

## Company Report: Dali Foods (03799 HK)

公司报告: 达利食品 (03799 HK)

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# Solid Earnings Growth with Potential Expansion of Diversified Portfolio, Initiate with "Buy"

积极拓展各种有潜力产品带来稳健盈利增长, 首予“买入”

- **Dali Foods is a leading F&B company in China.** After many years of development, the Company has expanded into multiple categories of operation. With distinct advantages and strategies, Dali holds market-leading positions in each business it operates.
- **Soy milk and energy drinks will be the major drivers for top-line growth.** "Doubendou" soy milk will be a game-changing product for Dali due to its huge market potential, which will drive sales of Dali's plant-based beverages to grow at a CAGR of 35.1% in 2016-2019. Besides, we expect that Dali's energy drinks sales will maintain high growth with a CAGR of 27.6% in 2016-2019. On the other hand, the Quality Breakfast series will be the next star product in Dali's food business.
- **Net profit is expected to grow at a CAGR of 13.8% from 2016 to 2019.** Dali has extremely high net margin (17.7% in 1H17) due to its excellent operating margin, low finance costs and favorable tax rate. We expect that further expansion of high-gross-margin products will ensure sustainable growth of earnings.
- **Initiate with TP of HK\$7.30 and "Buy" investment rating.** Dali has shown its ability in the operations across multiple categories, development of new products and optimization of product mix. As a major player in China's F&B market, we view Dali's valuation as significantly undervalued. As a result, we initiate with "Buy" investment rating for and set TP at HK\$7.30, which represents 24.7x/ 21.3x/ 18.4x 2017/ 2018/ 2019 PER.
- **达利是中国领先食品饮料公司。**经过多年发展, 公司已经拓展至多品类经营。因为有着独特的优势以及经营策略, 达利在其经营的每块业务中均保持市场领先。
- **豆奶和功能饮料将会成为收入增长的主要贡献。**“豆本豆”豆奶将会是达利突破性的一款产品因为其广阔的市场前景, 其将驱动达利的植物蛋白饮品销售在 2016-2019 年录得 35.1% 的复合增长率。而且我们预计达利的功能饮料将会保持高速增长, 2016-2019 年复合增长率将达到 27.6%。另一方面, 品质早餐系列将成为达利食品板块的下一个明星产品。
- **净利润在 2016 年至 2019 年复合增长率预计将为 13.8%。**因为出色经营利润率, 较低的财务费用以及优惠税率, 达利有着非常高的净利润率 (2017 年上半年为 17.7%)。我们预期高毛利率产品的进一步扩张将会保证其盈利的稳定增长。
- **首予目标价 7.30 港元和“买入”评级。**达利已经展现了其经营多种类别产品, 开发新产品和优化产品结构的能力。作为中国食品饮料市场主要的参与者, 我们认为达利的估值被显著低估。因此, 我们首予达利“买入”评级, 并给予 7.30 港元目标价, 相当于 24.7 倍, 21.3 倍和 18.4 倍 2017 年, 2018 年和 2019 年市盈率。

Rating:

**Buy**  
Initial

评级:

买入 (首次覆盖)

6-18m TP 目标价:

**HK\$7.30**

Revised from 原目标价:

Share price 股价:

**HK\$6.150**

## Stock performance

股价表现



Change in Share Price	1 M	3 M	1 Y
股价变动	1 个月	3 个月	1 年
Abs. % 绝对变动 %	1.5	16.5	50.4
Rel. % to HS Index 相对恒指变动 %	2.0	12.9	23.1
Avg. share price (HK\$) 平均股价 (港币)	6.2	6.0	4.8

Source: Bloomberg, Guotai Junan International.

Year	Revenue	Net Profit	EPS	EPS	PER	BPS	PBR	DPS	Yield	ROE
年结	收入	股东净利	每股净利	每股净利变动	市盈率	每股净资产	市净率	每股股息	股息率	净资产收益
12/31	(RMB m)	(RMB m)	(RMB)	(△%)	(x)	(RMB)	(x)	(RMB)	(%)	(%)
2015A	16,865	2,912	0.241	33.9	21.4	0.985	5.2	0.126	2.4	46.8
2016A	17,842	3,137	0.229	(5.0)	24.1	1.013	5.4	0.180	3.3	24.3
2017F	19,815	3,439	0.251	9.6	20.8	1.104	4.7	0.151	2.9	23.7
2018F	22,240	3,992	0.292	16.3	17.9	1.244	4.2	0.175	3.3	24.8
2019F	24,618	4,619	0.337	15.4	15.5	1.407	3.7	0.202	3.9	25.4
Shares in issue (m) 总股数 (m)				13,694.0	Major shareholder 大股东				Famiv Xu 85.0%	
Market cap. (HK\$ m) 市值 (HK\$ m)				84,218.1	Free float (%) 自由流通比率 (%)				15.0	
3 month average vol. 3 个月平均成交股数 ('000)				12,582.0	FY17 Net gearing (%) FY17 净负债/股东资金				Net cash	
52 Weeks high/low (HK\$) 52 周高/低 (HK\$)				6.660 / 3.130	FY17 Est. NAV (HK\$) FY17 每股估值 (港元)				7.5	

Source: the Company, Guotai Junan International.

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## Company Analysis

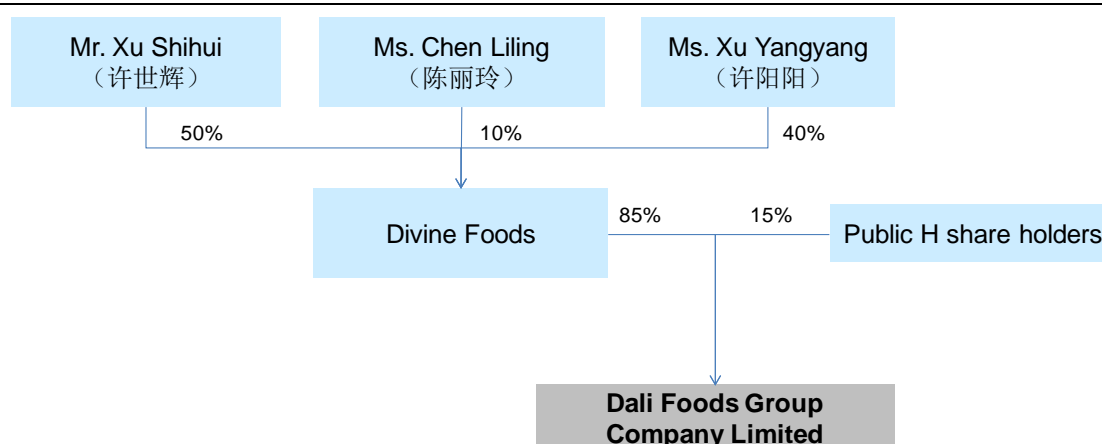
### Company Profile

**Dali Foods ("Dali" or the "Company") is a leading casual food and beverage manufacturer in China.** Established in 1989, Dali has gradually become famous in mainland China and is now well reputable for its casual foods and beverages. Its current headquarters is located in Hui'an, Fujian Province. Initially, the factory of the Company produced biscuits as their main business, but after years, the Company has expanded into numerous brand products, comprised of six core product categories including baked goods (bread, cakes and pastries), potato chips (chips, fries and others), biscuits, herbal tea, plant-based dairy beverages and energy drinks. With distinct advantages and strategies, Dali holds a market-leading position in its field.

### Shareholder Structure

As at 30 June, 2017, the shareholder structure of Dali is illustrated below:

**Figure-1: Shareholder structure of Dali as at 30 June, 2017**



Source: the Company, Guotai Junan International.

Note 1: Ms. Chen Liling is Mr. Xu Shihui's spouse

Note 2: Ms. Xu Yangyang is the daughter of Mr. Xu Shihui and Ms. Chen Liling.

### Milestones

**Dali Foods was founded by Mr. Xu Shihui in September, 1989, under the name of "Meili Food" to provide biscuits to the masses in mainland China.** In 1992, Fujian Dali was officially established and introduced its first snack product, biscuits, under the brand of "Dali" to the market. The "Dali" branded biscuit later received fame as a "Quality Product known to and Trusted by Chinese Consumers", as recommended by the China Light Industry Machinery Association in 1996, and was categorized as "Well-known Chinese Brand-name Products" in 1997. In 1998, the Company's first subsidiary, Fujian Dali Food Co. Ltd. Chengdu Branch was set up outside of Fujian Province. In 2002, the "Daliyuan" brand was founded with its bread, cakes and pastries products and Dali was rated as "the leading enterprise of National Food Industry" by the China National Food Industry Association. In 2003, "Copico" was introduced as the brand of its potato chips. The "Haochidian" and "Heqizheng" brand was launched to represent the products of Haochidian biscuits and Heqizheng herbal tea in 2004 and 2007, respectively. In 2008, Dali pioneered the application of 600 ml PET bottled herbal tea under the "Heqizheng" brand and was rated as a "Leading Enterprise of National Industry" by the China National Food Industry Association. In 2010, soft French bread was presented to the market. Dali accomplished a reputation, awarded the "China Top 500 Private Enterprises" title in 2011 and entered into the energy drinks market by introducing a self-developed energy drinking product, "Hi-Tiger" ( "乐虎" ), in 2013. In 2014, the "High-end Danish butter" was introduced under the Daliyuan Landy Castle brand to enhance its position in the domestic market. In 2015, Dali Group achieved the biggest annual global consumer goods IPO of 2015 and in 2016 the stock of the Company was officially included into the Hang Seng Index and Shanghai-Hong Kong Stock Connect and joining "Forbes" list of top 2,000 Global Enterprises. In the first half of 2017, Dali launched the "Doubendou" pure soy milk drink, which was aimed strategically at the potential plant-based market.

**Table-1: History and Key Milestones of Dali**

Time	Key milestones
1989	Meili Food Factory was established.
1992	Fujian Dali was officially established and provided the "Dali" Brand biscuit to the market.
1996	"Dali" branded biscuits won the laurels of "Quality Product known to and Trusted by Chinese Consumers" by China Light Industry Machinery Association.
1998	The Company established its first Subsidiary in Chengdu.
2002	The Company introduced the "Daliyuan" branded product.
2003	The Company introduced the "Copico" brand of chips, fries and other products.
2004	The Company launched the "Haochidian" brand of biscuits and expanded the sales network into five geographic regions of China.
2005	The Company set up its potato powder production facility in Gansu province so as to guarantee the quality of raw material.
2006	The Company was awarded as a "China Top Brand (Daliyuan)" by the AQSIQ
2007	The Company launched the "Heqizheng" brand of herbal tea and marched into beverage market by introducing "Heqizheng" ready-to-drink herbal tea, "Daliyuan" ready-to drink tea.
2008	The Company first adopted 600ml PET bottled herbal tea and was included as one of the "Leading Enterprise of National Industry" by China National Food Industry Association
2010	Dali launched soft French Bread to the market.
2013	The company introduced its self-developed energy drink "Hi-Tiger".
2014	The company entered into domestic high-end biscuit market by introducing high-end Danish butter cookies under the brand "Daliyuan Landy Castle".
2014	Dali launched Kaqu French fries to extend the product portfolio of Copico.
2015	Dali's headquarters was formally put into operation.
2015	The Company listed on the main board of SEHK and was the biggest IPO of 2015 annual global consumer goods.
2016	The stock of the Company was officially included in the Hang Seng Index.
2016	Dali launched Zhenhao cookie and caramel cookies.
2017	The Company launched its pure soy milk product "Doubendou" to explore Chinese soy milk market.

