

China/Hong Kong Company Update

China Modern Dairy

Bloomberg: 1117 HK Equity | Reuters: 1117.HK

Refer to important disclosures at the end of this report.

DBS Group Research . Equity

21 Jan 2022

BUY

Last Traded Price (20 Jan 2022): HK\$1.40 (HSI : 24,952)
Price Target 12-mth: HK\$3.00 (114% upside) (Prev HK\$3.01)

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What's New

- Raw milk prices held steady with higher raw material costs such as soybean and corn prices; we forecast prices to rise by 2% in FY22F
- With the consolidation of Fuyuan, CMD's herd size is on track to expand by c.10% p.a. to 500,000 heads by 2025E
- Reiterate BUY, TP unchanged

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2019A	2020A	2021F	2022F
Turnover	5,514	6,020	6,820	9,529
EBITDA	3,794	4,656	2,511	2,916
Pre-tax Profit	2,289	3,062	1,088	1,517
Net Profit	2,280	3,047	1,074	1,503
Net Pft (Pre Ex) (core profit)	3,319	4,079	1,974	2,403
Net Profit Gth (Pre-ex) (%)	N/A	33.7	(64.8)	40.0
EPS (RMB)	0.37	0.43	0.14	0.19
EPS (HK\$)	0.45	0.53	0.17	0.23
EPS Gth (%)	N/A	16.3	(68.4)	40.0
Core EPS Gth (%)	772.8	6.9	(56.5)	21.7
Diluted EPS (HK\$)	0.45	0.53	0.17	0.23
DPS (HK\$)	0.00	0.02	0.01	0.01
BV Per Share (HK\$)	1.41	1.36	1.37	1.60
PE (X)	3.1	2.7	8.4	6.0
CorePE (X)	2.1	2.0	4.6	3.8
P/Cash Flow (X)	3.4	4.2	6.7	5.2
P/Free CF (X)	14.4	17.8	8.6	8.0
EV/EBITDA (X)	3.4	2.7	5.2	4.2
Net Div Yield (%)	0.0	1.8	0.6	0.8
P/Book Value (X)	1.0	1.0	1.0	0.9
Net Debt/Equity (X)	0.8	0.6	0.4	0.3
ROAE (%)	33.7	40.7	12.8	15.7
Earnings Rev (%)			3	(2)
Consensus EPS (RMB)			0.16	0.22
Other Broker Recs:		B:11	S:0	H:0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Steady growth ahead

Investment Thesis

Expanding herd size. With the acquisition of Zhongyuan and Fuyuan (end-Nov'21), the company's herd size has expanded to over c.340,000 heads by end-Nov'21 (Jun'21: c.250,000 heads). CMD is committed to expanding its herd size by c.10% p.a. to 500,000 heads by 2025E, with annual production of fresh milk to expand to c.3.6m tons.

Raw milk prices. China Modern Dairy (CMD) is a key beneficiary of the raw milk upcycle led by tightening milk supply and rising demand for pasteurised products. We forecast raw milk prices to increase 2% in FY22F.

Committed to improving its financials. CMD has been steadily improving its net gearing to 24.6% as of Jun'21 (Dec'20: 53%). With the acquisition of Fuyuan, CMD allotted 807m shares at HK\$2.24/sh to China Mengniu, equivalent to a sum of Rmb1.5bn.

Valuation:

Our target price (TP) is based on discounted cash flow (DCF) valuation with weighted average cost of capital (WACC) at 8.9% and terminal growth of 3%.

Where we differ:

Our topline expectation in FY22F is higher as we forecast stronger contribution from recently acquired farms.

Key Risks to Our View:

Reliance on China Mengniu for raw milk, outbreak of diseases, food safety issues, raw milk price and raw material cost fluctuations, and ESG concerns are some of the key risks.

At A Glance

Issued Capital (m shrs)	6,459
Mkt Cap (HK\$/US\$m)	9,043 / 1,161
Major Shareholders (%)	
China Mengniu Dairy Co Ltd	56.4
New Hope Dairy Co., Ltd.	8.0
Free Float (%)	35.6
3m Avg. Daily Val. (US\$m)	3.51
GICS Industry: Consumer Staples / Food, Beverage & Tobacco	



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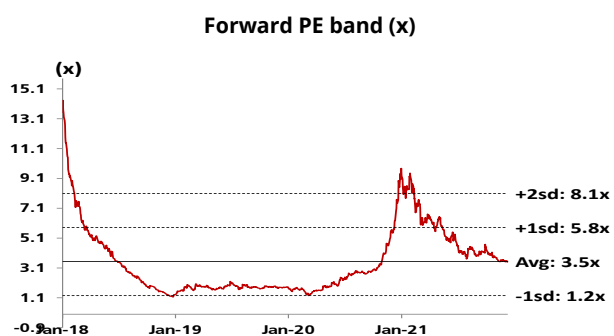
China Modern Dairy

Company Background

Largest upstream dairy player. Established in 2005 in Maanshan, Anhui province, China Modern Dairy (CMD) is one of the leading dairy farming companies in terms of herd size, as well as the largest raw milk producer in China. The group operated 26 dairy farms in China with over 340,000 dairy cows, with the acquisition of Fuyuan.

