

Result update

China Huishan Dairy 6863 HK

Headwinds in dairy industry bring downside risks

- *For 1H FY03/15E, the company recorded net profit attributable to shareholders of RMB789.3m, a 53.0% YoY increase*
- *In the long-run, headwinds in the dairy industry will bring downside risks to the company*
- *However, its stock price will be supported by its share repurchase plan in the short-run*
- *We revised our TP from HKD2.92 to HKD1.47 based on our expectation that the price of raw/liquid milk will decrease in the coming years*

David Li

(852) 2533 3723

davidli@sbichinacapital.com

Stock Data (6863 HK)

Rating	Hold
Price (HK\$)	1.5
Target Price (HK\$)	1.47
12m Price Range (HK\$)	1.49-2.94
Market cap. (HK\$m)	21,549.9
Daily t/o (HK\$m)	43.1
Free float (%)	33.4
<i>Source: Bloomberg</i>	

1H FY03/15E result in line with our forecast. Last week, China Huishan Dairy (CHD) announced its 1H FY03/15E results. During the period, the company recorded revenue of RMB1,994.8m, a 30.0% YoY increase; gross profit of RMB1,138.1m, a 27.8% YoY increase with the GPM of 57.1%; and profit attributable to shareholders of RMB789.3m, a 53.0% YoY increase. Such increase represents 51.3% of the total profit we estimated for FY03/15E in our initial coverage report and also 52.9% of total profit for FY03/15E under our new estimate. The increase in profit is mainly driven by the expansion of milkable cows and the growing average milk yield. Specifically, the number of milkable cows expanded to 65,312 heads during the period, a 6.6% YoY increase; and the average milk yield increased to 9.1 tons per year compared with 8.6 tons per year recorded in the same period last year. Total ASP of raw milk also picked up from RMB4,823.0 per ton in 1H FY12/14 to RMB5,033.0 per ton in 1H FY12/15E. In addition, profit during the period was strongly supported by its upstream farm business, without which the GPM will drop to 22.2%.

Headwinds in the dairy industry appeared as the ASP of nation-wide raw milk continues to decrease in the past few months. It attracts our attention that headwinds in the dairy industry have appeared: ASP of nation-wide raw milk price started to decrease few months ago, after continuous increased between July 2009 and May 2014. By the end of Nov 2014, the average nation-wide raw milk price declined to RMB3.85 per kilogram, a 8.3% decrease compared with its peak price. We expect it will continue to decrease in the following months. Accordingly, we have downgraded the rating of CHD from BUY to HOLD with the target price of HKD1.47, representing a prospective P/E of 11.4x for FY03/15E.

Limited downside risk in the short run due to share purchase plan. In October this year, CHD announced that it has decided to implement a share purchase plan to repurchase shares from the market worth up to a total amount of HKD780.0m. By the end of 1H FY12/15E, the company has used only HKD72.1m to support the price. In another words, the company still has HKD707.9m amount of capital to repurchase its stocks. Thus we think the downside risk of its stock price is quite limited before the purchase amount being used out.

Figure 1: Financials and valuation

	FY03/13	FY03/14	FY03/15E	FY03/16E	FY03/17E
Total revenue (RMB m)	2,552.4	3,530.4	4,648.8	5,346.1	6,148.1
Revenue growth (YoY)	91.5%	38.3%	31.7%	15.0%	15.0%
Gross profit (RMB m)	1,378.1	2,204.6	2,772.3	3,094.3	3,445.8
Gross profit growth (YoY)	150.7%	60.0%	25.7%	11.6%	11.4%
Net profit (RMB m)	1,013.9	1,249.3	1,491.4	1,734.6	1,872.3
Net profit growth (YoY)	128.1%	23.2%	19.4%	16.3%	7.9%
EPS (RMB)	0.08	0.10	0.10	0.12	0.13
P/E (x)	16.7	13.6	11.4	9.8	9.1

Source: Company data, SBI China Capital

1H FY03/15E result in line with our forecast. Last week, China Huishan Dairy (CHD) announced its 1H FY03/15E results. During the period, the company recorded revenue of RMB1,994.8m, a 30.0% YoY increase; gross profit of RMB1,138.1m, a 27.8% YoY increase with the GPM of 57.1%; and profit attributable to shareholders of RMB789.3m, a 53.0% YoY increase. Such increase represents 51.3% of the total profit we estimated for FY03/15E in our initial coverage report and also 52.9% of total profit for FY03/15E under our new estimate. The increase in profit is mainly driven by the expansion of milkable cows and the growing average milk yield, which leads to an increase in the production of raw milk (See Figure 2). Specifically, the number of milkable cows expanded to 65,312 heads during the period, a 6.6% YoY increase; and the average milk yield increased to 9.1 tons per year compared with 8.6 tons per year recorded in the same period last year. Total ASP of raw milk has also picked up from RMB4,823.0 per ton in 1H FY12/14 to RMB5,033.0 per ton in 1H FY12/15E.

