

COMPANY UPDATE

China Mengniu Dairy (2319 HK)

Takeaways From Mengniu Factory Visit; Full-Year Guidance Unchanged

We visited Mengniu's first fully intelligent factory and met with the senior management in Yinchuan, Ningxia. Overall ytd top-line performance was in line with its 2023 growth guidance in the mid-single digits yoy, and management's full-year guidance was unchanged. Mengniu will continue to lead in the UHT milk market with its high-end Deluxe brand while efforts in product mix upgrade (ie promoting Selection Meadow) will lift its gross margin. Maintain BUY with an unchanged target price of HK\$39.30.

WHAT'S NEW

- We attended China International Dairy Intelligent Manufacturing Summit and China Mengniu Dairy's (Mengniu) first fully intelligent factory visit in Yinchuan, Ningxia. Our key takeaways are as below:
- Ytd sales running in line with full-year guidance.** Per management, ytd sales performance was in line with its full-year mid-to-high single-digit growth guidance, and showed a sequential yoy improvement trend each month. However, the growth was below the company's more-aggressive-internal target. By category, Milk Deluxe and the basic ultra-high-temperature (UHT) milk, fresh milk and ice cream registered yoy growth, while the low-temperature yoghurt declined by low-single-digit yoy ytd, better than 2022 and the industry's level. Milk beverage (真果粒) saw decent recovery in 2Q23.
- Guidance remains unchanged.** Management maintains its top-line growth guidance at mid-to-high single digit in 2023, and an operating margin expansion of 30-50bp. In 2023, it will allocate more expenses in advertising and promoting the basic UHT milk as well as to convert raw milk to milk powder. However, that will be offset by the higher gross profit margin as a result from the raw milk price decline and product mix upgrade.
- The new factory caters for the production of the Deluxe DreamCap series.** The new factory is the world's first fully intelligent dairy factory. It only caters to Milk Deluxe's DreamCap production, and currently eight out of 24 production lines have commenced operation. The factory has a designed capacity of around 1m tonnes with 100 workers, hence, it is expected to produce an output value of Rmb10b. Currently, the DreamCap series accounted for one-third of Deluxe revenue since the release in 2019.
- Liquid milk sales growth to recover next year.** Liquid milk sales growth will be the slowest this year, and is expected to recover subsequently, per management. Sales growth target for Deluxe remained unchanged at double digit yoy in 2023, while basic UHT milk is expected to grow by single digit yoy. Nevertheless, management aims to grow Deluxe sales to Rmb5b-6b (vs 2022's Rmb3b) in the coming years, thanks to the rise in consumption scenes such as specialty coffee shops. Furthermore, it is keen on producing ready to drink (RTD) coffee in the future.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2021	2022	2023F	2024F	2025F
Net turnover	88,141	92,593	102,016	111,817	122,734
EBITDA	7,483	7,620	8,736	9,705	10,803
Operating profit	5,087	5,723	7,021	8,152	9,398
Net profit (rep./act.)	5,222	5,193	6,165	7,093	8,191
Net profit (adj.)	5,222	5,193	6,165	7,093	8,191
EPS (sen)	131.6	131.4	155.9	179.5	207.2
PE (x)	20.7	20.8	17.5	15.2	13.2
P/B (x)	2.9	2.7	2.4	2.2	1.9
EV/EBITDA (x)	18.2	17.9	15.6	14.1	12.6
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Net margin (%)	5.9	5.6	6.0	6.3	6.7
Net debt/(cash) to equity (%)	32.1	56.0	41.6	29.7	18.4
ROE (%)	15.0	13.5	14.5	15.0	15.5
Consensus net profit	-	-	6,232	7,289	8,396
UOBKH/Consensus (x)	-	-	0.99	0.97	0.98

Source: Mengniu, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$30.20
Target Price	HK\$39.30
Upside	+30.1%

COMPANY DESCRIPTION

Mengniu is the second largest dairy company in China. Its Deluxe brand is the leading high-end UHT milk brand with the largest market size in China.