A pioneer in large-scale dairy farming in China. CMD was among the first to adopt a free-stall dairy farming business model in China to ensure higher yields and cost efficiency compared with small-scale backyard farmers.

Historical PE and PB band



Source: Thomson Reuters, DBS HK

China Modern Dairy

Income Statement (RMB m)

FY Dec	2018A	2019A	2020A	2021F	2022F
Revenue	4,957	5,514	6,020	6,820	9,529
Cost of Goods Sold	(3,411)	(3,412)	(3,562)	(5,154)	(7,211)
Gross Profit	1,546	2,102	2,459	1,666	2,318
Other Opng (Exp)/Inc	(740)	1,678	1,761	572	321
Operating Profit	806	3,780	4,219	2,238	2,639
Other Non Opg (Exp)/Inc	(139)	(121)	143	10	10
Associates & JV Inc	25	34	32	32	32
Net Interest (Exp)/Inc	(328)	(366)	(300)	(292)	(263)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	(870)	(1,039)	(1,031)	(900)	(900)
Pre-tax Profit	(506)	2,289	3,062	1,088	1,517
Tax	(1)	(1)	(1)	0	0
Minority Interest	10	(9)	(14)	(14)	(14)
Preference Dividend	0	0	0	0	0
Net Profit	(496)	2,280	3,047	1,074	1,503
EBITDA	1,007	3,794	4,656	2,511	2,916
Growth					
Revenue Gth (%)	3.6	11.2	9.2	13.3	39.7
EBITDA Gth (%)	77.4	276.8	22.7	(46.1)	16.1
Opg Profit Gth (%)	211.2	369.1	11.6	(47.0)	17.9
Net Profit Gth (%)	49.1	N/A	33.7	(64.8)	40.0
Margins & Ratio					
Gross Margins (%)	31.2	38.1	40.8	24.4	24.3
Opg Profit Margin (%)	16.3	68.6	70.1	32.8	27.7
Net Profit Margin (%)	(10.0)	41.3	50.6	15.7	15.8
ROAE (%)	(7.4)	33.7	40.7	12.8	15.7
ROA (%)	(3.0)	14.4	19.5	6.6	8.6
ROCE (%)	5.6	27.0	29.9	15.2	16.6
Div Payout Ratio (%)	0.0	0.0	3.5	2.5	2.9
Net Interest Cover (x)	2.5	10.3	14.0	7.7	10.0

Source: Company, DBS HK

Interim Income Statement (RMB m)

FY Dec	1H2019	2H2019	1H2020	2H2020	1H2021
Revenue	2,570	2,944	2,828	3,192	3,180
Cost of Goods Sold	(1,672)	(1,740)	(1,776)	(1,786)	(3,106)
Gross Profit	898	1,204	1,052	1,407	74
Other Oper. (Exp)/Inc	(139)	1,626	523	919	832
Operating Profit	759	2,830	1,575	2,326	906
Other Non Opg (Exp)/Inc	(27)	(94)	40	102	(10)
Associates & JV Inc	12	22	13	19	16
Net Interest (Exp)/Inc	(181)	6	8	11	0
Exceptional Gain/(Loss)	(430)	(609)	(449)	(583)	(406)
Pre-tax Profit	134	2,155	1,187	1,875	506
Tax	0	0	0	0	0
Minority Interest	(9)	0	(6)	(8)	0
Net Profit	125	2,155	1,181	1,866	506
Growth					
Revenue Gth (%)	4.1	18.3	10.0	8.4	12.4
Opg Profit Gth (%)	50.4	840.9	107.4	(17.8)	(42.5)
Net Profit Gth (%)	N/A	N/A	846.1	(13.4)	(57.1)
Margins					
Gross Margins (%)	34.9	40.9	37.2	44.1	2.3
Opg Profit Margins (%)	29.5	96.1	55.7	72.9	28.5
Net Profit Margins (%)	4.9	73.2	41.8	58.5	15.9

Source: Company, DBS HK

China Modern Dairy

Balance Sheet (RMB m)

