Yili (600887 CH)

Four measures to offset raw milk pressure

3Q20 NP +24% YoY to RMB2,289mn, 9% above consensus due to RMB94mn/82mn YoY increase of fair value gain/other income. The 10% share price drop last Friday was partly because share price already ran ahead of 3Q20 results release. Share price jumped 9% from 23 to 29 Oct (vs MN's 1% drop). We think Yili will implement four measures to offset raw milk pressure, and therefore we kept FY21/22E NP estimates unchanged. We expect Yili would continue to benefit from industry consolidation. Maintain Buy.

- **3Q20 NP beat but GPM missed.** Revenue rose 11% YoY in 3Q20, which is in line with consensus and our expectation, led by 19%/10%/1% growth of milk powder/liquid milk/ice-cream segments. GPM fell 1.3ppt to 34.7% because of 6-7% raw milk price growth (RMB4.5kg in 3Q20 vs China Modern Dairy's ASP ~RMB4.2/kg) and dilution by Westland. That said, selling expenses ratio fell 1.4ppt to 20.5%, offsetting the impact of GPM decline.
- **Four measures to offset raw milk pressure.** Management expects raw milk price to grow by high single-digit in 2H20E and increase further in FY21E. **(1) Reduce discount promotion:** Our sources of channel check found retail prices of Satine rose to RMB65 in second half of Oct (highest level since Feb) and so did MN's Milk Deluxe (Figure 4 & 5). Management expects the sector would be more disciplined in promotions. **(2) Control raw milk source:** Yili became the largest shareholder of Zhongdi (1492 HK) in Sep and its associate company, Youran, bought two farms from Fonterra China in Oct. **(3) Product innovation:** For example, Ambrosial launched a high-end 5G protein in Aug and Satine will launch a high-end 4.0g UHT milk in 1Q21. The retail price/gram of 5G protein is more than double of Ambrosial original favour (Figure 6 & 7). **(4) Improve efficiency of selling expenses:** Selling expenses ratio fell 0.9ppt to 22.7% in 9M20 through more precise marketing such as online advertising. It's 12.3% A&P exp. ratio in FY19 was higher than many major consumer names (Figure 9). As dairy sector leader, we think Yili has room to improve efficiency. Management expects slight drop of selling expenses ratio in FY21E.
- **To become global top three dairy company in 2025.** The Company targets to become global top 3 dairy players in 2025 and the largest player in 2030. In the 14th five year period, Yili will strengthen its leadership and growth in dairy sector, while sales contribution by non-dairy products and overseas market will not be significant. At a 10% sales CAGR in 2019-25, we believe Yili could reach top 3 in 2025 (Figure 8).
- **Maintain Buy.** We lifted FY20E NP by 4% to reflect strong 3Q20 results and maintain our NP estimates in FY21/22E. Our TP is kept at RMB45.90, still based on 32x FY21E P/E. **Catalysts:** better-than-expected revenue and margins. **Risks:** Raw milk cost pressure, food safety issues.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	78,976	90,009	96,852	108,639	119,549
YoY growth (%)	17	14	8	12	10
Net profit (RMB mn)	6,440	6,934	7,414	8,763	10,105
EPS (RMB)	1.060	1.150	1.216	1.437	1.658
YoY growth (%)	7	8	6	18	15
Consensus EPS (RMB)	na	na	1.174	1.391	1.608
P/E (x)	37.5	34.5	32.7	27.6	24.0
P/B (x)	8.7	9.3	8.5	7.5	6.7
Yield (%)	1.8	2.0	2.1	2.5	2.9

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	**RMB45.90**
(Previous TP	RMB45.90)
Up/Downside	**+16%**
Current Price	**RMB39.73**

China F&B Sector

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Stock Data

Mkt Cap (HK$ mn)	241,686
Avg 3 mths t/o (HK$ mn)	2,211.39
52w High/Low (HK$)	44.54/ 26.89
Total Issued Shares (mn)	5,907.5

Source: Bloomberg

Shareholding Structure

Huhhot Investment	8.85%

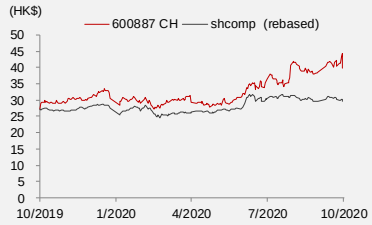
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	15.3%	13.6%
3-mth	23.1%	23.9%
6-mth	50.7%	30.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Da Hua

Related reports

1. "Yili – 2Q20 strongly beat; TP lifted to RMB45.90" – 31 Aug 2020
2. "Yili – Expect full recovery of sales by Jun" – 4 May 2020
3. "China Dairy Sector - Multiple growth drivers ahead; sector consolidation to continue" – 19 Nov 2019

