

Consumer & Retail
Food Products
Equity – China

China Huishan Dairy (6863 HK)

Hold

Target price (HKD)	1.45
Share price (HKD)	1.69
Upside/Downside (%)	-14.2

Performance	1M	3M	12M
Absolute (%)	5.6	22.5	-5.6
Relative ^A (%)	8.6	11.5	-18.2

Index^A HANG SENG INDEX

RIC 6863.HK
Bloomberg 6863 HK

Market cap (USDm) 3,122
Market cap (HKDm) 24,201

Enterprise value (CNYm) 24,470
Free float (%) 33

Hold: FY15 results first take

- ▶ **FY15 core net profit declined by 29% yoy to RMB906m with total revenue up 11% yoy to RMB3,923m**
- ▶ **Net debt increased from RMB3.7bn in September 2014 to RMB4.9bn in March 2015, with net gearing of 36%**
- ▶ **Maintain Hold and TP of HKD1.45**

What's new? FY15 (YE: March) core net profit was down 29% yoy to RMB906m, which was at the high-end of its profit warning issued on 12 June 2015. Total revenue was up 11% yoy to RMB3,923m, which was mainly driven by the liquid milk and milk powder businesses. The group's gross margin was down 4.8ppt yoy to 57.6%, mainly due to operational deleverage as a result of falling raw milk prices. Despite the decline in gross margin, the EBIT margin was down 10.6ppt yoy to 32.9% and net margin also dropped by 13ppt yoy to 23.1% on the back of higher A&P, admin, and finance expenses. As at end-March 2015, the company had net debt of RMB4.9bn and net gearing of 36%. The company recommended a final DPS of RMB1.53cents, representing a payout of 24% on reported earnings (FY14: 24%).

Business segment results. For the company's core dairy farming businesses (26% of revenue and 83% of profit), revenue was up 4% yoy (1H-FY15: +31% yoy, 2H-FY15: -16% yoy) and gross margin was down 6.5ppt to 55.7% (1H-FY15: 56.4%, 2H-FY15: 54.9%), mainly due to the decline in raw milk ASP, which 4% yoy to RMB4,856/ton (1H-FY15: RMB4,995/ton, 2H-FY15: RMB4,703/ton). The average milk yield was unchanged at 9.1 tons, and the company's herd size increased by 25% yoy to 180,331 cows, including 74,389 milkable cows, 79,951 heifers, and 25,991 calves. For the liquid milk business (62% of revenue), sales were up 6% yoy, including 2% volume growth and 4% ASP growth. However, on a semi-annual business, liquid milk ASP was down 7% yoy in 2H-FY15 while volume was up 4% yoy, suggesting higher promotional discounts. For the milk powder business (12% of revenue), sales were up 87% yoy and the strong growth was mainly due to distribution network expansion.

Working capital and cash flow. Cash conversion cycle lengthened from 52 days in FY14 to 175 days in FY15, mainly due to deterioration in inventory as the inventory days increased from 187 days in FY14 to 274 days in FY15 as a result of an increase in feed and finished goods inventory. Receivable days were largely unchanged at 23 days in FY15 (FY14: 20 days). Total capex in FY15 amounted to RMB4.3bn, and we estimated the company had a negative free-cash-flow of around RMB3.3bn in FY15.

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Financials & valuation

Financial statements

Year to	03/2014a	03/2015e	03/2016e	03/2017e
Profit & loss summary (CNYm)				
Revenue	3,530	4,495	5,408	6,248
EBITDA	1,732	2,143	2,471	2,869
Depreciation & amortisation	-164	-394	-517	-572
Operating profit/EBIT	1,568	1,748	1,954	2,297
Net interest	-206	-332	-445	-520
PBT	1,294	1,257	1,206	1,028
HSBC PBT	1,294	1,257	1,206	1,028
Taxation	-45	-85	-91	-107
Net profit	1,249	1,172	1,116	921
HSBC net profit	1,284	1,331	1,418	1,671

Cash flow summary (CNYm)

