

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

30 Mar 2022

BUY

Last Traded Price (29 Mar 2022): HK\$1.31 (HSI : 21,928)

Price Target 12-mth: HK\$1.60 (22% upside)

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What's New

- CMD net earnings rose 32% y-o-y, below expectations, but in line with our estimates
- Herd size expanded by 43% to 354,000 heads in FY21, with commitment to deliver a 2021-25E CAGR of 9%, to over 500k heads
- Maintain BUY, TP unchanged at HK\$1.60

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	6,020	7,078	9,509	10,656
EBITDA	79	121	2,926	3,286
Pre-tax Profit	784	1,035	1,484	1,874
Net Profit	770	1,019	1,468	1,858
Net Pft (Pre Ex) (core profit)	(476)	(404)	2,424	2,814
Net Profit Gth (Pre-ex) (%)	125.6	32.3	44.1	26.5
EPS (RMB)	0.11	0.14	0.21	0.26
EPS (HK\$)	0.13	0.18	0.25	0.32
Core EPS (RMB)	(0.07)	(0.06)	0.34	0.40
Core EPS (HK\$)	(0.08)	(0.07)	0.42	0.49
EPS Gth (%)	96.2	32.8	44.1	26.5
Core EPS Gth (%)	N/A	14.9	N/A	16.1
Diluted EPS (HK\$)	0.13	0.18	0.25	0.32
DPS (HK\$)	0.02	0.03	0.05	0.06
BV Per Share (HK\$)	1.37	1.89	2.11	2.39
PE (X)	9.8	7.4	5.1	4.1
CorePE (X)	nm	nm	3.1	2.7
P/Cash Flow (X)	3.9	4.5	5.2	3.4
P/Free CF (X)	16.7	nm	8.9	4.7
EV/EBITDA (X)	154.5	118.0	4.8	4.1
Net Div Yield (%)	1.9	2.4	3.5	4.4
P/Book Value (X)	1.0	0.7	0.6	0.5
Net Debt/Equity (X)	0.6	0.6	0.5	0.4
ROAE(%)	10.3	10.9	12.8	14.3
Earnings Rev (%)			(3)	2
Consensus EPS (RMB)			0.22	0.26
Other Broker Recs:		B:10	S:0	H:0

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

Firm expansion in herd size

Investment Thesis

Expanding herd size. With the acquisition of Zhongyuan and Fuyuan, the company's herd size expanded to over c.354,000 heads by end-Dec 21 (Jun 21: c.250,000 heads). China Modern Dairy (CMD) is committed to expanding its herd size by a CAGR of 9%, to 500,000 heads by 2025E, with annual production of fresh milk to expand to c.3.6m tonnes.

Raw milk prices. 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's net gearing rose to 56% as of Dec 21 (Dec 20: 53%) with the acquisition of Fuyuan and Zhongyuan.

Valuation:

Our target price (TP) is based on a discounted cash flow (DCF) valuation with the weighted average cost of capital (WACC) at 8.9% and terminal growth of 3%. We revise down the long-term growth rate, as we forecast volume growth should stabilise post 2025E. We keep our TP unchanged at HK\$1.60.

Where we differ:

Our top-line expectation in FY22F is higher, as we forecast stronger contributions 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)	7,916
Mkt Cap (HK\$/US\$m)	10,370 / 1,325
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)	3.70
GICS Industry: Consumer Staples / Food, Beverage & Tobacco	



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China Modern Dairy

WHAT'S NEW

Steady herd expansion

China Modern Dairy's net earnings growth of 32% came in below market expectations, but in line with our estimates. Revenue rose 18% to Rmb7,078m. Gross profit margin contracted 4.8ppt to 36%. Cash EBITDA rose 7.5% to Rmb2,434m, with the EBITDA margin contracting by 3.2ppt to 34.4%. Net earnings rose 32.3% to Rmb1,019m. The group recommended a final dividend of Rmb0.026/sh, equivalent to a c.18% dividend payout ratio (FY20: 19%).

Production volume rose 8% to 1.61m tonnes in FY21, lifted by the acquisition of Zhongyuan Muyu and Fuyuan International, which had added a total of 80,000 cows to CMD's herd. Of this, 86.5% was sold to Mengniu, 9.1% to New Hope Dairy, and the remainder to others. Overall, the company's herd size expanded by 43% to 354,000 heads. Productivity yield rose to 11.3 tonnes/annum (FY20: 11.1 tonnes/annum). Raw milk prices rose 6.8% to Rmb4.41/kg.

