

EARNINGS REVIEW

Mengniu Dairy (2319.HK)

Neutral

Equity Research

Above expectations: Sales growth remains a headline risk; Neutral**What surprised us**

We raise our 2015/16E recurring NPAT by 9%/8% and introduce 2017E of RMB3.7bn after a 12% beat in FY2014. **The major surprise was yoghurt sales growth of 49% in 2H14.** Nielsen category growth for yoghurt was c.14% yoy in 2014, and Mengniu's market share was flat at c.32%. Of the c.RMB2bn uplift in 2014 yoghurt sales, c.RMB200-300mn was from an increase in Champion yoghurt sales, another RMB200-300mn was from the consolidation of Danone's Bio brand in 2H14. Excluding these, the rest of the portfolio grew c.30% yoy, which is above market. We are concerned about a potential build-up of inventory in channels (although Chilled products should be perishable) and hence forecast slower growth for yoghurt at c.16/15% in 2015/16E. UHT milk, we forecast sales growth of 10% in 2015E (7% volume, 3% mix). We expect volume growth in 2015E to be higher than 2014 (GSe 1%) due to a recovery in consumer demand given price discounts. Mengniu also noted that it will aim to recover market share via its basic pure milk products, which are lower in price. For Milk Beverages and IMF, we forecast only 4-5% sales growth due to intense competition, and ice-cream -25% sales growth as the segment continues to undergo restructuring. Overall, **we forecast sales growth of 7.5% in 2015/16E which is below management guidance of 10%.** Lower ASP means more subdued GPM improvement of 1.4ppt to 32.2%, and only 20bps improvement in OP margin to 6.4% due to higher SG&A spend. We forecast 13%/14% NPAT growth in 2015/16E and are -3%/-7% vs Bloomberg consensus.

What to do with the stock

Retain Neutral. Sales growth remains the headline risk for Mengniu. Our new TP of HK\$38.50 (from HK\$35.20) remains based on 21.9x 2015 P/E. Key risks: higher/lower sales, milk costs and selling expense.

Mengniu FY14 Actual vs. GSe

RMB mn	1H13	2H13	1H14	2H14A	2H14E	Act. Vs GSe	YoY %
Recurring NPAT	776	871	1,164	1,296	966	34%	49%

Source: Company data, Goldman Sachs Global Investment Research.

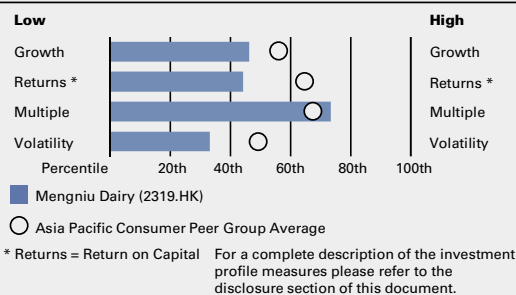
INVESTMENT LIST MEMBERSHIP

Neutral

Coverage View: Neutral

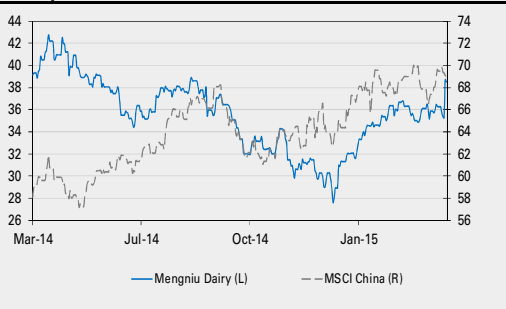
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Investment Profile**Key data**

	Current
Price (HK\$)	38.50
12 month price target (HK\$)	38.50
Market cap (HK\$ mn / US\$ mn)	67,862.9 / 8,752.0
Foreign ownership (%)	--

	12/14	12/15E	12/16E	12/17E
EPS (Rmb) New	1.26	1.40	1.58	1.87
EPS revision (%)	12.6	9.4	8.0	--
EPS growth (%)	39.1	11.0	13.3	18.3
EPS (dil) (Rmb) New	1.20	1.35	1.53	1.82
P/E (X)	22.8	22.1	19.5	16.5
P/B (X)	2.6	2.6	2.3	2.1
EV/EBITDA (X)	15.5	14.9	12.6	10.6
Dividend yield (%)	1.0	1.0	1.2	1.4
ROE (%)	12.8	11.7	12.1	12.9
CROCI (%)	10.9	9.1	10.0	11.4

Price performance chart

Share price performance (%)	3 month	6 month	12 month
Absolute	23.0	15.6	(1.7)
Rel. to MSCI China	14.6	5.9	(17.4)

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 3/27/2015 close.