Figure 1: 3Q20 results review

Y/E Dec (RMB mn)	3Q20	3Q19	change (%)	Remarks
Revenue	**26,162**	**23,552**	**11%**	**Satine growth improved from 10% in 1H to 15% in 9M. Ambrosial returned to growth in 3Q**
Cost of sales	(17,077)	(15,075)	13%	
Gross profit	9,084	8,477	7%	
Other income and gains/(losses)	422	198	113%	RMB94mn/82mn increase of FV gain/other income
Selling and distribution expenses	(5,363)	(5,149)	4%	
Administrative expenses	(1,242)	(1,060)	17%	
R&D expenses	(124)	(132)	-6%	
Tax & surcharges	(135)	(118)	15%	
Other expenses	(33)	4	-841%	
Operating profit	2,610	2,221	17%	
Finance income, net	(17)	(101)	-83%	
Other gains/(losses)	7	(12)	-156%	
Share of profit from JV/associate	111	56	100%	
Profit before tax	2,710	2,164	25%	
Tax expense	(423)	(314)	35%	
Profit after tax	2,287	1,850	24%	
Non-controlling interests	2	0	2184%	
Net profit	**2,289**	**1,850**	**24%**	
Margin & Ratio (%)				
Gross margin	34.7	36.0	(1.3)	Raw milk+6-7% and dilution by Westland
Operating margin	10.0	9.4	0.5	
Selling expenses ratio	20.5	21.9	(1.4)	
Administrateive expenses ratio	4.7	4.5	0.1	
R&D expenses ratio	0.5	0.6	(0.1)	
Net margin	8.7	7.9	0.9	
Effective tax rate	15.6	14.5	1.1	

Source: Company, CMBIS

Figure 2: Earnings revision

	New			Old			Diff (%)		
US$ mn	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	96,852	108,639	119,549	97,286	108,915	119,932	0%	0%	0%
Gross Profit	35,494	40,349	44,875	36,235	41,195	45,721	-2%	-2%	-2%
Operating Profit	8,915	10,061	11,474	8,585	10,126	11,560	4%	-1%	-1%
Net Profit	7,415	8,763	10,105	7,107	8,745	10,124	4%	0%	0%
Gross Margin	36.6%	37.1%	37.5%	37.2%	37.8%	38.1%	-0.6ppt	-0.7ppt	-0.6ppt
Operating Margin	9.2%	9.3%	9.6%	8.8%	9.3%	9.6%	+0.4ppt	flat	flat
Net Margin	7.6%	7.9%	8.2%	7.4%	7.9%	8.2%	+0.2ppt	flat	flat

Source: Company data, CMBIS estimates

Figure 3: CMBIS estimates vs consensus

	CMBIS			Consensus			Diff (%)		
US$ mn	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	96,852	108,639	119,549	98,709	110,995	123,418	-2%	-2%	-3%
Gross Profit	35,494	40,349	44,875	36,730	41,659	46,571	-3%	-3%	-4%
Operating Profit	8,915	10,061	11,474	8,554	9,898	11,338	4%	2%	1%
Net profit	7,415	8,763	10,105	7,128	8,556	9,814	4%	2%	3%
Gross Margin	36.6%	37.1%	37.5%	37.2%	37.5%	37.7%	-0.6ppt	-0.4ppt	-0.2ppt
Operating Margin	9.2%	9.3%	9.6%	8.7%	8.9%	9.2%	+0.5ppt	+0.4ppt	+0.4ppt
Net Margin	7.6%	7.9%	8.2%	6.6%	7.6%	7.6%	+1.0ppt	+0.3ppt	+0.6ppt

Source: Bloomberg, CMBIS estimates

Figure 4: Retail price of Satine (250mL*12) was lifted to RMB65.0 in a supermarket in Hunan in late Oct



Source: CMBIS

Figure 5: Retail price of Mlik Deluxe (250mL*12) was also lifted to RMB58.0 in Hunan in late Oct



Source: CMBIS

Figure 6: Retail price of 5G yogurt (125g*8) was set at RMB79.20, representing RMB0.08/g which is more high-end than Ambrosial original favour



Source: CMBIS

Figure 7: Retail price of Ambrosial original favour (205g*12) was lifted to RMB66.0 in a supermarket in Hunan in late Oct, representing RMB0.03/g



Source: CMBIS

Figure 8: Global top 10 companies in terms of dairy turnover

	2019 US$bn	2019-25 CAGR	2025E US$bn
Nestle	22.1	4.0%	28.0
Lactalis	21.0	2.5%	24.4
Dairy Farmers of America	20.1	2.5%	23.3
Danone	18.2	4.0%	23.0
Yili	13.4	10.0%	23.7
Fonterra	13.2		
FrieslandCampina	12.6		
Mengniu	11.9		
Arla Foods	11.8		
Saputo	11.3		