Cash cost rose 17% to Rmb2.67/kg in FY21, of which, feed costs rose 19% to Rmb2.11/kg. Other costs (utilities, labour, etc.) rose 8% to Rmb0.56/kg. The company continued to lower the impact of rising feed costs through the adjustment of feed formulas (higher corn proportion). Subsequently, selling and distribution expenses contracted 0.8ppt to 2.6%, while administrative expenses contracted 0.8ppt to 5.4% in FY21.

As of end-FY21, the group's net gearing was lifted to 56% (Dec 20: 53.4%), with interest bearing loans expanding to Rmb8,495m (FY20: Rmb5,642m). The group was assigned a "BBB" investment grade by Standard & Poor's, allowing the group to successfully issue bonds of US\$500m at a coupon rate of 2.125% due in 2026.

CMD has been steadily expanding its branded milk business with the support of China Mengniu. In FY21, branded milk sales rose 22% to Rmb1.5bn, with the share of results of associates rising by 17% y-o-y to Rmb36m. Of this, sales of its three best-selling products contributed >60% to total sales. New products, including the A2 series launched in Dec, are targeted at the medium to high-end dairy market.

Medium-term prospects in place. CMD delivered a CAGR of 23%, expanding its herd size to 353,793 heads in 2019-21. Besides building its dairy farming business, the group has entered the feed business to drive integration in its supply chain. The group plans to (1) establish an e-commerce platform, (2) cultivate its breeding business, (3) develop its beef cattle business, and (4) integrate its land & forage business. We believe the group is on track to expand its herd size to more than 500,000 by 2025, indicating a 2021-25E CAGR of 9%, and also achieve a milk production volume of 3.6m tonnes (2021-25E of 23%). We expect this target will be achieved through herd size expansion and a rise in productivity yield.

Cost pressure likely to rise. In Jan-Feb, the group reported a slightly higher raw milk price trend, as well as lower-than-industry feed costs, thanks to its procurement strategy. Looking ahead, the group will place efforts in hedging its feed to partly offset the raw material cost pressure. The company looks forward to (1) the end of the conflict in the Black Sea and (2) the government's strategy in releasing coarse grains to stabilise food prices. We trim our sales volume forecast, now expecting a volume growth of 32%/14.5% in FY22/23F, with raw milk prices +2%/-2%, respectively. We now expect the group to deliver earnings growth of 44%/27% in FY22F/23F. Maintain BUY.

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 33 dairy farms in China with over 354,000 dairy cows, with the acquisition of Fuyuan and Zhongyuan.

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.

China Modern Dairy

Income Statement (RMB m)

FY Dec	2020A	2021A	% cha v-o-v
Revenue	6,020	7,078	17.6
Cost of Goods Sold	(5,839)	(6,907)	18.3
Gross Profit	181	171	(5.7)
Other Opng (Exp)/Inc	(558)	(445)	(20.2)
Operating Profit	(377)	(274)	(27.2)
Other Non Opg (Exp)/Inc	143	51	(64.1)
Associates & JV Inc	32	37	17.0
Net Interest (Exp)/Inc	(259)	(201)	22.4
Exceptional Gain/(Loss)	1,246	1,422	14.2
Pre-tax Profit	784	1,035	32.0
Tax	(1)	(2)	216.6
Minority Interest	(14)	(14)	(4.4)
Net Profit	770	1,019	32.3
Net Profit before Except.	(476)	(404)	32.3
EBITDA	79	121	53.7
Margins & Ratio			
Gross Margins (%)	3.0	2.4	
Opg Profit Margin (%)	(6.3)	(3.9)	
Net Profit Margin (%)	12.8	14.4	

Source: Company, DBS HK

China Modern Dairy

Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Sales volume ('000 tonnes)	1,365,739.0	1,456,962.0	1,586,857.0	2,094,369.6	2,399,763.3
Raw milk price (Rmb/kg)	4.0	4.1	4.4	4.5	4.4

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (RMB m)					
Dairy farming	5,514	6,020	7,005	9,425	10,559
Feed	0	0	73	84	97
Total	5,514	6,020	7,078	9,509	10,656

