%, higher than management team's expectation. But thanked for the product mix optimization, the high-end milk business is growing rapidly. The prices of other raw materials fell, and the tax rate has also had a positive impact, which led to an improvement in operating profit margins.

After the announcement of the interim results, the stock price was under pressure. The market worried that the price of raw milk would remain high, and the market competition continued, which put pressure on operating profit. We believe the increase of raw milk price will help the performance of Modern Dairy (1117.hk) to resume. Mengniu's product mix will continue to be optimized, and it is expected that GPM can be maintained. After the completion of the disposal of Junlebao, profit margin can be improved. In 1H, the liquid milk business, which accounted for 83% of total revenue, increased by 14.4% y.o.y., the milk powder business increased by 43.8%, and ice cream decreased by 2.4%. For the liquid milk business, the market share of UHT products and chilled yogurt increased compared with the same period of last year. The former increased by 0.5 ppt to 28.5%, and continued to rank the second in the market. The latter increased by 1.3 ppt to 34.5%, and continued to be the market leader. For the e-commerce liquid milk category, the market share increased by 0.9 ppt to 24.6%, which also ranked the first in the market.

During the period, the income of Milk Deluxe and Just Yoghurt which belong to the room temperature product business increased by 20% and 24% respectively, and Fruit Milk Drink also recorded double-digit growth, while the basic white milk business increased by 19%. During the period, Milk Deluxe had been launched fully revamped packaging, Just Yoghurt had been launched new flavor products, Fruit Milk Drink had been launched high-end products. The chilled product business has also introduced new packaging and a variety of new products. We give a forecast PE of 31 times and target price of HKD34.6. (current price as of 21st October, 2019)

Accumulate

CMP HKD31.2

(Closing price at 21/10/2019)

TARGET HKD 34.6(+10.8%)

COMPANY DATA

O/S SHARES (MN) :	3927
MARKET CAP (HKDMN) :	122696
52 - WK LO/HI (HKD):	22.05/34.6

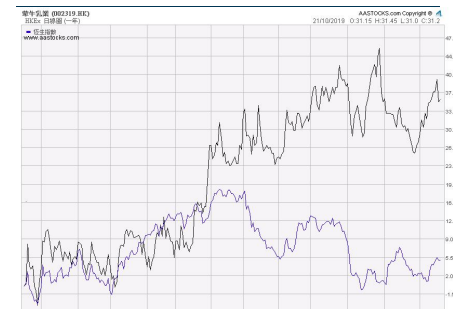
SHARE HOLDING PATTERN , %

COFCO Dairy Inv.	31.43
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PRICE PERFORMANCE , %

	1 個月	3 個月	1 年
Mengniu	5.8	-0.8	25.6
HSI	1.9	-5.8	2.2

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

RMB mn	FY17	FY18	FY19E	FY20E
Net Sales	60,156	68,977	78,289	88,467
Net Profit	2,048	3,043	3,975	4,679
EPS, RMB	0.53	0.78	1.01	1.19
PER, x	53.76	36.30	27.98	23.77
BVPS, RMB	6.96	7.80	8.56	9.53
P/BV, x	4.06	3.62	3.30	2.97
ROE, %	7.49%	10.52%	12.43%	13.15%

Source: Company reports, Phillip Securities Est.

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Valuation and risk

We are optimistic about the industry and the company's prospects, thus give forecast PE ratio of 31 times and target price of HKD34.6. Potential risks include failure to meet revenue growth, lower profit margins than expected, and huge fluctuations in raw milk prices. (current price as of 21st October 2019)

Figure: historical PE ratios



Source: Bloomberg, Phillip Securities

Figure: peers comparison

	Market Price	Market Cap	PE ratio
Mengniu(2319.HK)	HKD31.2	HKD122.969B	30.91
H&H (1112.HK)	HKD28.9	HKD18.494B	14.2
Inner Mongolia Yili(600887.SH)	CNY27.89	CNY169.805B	25.17
Bright Dairy & Food(600597.SH)	CNY10.42	CNY12.758B	34.09
Danone SA(BN:FP)	EUR71.4	EUR49.373B	21.42
Meiji(2269.JP)	JPY7760	JPY1.185T	18.99

Source: Bloomberg, Phillip Securities

Financials

FYE	2016	2017	2018	2019E	2020E
Valuation Ratios					
Price to Earnings (P/E)	NA	53.8	36.3	28.0	23.8
Price to Book (P/B)	4.3	4.1	3.6	3.3	3.0
Per Share Data (RMB)					
EPS	NA	0.53	0.78	1.01	1.19
Book Value Per Share	6.56	6.96	7.80	8.56	9.53
Dividend Per Share	0.09	0.12	0.18	0.23	0.28
Growth (%)					
Revenue	9.7%	11.9%	14.7%	13.5%	13.0%
Operating Income	-115.9%	NA	29.0%	20.3%	19.3%
Net Profit	-131.7%	NA	48.6%	30.6%	17.7%
Margins (%)					
Gross Profit Margin	32.8%	35.2%	37.4%	37.7%	38.0%
Operating Profit Margin	-0.8%	4.9%	5.6%	5.9%	6.2%
Net Profit Margin	-1.4%	3.4%	4.4%	5.1%	5.3%
Key Ratios					
ROE (%)	-3.2%	7.5%	10.5%	12.4%	13.2%
ROA (%)	-1.7%	3.5%	4.8%	5.7%	6.0%
Income Statement (RMB)					
Revenue	53,779	60,156	68,977	78,289	88,467
- Cost of Goods Sold	-36,144	-38,973	-43,193	-48,790	-54,867
Gross Income	17,635	21,183	25,784	29,499	33,600
- SG&A expenses	-15,907	-17,366	-21,748	-24,684	-27,893
Operating Income	-420	2,972	3,835	4,615	5,506
Pretax Income	-461	2,625	3,853	5,032	5,924
- Minority Interest	-62	-17	161	210	247
Net Profit	-751	2,048	3,043	3,975	4,679

Source: Company, Phillip Securities (HK) Research Estimates
The exchange rate assumption is 0.9064.
(Financial figures as at 21st October 2019)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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