What attracts our eyes is its outstanding upstream business, which saved approximately RMB695.1m for its forage cost and strongly supported its performance in 1H FY03/15E. Without its upstream resources, the gross profit recorded in the period would be only RMB443.1m (actual: RMB1,138.1m) and the GPM would drop to 22.2% (actual: 57.1%).

Figure 2: Core operating data in 1H FY03/14 and 1H FY03/15E

Period	Cows	Milkable cows	Averaged milk yield (tons/year)	Production of raw milk (tons)	Raw milk price (RMB/ton)	Liquid milk price (RMB/ton)
1H FY03/14	144,191	61,286	8.6	230,309	4,823	7,222
1H FY03/15E	162,394	65,312	9.1	289,116	5,033	8,500
FY03/15E*	203,029	76,292	9.0	597,366	5,100	8,275

Source: Company data, SBI China Capital

* The data stated here are the ones we assumed in our initial coverage report for its FY03/15E performance.

Headwinds in the dairy industry appeared as the ASP of nation-wide raw milk continues to decrease in the past few months. From Figure 3, it can be easily observed that the average nation-wide raw milk price kept increasing from July 2009 to May 2014. However, it started to decline afterwards. By the end of Nov 2014, the average nation-wide raw milk price decreased to RMB3.85 per ton, a 9.4% decrease compared with the peak price, where RMB4.25 per ton was recorded.

In the long run perspective, we think the downside risk from the decreasing raw milk price is quite high and this trend is likely to continue. Such result is mainly attributable to the increasing number of cows in recent years (See Figure 4). Accordingly, we have downgraded the rating of CHD from BUY to HOLD with the target price of HKD1.47, representing a prospective P/E of 11.4x for FY03/15E.

Figure 3: Average price of nation-wide raw milk

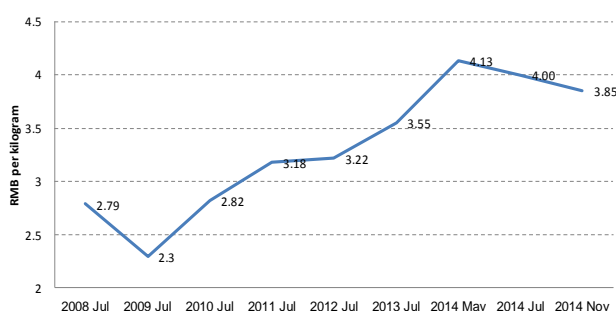
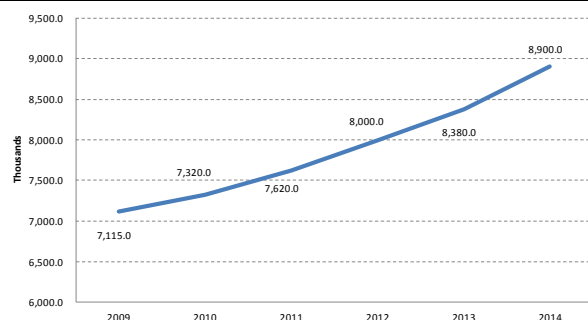


Figure 4: Number of cows in China



Source: WIND

Limited downside risk in the short run due to share purchase plan. Last month, CHD announced that it has decided to implement a share purchase plan to repurchase a total amount up to HKD780.0m worth of shares from the market. By the end of 1H FY12/15E, the company has used only HKD72.1m to support the price (See Figure 5). In another words, the company still has HKD707.9m amount of capital to purchase its stocks in the following days. We think the management and the shareholders will display their confidence to CHD's future and the downside risk of its stock price is quite limited before the purchase amount being fully used out.