Source: the Company, Guotai Junan International.

## Management

**The Executive Chairman of Dali is Mr. Xu Shihui (许世辉), the founder of Dali Food Group and the current Chief Executive Officer of the Company.** Mr. Xu, aged 59, has been the chairman and the president of Fujian Dali and all subsidiaries since its establishment in 1992. Mr. Xu is responsible for developing overall strategies and making primary business decisions of the Company to achieve the Company's goals. He has accumulated an extensive scope of experience of management since he served as head of factory for Hui'an Succade Factory from 1987 to 1989, leading Dali from a local snack food manufacturing company to a national company with a diversified portfolio of numerous brand products.

**The Executive Vice President and Executive Director of Dali is Mr. Zhuang Weiqiang (庄伟强).** Mr. Zhuang, aged 39, was appointed as executive director on June 14, 2015. Mr. Zhuang joined the Company in 1998 and has more than 18 years of experience in management with Dali. Mr. Zhuang has been the Executive Vice President of the Company, in charge of overall marketing and distribution of products of the Company since 2006. Prior to this, Mr. Zhuang was previously the General Manager of Jinan Dali Foods Co., Ltd. from 2004 to 2006 and the General Manager of Chengdu Dali Foods Co., Ltd. from 2000 to 2004. He was a financial specialist for Chengdu Dali from 1998 to 2000.

**The Vice President and Executive Director of Dali is Ms. Xu Yangyang (许阳阳).** Ms. Xu is in charge of making corporate and operational decisions and managing the day-to-day operations of the Group. Ms. Xu was appointed as a director on November 4, 2014. Mr. Xu joined Dali in 2008 and has worked as a Director and the Vice President of Fujian Dali from 2009 to date, and is also the supervisor of various subsidiaries of the Company. With more than 8 years of experience in the Group, Ms. Xu has held various positions in Fujian Dali from July 2008 to date, including the Chairman of the labour union, workshop director and deputy factory manager. Ms. Xu is the daughter of Mr. Xu Shihui.

## Industry Analysis

### Casual Food Industry Analysis

**Casual food has solid demand and diversified consumption scenarios.** The definition, boundary and categories of casual food have not reached final consensus in the industry, and casual food is also referred to as leisure food or snack food. But generally speaking, casual food is part of packaged food, and is eaten between meals for pleasure, satisfying less hunger demand. Besides, we can tell casual food from its consumption scenarios, which commonly includes personal enjoyment, social gifts, killing time, excursions, office snacks, substitute for meal, etc. Casual food is often consumed to meet the high-level demands of customers, such as emotional demands, epicurean needs and requirements for health.

**The landscape of China's casual food industry has been changing dynamically.** Before 1980, although Chinese people have a long history of making and eating casual food, mainly including Chinese pastries, the casual food industry in China is still in the preliminary stage, with inconsistent quality and low industrial manufacturing technologies, due to restrictions of economic development. Before the 1980s, China's casual food market was dominated by local snacks, including Chinese pastries, preserved fruit, candy, and domestic nuts. After China's reform and opening-up, mature multinational food corporations rapidly occupied China's snack market, especially in tier-1 and tier-2 cities, by introducing snacks with westernized features, such as potato chips, sandwich biscuits and chocolate, all of which were instantly accepted and welcomed by Chinese customers. But as the Chinese economy was developing, the consumption habits of Chinese consumers was changing, local casual food manufacturers gradually grasped the market shares of MNC by launching upgraded local snacks and innovated new snacks, which are healthier and more suitable for Chinese tastes. At the same time, the concept of leisure snacks has arisen and gradually heated up, and localization and health have become the important characteristics of casual food.

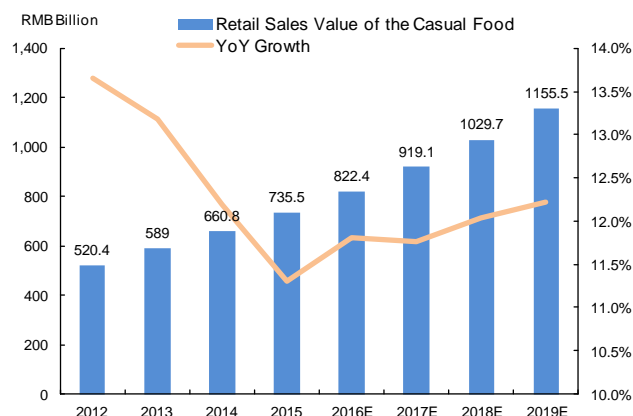
**Figure-2: The History of China's Casual Food Industry**



Source: Yiou Intelligence.

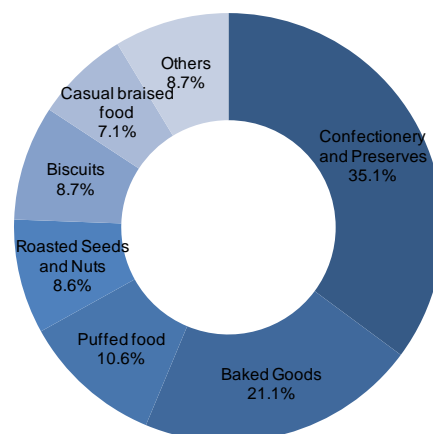
**The foundation for casual food is solid and long-term growth is sustainable.** Over the last ten years, the casual food industry in China witnessed high growth, mainly driven by economic growth, increasing disposable income, population growth in urban areas, expanded consumption scenarios, increased leisure time and improved sales channels. According to Frost & Sullivan, the retail sales of casual food in China grew from RMB520.4 billion in 2012 to RMB822.4 billion in 2016, representing a CAGR of 12.1%. We expect casual food will maintain high growth as more innovative products launched meets customers' demands for healthy food and small meals. Although the definition and classification of casual food is dynamically changing, based on Frost & Sullivan's research, we have classified casual food into 7 categories, including confectionery and preservatives, baked goods, puffed food (potato snacks and rice cracker), roasted seeds and nuts, casual braised food, biscuits and others. Confectionery and preserves contributed most sales to casual food in 2015, representing 35.1%, followed by baked goods, around 21.1%.

Figure-3: Retail Sales of Casual Food in China



Source: Frost & Sullivan.

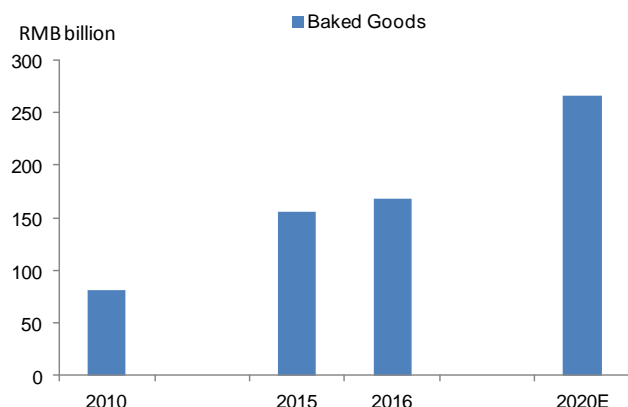
Figure-4: Sales Percentage of Each Category



Source: Frost & Sullivan.

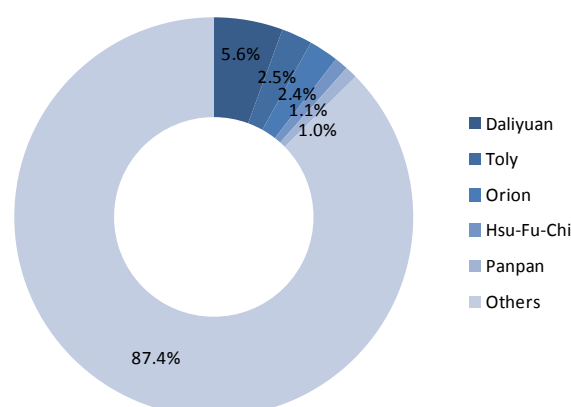
**Baked goods - Fragmented market with two business models.** Baked goods include a wide range of products, including bread, cakes, pastries, and pies. The history of baked goods can be dated back to the Ancient Egypt period and has evolved with human history. In the western world, baked goods play an important role in catering, and is often a main course. But in China, baked goods are usually consumed by customers as snacks or for breakfast meals. There are two main business models in the baked goods market, comprised of packaged bread and artisanal bread. Packaged bread products, usually sold in retail channels, have the advantage of convenience. On the other hand, artisanal bread products, usually sold in bakeries, are relatively fresh and tasty. The baked goods market remains extremely fragmented due to low entry barriers. The top five players only had a combined share of less than 15% in 2016, all of which were packaged bread manufacturers. Dali is the largest baked goods manufacturer in China with a market share of 5.6% in 2016. In 2014-2016, China's baked goods retail sales recorded a CAGR of 9.2%. We expect that as more innovative baked goods are being launched by domestic and foreign companies, especially through online channels and as breakfast meals and as consumption occasions of baked goods are increasingly expanding, the baked goods market can maintain high-single digit growth.

Figure-5: Retail Sales of Baked Goods in China



Source: Frost & Sullivan, Guotai Junan International.

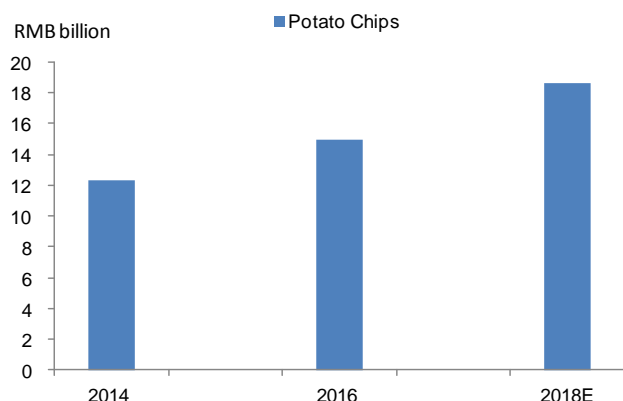
Figure-6: Market Share of Baked Goods Companies



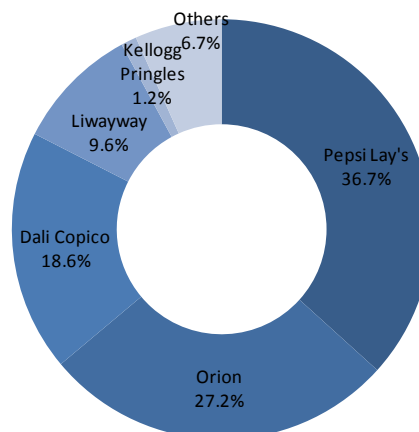
Source: Euromonitor, Guotai Junan International.

**Potato Chips - Classic snack food with stable industry landscape.** Potato chips, which are thin slices of potato that have been deep fried or baked until crunchy, are predominantly part of the snack food market in modern society. The first recipes of potato chips can be dated back to 1817. Potato chips were mainly homemade or sold in restaurants. In the 20<sup>th</sup> century, potato chips began to be mass-produced for home consumption and spread beyond restaurants. Compared to other snack food categories, the potato chips market is highly concentrated as the top-five players dominate more than 90% market share. Pepsi Lay's holds a solid position in China's market due to its product quality, brand popularity and long-term operational history. Dali's Copico ranked No.3 with market share of 19%, expanding fast since its launch. In 2014-2016, China's potato chips retail sales reported a CAGR of 10.2 to around RMB15 billion in 2016. In recent years, the position of potato chips in the casual food market has been challenged by roasted nuts, which contain more healthy characteristics. But as lifestyles in low-tier cities is evolving toward high-tier cities, the consumption of potato chips is expected to catch up. The huge gap between China and developed countries is not expected to be maintained; we expect that the potato chips market in China has potential to double.