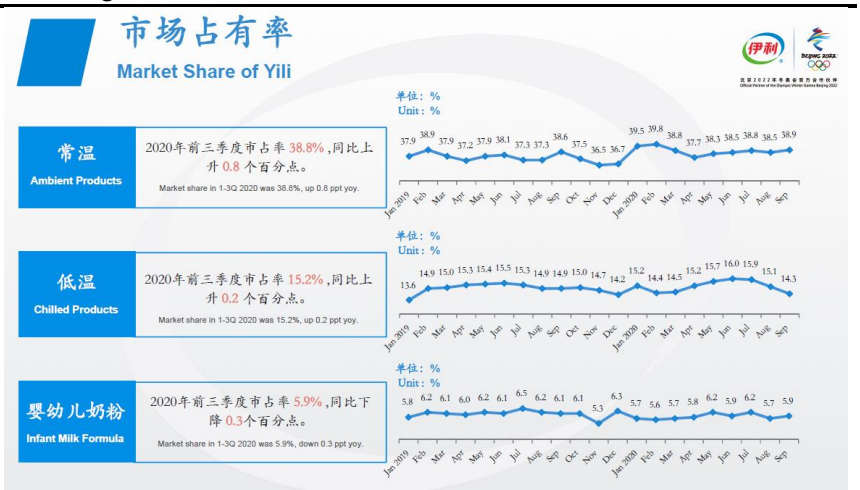
Source: Rabobank, CMBIS estimates

Figure 9: A&P expenses and exp ratio of major consumer companies

	A&P exp ratio	RMB mn
Yili	12.3%	11,041
Feihe *	17.1%	1,775
Mengniu	10.8%	8,500
Anta	10.6%	3,596
Li Ning	9.6%	1,327
Nongfu Spring	5.1%	1,219
Hengan	5.1%	1,137
Haitian Flavour	4.3%	860
Tsingtao Brewery	3.4%	864
Moutai	3.1%	2,975
Want Want	2.9%	583

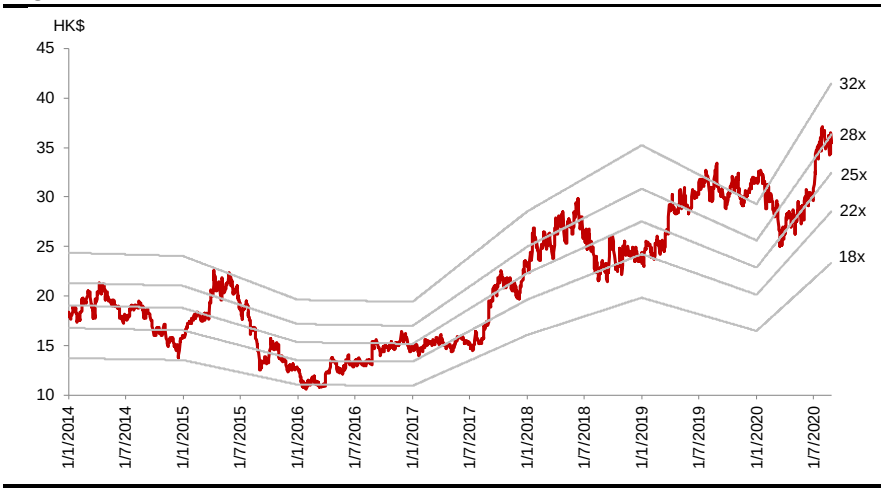
Source: CMBIS estimates
*FY18 figure

Figure 10: Market shares of ambient and chilled products are increasing



Source: Company data, Nielsen

Figure 11: P/E band chart



Source: CMBIS estimates, Bloomberg, Company data

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	**78,976**	**90,009**	**96,852**	**108,639**	**119,549**
Liquid milk	65,679	73,761	77,043	86,807	95,799
Milk powder	8,045	10,055	12,860	14,243	15,591
Ice-cream	4,997	5,631	6,214	6,782	7,261
Others	833	776	1,036	1,107	1,198
Cost of sales	(49,106)	(56,392)	(61,358)	(68,290)	(74,674)
Gross profit	29,870	33,617	35,494	40,349	44,875
Other income	1,402	1,125	1,278	1,113	1,142
Selling expenses	(19,773)	(21,070)	(21,792)	(24,770)	(27,377)
Admin expenses	(2,980)	(4,285)	(4,843)	(5,215)	(5,619)
Other op expenses	(1,033)	(1,314)	(1,223)	(1,415)	(1,549)
EBIT	7,486	8,075	8,915	10,061	11,474
Finance income, net	60	(8)	(131)	(129)	(44)
Other gains/(losses)	(113)	(86)	(420)	(86)	(86)
JV & associates	144	214	332	472	552
Pre-tax profit	7,578	8,194	8,696	10,318	11,895
Income tax	(1,126)	(1,243)	(1,263)	(1,536)	(1,770)
Less: Minority interests	(12)	(17)	(19)	(19)	(20)
Net profit	**6,440**	**6,934**	**7,414**	**8,763**	**10,105**

