

Deal Terms

1 BAL = A\$13.25 /share in cash

Target: Sotheby's

Country	Australia
Bloomberg	BAL AU
Sector	Package Food
Share price (AUD)	12.92
Market cap (AUD bn)	1.46
Free float %	~61

Acquirer: China Mengniu Dairy Co Ltd

Country	Hong Kong
Bloomberg	2319 HK
Sector	Packaged Food
Share price (HKD)	30.05
Market cap (HKD mn)	118,169.90
Free float %	68

BAL Price Chart



Status: Deal announcement: September 16, 2019

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Bellamy's (BAL AU) / China Mengniu (2319 HK) Scheme of Arrangement

We believe FIRB will ultimately approve the deal given the nature of BAL's business the deal should not be a concern from national interest viewpoint if owned by a foreign company. We think that there might be a better entry point after counterbid expectation fades away.

CBR View: We believe that there are three key risks (FIRB, shareholder approval, counterbid) to the deal.

- In our opinion, FIRB is the greatest risk given Chinese government holds a major stake in the bidder via an SOE – COFCO.
- Politicians are concerned with the deal. Tasmanian independent federal MP Andrew Wilkie has already said that the FIRB will need to undertake "a very stringent assessment of whether or not the public interest is served by the (Bellamy's) sale going through".
- Another Australian politician also highlighted that this whole deal is being structured by the Chinese state to gain control of an Australian brand.
- He mentioned that Chinese government intentionally delayed BAL's China products approval process in order to depress its price and made its move after the share price slumped.
- However, we disagree with this as we think that Chinese regulators have recently stepped up the regulation to manage the country's infant formula market. This might be the reason for an extended review time for the approval.
- Bellamy's chief executive Andrew Cohen has said that the \$1.5 billion offer from Mengniu would not "change the likelihood" of Bellamy's receiving Chinese approval.
- We also note that CEO of BAL's rival dismissed suggestions that Chinese authorities delayed BAL's approval. She said China has taken a logical and sensible step to regulate the industry.

Despite the reasons mentioned above, we believe that FIRB will ultimately approved the deal given the following.

- BAL's chairman said he was feeling very positive about gaining all clear from FIRB.
- We note that BAL is purely a manufacturing business along with a distribution network. It does not own any sensitive land or any other agricultural infrastructure as was the case with the Kidman deal which was blocked by FIRB.
- We see that the industry is highly regulated. Certifications should be obtained from the relevant authorities before companies can start selling their products. Therefore, we believe even if the owner is Chinese, it is highly unlikely that the business will adversely impact Australians.
- The deal can result in acceleration of growth at BAL due to expansion into China. This will create more jobs for Australians.
- BAL has a small market share (3% of the overall baby category, as per Wikipedia) in the category, although we think that the relevant product market will be defined as "premium brands". We see that there are 3 major brands in this category along with several small players, and therefore, we think consumers will continue to have sufficient choices even if BAL will not be able to deliver under Mengniu.
- We believe that it also presents the Australian government a chance to smooth relations between the two countries by approving this relatively less sensitive deal.
- There are precedents within the dairy industry where FIRB/OIO approved the deal and the buyer was Chinese.
 - Chinese businessman Xianfeng Lu bought Australia's dairy farm in 2015 (FIRB).
 - Yili bought Westland Co-operative in 2019 (OIO).
- We also note that COFCO has been involved in an acquisition of a Dutch company, Nidera, which is a major international agribusiness and trading company.

As far as shareholder approval is concerned, we think it is mainly dependent on the largest shareholder, Jan Cameron, who holds around 18% stake in BAL. We note that the talks with Mengniu were led by chairman of the board and chairman, both of whom are close to Jan Cameron, as they were involved in replacing three board members in 2017.