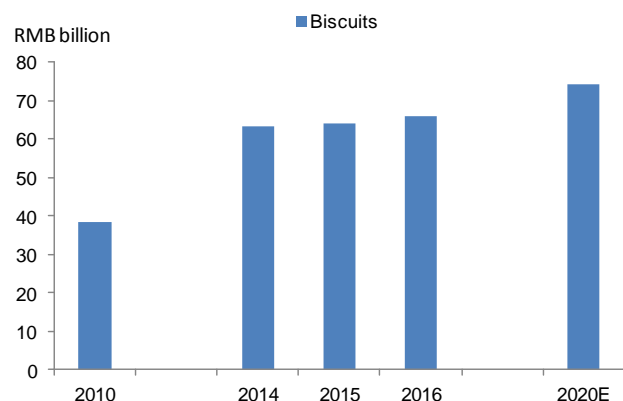
**Figure-7: Retail Sales of Potato Chips in China**


Source: Frost &amp; Sullivan, Guotai Junan International.

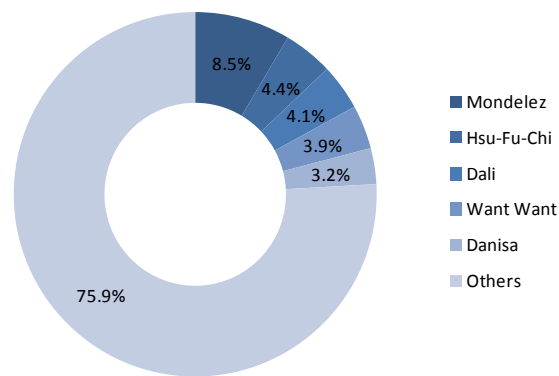
**Figure-8: Market Share of Potato Chip Companies**


Source: Euromonitor, Guotai Junan International.

**The biscuit market is slowing down but more innovative products are being launched.** Biscuits include a variety of primarily flour-based baked food products, such as plain biscuits, sandwich biscuits, cookies, and wafers, that are usually drier and harder than bread. China's biscuit market is fragmented as the top five players have a combined market share of around 24.1%, but the leading position of Mondelez is clear, with 8.5% market share thanks to its long-lasting classic product, Oreo (奥利奥). The sales of biscuits in China have lost steam with a CAGR of 2.3% during 2014-2016 due to high penetration and more substituted snack categories. Nevertheless, we have seen more innovative products emerging from domestic products such as Jiangzhong hercium erinaceus biscuit (江中猴姑饼干), which is being promoted as a healthy product, good for digestion. Besides, high-end Danish cookies also witnessed high growth. The biscuit market may not regain high growth in the next few years, but we expect that market concentration will go up as big companies have more capital and the ability to launch innovative products.

**Figure-9: Retail Sales of Biscuits in China**


Source: Frost &amp; Sullivan, Guotai Junan International.

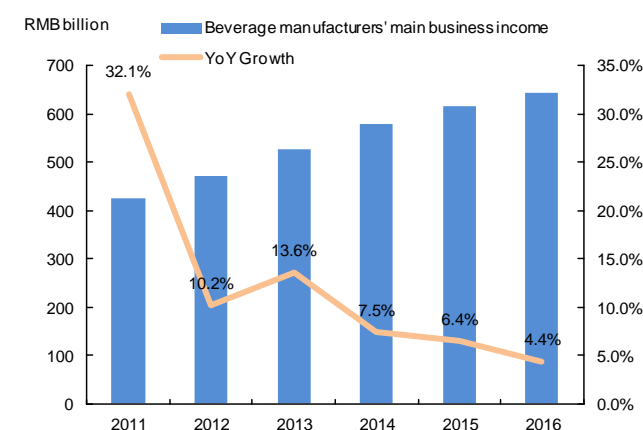
**Figure-10: Market Share of Biscuit Companies**


Source: Euromonitor, Guotai Junan International.

## Beverage Industry Analysis

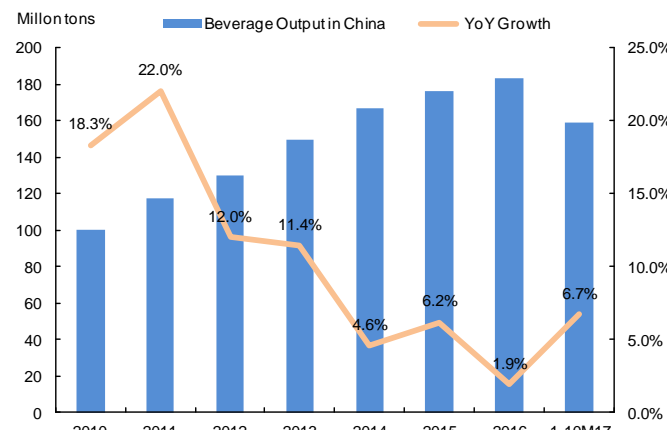
**Mainland China's beverage industry lost steam starting 2012.** Before 2012, mainland China's beverage industry experienced a 10-year golden age, maintaining high growth rates, mainly attributable to rapid growth of disposable income, low penetration rates and huge demographic benefits. However, after 2012, the beverage industry entered the "New Normal" as the growth rate of beverage retail sales and beverage output in China both rapidly slumped. According to the National Bureau of Statistics of China, during 2013-2016, China's beverage manufacturers' main business income grew at a CAGR of 6.8% to RMB643.0 billion and beverage output recorded a CAGR of 7.1%, both much lower than in 2002-2012. According to Nielsen, the retail sales of beverages hit bottom in 2015 with 1.2% YoY growth. The slowdown in China's beverage industry was due to plateaued penetration, economic slowdown and weakening consumer confidence. But the beverage industry saw rebound in 2017.

**Figure-11: Beverage manufacturers' main business income**



Source: National Bureau of Statistics of China, Guotai Junan International.

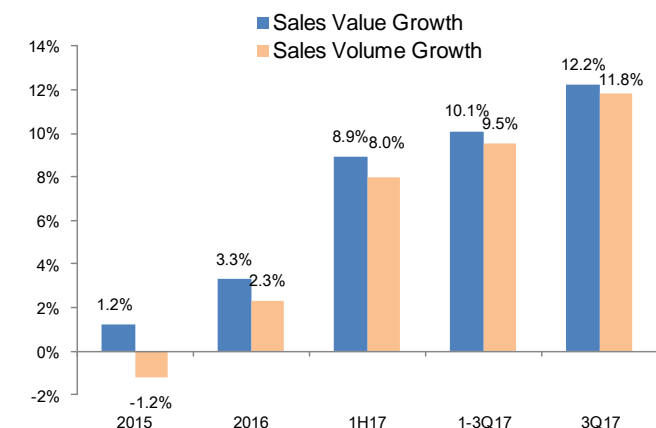
**Figure-12: Beverage Output in China**



Source: National Bureau of Statistics of China, Guotai Junan International.

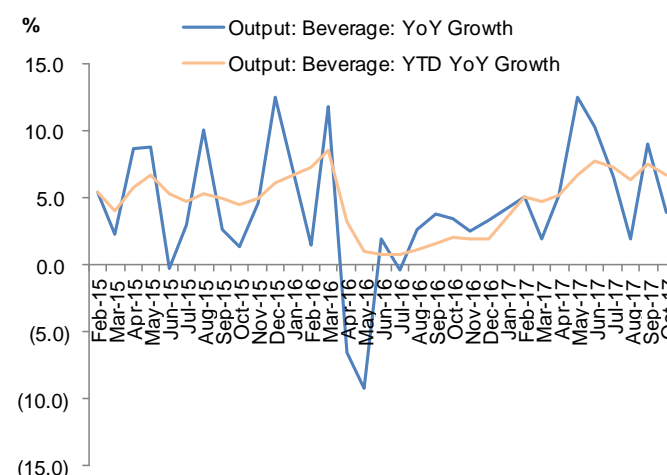
**Beverages achieved considerable recovery in 2017.** According to Nielsen, in 1-3Q17, China's beverage sales value and sales volume grew YoY by 10.1% and 9.5%, respectively, higher than in that in 2016 and 1H17. The recovery of China's beverage markets in 3Q17 continuously improved from 2Q17, setting a new record in recent years. Amid the beverage market, sales value of RTD tea, bottled water, carbonated drinks, functional drinks, Asian traditional drinks, milk tea and juice recorded YoY growth of 25.4%, 17.4%, 8.5%, 7.4%, 4.3%, 2.8% and 1.4% growth in 1-3Q17, respectively. Data from the National Bureau of Statistics of China also confirmed the trend. YTD beverage output in China increased 6.7% YoY in 1-10M2017, much higher than in 2016. The recovery in beverage sales was mainly attributable to favorable weather, improvement in China's consumer confidence level and rising income in low-tier cities.

**Figure-13: Retail Sales Growth of Beverages in China**



Source: the Company, Nielsen, Guotai Junan International.

**Figure-14: Output of Beverages in China**

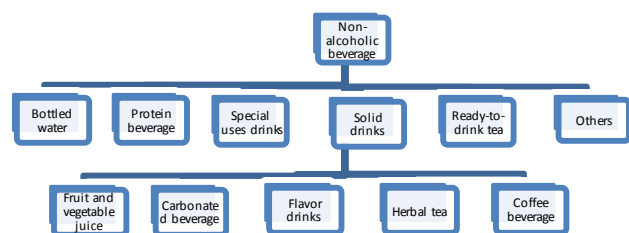


Source: National Bureau of Statistics of China, Guotai Junan International.

**Market share of beverage products are relatively even in China but healthy products are booming.** According to the *General Standard for Beverage* (GB/T 10789—2015), in China, non-alcoholic beverages are classified under 11 major categories, including fruit and vegetable juice, bottled water, protein beverages (including milk beverages and plant-based beverages), carbonated beverages, special use drinks (energy drinks and sports drinks), flavored drinks, solid drinks, herbal tea, ready-to-drink tea, coffee beverages and other beverages. Carbonated drinks, fruit and vegetable juice, bottled water and RTD tea were all once the four main categories of the beverage industry in China. But as customer awareness towards health awakened, carbonated drinks, often recognized by the media and customers as unhealthy drinks with high sugar and high calorie content, have been lagging behind bottled water, juice drinks, tea drinks and plant-based beverages. We expect the market share of carbonated drinks to continually shrink, which will benefit plant based beverages and healthy tea drink markets.

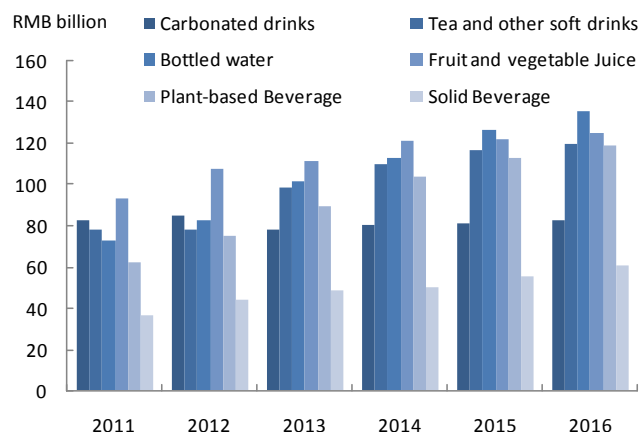


Figure-15: Classification of Beverages in China



Source: General Standard for Beverage, Guotai Junan International.