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before tax	7,578	8,194	8,696	10,318	11,895
JV & associates	(144)	(214)	(332)	(472)	(552)
D&A	1,598	1,891	2,373	2,812	3,142
Net finance income	(60)	8	131	129	44
Change in working capital	313	3,312	744	1,042	1,009
Others	(660)	(4,736)	(763)	(1,336)	(1,570)
Operating cash flow	**8,625**	**8,455**	**10,849**	**12,494**	**13,969**
Capex	(5,091)	(9,243)	(8,000)	(6,000)	(3,000)
Acquisitions	0	(1,617)	(1,467)	0	0
Others	(284)	861	(828)	138	138
Investing cash flow	**(5,375)**	**(9,999)**	**(10,295)**	**(5,862)**	**(2,862)**
Change of debt	(6,337)	6,633	8,431	(3,000)	(2,500)
Dividend and interest paid	(4,393)	(4,406)	(5,507)	(5,706)	(6,565)
Others	(19)	(3,244)	0	0	0
Financing cash flow	**(10,749)**	**(1,016)**	**2,924**	**(8,706)**	**(9,065)**
Net change in cash	(7,499)	(2,560)	3,478	(2,075)	2,042
Cash at the beginning	20,756	13,564	11,066	14,544	12,469
Exchange difference	307	62	0	0	0
Cash at the end	**13,564**	**11,066**	**14,544**	**12,469**	**14,511**

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	**23,151**	**34,755**	**42,231**	**45,940**	**46,399**
Fixed asset	17,374	24,461	30,138	33,374	33,281
Prepaid lease payments	650	1,936	1,936	1,936	1,936
Interest in JV	1,909	1,961	3,760	4,232	4,784
Other non-current assets	3,217	6,397	6,397	6,397	6,397
Current assets	**24,455**	**25,706**	**30,832**	**30,097**	**33,375**
Inventories	5,507	7,715	8,395	9,343	10,216
Account receivables	1,282	1,837	1,977	2,217	2,440
Prepayments	1,614	1,352	1,440	1,591	1,732
Others	5,001	3,476	4,476	4,476	4,476
Cash	11,051	11,325	14,544	12,469	14,511
Current liabilities	**19,171**	**31,432**	**37,514**	**38,396**	**38,142**
Account payables	9,116	10,801	11,753	13,080	14,303
Other payables	8,135	12,262	12,962	14,016	15,039
Borrowings	1,556	4,866	9,366	9,866	8,366
Tax payables	353	397	397	397	397
Others	10	3,106	3,037	1,037	37
Non-current liabilities	**398**	**2,755**	**6,755**	**5,255**	**5,255**
Borrowings	0	1,971	5,971	4,471	4,471
Others	398	784	784	784	784
Total net assets	**28,037**	**26,274**	**28,794**	**32,386**	**36,378**
Shareholders' equity	**27,916**	**26,131**	**28,632**	**32,205**	**36,176**
Non-controlling interests	**122**	**143**	**162**	**181**	**202**

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Liquid milk	83.2	81.9	79.5	79.9	80.1
Milk powder	10.2	11.2	13.3	13.1	13.0
Ice-cream	6.3	6.3	6.4	6.2	6.1
Others	1.1	0.8	0.8	0.7	0.7
P&L ratios (%)					
Gross margin	37.8	37.3	36.6	37.1	37.5
EBIT margin	9.5	9.0	9.2	9.3	9.6
Net margin	8.2	7.7	7.7	8.1	8.5
Payout ratio	66.1	70.9	70.0	70.0	70.0
Balance sheet ratios					
Current ratio (x)	1.3	0.8	0.8	0.8	0.9
Quick ratio (x)	1.0	0.6	0.6	0.5	0.6
A/C receivables days	5	6	7	7	7
A/C payables days	62	64	67	66	67
Inventory days	38	43	48	47	48
Net cash (RMB mn)	9,495	4,488	(3,793)	(2,868)	1,674
Returns (%)					
ROAE	24.3	25.7	27.1	28.8	29.6
ROAA	13.3	12.8	11.1	11.8	13.0
Per share					
EPS (RMB)	1.06	1.15	1.22	1.44	1.66
DPS (RMB)	0.70	0.81	0.85	1.01	1.16
BVPS (RMB)	4.59	4.29	4.70	5.28	5.93

Source: Company data, CMBIS estimates

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