FY Dec	2018A	2019A	2020A	2021F	2022F
Net Fixed Assets	4,038	3,775	3,622	3,690	3,754
Invt in Associates & JVs	181	215	290	290	290
Other LT Assets	9,118	8,835	8,572	8,572	8,872
Cash & ST Invt	764	1,041	1,158	2,169	2,534
Inventory	979	1,078	1,159	1,341	1,877
Debtors	781	618	707	654	914
Other Current Assets	84	161	61	100	100
Total Assets	15,946	15,724	15,568	16,816	18,341
ST Debt	4,419	4,874	3,471	3,471	3,021
Creditors	2,072	1,522	1,411	1,341	1,877
Other Current Liab	1	41	84	84	84
LT Debt	2,746	1,716	2,171	2,571	2,571
Other LT Liabilities	153	364	393	393	393
Shareholder's Equity	6,445	7,082	7,897	8,829	10,282
Minority Interests	109	126	142	128	114
Total Cap. & Liab.	15,946	15,724	15,568	16,817	18,342
Non-Cash Wkg. Capital	(229)	295	432	670	930
Net Cash/(Debt)	(6,401)	(5,549)	(4,484)	(3,874)	(3,058)
Debtors Turn (avg days)	66.4	46.3	40.2	36.4	30.0
Creditors Turn (avg days)	241.2	198.1	162.2	102.0	84.2
Inventory Turn (avg days)	107.7	113.4	123.8	92.7	84.2
Asset Turnover (x)	0.3	0.3	0.4	0.4	0.5
Current Ratio (x)	0.4	0.5	0.6	0.9	1.1
Quick Ratio (x)	0.2	0.3	0.4	0.6	0.7
Net Debt/Equity (X)	1.0	0.8	0.6	0.4	0.3
Net Debt/Equity ex MI (X)	1.0	0.8	0.6	0.4	0.3
Capex to Debt (%)	22.1	23.7	26.3	5.0	10.7
Z-Score (X)	0.6	1.0	1.1	1.2	1.2

Source: Company, DBS HK

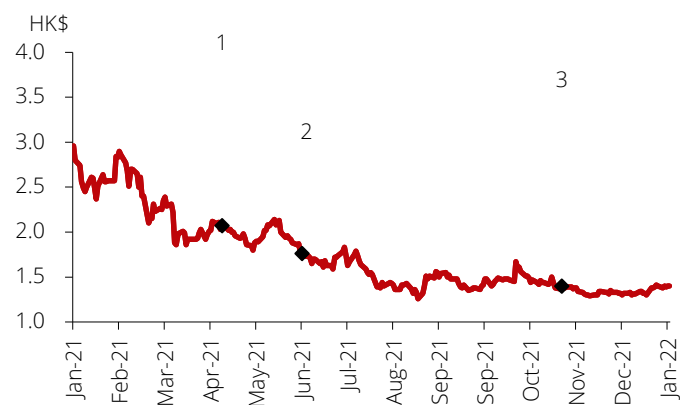
Cash Flow Statement (RMB m)

FY Dec	2018A	2019A	2020A	2021F	2022F
Pre-Tax Profit	(506)	350	784	1,088	1,517
Dep. & Amort.	315	309	263	231	236
Tax Paid	0	(1)	0	0	0
Assoc. & JV Inc/(loss)	(25)	(34)	(32)	(17)	(17)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(79)	42	(256)	(238)	(260)
Other Operating CF	1,700	1,383	1,180	280	251
Net Operating CF	1,406	2,049	1,939	1,345	1,728
Capital Exp.(net)	(1,585)	(1,559)	(1,484)	(300)	(600)
Other Invt.(net)	694	566	574	0	0
Invt in Assoc. & JV	(181)	(34)	(74)	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	11	2	219	23	28
Net Investing CF	(1,062)	(1,026)	(766)	(277)	(572)
Div Paid	0	0	0	(142)	(50)
Chg in Gross Debt	80	(773)	283	400	(450)
Capital Issues	(24)	0	(1,015)	0	0
Other Financing CF	(496)	(59)	(210)	(315)	(291)
Net Financing CF	(439)	(832)	(943)	(57)	(791)
Currency Adjustments	0	0	0	0	0
Chg in Cash	(95)	191	230	1,011	365
Opg CFPS (RMB)	0.24	0.32	0.31	0.20	0.25
Free CFPS (RMB)	(0.03)	0.08	0.06	0.13	0.14

Source: Company, DBS HK

China Modern Dairy

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	22-Apr-21	HK\$2.03	HK\$3.36	Buy
2:	10-Jun-21	HK\$1.76	HK\$3.36	Buy
3:	16-Nov-21	HK\$1.37	HK\$3.01	Buy

Source: DBS HK

Analyst: Alison FOK

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BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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