Figure-16: Beverage Manufacturers' Main Business Income

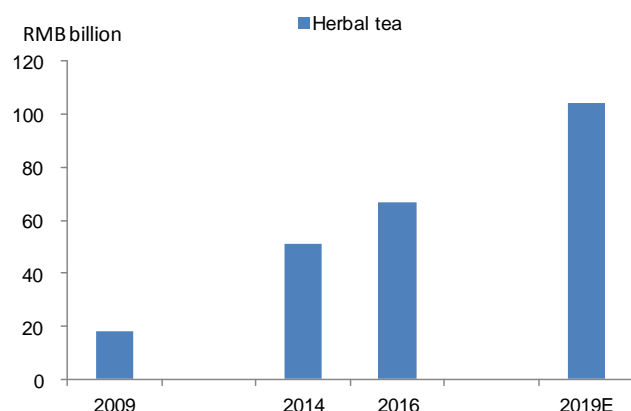


Source: National Bureau of Statistics of China, Guotai Junan International.

**Herbal teas - Duopoly market with less room for small players.** In China, herbal teas are commonly known as Liang Cha (凉茶), usually containing Chinese herbal medicine like honeysuckle, chrysanthemum, mesona and Chinese licorice, etc. As herbal teas have the characteristics of clearing heat and eliminating dampness, residents in Guangdong province have a long history of drinking herbal tea, where the weather is hot and damp in summer. Originally, herbal teas were freshly cooked and sold in herbal tea shops. In 1996, Jiaduobao (加多宝) was authorized by Guangzhou Pharmaceuticals holdings limited (GPHL) to use the brand of Wont Lo Kat to mass-produce packaged herbal tea in mainland China. Due to Jiaduobao's huge investment in promotion and great efforts on educating the market, China's packaged herbal tea market experienced extremely high growth since 2000. In 2012, GPHL took back the brand of Wont Lo Kat and now independently operates the brand. Jiaduobao had to produce and sell herbal tea in its own name, Jiaduobao. Due to its mature distribution system and smart marketing means, Jiaduobao maintains its No.1 position in China's herbal tea market, with a market share of 51.7% in 2016, followed by GPHL's Wont Lo Kat with a market share of 20.5%.

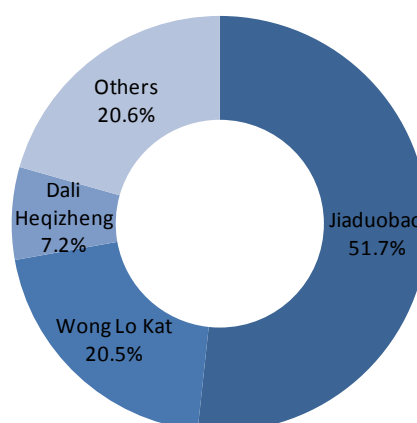
**Hezhiqing holds solid ground in the competitive market.** Head-to-head competition between Jiaduobao and Wont Lo Kat unexpectedly caused other small herbal tea companies to struggle due to intense promotional activities and price wars. But Hezhiqing made it through and ranked No.3 as it found a niche market, PET bottled herbal tea. China's herbal tea retail market grew at a CAGR of 15.6% in 2013-2016, but the growth rate of China's herbal tea market slowed down in 1-3Q17 due to high penetration. Nevertheless, as consumers have formed solid herbal tea drinking habits during hotpot and barbecue meals, and that catering business in China is still prosperous, we expect that retail sales of herbal tea can maintain low-single-digit growth to mid-single-digit growth.

Figure-17: Retail Sales of Herbal Tea in China



Source: Frost & Sullivan, Guotai Junan International.

Figure-18: Market Share of Herbal Tea Companies



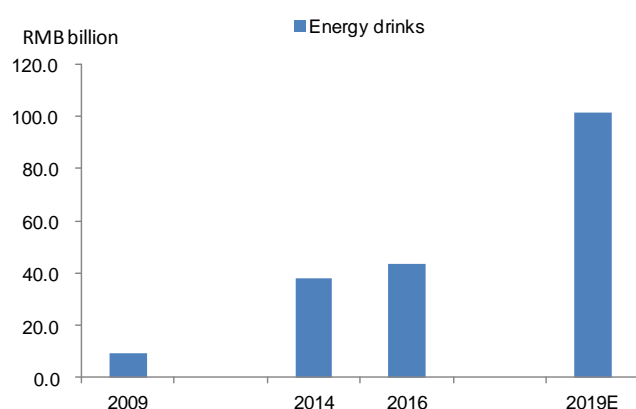
Source: Euromonitor, Guotai Junan International.

**Energy drinks – An oligopoly market but the landscape is changing.** Energy drinks contain stimulant drugs, usually including caffeine and taurine, which can provide mental and physical stimulation to the human body. China's energy drinks market was activated firstly by China Red Bull, which was brought by Yan Bin (严彬) from Thailand TC Pharmaceuticals in 1995. As a pioneer in China's energy drinks market, China Red Bull drove the market, growing and gradually developing into a leading brand of

energy drink with a dominating market share of 80.1% in 2016. Although China's energy drinks market is still dominated by China Red Bull, the market landscape has seen a change due to the conflict between Yan Bin's China Red Bull and its trademark holder, Thailand TC Pharmaceuticals. China Red Bull's trademark of Red Bull licensed by Thailand TC Pharmaceuticals expired at the end of 2016, but they have not renewed a deal for the continuation of licensing. The daily operations of China Red Bull has been significantly disturbed by the conflict, leaving room for new entrants such as Dali's Hi-Tiger (乐虎). Due to Dali's sophisticated distribution system and intense brand promotions, Hi-Tiger quickly grasped 5.3% market share in 2014 and further expanded to 9.3% in 2016.

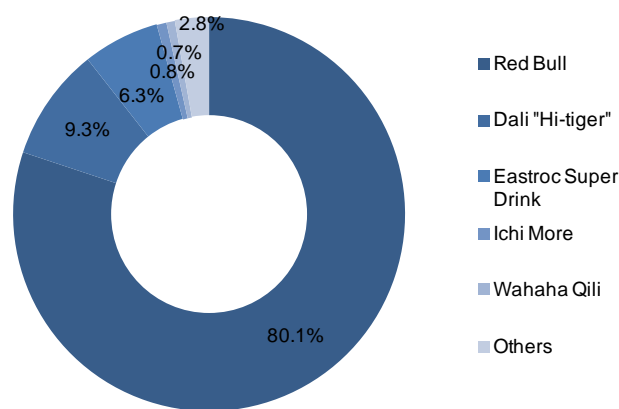
**Energy drinks saw high growth but slowed down this year.** As fitness has been becoming increasingly popular and customers are more conscious of their health, energy drinks experienced high growth in China, witnessing more than 20% growth in the last few years. But in 1-3Q2017, the growth of energy drinks lost steam, only up 7.4% YoY. Even so, we expect that energy drinks in China can maintain mid-single-digit growth in the next few years as China's low average consumption volume and penetration rate compared to other developed countries is not high.

**Figure-19: Retail Sales of Energy Drinks in China**



Source: Frost & Sullivan, Guotai Junan International.

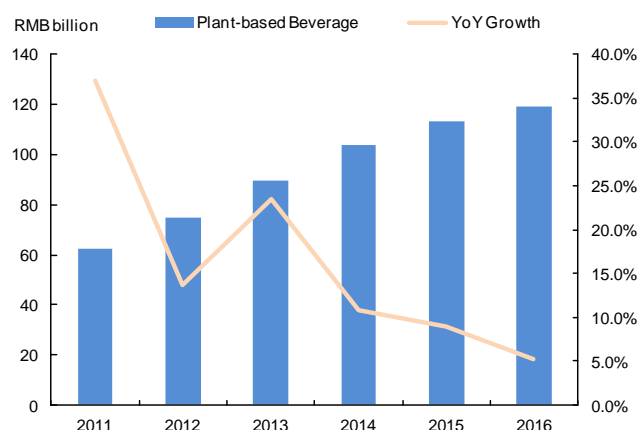
**Figure-20: Market Share of Energy Drink Companies**



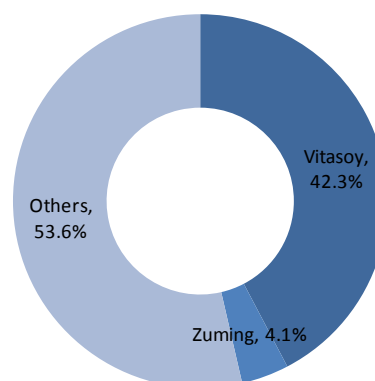
Source: Euromonitor, Guotai Junan International.

**Plant-based beverages - Different leading players in each category.** Plant-based beverages consist of two main categories, plant-based non-dairy beverages and plant-based dairy beverages. Plant-based non-dairy beverages include a variety of protein drinks such as soy milk beverages (without milk), walnut beverages, almond beverages, coconut beverages, etc. Plant-based dairy beverages refer to beverages made by mixing plant protein sources and milk. In every niche market, there is a relatively strong brand such as Six Walnuts (六个核桃) in the walnut beverage market and Coconut Palm (椰树) in the coconut beverage market. Plant-based beverages are increasingly being accepted and consumed by consumers because of the characteristics of health and taste. In the plant-based beverage market, Dali is the fifth largest manufacturer by retail sales with a market share of 4.7% in 2014. As for plant-based dairy beverages, Dali ranked No.2 with a market share of 16.3%.

**Market potential is huge for soy milk.** Soy milk is an upgraded version of a Chinese traditional beverage, soybean milk (豆浆). In the soy milk production process, there is a very critical step called homogenization, which makes soybean particles refined and more evenly mixed with each other. After homogenization, the fat particles in soymilk become smaller, more stable and tastier, and more easily absorbed by humans. Soy milk is a perfect substitution for milk for those customers who are lactose intolerant. Soybean milk is a common breakfast drink for Chinese people, and consumption usually occurs at breakfast carts, stalls and restaurants. But packaged soy milk only contributed 15% to sales. According to Euromonitor, the retail sales of soy milk in China only recorded RMB8.3 billion in 2016. We expect the market potential to be huge for soy milk as the penetration of soy milk is still pretty low alongside increasing health conscious attitudes. Besides, the customer base of soy milk is wide as almost every Chinese person drinks soybean milk and can be easily transferred to packaged soy milk due to its characteristics of convenience and high quality. The packaged soy milk market in mainland China, especially in Guangdong province, was firstly cultivated by Vitasoy, which had a market share of 42% in 2016. But the leadership of Vitasoy is not solid given that it has not built on a sophisticated national distribution system, leaving room for new entrants such as Dali's Doubendou, which has seen strong growth since 2Q17.

**Figure-21: Retail Sales of Plant-based Beverages in China**


Source: National Bureau of Statistics of China, Guotai Junan International.

**Figure-22: Market Share of Soy Milk Companies**


Source: Euromonitor, Guotai Junan International.