Figure 5: Share repurchase activities (By the end of 1H FY12/15E)

Date	Shares	Paid amount (HKD m)	Paid per share (HKD)
Oct-15-2014	8,000.0	14.0	1.754
Oct-16-2014	1,620.0	2.8	1.741
Oct-17-2014	5,804.0	10.1	1.741
Oct-20-2014	13,600.0	23.6	1.737
Oct-21-2014	5,278.0	9.2	1.752
Oct-22-2014	6,870.0	12.3	1.794
Total	41,172.0	72.1	1.752

Source: Company data, Hong Kong Exchange

Valuation. As the risk of declining raw milk price is approaching, we adjusted some operating figures and revised the company's expanding speed of its revenue and profit for FY03/15E and afterwards. Specifically, we forecast its number of cows to reach approximately 203 thousands by the end of FY03/15E, with approximately 37.6% of which are milkable ones. The average milk yield will keep stable at approximately 9.0 tons per year in FY03/15E, compared with 9.1 tons per year achieved in 1H FY03/15E. In addition, we estimate that the raw milk price will slip from RMB5,033 per ton in 1H FY03/15E to around RMB4,950.0 per ton in FY03/15E, and the average liquid milk price to decline from RMB8,500.0 per ton in 1H FY03/15E to RMB8,275.0 per ton in FY03/15E (See Figure 6). Due to the potential decrease of raw/liquid milk price in the following year, we think its revenue growth will slow down from 38.3% in FY03/14 to 31.7% in FY03/15E, and will increase at a rate of 15.0% afterwards. Simultaneously, profit attributable to shareholders will be around RMB1,491.4m, RMB1,734.6, and RMB1,872.3m in FY03/15E, FY03/16E and FY03/16E, respectively.

Figure 6: Key assumptions for its performance in FY03/15E

Cows	Milkable cows	Averaged milk yield (tons/year)	Production of raw milk (tons)	Raw milk price (RMB/ton)	Liquid milk price (RMB/ton)
203,029	76,292	9.0	597,366	4,950	8,275

Source: SBI China Capital

We also revised our target price from HKD2.92 to HKD1.47 based on our expectation to the slowing growth rate. Our target price is derived from our DCF model, which assumes the Weighted Average Cost of Capital (WACC) of 12.7% and the terminal growth rate of 7.0%. In doing so, CHD is trading at a prospective P/E of 11.4x for FY03/15E.

Figure 7: DCF model

	FY03/15E	FY03/16E	FY03/17E	FY03/18E	FY03/19E	FY03/20E	FY03/21E	FY03/22E	FY03/23E	FY03/24E
WACC@12.7%										
FCFF (RMB m)	(1,733.3)	371.7	618.0	1,618.9	1,832.3	2,134.7	2,478.1	2,868.1	3,307.4	3,799.7
Discount Factor	0.9	0.8	0.7	0.6	0.5	0.5	0.4	0.4	0.3	0.3
Discounted FCFF (RMB m)	(1,537.7)	292.5	431.5	1,002.9	1,007.0	1,040.8	1,072.0	1,100.6	1,126.0	1,147.7
PV of estimated FCFF (RMB m)	6,683.3									
PV of terminal FCFF (RMB m)	14,107.1									
Value of Firm (RMB m)	20,790.5									
Minus: debt (RMB m)	(7,120.4)									
Plus: cash and cash equivalent (RMB m)	3,355.3									
Value of Equity (RMB m)	17,025.4									
No. of share (m)-fully diluted	14,740.4									
Intrinsic value of share (HKD)	1.47									

Source: Bloomberg, SBI China Capital

Risks: Major risks to the company include: (1) Sharp decline in the price of raw milk, liquid milk, and milk powder; (2) Sharp increase in the supply of raw milk; (3) Natural disasters, including drought, flood, and animal diseases, which could negatively impact the productivity of its dairy cows; and (4) general execution risks with regard to its new market expansion.