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Mengniu Dairy: Summary Financials

Profit model (Rmb mn)	12/14	12/15E	12/16E	12/17E	Balance sheet (Rmb mn)	12/14	12/15E	12/16E	12/17E
Total revenue	50,049.2	53,797.8	57,904.1	62,052.1	Cash & equivalents	4,649.6	2,682.0	3,587.2	5,295.6
Cost of goods sold	(34,615.6)	(36,479.4)	(39,088.9)	(41,624.6)	Accounts receivable	1,031.2	1,255.9	1,510.4	1,788.6
SG&A	(12,332.4)	(13,875.6)	(14,761.0)	(15,818.4)	Inventory	4,342.3	4,076.4	3,748.2	3,421.2
R&D	--	--	--	--	Other current assets	10,309.5	10,309.5	10,309.5	10,309.5
Other operating profit/(expense)	(327.5)	(386.9)	(460.7)	(367.2)	Total current assets	20,332.6	18,323.7	19,155.3	20,814.9
EBITDA	4,115.4	4,564.5	5,346.8	6,251.9	Net PP&E	13,228.0	15,039.1	16,983.1	18,598.9
Depreciation & amortization	(1,341.7)	(1,508.6)	(1,753.3)	(2,010.0)	Net intangibles	7,550.5	7,511.4	7,535.4	7,550.5
EBIT	2,773.7	3,055.9	3,593.5	4,241.8	Total investments	3,840.6	4,028.8	4,160.9	4,336.0
Interest income	547.6	542.4	542.4	542.4	Other long-term assets	2,129.0	2,202.5	2,178.5	2,163.4
Interest expense	(339.9)	(337.2)	(337.2)	(290.9)	Total assets	47,080.8	47,105.5	50,013.3	53,463.7
Income/(loss) from uncons. subs.	277.7	188.2	132.2	175.1	Accounts payable	3,208.1	3,280.9	3,408.5	3,515.6
Others	0.0	0.0	0.0	0.0	Short-term debt	4,360.6	5,235.5	5,235.5	5,235.5
Pretax profits	3,259.1	3,449.2	3,930.8	4,668.4	Other current liabilities	6,782.4	6,782.4	6,782.4	6,782.4
Income tax	(459.3)	(509.1)	(601.4)	(740.1)	Total current liabilities	14,351.1	15,298.8	15,426.4	15,533.5
Minorities	(339.9)	(186.2)	(208.9)	(237.8)	Long-term debt	5,464.1	4,461.5	4,461.5	4,461.5
Net income pre-preferred dividends	2,460.0	2,753.9	3,120.4	3,690.5	Other long-term liabilities	2,772.7	2,934.7	2,934.7	2,934.7
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	8,236.8	7,396.2	7,396.2	7,396.2
Net income (pre-exceptionals)	2,460.0	2,753.9	3,120.4	3,690.5	Total liabilities	22,587.9	22,695.0	22,822.6	22,929.7
Post-tax exceptionals	(109.2)	(100.0)	(100.0)	(100.0)	Preferred shares	0.0	0.0	0.0	0.0
Net income	2,350.8	2,653.9	3,020.4	3,590.5	Total common equity	21,489.4	23,726.5	26,297.8	29,403.4
EPS (basic, pre-exception) (Rmb)	1.27	1.41	1.59	1.88	Minority interest	3,003.5	683.9	892.9	1,130.7