## Business Analysis

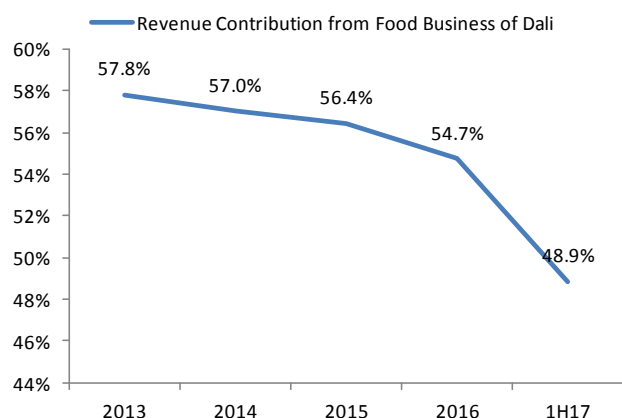
**Dali is a national food and beverage company in China.** Dali mainly operates six core product categories of food and beverage, including baked goods, potato chips, biscuits, herbal tea, plant-based dairy beverages and energy drinks. With distinct advantages and strategy, Dali holds market-leading positions in all the markets where it operates. The Company has established 18 subsidiaries in 16 provinces and regions across the country based on industry characteristics, and it has 30 food and beverage production bases, one mashed potato production base, and one packaging and printing company. Dali has formed a nationwide distribution network which covers all provinces, cities and most of the county-level regions in China. In cooperation with distributors, Dali can market and advertise its products nationally and uniformly.

**Dali's distribution system is becoming sophisticated.** Dali's previous distribution strategy was to attract vast numbers of distributors to penetrate more regions across China by giving them lower factory prices but providing less market investment. During that period, the distribution strategy helped Dali to achieve extensive growth at a fast pace and at low costs, but also exposing some problems such as relying heavily on distributors and traditional channels, and having less control over retail terminals. In response to fast-moving markets and fragmented channels, the Company implemented a series of distribution reforms, including optimizing sales regions to 8, setting up different sales teams for the food and beverage segment and engaging more sales representatives. As at December 31, 2016, the Company had more than 12,000 sales staff to maintain and support and approximately 4,225 distributors and 2 million selling points. Traditional channels once contributed most revenue to Dali, but after actively developing within modern channels, Dali's sales contribution from modern channels rose to 30% in 2016.

## Food Business Analysis

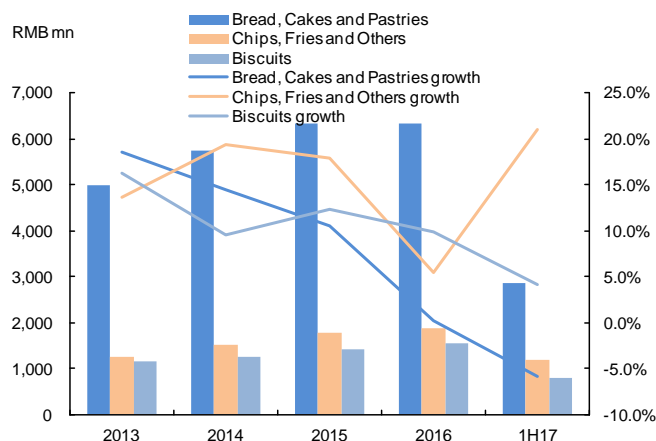
**Dali has a long operational history in food business.** Dali Group entered into the casual food market at a very early stage, which can be dated back to 1989, when Mr Xu Shihui established Hui'an Meili Minzheng Food Factory, the predecessor of Dali Foods. Food business is the foundation and backbone of Dali, which mainly includes 3 segments: baked goods, potato chips and biscuits. Food business used to contribute most revenue to Dali, but as its beverage business is surging, the contribution of food is in relative decline. Even so, food business still contributed 48.9% of sales to Dali, higher than beverages at 45.2% in 1H17. The CAGR of food sales from 2013 to 2016 was 9.6%, but the growth rate declined to 1.3% in 1H17, largely due to the fall in sales of baked goods. Viewed separately, potato chips maintained the highest growth rate in food business, while the growth rate of baked goods and biscuits stagnated.

Figure-23: Revenue Contribution from Food business of Dali



Source: the Company, Guotai Junan International.

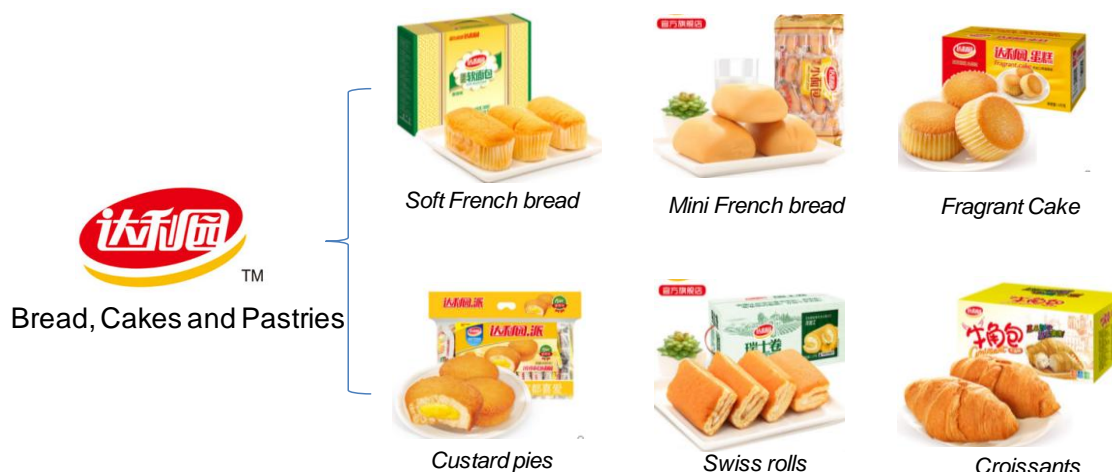
Figure-24: Revenue and growth of Food Segments of Dali



Source: the Company, Guotai Junan International.

**Baked goods: An Indisputable market leader with major revenue contribution to Dali.** Dali entered the baked goods market in 2002 under the Daliyuan (达利园) brand. Due to brand recognition, control of channels, manufacturing expertise and insight on markets, Dali successfully introduced some westernized baked goods, including mini French bread, Swiss rolls and cakes in 2006, 2008 and 2010, respectively. In 2010, the Company launched its self-developed soft French bread products, which are an upgraded version of their mini French bread product with a softer texture, achieving success with more than RMB1 billion in retail sales in 2011. The Company is making ongoing efforts on innovation with continuous launch of new products such as packaged croissants in 2014. The CAGR of sales of baked goods from 2013 to 2016 was 8.2%, but the sales of baked goods declined 5.9% in 1H17 due to price adjustments. Nevertheless, baked goods still contribute most revenue to Dali, 28.8% in 1H17, down 10.2 ppt from 39.0% in 2013. Dali launched their Quality Breakfast series with higher quality and gross margin, which could be positioned as an upgraded version of its existing products, but also as new products in the breakfast market. As Dali is launching into the breakfast market and exploring more sales channels, we expect that Dali's baked goods sales can regain growth. We expect its baked goods sales to grow at a CAGR of 5.0% in 2016-2019.

Figure-25: Product Category of Baked goods of Dali



Source: the Company, Guotai Junan International.



**Figure-26: Quality Breakfast Series of Dali**



Source: the Company, Guotai Junan International.

**Potato chips: a strong competitive domestic food product with high growth rate.** Dali launched potato chips in 2003 under the Copico (可比克) brand. The Company has developed a sophisticated product portfolio, including various sizes, tastes and packaging designs. Although foreign brands (Pepsi Lay's and Orion) still hold the strongest market share, Copico has unique competitiveness in channels in tier-3 cities, tier-4 cities and villages and towns, witnessing fast growth rate over the last ten years. In 2014, Dali introduced another brand, Kaqu French fries (咔趣薯条), to meet fast-growing demand of young customers for quality fries. The CAGR of potato chips sales from 2013 to 2016 was 14.0%, and sales of potato chips recorded 21.0% YoY growth in 1H17 due to better penetration into tier-1 cities, tier-2 cities and modern trade channels. The sales contribution to Dali from potato chips rose 2.1 ppt to 12.0% in 1H17 from 9.9% in 2013. We expect its potato chips sales to grow at a CAGR of 11.9% in 2016-2019.

**Figure-27: Product Category of Potato Chips of Dali**



Source: the Company, Guotai Junan International.

**Biscuits: a competitive player with successful innovation and marketing.** Dali first entered the biscuit market in 1989, and launched Haochidian (好吃点) biscuit brand in 2004. In 2014, Dali launched high-end Danish butter cookies under Landy Castle (蓝帝堡) to enter the fast-growing cookies market. Zhenhao (甄好) cookies, which was launched in 2016, continued to grow rapidly in the mass market. The CAGR of biscuit sales from 2013 to 2016 was 10.5%, and the sales of biscuits increased 4.2% YoY in 1H17. The sales contribution to Dali from biscuits fell 0.9 ppt to 8.0% in 1H17 from 8.9% in 2013. We expect its biscuits sales to grow at a CAGR of 3.3% in 2016-2019.

**Figure-28: Product Category of Biscuits of Dali**



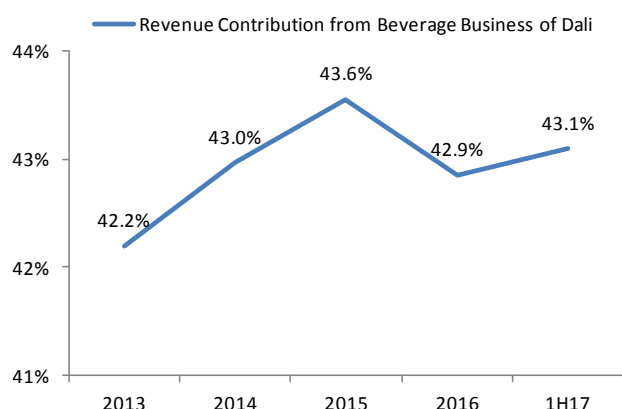
Source: the Company, Guotai Junan International.

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## Beverage Segment Analysis

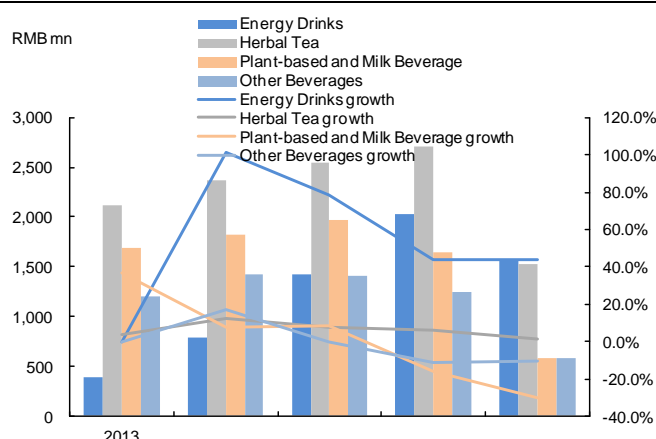
**Dali is a competitive follower in the beverage market.** In 2007, Dali entered the beverage market by launching ready-to-drink herbal tea under "Heqizheng" ("和其正"), milk beverage under the First Milk sub-brand and other ready-to-drink tea products under the Daliyuan brand. The Company expanded to plant-based beverage products by launching peanut milk under the Daliyuan brand in 2010. In 2013, Dali launched energy drinks under the "Hi-Tiger" ("乐虎") brand. In the herbal tea and energy drinks market, Dali has become a competitive player, challenging leaders' positions. The CAGR of beverage sales from 2013 to 2016 recorded 12.2%, and the growth rate recorded 4.4% YoY growth in 1H17 due to the fall in sales of plant-based and milk beverages. Viewed separately, energy drinks maintained robust growth rate, while the growth rate of herbal tea and plant-based beverages slowed down. In 1H17, energy drinks surpassed herbal tea as Dali's major revenue contributor.