Cash flow from operations	1,152	1,810	2,163	2,600
Capex	-2,886	-2,141	-1,811	-1,515
Cash flow from investment	-5,923	-4,975	-3,045	-2,249
Dividends	-326	-333	0	0
Change in net debt	-928	3,830	1,328	169
FCF equity	-1,941	-663	-94	565

Balance sheet summary (CNYm)

Intangible fixed assets	932	904	876	848
Tangible fixed assets	12,678	17,128	19,382	20,338
Current assets	7,344	6,128	7,286	7,460
Cash & others	5,063	3,233	3,904	3,735
Total assets	21,020	24,226	27,610	28,712
Operating liabilities	1,505	1,871	2,139	2,320
Gross debt	6,320	8,320	10,320	10,320
Net debt	1,258	5,088	6,416	6,585
Shareholders funds	13,195	14,035	15,151	16,072
Invested capital	14,387	19,057	21,501	22,592

Ratio, growth and per share analysis

Year to	03/2014a	03/2015e	03/2016e	03/2017e
Y-o-y % change				
Revenue	38.3	27.3	20.3	15.5
EBITDA	32.3	23.7	15.3	16.1
Operating profit	26.4	11.5	11.8	17.6
PBT	27.8	-2.9	-4.1	-14.8
HSBC EPS	12.2	-10.9	6.5	17.8

Ratios (%)

Revenue/IC (x)	0.3	0.3	0.3	0.3
ROIC	13.5	9.7	8.9	9.3
ROE	13.5	9.8	9.7	10.7
ROA	9.2	6.6	5.9	4.9
EBITDA margin	49.1	47.7	45.7	45.9
Operating profit margin	44.4	38.9	36.1	36.8
EBITDA/net interest (x)	8.4	6.4	5.5	5.5
Net debt/equity	9.5	36.3	42.3	41.0
Net debt/EBITDA (x)	0.7	2.4	2.6	2.3
CF from operations/net debt	91.6	35.6	33.7	39.5

Per share data (CNY)

EPS reported (fully diluted)	0.10	0.08	0.07	0.06
HSBC EPS (fully diluted)	0.10	0.09	0.09	0.11
DPS	0.02	0.02	0.00	0.00
Book value	0.87	0.93	1.00	1.07

Valuation data

Year to	03/2014a	03/2015e	03/2016e	03/2017e
EV/sales	5.8	5.4	4.8	4.2
EV/EBITDA	11.9	11.4	10.4	9.1
EV/IC	1.4	1.3	1.2	1.1
PE*	13.7	15.3	14.4	12.2
P/Book value	1.5	1.5	1.3	1.3
FCF yield (%)	-10.0	-3.4	-0.5	2.9
Dividend yield (%)	1.6	1.7	0.0	0.0

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 19 Jun 2015

Valuation and risks

We use PE methodology to value the stock as it best reflects the company's near-term earnings momentum. Our target price of HKD1.45 is based on a 12.5x CY2015e PE, which is derived from a 20% premium to our target multiple for Modern Dairy's 10.5x 2015e PE. We apply a 20% premium because it operates a vertically integrated business model and should see less volatile earnings growth.

Key upside/downside risks

Key upside risks: 1) a sooner-than-expected rebound in raw milk prices; and 2) faster-than-expected growth of the liquid milk business.

Key downside risks: 1) disease outbreak (e.g. foot-and-mouth disease) or natural disasters (such as wildfires) at dairy farms or plantation fields; 2) lower-than-expected milk prices and output; 3) changes in government policy on preferential tax treatment; 4) dairy cow supply; 5) product safety issues; 6) execution risks; and 7) competition.