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	5,514	6,020	7,078	9,509	10,656
Cost of Goods Sold	(3,412)	(5,839)	(6,907)	(6,237)	(6,906)
Gross Profit	2,102	181	171	3,272	3,750
Other Opng (Exp)/Inc	(260)	(558)	(445)	(676)	(807)
Operating Profit	1,842	(377)	(274)	2,596	2,943
Other Non Opg (Exp)/Inc	(121)	143	51	50	50
Associates & JV Inc	34	32	37	44	53
Net Interest (Exp)/Inc	(366)	(259)	(201)	(250)	(216)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	(1,039)	1,246	1,422	(956)	(956)
Pre-tax Profit	350	784	1,035	1,484	1,874
Tax	(1)	(1)	(2)	(2)	(2)
Minority Interest	(9)	(14)	(14)	(14)	(14)
Preference Dividend	0	0	0	0	0
Net Profit	341	770	1,019	1,468	1,858
Net Profit before Except.	1,380	(476)	(404)	2,424	2,814
EBITDA	1,856	79	121	2,926	3,286
Growth					
Revenue Gth (%)	11.2	9.2	17.6	34.3	12.1
EBITDA Gth (%)	84.3	(95.7)	53.7	2,311.5	12.3
Opg Profit Gth (%)	128.6	(120.5)	(27.2)	(1,046.0)	13.4
Net Profit Gth (%)	N/A	125.6	32.3	44.1	26.5
Margins & Ratio					
Gross Margins (%)	38.1	3.0	2.4	34.4	35.2
Opg Profit Margin (%)	33.4	(6.3)	(3.9)	27.3	27.6
Net Profit Margin (%)	6.2	12.8	14.4	15.4	17.4
ROAE (%)	5.0	10.3	10.9	12.8	14.3
ROA (%)	2.2	4.9	5.2	6.1	7.4
ROCE (%)	13.1	(2.7)	(1.6)	12.4	13.3
Div Payout Ratio (%)	0.0	N/A	N/A	10.9	11.9
Net Interest Cover (x)	5.0	(1.5)	(1.4)	10.4	13.6

Source: Company, DBS HK

China Modern Dairy

Interim Income Statement (RMB m)

FY Dec	2H2019	1H2020	2H2020	1H2021	2H2021
Revenue	2,944	2,828	3,192	3,180	3,899
Cost of Goods Sold	(1,740)	(1,776)	(4,063)	(3,106)	(3,801)
Gross Profit	1,204	1,052	(871)	74	97
Other Oper. (Exp)/Inc	(312)	(437)	(398)	(175)	(472)
Operating Profit	892	615	(1,269)	(101)	(374)
Other Non Opg (Exp)/Inc	(94)	40	102	(10)	61
Associates & JV Inc	22	13	19	16	21
Net Interest (Exp)/Inc	6	8	11	0	0
Exceptional Gain/(Loss)	(609)	(449)	1,695	(406)	1,828
Pre-tax Profit	217	227	558	(501)	1,536
Tax	0	0	0	(91)	89
Minority Interest	0	(6)	(8)	0	(15)
Net Profit	216	221	549	(592)	1,611
Net profit bef Except.	825	670	(1,146)	(186)	(217)
Growth					
Revenue Gth (%)	18.3	10.0	8.4	12.4	22.1
Opg Profit Gth (%)	196.4	(19.1)	(242.3)	(116.4)	(70.5)
Net Profit Gth (%)	N/A	76.9	153.8	N/A	193.3
Margins					
Gross Margins (%)	40.9	37.2	(27.3)	2.3	2.5
Opg Profit Margins (%)	30.3	21.7	(39.7)	(3.2)	(9.6)
Net Profit Margins (%)	7.4	7.8	17.2	(18.6)	41.3