STOCK DATA

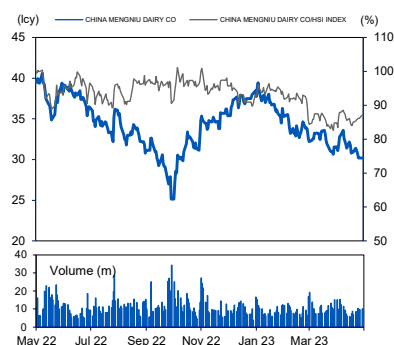
GICS sector	Consumer Staples
Bloomberg ticker:	2319 HK
Shares issued (m):	3,954.9
Market cap (HK\$m):	119,436.5
Market cap (US\$m):	15,256.8
3-mth avg daily t'over (US\$m):	39.1
Price Performance (%)	

52-week high/low HK\$40.63/HK\$25.15

1mth	3mth	6mth	1yr	YTD
79.9	34.7	64.9	(17.7)	(7.4)

Major Shareholders	%
COFCO Corp	24.02
-	-
-	-
FY23 NAV/Share (Rmb)	11.30
FY23 Net Cash/Share (Rmb)	4.70

PRICE CHART



Source: Bloomberg

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- **Current capacity utilisation rate is at an average level of 60-70%**, vs the earlier period's 58-60% and the highest was 76-78%.
- **Milk powder.** Management does not think birth rates will rebound this year. Nevertheless, Bellamy saw positive growth ytd from a decline. The market share of adult milk powder is expected to surpass that of infant milk powder, though the company will keep investing in both segments.
- **Expansion of ice-cream into Southeast Asian markets.** Mengniu will replicate its success of Aice products, driven by low-cost operations, affordable prices and strong distribution capability, to other countries in Southeast Asia. The Philippine factory achieved profits within the first year of operation commencement.
- **Capex update.** The company expects annual capital expenditure to return to a normal level at Rmb4b vs Rmb5b-6b in previous years, hence, free cash flow is expected to improve. The overall technical transformation cost for the factories is Rmb500m-600m per year. Management plans to raise dividend payout ratio (from 30%) if it performs well.
- **The company will promote Selection Meadow products this year**, which targets the mid-end price range, as: a) management sees the opportunity to grab market shares from those mid-to-small brands, and b) it has higher gross margins. The company targets selling prices of Milk Deluxe, Selection Meadow, and basic UHT milk at <Rmb5.0/Rmb3.5-5.0/Rmb<3.5 per package. In terms of gross profit margins, the room-temperature Milk Deluxe is at >45%, basic UHT milk is nearly 30%, while gross margin of the Selection Meadow lies in between.

EARNINGS REVISION/RISK

- **Unchanged earnings forecasts.**
- **Risks.** Slowdown in consumption recovery; higher-than-expected selling expenses.

VALUATION/RECOMMENDATION

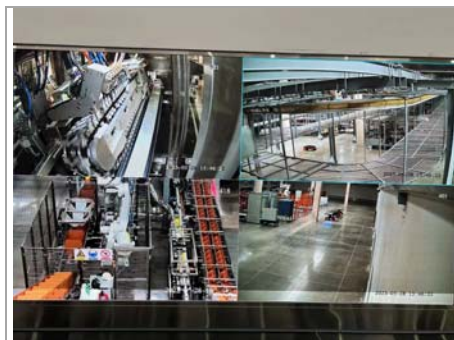
- **Maintain BUY and target price of HK\$39.30.** We are positive on Mengniu's robust OPM expansion in 2023 and thereafter. Maintain BUY and target price of HK\$39.30, which implies 22.7x 2023F PE and 19.7x 2024F PE.