**Figure-29: Revenue Contribution from Beverage business of Dali**



Source: the Company, Guotai Junan International.

**Figure-30: Revenue and growth of Food Segments**



Source: the Company, Guotai Junan International.

**Herbal tea: an unbeatable competitor in a highly monopolized market.** Dali entered the herbal tea market in 2007 by introducing "Heqizheng" herbal tea. In 2008, although the market was monopolized by Wong Lo Kat (Jiaduobao), Dali successfully introduced PET-bottled herbal tea (600ml, 1.5L), which grasped market share due to portability and great value for price. In 2014, the Company launched herbal tea in large cans (480ml) to meet the demands for catering and family consumption at competitive prices. To survive in the highly monopolized market, Dali figured a way out in large packaging market with the marketing tagline of "Heqizheng, more fun with large-can". Despite strong competition, the CAGR of Dali herbal tea sales from 2013 to 2016 reached 8.6%, and the sales of herbal tea slightly increased 1.5% YoY in 1H17. The sales contribution to Dali from herbal tea declined 1.0 ppt to 15.5% in 1H17 from 16.5% in 2013. We expect the Company's herbal tea sales to grow at a CAGR of 1.2% in 2016-2019.

**Figure-31: Product Category of Herbal Tea of Dali**



Source: the Company, Guotai Junan International.

**Energy drinks: A star product in Dali's beverage segment.** In 2013, Dali introduced energy drink products under the "Hi-Tiger" brand to meet strong demand from customers who work long hours, play and exercise. Hi-Tiger energy drinks completed the CFDA's certification process and obtained a "Certificate of Health Food", which permits the Company to use the "Health Food" mark on its Hi-Tiger energy drink products. To differentiate its products from those of the existing market-leader, Dali launched



PET-bottled energy drink products with a focus on convenience. It currently offers energy drink products in 380ml PET bottles and 250ml cans. To increase its popularity, Dali has been the sponsor of various sports competitions such as the FIA F4 Chinese Championship and China Formula Grand Prix. Dali has found another way to promote its products by connecting its image with e-sports, which is favored by young generation. Hi-Tiger has sponsored the most popular e-sport event, League of Legends 2017 world championship in Douyu (斗鱼), China's biggest game-streaming media company. We think that e-sports is a good breakthrough point to differentiate its products from Red Bull. Dali achieved great growth in energy drinks since the launch of Hi-Tiger with CAGR of 72.9% from 2013 to 2016. In 1H17, Dali's sales of energy drinks maintained high growth rate of 43.4%. We expect its energy drinks sales to grow at a CAGR of 27.6% in 2016-2019.

**Figure-32: Product Category of Energy Drinks of Dali**



Source: the Company, Guotai Junan International.

**Figure-33: FIA F4 Chinese Championship**



Source: Eastday.com.

**Figure-34: League of Legends 2017 world championship in Douyu**



Source: Douyu.

**Plant-based beverages and milk beverages: A game-changer in the soy milk market.** Dali launched its milk beverage products such as original-flavored milk and honeydew-flavored milk beverages under the First Milk sub-brand in 2007. The Company entered the plant-based beverage market with the launch of PET-bottled peanut milk products in 2010 and aseptic pack in 2012. The CAGR of Dali's plant-based and milk beverage sales reported -0.8% from 2013 to 2016. In 1H17, Dali's sales of plant-based and milk beverage products retreated 4.5% YoY. The decline of Dali's plant-based and milk beverage products in 2016 and 1H17 was mainly due to aging product category with market saturation and competition from similar products. But Dali launched a game-changing soy milk product, "Doubendou" ("豆本豆") in April 2017, which is expected to improve the sales of Dali's sales of plant-based and milk beverage. Since the soy milk market is still in a fast-growing period and there is no dominating national player, Doubendou has the potential to become a leading player due to Dali's sophisticated distribution channel and huge investment in promotion. Douebendou is divided into three types of product series: original flavor, organic and sugar-free. There are also two types of packaging: Tetra Pak packaging and PP bottle. Family-sized packages and PP bottles have not yet been introduced. Its diversified products target to satisfy the diverse needs of customers of different age groups and consumption habits. We expect the Company's plant-based and milk beverage sales to grow at a CAGR of 35.1% in 2016-2019.

Figure-35: Product Category of Plant-based Beverages of Dali



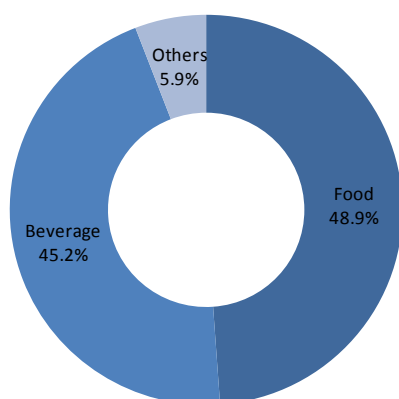
Source: the Company, Guotai Junan International.

Except for the three major beverage categories above, Dali also sets foot in other beverage categories such as mixed porridge, RTD tea, bottled water and juices. The CAGR of Dali's other beverage sales was 1.1% from 2013 to 2016. In 1H17, Dali's sales of other beverages retreated 10.3% YoY due to intense competition and downtrend of these categories. We expect its other beverage sales to grow at a CAGR of -10.0% in 2016-2019.

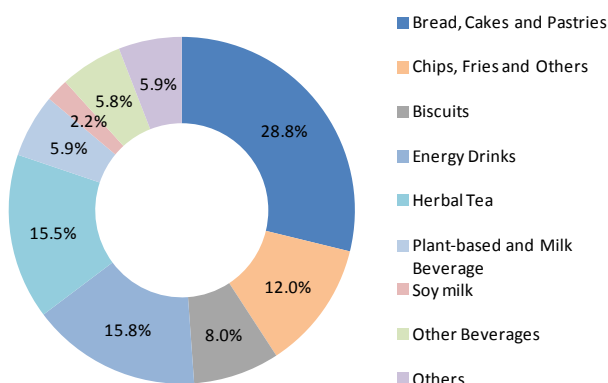
Figure-36: Product Category of Other Beverages of Dali



Source: the Company, Guotai Junan International.

**Figure-37: Dali's Food and Beverage Revenue Contribution in 1H2017**


Source: the Company, Guotai Junan International.

**Figure-38: Breakdown of Dali's Revenue in 1H2017**


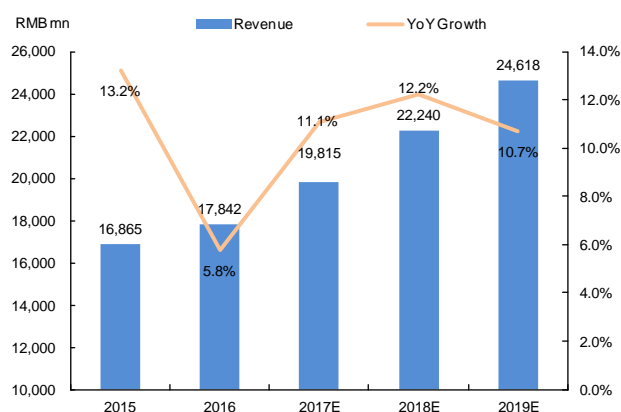
Source: the Company, Guotai Junan International.

## Financial Analysis

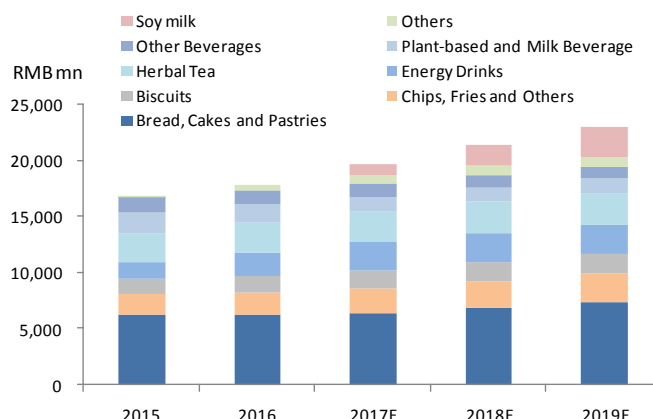
### Revenue

**Revenue grew at a CAGR of 11.6% from 2013 to 2016 and 3-Year revenue CAGR in 2016-2019 is expected to reach 11.3%.**

Dali has maintained high growth over the last three years in spite of the lackluster performance of China's F&B industry, due to Dali's great efforts on entering new markets and upgrading existing products, such as Hi-Tiger in 2013, Kaqu French Fries in 2014, Zhen Hao Cookies and Fruit Bread in 2016 and Doubendou and Quality Breakfast series in 2017. Category expansion is the main driving force for Dali's top-line growth as the Company successfully entered a new market every one-two years. Baked goods contributed 37.5% of sales in 2015, and it will still be a major sales contributor, but its contribution will relatively decline as sales of soy milk and energy drinks expand. We expect that the launch of soy milk and Quality Breakfast series will be the major driver for the Company's top-line growth due to their strong competitiveness. We expect the Company's revenue in 2017-2019 to reach RMB19,815 mn, RMB22,240 mn, and RMB24,618 mn, respectively, representing YoY change of 11.1%, 12.2%, and 10.7%.

**Figure-39: Historical & Forecast Revenue of Dali**


Source: the Company, Guotai Junan International.

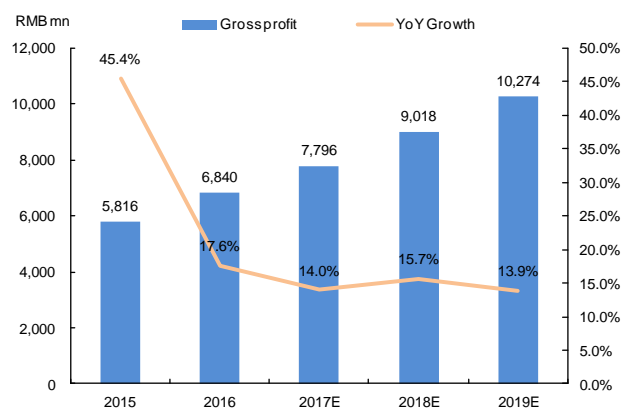
**Figure-40: Composition of Revenue of Dali**


Source: the Company, Guotai Junan International.