EPS (basic, post-exception) (Rmb)	1.21	1.36	1.54	1.83	Total liabilities & equity	47,080.8	47,105.5	50,013.3	53,463.7
EPS (diluted, post-exception) (Rmb)	1.20	1.35	1.53	1.82	BVPS (Rmb)	10.99	12.04	13.34	14.92
DPS (Rmb)	0.28	0.31	0.36	0.42	Ratios	12/14	12/15E	12/16E	12/17E
Dividend payout ratio (%)	23.1	23.1	23.1	23.1	CROCI (%)	10.9	9.1	10.0	11.4
Free cash flow yield (%)	(0.5)	1.2	1.9	3.0	ROE (%)	12.8	11.7	12.1	12.9
Growth & margins (%)	12/14	12/15E	12/16E	12/17E	ROA (%)	5.4	5.6	6.2	6.9
Sales growth	15.4	7.5	7.6	7.2	ROACE (%)	10.0	9.1	9.8	10.9
EBITDA growth	32.4	10.9	17.1	16.9	Inventory days	36.5	42.1	36.5	31.4
EBIT growth	46.6	10.2	17.6	18.0	Receivables days	6.3	7.8	8.7	9.7
Net income growth	46.3	12.9	13.8	18.9	Payable days	33.0	32.5	31.2	30.4
EPS growth	36.0	12.0	13.8	18.9	Net debt/equity (%)	21.1	28.7	22.5	14.4
Gross margin	30.8	32.2	32.5	32.9	Interest cover - EBIT (X)	NM	NM	NM	NM
EBITDA margin	8.2	8.5	9.2	10.1	Valuation	12/14	12/15E	12/16E	12/17E
EBIT margin	5.5	5.7	6.2	6.8	P/E (analyst) (X)	22.8	22.1	19.5	16.5
Cash flow statement (Rmb mn)	12/14	12/15E	12/16E	12/17E	P/B (X)	2.6	2.6	2.3	2.1
Net income pre-preferred dividends	2,460.0	2,753.9	3,120.4	3,690.5	EV/EBITDA (X)	15.5	14.9	12.6	10.6
D&A add-back	1,341.7	1,508.6	1,753.3	2,010.0	EV/GCI (X)	1.6	1.6	1.4	1.5
Minorities interests add-back	339.9	186.2	208.9	237.8	Dividend yield (%)	1.0	1.0	1.2	1.4
Net (inc)/dec working capital	(5,692.5)	(7,766.2)	(5,759.5)	471.2					
Other operating cash flow	4,630.9	7,376.7	5,551.0	(918.9)					
Cash flow from operations	3,079.9	4,059.2	4,874.2	5,490.6					
Capital expenditures	(3,401.9)	(3,319.6)	(3,697.4)	(3,625.9)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	747.4	22.3	22.3	22.3					
Others	(6,961.1)	520.0	520.0	520.0					
Cash flow from investments	(9,615.6)	(2,777.2)	(3,155.0)	(3,083.5)					
Dividends paid (common & pref)	(361.0)	(543.8)	(614.0)	(698.8)					
Inc/(dec) in debt	(2,000.0)	0.0	0.0	0.0					
Common stock issuance (repurchase)	5,152.5	0.0	0.0	0.0					
Other financing cash flows	1,292.2	(2,705.7)	(200.0)	0.0					
Cash flow from financing	4,083.7	(3,249.6)	(814.0)	(698.8)					
Total cash flow	(2,452.0)	(1,967.6)	905.2	1,708.4					