BRANDS UNDER MENGNIU



Source: Mengniu, UOB Kay Hian

SCREEN MONITORING OF THE FACTORY



Source: Mengniu, UOB Kay Hian

EIGHT PRODUCTION LINES IN OPERATION



Source: Mengniu, UOB Kay Hian

PACKAGED MILK ON BELT CONVEYORS



Source: Mengniu, UOB Kay Hian

FACTORY CONTROL ROOM



Source: Mengniu, UOB Kay Hian

FACTORY CONTROL OFFICE



Source: Mengniu, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Net turnover	92,593.3	102,016.3	111,816.6	122,733.7
EBITDA	7,620.2	8,736.4	9,704.5	10,803.2
Deprec. & amort.	1,896.7	1,715.4	1,552.3	1,405.4
EBIT	5,723.5	7,021.0	8,152.2	9,397.8
Total other non-operating income	408.9	925.0	1,111.5	1,217.0
Net interest income/(expense)	260.1	(142.9)	(316.9)	(285.8)
Pre-tax profit	6,392.5	7,803.0	8,946.8	10,329.0
Tax	(1,317.5)	(1,607.4)	(1,816.2)	(2,096.8)
Minorities	118.2	(31.0)	(37.8)	(41.2)
Net profit	5,193.2	6,164.6	7,092.8	8,191.0
Net profit (adj.)	5,193.2	6,164.6	7,092.8	8,191.0

BALANCE SHEET

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Fixed assets	19,652.6	21,944.7	24,203.8	26,535.2
Other LT assets	61,383.5	61,215.7	61,047.9	60,880.1
Cash/ST investment	12,765.8	12,730.1	13,514.5	16,325.7
Other current assets	24,011.2	25,677.5	27,410.5	29,341.0
Total assets	117,813.2	121,568.1	126,176.7	133,082.0
ST debt	9,094.7	9,831.9	9,448.0	9,661.8
Other current liabilities	24,058.5	27,083.6	29,415.5	31,911.5
LT debt	26,106.3	21,493.3	18,872.7	16,963.8
Other LT liabilities	8,501.9	8,501.9	8,501.9	8,501.9
Shareholders' equity	40,098.5	44,673.2	49,916.6	55,979.8
Minority interest	9,953.3	9,984.2	10,022.0	10,063.2
Total liabilities & equity	117,813.2	121,568.1	126,176.7	133,082.0

CASH FLOW

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Operating	2,981.9	9,453.7	9,465.6	10,387.1
Pre-tax profit	6,502.4	7,803.0	8,946.8	10,329.0
Tax	(1,317.5)	(1,607.4)	(1,816.2)	(2,096.8)
Deprec. & amort.	1,896.7	1,715.4	1,552.3	1,405.4
Working capital changes	(1,040.4)	1,358.9	598.9	565.6
Other operating cashflows	(3,059.1)	183.9	183.9	183.9
Investing	(965.4)	(4,023.6)	(3,827.4)	(3,752.9)
Capex (growth)	(5,621.9)	(3,923.6)	(3,727.4)	(3,652.9)
Investments	5,397.5	0.0	0.0	0.0
Proceeds from sale of assets	0.0	0.0	0.0	0.0
Others	(741.0)	(100.0)	(100.0)	(100.0)
Financing	(467.5)	(5,465.8)	(4,853.8)	(3,822.9)
Dividend payments	(1,506.2)	(1,590.0)	(1,849.4)	(2,127.8)
Proceeds from borrowings	5,304.1	5,218.9	6,827.4	7,752.9
Loan repayment	(4,265.5)	(9,094.7)	(9,831.9)	(9,448.0)
Others/interest paid	0.0	0.0	0.0	0.0
Net cash inflow (outflow)	1,549.0	(35.7)	784.4	2,811.2
Beginning cash & cash equivalent	11,216.9	12,765.8	12,730.1	13,514.5
Changes due to forex impact	0.0	0.0	0.0	0.0
Ending cash & cash equivalent	12,765.8	12,730.1	13,514.5	16,325.7

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	8.2	8.6	8.7	8.8
Pre-tax margin	6.9	7.6	8.0	8.4
Net margin	5.6	6.0	6.3	6.7
ROA	4.8	5.2	5.7	6.3
ROE	13.5	14.5	15.0	15.5
Growth				
Turnover	5.1	10.2	9.6	9.8
EBITDA	1.8	14.6	11.1	11.3
Pre-tax profit	5.4	22.1	14.7	15.4
Net profit	(0.5)	18.7	15.1	15.5
Net profit (adj.)	(0.5)	18.7	15.1	15.5
EPS	(0.1)	18.6	15.1	15.5
Leverage				
Debt to total capital	41.3	36.4	32.1	28.7
Debt to equity	87.8	70.1	56.7	47.6
Net debt/(cash) to equity	56.0	41.6	29.7	18.4
Interest cover (x)	n.a.	61.1	30.6	37.8

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