- Based on the above, we believe that BAL's board members were aware of the price level at which Jan Cameron must be willing to approve the deal. Hence, we think the price agreed by the board should be enough for Jan Cameron.
- We also note that the deputy chairman of takeover target BAL's Australia said he's had a "very positive first chat" with the group's largest shareholder Jan Cameron

With respect to counterbid, we cannot completely rule out a counterbid given the growth potential of the business in China, while a non-Chinese buyer might face difficulties with regards to navigating the regulatory landscape in China. Although the pool of potential counterbidders is small given the size of BAL, there might be some international players interested in BAL (Danone/Nestle).

- We see that the deal comes with a highly attractive premium of 59% to the pre-bid share price.

Downside: Based on pre-deal announcement trading, we believe the downside should be in the range of A\$7.50-A\$8.00.

Key terms of the merger

Merger Details

■ Deal announcement	September 16, 2019
■ Offer terms	1 BAL AU = A\$ 13.25 per share in cash Consideration is made up of the following: <ul style="list-style-type: none"> • A\$ 12.65 cash per share • A\$ 0.60 per share special dividend
■ Deal size (equity value)	A\$ 1.5 bn
■ Offer structure	Scheme
■ Target's Board Recommendation	Yes
■ Voting Agreement	No
■ BAL incorp.	Australia
■ Mengniu incorp.	Cayman Islands
■ Merger Agreement	Click here
■ Synergies	Not disclosed

Capital Structure

- BAL
 - **Equity:** BAL has 113.4 shares outstanding as at September 17, 2019.
 - **Debt:** Net cash: A\$112.3 mn (\$2 2019)

Indicated Closing Date

- The transaction is expected to close prior to the end of 2019.

Dividends

- The company does not pay dvd.

Financing

- We believe it should be relatively easy for Mengniu to arrange financing given its reputation and size.

Timetable

■ Deal announcement	September 15, 2019
■ BAL submits draft scheme to ASIC	October 14, 2019
■ Mengniu to execute Deed Poll	October 25, 2019
■ First court hearing for scheme	October 29, 2019
■ BAL sends scheme to BAL's shareholders	November 1, 2019
■ Scheme meeting	December 4, 2019
■ Second court hearing	December 6, 2019
■ Effective date	December 9, 2019
■ Scheme record date	December 17, 2019
■ Implementation date	December 24, 2019

Company Solicitation

There is a clause related to no current discussions (no shop/no talk) regarding a competing proposal with fiduciary out prior to shareholder vote.

- There is a 5-business days matching period for the bidder.

Superior Proposal

- "Company Superior Proposal" means a bona fide, written competing proposal received after the date of this deed that the BAL's board determines, acting in good faith, would, if completed substantially in accordance with its terms, be more favorable to BAL's shareholders than the scheme. Any such determination may only be made after consultation with BAL's legal and financial advisers.

Key Conditions to the Merger

■ Shareholder approval	■ Yes:	○ BAL's shareholder approval
■ FIRB	■ Yes	
■ Court approval	■ Yes	
■ No restraints	■ Yes	
■ No BAL's MAC	■ Yes	
■ No BAL's prescribed occurrence	■ Yes	
■ Best endeavours and cooperation	■ Yes	

MAE Definition

"Company Material Adverse Effect" means an event, occurrence or matter which has resulted in, or is reasonably likely to result in, either individually or when aggregated with all such events, occurrences or matters:

- A diminution in the consolidated net assets of the BAL's group by an amount equal to A\$35 mn or more, as compared to what the consolidated net assets of the BAL's group could reasonably be expected to have been but for the relevant events, occurrences or matters; or
- The consolidated annual EBITDA of the BAL's group being reduced (on a recurring basis) by an amount more than A\$10 mn, as compared to what the consolidated annual EBITDA of the BAL's group could reasonably be expected to have been but for the relevant events, occurrences or matters,

MAE Carve-Outs

In each case other than an event, occurrence or matter:

- (1) required or expressly permitted by this deed or the scheme
- (2) which Mengniu has previously approved
- (3) to the extent that it was fairly disclosed in the due diligence material
- (4) fairly disclosed to ASX within 3 years prior to the date of this deed
- (5) arising from any change in law or regulatory or administrative ruling
- (6) arising from general economic, political, business or trading conditions in the markets and jurisdictions in which BAL's group operates
- (7) arising from an act of terrorism, war, or natural disaster
- (8) relating to third party costs and expenses incurred by BAL's associated with the transaction

Termination Fees

- "Bellamy's Break Fee" means A\$14.3 mn. It will be paid in case of:
 - Superior proposal

Key Shareholders

BAL

Shareholders	%
BLACK PRINCE PRIVATE FOUNDATION	11.8
JPMorgan Chase & Co	7.8
Janchor Partners Ltd	7.7
FORT CANNING INVST	6.9
Quality Life Pty Ltd	5.8
JAN CAMERON	5.4
Delta Partners LP	4.8
Norges Bank	3.8
Vanguard Group Inc/The	2.5
Dimensional Fund Advisors LP	1.9
Others	41.6

Source: Bloomberg, CBR

Company Descriptions

BAL's Description

Company's business

History

- Established by David Bellamy and Dooley Bellamy in northern Tasmania in 2003, Bellamy's was an early entrant into the organic food market, producing Australia's first organically certified baby food in 2003 and first organic baby formula in 2005. To date Bellamy's is the only Australian-made organic infant formula on the Australian market.
- The company was founded by a small group of investors, including the Bellamy family, and was acquired by Tasmanian Pure Foods Ltd in 2007. In June 2014 Tasmanian Pure Foods was renamed Bellamy's Australia. Following a highly successful July 2014 IPO, Bellamy's Australia Limited (BAL) listed on the Australian Stock Exchange (ASX) on 5 August 2014. Heavy trading and a more than 30% rise in initial share price saw the launch of the company deemed an "outstanding success" by financial industry commentators.
- In December 2016 Bellamy's Australia suspended trading of shares following a tumultuous fortnight for the organic group, which had half a billion dollars wiped off its value on Friday, 2 December.
- In April 2017, Bellamy's confirmed acting CEO Andrew Cohen as its permanent chief executive. In June 2016, Cohen, formerly of Bain & Company, was appointed to the role of Chief Operations & Strategic Officer, before being appointed acting CEO in January 2017. The appointment of financial advisor and Acting CFO Nigel Underwood was also finalised in April 2017.[4] Underwood, formerly CFO of transport operator Keolis Downer, was appointed to the role of Acting CFO on in January 2017 and subsequently made permanent in that role in April 2017.
- In May 2017, Bellamy's Australia appointed John Ho of Hong Kong-based investment firm Janchor Partners as chairman.

Products

- The company's product range includes infant formula, follow-on formula, toddler milk, baby rice, baby porridge, apple and cinnamon breakfast, teething rusks, brown rice pasta, baby macaroni and spelt pasta, grain and fruit snacks, ready to serve baby meals, and vegetable macaroni. Products are developed for three specific age groups, targeting newborns

(0–6 months), infants (6–12 months) and toddlers (1–3 years). In 2014 this range was expanded to include organic milk drinks for children in the 3+ years age group. Bellamy's Ready2Go UHT product is a supplementary food for children created to complement the dietary needs of toddlers and children who may require additional energy and nutrients.