Note: Last actual year may include reported and estimated data.
Source: Company data, Goldman Sachs Research estimates.

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Exhibit 1: Mengniu New vs Old estimates**Mengniu (2319.HK)**
RMB mn

Divisional P/L	2013	2014	FY2015E			FY2016E			FY2017E
	Actual	Actual	Old	New	% Chg	Old	New	% Chg	New
Revenue									
...UHT Milk	22,053	23,702	26,739	26,122	-2.3%	29,469	27,981	-5.0%	29,685
...Milk Bev	10,426	11,921	11,930	12,401	3.9%	12,657	13,028	2.9%	13,688
...Yoghurt	5,424	7,414	7,198	8,626	19.8%	8,199	9,910	20.9%	11,244
Liquid Milk	37,903	43,036	45,868	47,149	2.8%	50,324	50,920	1.2%	54,617
Ice-Cream	3,023	2,716	3,018	2,037	-32.5%	3,170	2,037	-35.7%	2,140
Infant Formula (Other Dairy until 2012)	2,177	3,961	4,961	4,612	-7.0%	5,486	4,947	-9.8%	5,295
Other Dairy	253	336	0	0		0	0		0
Total Revenue	43,357	50,049	53,847	53,798	-0.1%	58,981	57,904	-1.8%	62,052
Consolidated P&L									
Sales	43,357	50,049	53,847	53,798	-0.1%	58,981	57,904	-1.8%	62,052
COGS	(31,660)	(34,616)	(36,202)	(36,479)	0.8%	(39,470)	(39,089)	-1.0%	(41,625)
Gross Profit	11,697	15,434	17,644	17,318	-1.8%	19,511	18,815	-3.6%	20,427
SG&A	(9,583)	(12,332)	(14,011)	(13,876)	-1.0%	(15,346)	(14,761)	-3.8%	(15,818)
Other income/(expense)	(262)	(437)	(626)	(487)	-22.2%	(717)	(561)	-21.8%	(467)
EBIT	1,852	2,665	3,008	2,956	-1.7%	3,447	3,494	1.3%	4,142
D&A	(1,216)	(1,342)	(1,575)	(1,509)	-4.2%	(1,815)	(1,753)	-3.4%	(2,010)
EBITDA	3,068	4,006	4,583	4,464	-2.6%	5,262	5,247	-0.3%	6,152
Net finance costs	199	208	106	205	94.3%	106	205	94.3%	251
Other non-operating income (expense)	154	278	111	188	69.1%	162	132	-18.5%	175
Pretax income	2,205	3,150	3,225	3,349	3.9%	3,715	3,831	3.1%	4,568
Provisions for taxes	(367)	(459)	(564)	(509)	-9.8%	(669)	(601)	-10.1%	(740)
Minority interest (I/S item)	(231)	(340)	(238)	(186)	-21.8%	(254)	(209)	-17.6%	(238)
Reported NPAT	1,631	2,351	2,422	2,654	9.6%	2,793	3,020	8.1%	3,591
Less: Net Non-Recurring	(16)	(109)	(100)	(100)	0.0%	(100)	(100)		(100)
Adjusted NPAT	1,647	2,460	2,522	2,754	9.2%	2,893	3,120	7.9%	3,691
Reported Diluted EPS	0.90	1.20	1.23	1.35	9.7%	1.41	1.53	8.3%	1.82
Adjusted Diluted EPS	0.90	1.26	1.28	1.40	9.4%	1.47	1.58	8.0%	1.87
YoY Growth %									
			ppt					ppt	
Sales	20%	15%	8%	7%		10%	8%		7%
COGS	17%	9%	4%	5%		9%	7%		6%
GP	30%	32%	18%	12%		11%	9%		9%
SG&A	30%	29%	18%	13%		10%	6%		7%
Other Op Income/(Expense)	-775%	66%	-6%	12%		14%	15%		-17%
Operating profit (GP less SG&A)	28%	47%	20%	11%		15%	18%		14%
Reported EBIT	10%	44%	27%	11%		15%	18%		19%
Reported NPAT	18%	44%	23%	13%		15%	14%		19%
Adjusted NPAT	18%	49%	14%	12%		15%	13%		18%
Margins									
GP	27.0%	30.8%	32.8%	32.2%	-0.6%	33.1%	32.5%	-0.6%	32.9%
SG&A/Sales	-22.1%	-24.6%	-26.0%	-25.8%	0.2%	-26.0%	-25.5%	0.5%	-25.5%
Operating profit (GP less SG&A)	4.9%	6.2%	6.7%	6.4%	-0.3%	7.1%	7.0%	-0.1%	7.4%
Reported EBIT	4.3%	5.3%	5.6%	5.5%	-0.1%	5.8%	6.0%	0.2%	6.7%
Effective tax rate (%)	-16.6%	-14.6%	-17.5%	-15.2%	2.3%	-18.0%	-15.7%	2.3%	-16.2%
Reported NPAT	3.8%	4.7%	4.5%	4.9%	0.4%	4.7%	5.2%	0.5%	5.8%
Recurring NPAT	3.8%	4.9%	4.7%	5.1%	0.4%	4.9%	5.4%	0.5%	5.9%

Note: EBIT is reported EBIT and includes share option expenses and other impairment adjustments.

Source: Company data, Goldman Sachs Global Investment Research.

Disclosure Appendix

Reg AC

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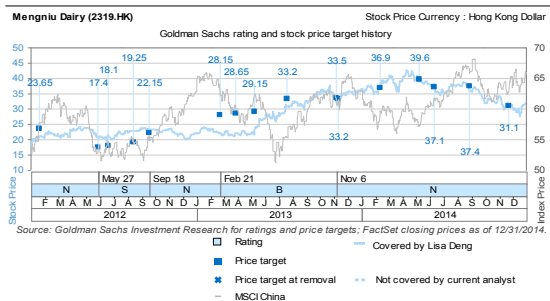
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