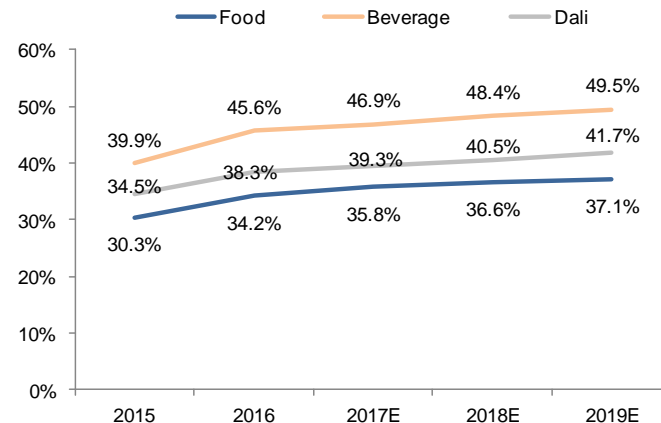
### Gross profit & Operating Profit

**3-Year gross profit CAGR in FY2016 to FY2019 is expected to reach 14.5%.** Although Dali usually offers its distributors favorable prices, the gross margin of Dali rose sharply from 16.5% in 2012 to 38.6% in 1H17. As a result, the CAGR of the Company's gross profit during FY2013-FY2016 achieved remarkable growth of 38.3%. The COGS of Dali mainly includes raw material costs such as sugar, palm oil and flour, packaging material costs, manufacturing costs, and wages and salaries. In 2016, raw material costs represented 53.3% of COGS and packaging material costs represented 27.0% of COGS. The gross margin of

Dali's food business was lower than beverage business as the food market is fragmented and Dali has not employed premium pricing. The rapid growth of the Company's gross profit mainly contributed to its continuous launch of high gross margin products and prices were raised indirectly and directly. Its newly launched products such as Hi-Tiger, Landy Castle Cookies, Zhenhao Cookies, DoubenDou and Quality Breakfast series all have high gross margin. Besides, Dali has indirectly raised ASP through packaging and size, and raised prices directly for all food products by 8% in 2Q17. We expect that as the sales of Doubendou and Quality breakfast series maintains a high growth rate, the gross margin of Dali will be further raised in 2017-2019. We expect the Company's gross profit in 2017-2019 to reach RMB7,796 mn, RMB9,018 mn and RMB10,274 mn, up YoY by 14.0%, 15.7%, 13.9%, respectively.

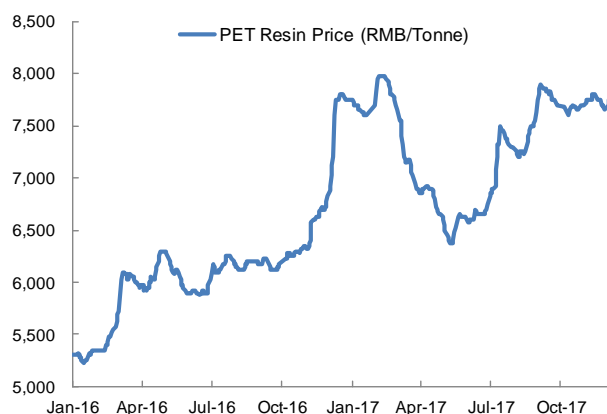
**Figure-41: Historical & Forecast Gross Profit of Dali**
**Figure-42: Gross Margin of Dali**


Source: the Company, Guotai Junan International.

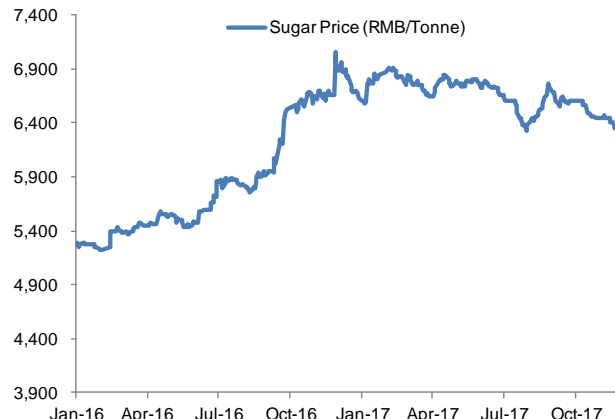


Source: the Company, Guotai Junan International.

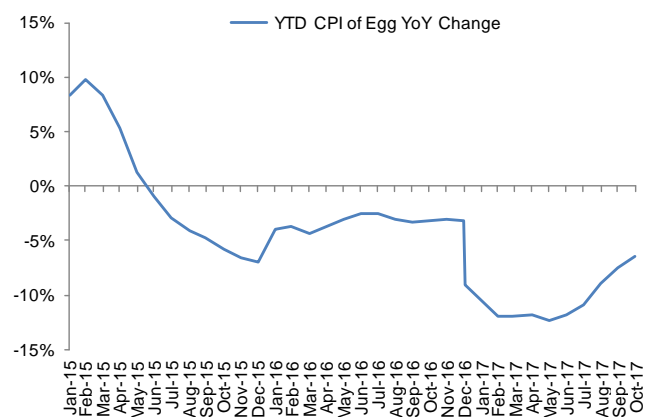
**Raw material prices may not be a big concern for Dali.** The YTD PET price as at 8 December 2017 climbed 21.3% YoY as PET price rapidly rebounded since May 2017 due to the rebound of oil prices. Affected by the limitation of imported sugar, The YTD sugar price increased 14.1% YoY as at 8 December 2017, but slightly decreased in 2017. On the other hand, as at 8 December 2017, YTD flour price increased 13.7% YoY but has remained stable since the beginning of 2017. YTD CPI of eggs decreased 6.5% YoY in 1-10M2017, but witnessed slight recovery in 2H2017. Egg prices may continuously pick up in 2018 but other raw material prices have lost momentum as supply and demand rebalances. Overall, raw material prices may not be a big concern for Dali in 2018.

**Figure-43: PET Price**
**Figure-44: Domestic Sugar Price YoY**


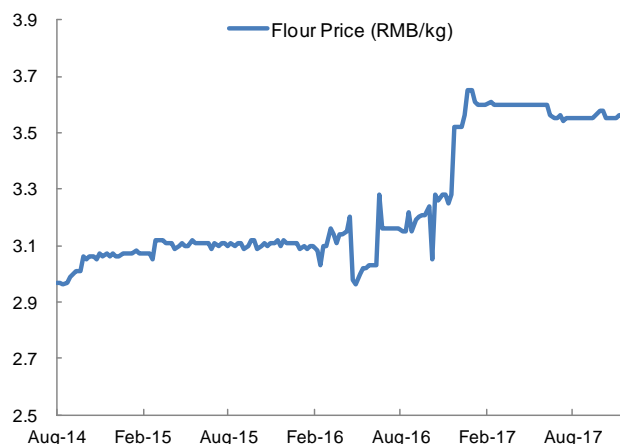
Source: www.tbs-china.com, WIND.



Source: Bloomberg.

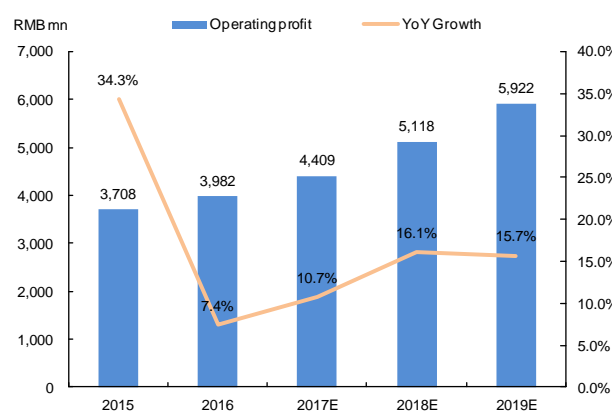
**Figure-45: YTD CPI of Egg Price change**


Source: MDEX.

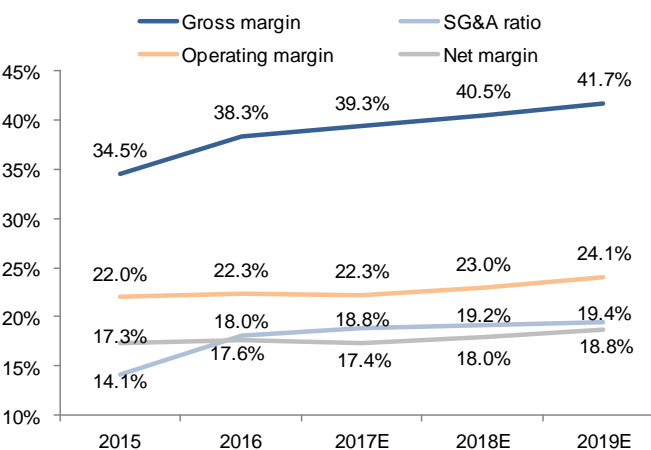
**Figure-46: Flour Price**


Source: Ministry of Agriculture of China.

**3-Year operating profit CAGR in FY2016-FY2019 is expected to reach 14.1%.** Dali used to be famous for its low gross margin and low expense strategy by offering distributors lower prices while taking less responsibility for promotions. But due to intense competition and faster moving markets, the Company gradually changed its distribution strategy and increased its investment in marketing to enhance its control over terminal markets. Dali hired 9,000 new business representatives to manage its retail terminals. Besides, the Company improved its presence in modern trade, which generated around 30% of sales to Dali, and the contribution of direct sales rose from 2.6% in 2012 to approximately 5.0% in 2016. As a result, Dali has been charged more for slotting fees and display fees. Together with surging sales staff costs, the SG&A expenses to sales ratio was hugely raised from 8.3% in 2012 to 18.8% in 1H17. Even so, the operating margins of Dali still maintained stable as the rise in gross margin covered the expansion in expense. In 2013-2016, the Company's operating profit grew at a CAGR of 35.9%. Although the SG&A ratio of Dali is expected to slightly increase and approach the average of the industry, the further increase in gross margin will guarantee the high operating margin of Dali. We expect its operating profit in 2017-2019 to reach RMB4,409 mn, RMB5,118 mn, and RMB5,922 mn, respectively, representing YoY change of 10.7%, 16.1% and 15.7%.

**Figure-47: Historical & Forecast Operating Profit of Dali**


Source: the Company, Guotai Junan International.

**Figure-48: Gross Margin of Dali**


Source: the Company, Guotai Junan International.

## Net profit

**Net profit is expected to grow at a CAGR of 13.8% from 2016 to 2019.** Dali has maintained extremely high net margin compared to its peers due to excellent operating margin, low finance cost and favorable tax rate. The Company has a remarkably healthy financial position as it has not recorded any interest-bearing liabilities. As a result, Dali has not reported any finance costs since 2016. Dali's effective tax rate is lower than a base tax rate of 25% under China's Income Tax Law primarily due to some of its subsidiaries in the west of China being subject to preferential tax rate of 15% under tax preference policy for development of the western region. Overall, Dali's net profit grew at a CAGR of 38.1% from 2013-2016. We expect the Company's net profit in 2017-2019 to reach RMB3,439 mn, RMB3,992 mn, and RMB4,619 mn, changing YoY by 9.6%, 16.1%, and 15.7%, respectively. We estimate net margin from 2017 to 2019 to be 17.4%/ 18.0%/ 18.8%, respectively, while the forecast EPS for the period is

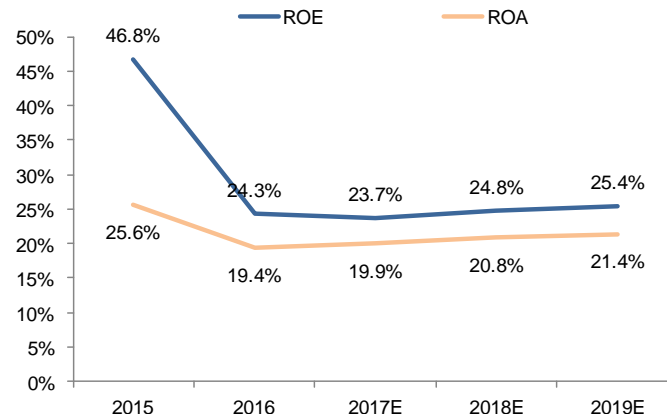
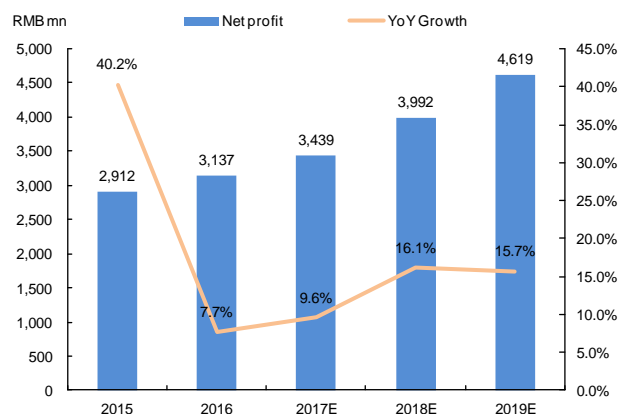


RMB0.251/ RMB0.292 / RMB0.337, respectively.