Source: Company, DBS HK

China Modern Dairy

Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	3,775	3,622	6,038	6,102	6,162
Invt in Associates & JVs	215	290	353	353	353
Other LT Assets	8,835	8,572	11,940	12,240	12,540
Cash & ST Invt	1,041	1,158	1,929	1,871	2,982
Inventory	1,078	1,159	2,191	1,978	2,191
Debtors	618	707	1,222	1,641	1,839
Other Current Assets	161	61	0	0	0
Total Assets	15,724	15,568	23,674	24,187	26,068
ST Debt	4,874	3,471	2,814	2,364	2,364
Creditors	1,522	1,411	3,144	2,839	3,144
Other Current Liab	41	84	107	107	107
LT Debt	1,716	2,171	5,649	5,641	6,489
Other LT Liabilities	364	393	845	851	0
Shareholder's Equity	7,082	7,897	10,865	12,149	13,742
Minority Interests	126	142	250	235	221
Total Cap. & Liab.	15,724	15,568	23,674	24,187	26,068
Non-Cash Wkg. Capital	295	432	162	674	779
Net Cash/(Debt)	(5,549)	(4,484)	(6,534)	(6,134)	(5,871)
Debtors Turn (avg days)	46.3	40.2	49.7	55.0	59.6
Creditors Turn (avg days)	198.1	96.3	126.0	182.0	163.8
Inventory Turn (avg days)	113.4	73.5	92.6	126.8	114.1
Asset Turnover (x)	0.3	0.4	0.4	0.4	0.4
Current Ratio (x)	0.5	0.6	0.9	1.0	1.2
Quick Ratio (x)	0.3	0.4	0.5	0.7	0.9
Net Debt/Equity (X)	0.8	0.6	0.6	0.5	0.4
Net Debt/Equity ex MI (X)	0.8	0.6	0.6	0.5	0.4
Capex to Debt (%)	23.7	26.3	44.6	7.5	6.8
Z-Score (X)	1.0	1.1	1.2	1.2	1.2

Source: Company, DBS HK

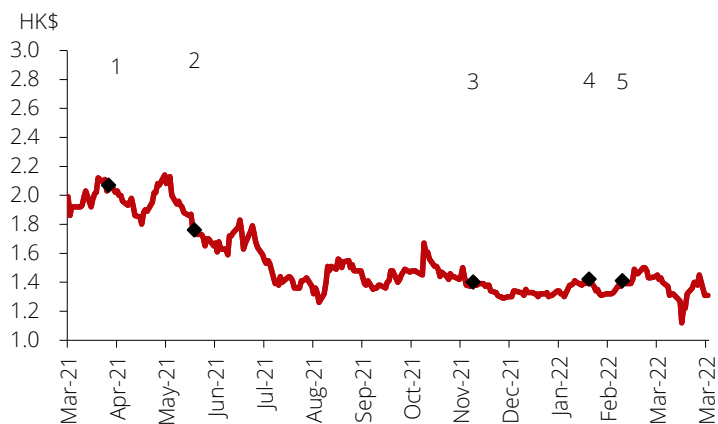
Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	350	784	1,035	1,484	1,874
Dep. & Amort.	309	263	231	236	240
Tax Paid	(1)	0	(2)	(2)	(2)
Assoc. & JV Inc/(loss)	(34)	(32)	(9)	(5)	(5)
(Pft)/Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg. Cap.	42	(256)	270	(512)	(106)
Other Operating CF	1,383	1,180	152	250	216
Net Operating CF	2,049	1,939	1,678	1,451	2,218
Capital Exp. (net)	(1,559)	(1,484)	(3,778)	(600)	(600)
Other Invt. (net)	566	574	(7)	0	0
Invt in Assoc. & JV	(34)	(74)	(63)	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	2	219	46	50	84
Net Investing CF	(1,026)	(766)	(3,803)	(550)	(516)
Div Paid	0	0	(143)	(184)	(265)
Chg in Gross Debt	(773)	283	2,821	(450)	0
Capital Issues	0	(1,015)	120	0	0
Other Financing CF	(59)	(210)	90	(325)	(326)
Net Financing CF	(832)	(943)	2,888	(959)	(590)
Currency Adjustments	0	0	0	0	0
Chg in Cash	191	230	764	(58)	1,111
Opg CFPS (RMB)	0.32	0.31	0.20	0.28	0.33
Free CFPS (RMB)	0.08	0.06	(0.30)	0.12	0.23

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
4:	21-Jan-22	HK\$1.40	HK\$3.00	Buy
5:	9-Feb-22	HK\$1.38	HK\$1.60	Buy

Source: DBS HK

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China Modern Dairy

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

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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China Modern Dairy

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