Figure 8: Per share items

	FY03/13	FY03/14	FY03/15E	FY03/16E	FY03/17E
EPS (RMB)					
- basic and diluted	0.07	0.08	0.10	0.12	0.13
DPS (RMB)	-	0.02	0.03	0.03	0.03
BVPS (RMB)					
- basic and diluted	0.40	0.90	0.98	1.07	1.17

Source: Company data, SBI China Capital

Figure 9: Ratio analysis

	FY03/13	FY03/14	FY03/15E	FY03/16E	FY03/17E
Growth (YoY)					
Revenue	91.5%	38.3%	31.7%	15.0%	15.0%
Operating profit	119.6%	22.7%	34.6%	15.1%	8.4%
Margins					
Gross profit margin	54.0%	62.4%	59.6%	57.9%	56.0%
Operating profit margin	47.9%	42.5%	43.4%	43.5%	41.0%
Net profit margin	39.7%	35.4%	32.1%	32.4%	30.5%
Other ratios					
Adjusted return of average assets	11.5%	9.7%	9.6%	9.9%	9.7%
Adjusted return on average equity	30.0%	18.8%	17.4%	17.3%	16.7%
Valuation measures	-				
P/E (x)	16.7	13.6	11.4	9.8	9.1
P/B (x)	2.9	1.3	1.2	1.1	1.0
Dividend yield	-	25.0%	25.0%	25.0%	25.0%

Source: Company data, SBI China Capital

Figure 10: Income statement (RMB m)

	FY03/13	FY03/14	FY03/15E	FY03/16E	FY03/17E
Turnover	2,552.4	3,530.4	4,648.8	5,346.1	6,148.1
Cost of sales	(1,174.3)	(1,325.8)	(1,876.5)	(2,251.9)	(2,702.2)
Gross profit	1,378.1	2,204.6	2,772.3	3,094.3	3,445.8
Loss arising from changes related to biological assets	(86.8)	(68.4)	(78.7)	40.0	46.0
SG&A	(197.5)	(713.7)	(674.0)	(808.8)	(970.6)
Others	128.4	77.6	103.0	90.3	96.7
Profit from operations	1,222.5	1,500.1	2,019.6	2,325.4	2,521.2
Finance costs	(141.6)	(205.7)	(462.8)	(514.8)	(566.8)
Profit before taxation	1,080.9	1,294.4	1,556.7	1,810.6	1,954.4
Taxation	(67.0)	(45.1)	(65.4)	(76.0)	(82.1)
Profit attributable to shareholders	1,013.9	1,249.3	1,491.4	1,734.6	1,872.3
EPS (RMB)	0.08	0.10	0.10	0.12	0.13

Source: Company data, SBI China Capital

Figure 11. Balance sheet (RMB m)

	FY03/13	FY03/14	FY03/15E	FY03/16E	FY03/17E
Non-current assets					
Property, plant and equipment	3,637.0	4,317.2	6,077.3	6,009.9	5,945.5
Biological asset	3,242.0	4,297.7	5,878.9	7,428.2	8,837.6
Others (including goodwill, lease prepayment)	1,685.8	5,122.6	5,225.1	5,329.6	5,436.1
Total non-current assets	8,564.8	13,737.5	17,181.2	18,767.7	20,219.3
Current assets					
Inventories	447.0	915.4	1,144.3	1,430.3	1,787.9
Trade and other receivables	173.0	220.4	253.5	291.5	335.2
Deposit, repayments and other receivable	500.3	1,084.1	1,246.7	1,433.7	1,648.8
Cash and cash equivalents	825.7	5,062.6	3,355.3	3,639.3	4,056.8
Total current assets	1,946.0	7,282.5	5,999.7	6,794.8	7,828.7
Total Asset	10,510.8	21,020.0	23,180.9	25,562.5	28,048.0
Current liabilities					
Trade and other payables	(910.0)	(737.7)	(848.4)	(975.6)	(1,121.9)
Receipts in advance	(14.0)	(26.1)	(30.0)	(34.5)	(39.7)
Accrued expenses and other payable	(434.0)	(489.7)	(563.2)	(647.6)	(744.8)
Amounts due to related parties	(15.0)	0.0	0.0	0.0	0.0
Bank loans	(909.0)	(1,641.2)	(1,841.2)	(2,041.2)	(2,241.2)
Tax payables	(10.0)	(24.5)	(17.3)	(20.9)	(19.1)
Total current liability	(2,292.0)	(2,919.2)	(3,300.0)	(3,719.8)	(4,166.7)
Non-current liability					
Bank loans	(2,103.0)	(4,679.2)	(5,279.2)	(5,879.2)	(6,479.2)
Deferred income	(233.0)	(226.6)	(226.6)	(226.6)	(226.6)
Total non-current liability	(2,336.0)	(4,905.8)	(5,505.8)	(6,105.8)	(6,705.8)
Total liability	(4,628.0)	(7,825.0)	(8,805.8)	(9,825.6)	(10,872.5)
Net asset	5,882.8	13,195.0	14,375.2	15,736.9	17,175.5
Equity	5,883.0	13,195.0	14,375.2	15,736.9	17,175.5