**ROE and ROA is expected to increase slightly in 2017-2019.** Although the Company's ROE and ROA sharply dropped from 46.8% and 25.6% in 2015 to 24.3% and 19.4% in 2016 due to new shares issued, its ROE and ROA are still impressively high among listed F&B companies mainly resulting from great net margin. In our forecast model, the ROE and ROA will slightly go up, in which ROE will average at 24.7% while ROA will average at 20.7% from 2017 to 2019.

**Figure-49: Historical & Forecast Net Profit of Dali**

**Figure-50: ROE and ROA of Dali**



Source: the Company, Guotai Junan International.

Source: the Company, Guotai Junan International.

## Valuation

**Dali has regained market confidence after its response to bearish reports.** On 7 June 2017, FG Alpha Management published a bearish report against Dali, in which the Company was charged with financial fraud regarding expense and capital expenditure. As a result, Dali's stock price fell 6.5% the same day. But Dali responded quickly to FG Alpha Management by issuing clarifications on 8 June 2017, which clearly explained and denied all the charges from FG Alpha. On 8 June 2017, Dali's stock price regained the loss from 7 June 2017. Due to adequate and genuine communication with investors, Dali regained the trust of the market. As at 8 December 2017, the stock price surged 46.9% since it was shorted on 7 June 2017.

**Initiate with TP of HK\$7.30 and "Buy" rating.** Dali has shown its ability in operations of numerous categories, development of new products and optimization of product mix. We expect that further expansion of sales will insure sustainable growth of earnings although selling expense may be raised due to intense market competition. As a major player in China's food and beverage market, we view the valuation of Dali to be significantly undervalued as it trades at 20.8x 2017 PER and 17.9x 2018 PER, even lower than the industry average. We believe that UPC is a good comparison for Dali as UPC also operates in the food and beverage market and has not achieved No.1 position. Dali has a better prospect due to its solid market position and more promising new products launched. Even so, UPC enjoys higher valuation with 25.4x 2017 PER and 21.6x 2018 PER. The market used to view Dali as a follower by implementing follow-up strategies and launching copycats of successful products. But Dali has transformed its operational strategy as it is becoming a market leader in the soy milk market. We expect that Dali is earning a valuation of a leading player in the F&B segment. As a result, we initiate with "Buy" rating for Dali and set TP at HK\$7.30, which represents 24.7x/ 21.3x/ 18.4x 2017/ 2018 /2019 PER.



**Table-2: Peers Comparison**

Company	Ticker	\$	Share Price	Market Cap (HK\$ mn)	PER (x)			PBR(x)	ROE(%)	Gross Margin(%)	Operating Margin(%)
					FY17F	FY18F	FY19F	FY17F	FY17F	FY17F	FY17F
Dali Foods	3799 HK	HKD	6.150	84,219	20.8	17.9	15.5	4.7	23.7	39.3	22.3
China Mengniu Dairy	2319 HK	HKD	21.000	82,473	28.5	21.1	17.9	3.1	10.7	35.1	5.7
China Resources Beer	291 HK	HKD	24.750	80,293	36.6	31.4	27.5	3.5	9.7	34.3	7.8
Tinavi	322 HK	HKD	13.700	76,809	38.4	31.1	27.3	3.4	9.2	30.1	5.6
Want Want China	151 HK	HKD	5.960	74,387	20.4	20.8	19.8	4.7	23.7	45.3	21.1
Tsingtao Brewery	168 HK	HKD	33.050	48,048	27.1	25.1	23.1	2.2	8.5	41.5	5.3
Uni-President China	220 HK	HKD	6.130	26,478	26.2	22.2	20.0	1.7	6.9	33.5	5.2
Vitasoy	345 HK	HKD	20.450	21,613	34.7	39.1	34.1	8.7	26.5	53.2	15.6
China Foods	506 HK	HKD	3.820	10,685	36.0	23.4	19.3	1.6	12.2	34.1	4.1
<b>Simple Average</b>					<b>27.6</b>	<b>26.0</b>	<b>23.0</b>	<b>3.7</b>	<b>14.0</b>	<b>38.2</b>	<b>10.2</b>
<b>Weighted Average</b>					<b>27.5</b>	<b>24.1</b>	<b>21.5</b>	<b>3.7</b>	<b>14.8</b>	<b>37.7</b>	<b>11.4</b>

Source: Bloomberg.

**Major risk factors include:** 1) Product liability claims, customer complaints, product tampering, food safety Issues, food-borne illnesses, etc.; 2) negative publicity for the Company or the Industry; 3) products are not welcome by customers; 4) operating expenses are out of control; 5) failure to launch new products or enhance existing products; and 6) Counterfeit products by other manufacturers.

Income Statement					
Year end 31 Dec (RMB m)	2015A	2016A	2017F	2018F	2019F
Total Revenue	16,865	17,842	19,815	22,240	24,618
Cost of sales	(11,049)	(11,001)	(12,019)	(13,222)	(14,344)
Gross profit	5,816	6,840	7,796	9,018	10,274
Other income and gains	277	360	340	375	429
Distribution costs	(2,046)	(2,788)	(3,250)	(3,736)	(4,185)
Administrative expenses	(339)	(431)	(478)	(538)	(596)
Operating Profit	3,708	3,982	4,409	5,118	5,922
Finance costs	(27)	(5)	0	0	0
Profit Before Tax	3,681	3,977	4,409	5,118	5,922
Income Tax	(769)	(840)	(970)	(1,126)	(1,303)
Profit after Tax	2,912	3,137	3,439	3,992	4,619
Non-controlling Interest	0	0	0	0	0
Shareholders' Profit / Loss	2,912	3,137	3,439	3,992	4,619
Basic EPS	0.241	0.229	0.251	0.292	0.337

Cash Flow Statement					
Year end 31 Dec (RMB m)	2015A	2016A	2017F	2018F	2019F
PBT	3,681	3,977	4,409	5,118	5,922
DD&A	512	531	562	630	686
Change in working capital	577	(213)	188	(48)	199
Others	20	(73)	(6)	(5)	(5)
Cash generated from operations	4,791	4,222	5,153	5,696	6,803
Income and interest tax paid	(734)	(811)	(958)	(1,097)	(1,280)
Cash from Operating Activities	4,057	3,412	4,195	4,599	5,523
Investing activities					
Capital expenditure	(396)	(452)	(1,521)	(652)	(278)
Available-for-sale investments	(835)	644	(30)	(14)	(15)
Increase in bank deposits	0	(1,874)	74	0	0
Others	(18)	(6)	15	31	42
Cash from Investing Activities	(1,249)	(1,688)	(1,462)	(635)	(251)
Financing activities					
Loans changes	(1,577)	0	0	0	0
Share placing	8,430	0	0	0	0
Dividend paid	(1,126)	(1,460)	(2,192)	(2,063)	(2,395)
Others	(374)	(1,507)	0	0	0
Cash from Financing Activities	5,354	(2,966)	(2,192)	(2,063)	(2,395)
Net Changes in Cash	8,162	(1,242)	541	1,900	2,876
Foreign exchange effect	144	293	0	0	0
Cash at Beg of Year	629	8,935	7,986	8,528	10,428
Cash at End of Year	8,935	7,986	8,528	10,428	13,305

Balance Sheet					
Year end 31 Dec (RMB m)	2015A	2016A	2017F	2018F	2019F
Property, plant and equipment	4,134	3,896	4,334	4,504	4,318
Prepaid lease payments	593	591	617	634	639
Others	100	248	775	622	401
Total Non-current Assets	4,827	4,735	5,726	5,760	5,358
Cash & Cash Equivalents	8,935	7,986	8,528	10,428	13,305
Inventories	930	1,109	1,171	1,388	1,444
Bills receivable	145	284	259	350	324
Others	960	2,366	2,312	2,395	2,385
Total Current Assets	10,970	11,746	12,269	14,562	17,458
Total Assets	15,797	16,480	17,995	20,323	22,816
Short-term debts	1,500	0	0	0	0
Bills payable	964	1,027	1,144	1,293	1,405
Accrued expenses and other payables	985	1,092	1,188	1,371	1,462
Others	149	177	196	220	244
Total Current Liabilities	3,598	2,296	2,529	2,884	3,111
Net current asset	7,372	9,450	9,741	11,678	14,347
Total assets less current liabilities	12,199	14,184	15,466	17,439	19,706
Deferred revenue	297	319	354	397	440
Total Non-current Liabilities	297	319	354	397	440
Total Liabilities	3,895	2,615	2,883	3,281	3,550
Share capital	113	113	113	113	113
Reserves	11,789	13,753	15,000	16,929	19,153
Total Shareholders' Equity	11,902	13,866	15,113	17,042	19,266
Minority Interest	0	0	0	0	0
Total Equity	11,902	13,866	15,113	17,042	19,266

Financial Ratios					
	2015A	2016A	2017F	2018F	2019F
Revenue growth (%)	13.2	5.8	11.1	12.2	10.7
Gross profit growth (%)	45.4	17.6	14.0	15.7	13.9
Operating profit growth (%)	34.3	7.4	10.7	16.1	15.7
Net profit growth (%)	40.2	7.7	9.6	16.1	15.7
Gross margin (%)	34.5	38.3	39.3	40.5	41.7
-Foods	30.3	34.2	35.8	36.6	37.1
-Beverages	39.9	45.6	46.9	48.4	49.5
PAT margin (%)	17.3	17.6	17.4	18.0	18.8
Net margin (%)	17.3	17.6	17.4	18.0	18.8
ROE (%)	46.8	24.3	23.7	24.8	25.4
ROA (%)	25.6	19.4	19.9	20.8	21.4
Inventory turnover days	21.9	20.9	21.0	21.0	21.0
Account receivable days	3.6	4.4	5.0	5.0	5.0
Account payable days	18.8	20.4	20.0	20.0	20.0
Net gearing (%)	Net	Net	Net	Net	Net
	cash	cash	cash	cash	cash
Payout ratio (%)	50.1	69.9	60.0	60.0	60.0

Source: the Company, Guotai Junan International.

### Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Buy	买入	Relative Performance > 15%; or the fundamental outlook of the company or sector is favorable.
Accumulate	收集	Relative Performance is 5% to 15%; or the fundamental outlook of the company or sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the company or sector is neutral.
Reduce	减持	Relative Performance is -5% to -15%; or the fundamental outlook of the company or sector is unfavorable.
Sell	卖出	Relative Performance < -15%; or the fundamental outlook of the company or sector is unfavorable.

### Sector Rating Definition

The Benchmark: Hong Kong Hang Seng Index

Time Horizon: 6 to 18 months

Rating		Definition
Outperform	跑赢大市	Relative Performance > 5%; or the fundamental outlook of the sector is favorable.
Neutral	中性	Relative Performance is -5% to 5%; or the fundamental outlook of the sector is neutral.
Underperform	跑输大市	Relative Performance < -5%; Or the fundamental outlook of the sector is unfavorable.

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