Huishan Dairy - FY15 results summary

Year to 31 Mar (RMBm)	2014	2015	%YoY	1H14	2H14	1H15	%YoY	2H15	%YoY
Revenue	3,530	3,923	11%	1,534	1,997	1,995	30%	1,929	-3%
COGS	(1,326)	(1,663)	25%	(644)	(682)	(857)	33%	(806)	18%
Gross profit before biological fair value adjustment	2,205	2,261	3%	890	1,314	1,138	28%	1,123	-15%
Biological FV adjustments	(1,496)	(1,370)	-8%	(642)	(854)	(695)	8%	(675)	-21%
Gain arising on initial recognition of agricultural produce at FV less cost to sell the point of harvest	1,564	1,790	14%	737	826	1,075	46%	715	-14%
Other net income	9	34	268%	4	6	21	479%	13	136%
Distribution costs	(344)	(595)	73%	(116)	(229)	(302)	161%	(293)	28%
Administrative expenses	(335)	(410)	23%	(157)	(177)	(186)	18%	(225)	27%
IPO expenses	(35)	-	nm	(31)	(4)	-	nm	-	nm
Core EBIT	1,568	1,709	9%	685	883	1,051	53%	657	-26%
Gain arising from changes in FV less costs to sell of biological assets	(68)	(450)	557%	(47)	(22)	(74)	60%	(375)	1614%
Net finance costs	(206)	(323)	57%	(107)	(98)	(156)	45%	(167)	70%
PBT	1,294	936	-28%	532	763	821	54%	115	-85%
Tax	(45)	(60)	33%	(16)	(29)	(32)	103%	(28)	-4%
PAT	1,249	876	-30%	516	733	789	53%	87	-88%
Minority	-	1	na	-	-	-	na	1	na
Net income	1,249	877	-30%	516	733	789	53%	88	-88%
Adjusted cash net profit	1,284	908	-29%	467	818	484	4%	424	-48%
Margins									
Core Gross margin	62.4%	57.6%	-4.8 ppt	58.0%	65.8%	57.1%	-1.0 ppt	58.2%	-7.6 ppt
Core EBIT margin	43.5%	32.9%	-10.6 ppt	40.5%	45.8%	0.0%	-40.5 ppt	0.0%	-45.8 ppt
Core Net margin	36.4%	23.1%	-13.2 ppt	30.4%	41.0%	24.2%	-6.2 ppt	22.0%	-19.0 ppt
Key ratios									
Distribution expense to sales	9.8%	15.2%	5.4 ppt	7.5%	11.4%	15.1%	7.6 ppt	15.2%	3.8 ppt
Admin expense to sales	9.5%	10.5%	1.0 ppt	10.3%	8.9%	9.3%	-0.9 ppt	11.6%	2.8 ppt
Effective tax rate	3.5%	6.4%	2.9 ppt	3.0%	3.9%	0.0%	-3.0 ppt	0.0%	-3.9 ppt

Source: Company data, HSBC

Disclosure appendix

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Rating distribution for long-term investment opportunities

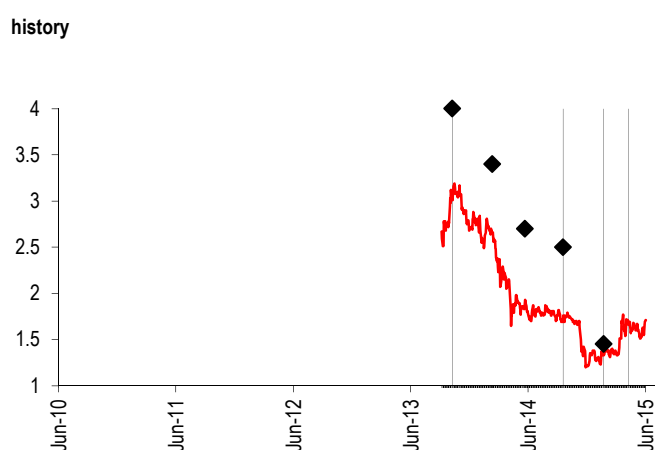
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For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities

China Huishan Dairy (6863.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight (V)	29 October 2013
Overweight (V)	Overweight	08 October 2014
Overweight	Neutral	11 February 2015
Neutral	Hold	29 April 2015
Target Price	Value	Date
Price 1	4.00	29 October 2013
Price 2	3.40	02 March 2014
Price 3	2.70	12 June 2014
Price 4	2.50	08 October 2014
Price 5	1.45	11 February 2015

Source: HSBC

HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price Date	Disclosure
CHINA HUIZHAN DAIRY	6863.HK	1.71	22-Jun-2015	1, 7, 11

Source: HSBC

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