Source: Company data, SBI China Capital

Figure 12. Cash flow statement (RMB m)

	FY03/13	FY03/14	FY03/15E	FY03/16E	FY03/17E
Cash flow from operating activities					
Profit before taxation	1,012.4	1,294.4	1,556.7	1,810.6	1,954.4
Adjustments for:					
Depreciation and amortisation	68.9	160.0	189.9	267.4	264.4
Interest income	(4.3)	(2.0)	(3.0)	(2.0)	(1.0)
Interest expenses	144.2	205.7	462.8	514.8	566.8
Foreign exchange (gain)/loss	0.5	(1.6)	1.2	(1.7)	0.6
Government grants amortisation	(6.8)	(7.0)	(6.0)	(5.0)	(2.0)
(Gain)/loss arising from the changes in fair value related to biological assets	86.8	68.4	78.7	(40.0)	(46.0)
Changes in working capital	228.4	(1,204.1)	(236.5)	(294.9)	(367.7)
Others	(33.3)	0.0	0.0	0.0	0.0
Cash generated from operations	1,496.9	513.8	2,043.8	2,249.2	2,369.5
PRC income tax paid	(53.8)	(30.6)	(72.6)	(72.4)	(83.9)
Net cash generated from operating activities	1,443.1	483.2	1,971.2	2,176.8	2,285.6
Cash flow from investing activities					
Payments for purchase of property, plant and equipment	(488.4)	(1,950.0)	(1,950.0)	(200.0)	(200.0)
Lease prepayments	(75.7)	(3,621.0)	(94.7)	(95.8)	(104.2)
Proceeds from disposal of property, plant and equipment	26.0	0.0	0.0	0.0	0.0
Payments for purchase of biological assets	(197.0)	(550.0)	(593.9)	(550.0)	(500.0)
Payments for breeding calves and heifers	(806.0)	(926.9)	(1,065.9)	(959.3)	(863.4)
Others	174.0	(15.0)	0.0	0.0	0.0
Net cash generated from investing activities	(1,367.1)	(7,062.9)	(3,704.5)	(1,805.1)	(1,667.6)
Cash flow from financing activities					
Cash received from contributions by investors of the Group	907.0	7,544.0	0.0	0.0	0.0
Net proceeds from new bank loans	385.9	3,478.3	800.0	800.0	800.0
Interest paid	(191.0)	(205.7)	(462.8)	(514.8)	(566.8)
Others	(852.5)	0.0	(311.2)	(372.8)	(433.6)
Net cash generated from financing activities	249.4	10,816.6	26.0	(87.7)	(200.5)
Opening balance of cash and cash equivalent	513.0	825.7	5,062.6	3,355.3	3,639.3
Net change	325.4	4,236.9	(1,707.3)	284.0	417.5
Effect of foreign exchange rate changes	(12.6)	0.0	0.0	0.0	0.0
Closing balance of cash and cash equivalent	825.7	5,062.6	3,355.3	3,639.3	4,056.8

Source: Company data, SBI China Capital

SBI China Capital is a dedicated small/mid cap investment banking/ stockbrokerage house. Find our research on: research@sbichinacapital.com, thomsononeanalytics.com, factset.com and multex.com

SBI China Capital stock ratings:

- STRONG BUY** : absolute upside of >50% over the next three months
- BUY** : absolute upside of >10% over the next six months
- HOLD** : absolute return of -10% to +10% over the next six months
- SELL** : absolute downside of >10% over the next six months

Investors should assume that SBI China Capital is seeking or will seek investment banking or other related businesses with the companies in this report.

Analyst certification: The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer:

This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of SBI China Capital Financial Services Limited ('SBI China Capital') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by SBI China Capital or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of SBI China Capital as of the date of this report only and are subject to change without notice. Neither SBI China Capital nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. SBI China Capital and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. This report is distributed in Hong Kong by SBI China Capital. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of SBI China Capital located in such recipient's home jurisdiction.

Copyright© SBI China Capital Financial Services Limited. All rights reserved.