Certification

- In Australia, the company's products are certified organic by the National Association for Sustainable Agriculture Australia (NASAA), which is an independent certifying body authorised by the United States Department of Agriculture (USDA), and which also holds accreditation under the US National Organic Program (USNOP) and the Japanese Agricultural Standard (JAS).
- The principal competitive advantage and differentiator of the Bellamy's brand within its markets is their Australian-made and certified organic product guarantee. The company backs the authenticity of this statement by maintaining a rigorous focus on their supply chain and source of raw materials, as well as by maintaining independent Australian certification for each product. This guarantee is increasingly important with respect to the Chinese market, where the gradual erosion of the credibility of locally produced and certified "organic" products link has seen local buyers increasingly preferring "premium" and "super-premium" imported organic products.
- Bellamy's has held individual organic certification for China since 2008.[9] however in May 2014, Beijing required companies to go through a new registration process to import infant formula into China, temporarily halting imports. Bellamy's has since secured Chinese certification for its organic milk formula product, along with accreditation to register a company in China.
- The company's formula and cereal products are certified Halal by the Islamic Coordinating Council of Victoria (ICCV). ICCV is the major Islamic organisation responsible for the certification, monitoring, and supervision of Halal food exports from Australia.

Mengniu

Company's business

- China Mengniu Dairy Company Limited is a manufacturing and distribution company of dairy products and ice cream in the People's Republic of China. The company is based in Inner Mongolia and manufactures dairy products under the Mengniu brand.
- In July 2009, Mengniu sold a 20% stake to a consortium led by state-owned China National Oils, Foodstuffs and Cereals Corp, China's largest importer and exporter of food. That sale made the state the single largest shareholder.
- Mengniu's products include liquid milk products, such as ultra heat treated (UHT) milk, yogurt and milk beverages, ice cream and other dairy products, such as powdered milk and milk tablets. During the year that ended 31 December 2015, the company operated 33 production bases with an aggregate annual production capacity of 8.68 million tons. China Mengniu Dairy Company Limited's operates in three segments: the liquid milk products segment, which manufactures and distributes processed UHT milk, milk beverages and yogurt; the ice cream products segment, which manufactures and distributes ice cream products, and the other dairy products segment, which manufactures and distributes processed milk powder and milk tablets products. The name Mengniu literally means 'Mongolian cow'.
- Mengniu was among those named for having powdered milk samples which tested positive for melamine. The company recalled tainted powdered milks and apologised to the public. Trading in Mengniu shares on the Hong Kong Stock Exchange was suspended on 17 September. Shares in other dairy companies fell strongly the next day. On discovery that their liquid milk was also contaminated, Mengniu was stripped of its status as 'Chinese national brands'.

COFCO

Company's business

- COFCO full name China National Cereals, Oils and Foodstuffs Corporation, is one of China's state-owned food processing holding companies. COFCO Group is China's largest food processor, manufacturer and trader.
- Founded in 1949, it is one of the largest SOEs of those under the direct supervision of China's State Council. Between 1952 and 1987, it was the sole agricultural products importer and exporter operating under direct control of the central government. In 2007, COFCO had just over 60,000 employees in multiple locations in China as well as overseas operations in countries such as the US, UK, Japan, Australia, and Canada.
- Besides the foodstuff business, COFCO has developed itself into a diversified conglomerate, involving planting, cultivation, food-processing, finance, warehouse, transportation, port facilities, hotels and real estate. It is one of the top 500 enterprises chosen by US's Fortune Magazine.
- COFCO has four companies listed in Hong Kong, namely, China Foods (SEHK: 506), China Agri-Industries Holdings (SEHK: 606), Mengniu Dairy (SEHK: 2319), and COFCO Packaging Holdings (SEHK: 906) and three companies listed in mainland China, namely, COFCO Tunhe (SSE: 600737), COFCO Property (SZSE: 000031), and BBKA (SZSE: 000930). COFCO boasts a wide range of branded products and service portfolios, such as Fortune edible oil, Great Wall wine, Mengniu dairy, Lohas fruit and vegetable juice, Le Conte chocolate, Tunhe tomato products, Joycome meat products, Joy City shopping mall, Yalong Bay resorts, Gloria hotels, Snow-Lotus cashmere, Zhongcha tea products, COFCO-Aviva Life Insurance, COFCO Trust, etc.

Strategic Rationale

- We believe that Mengniu sees a huge opportunity in expanding BAL's reach in China, especially if it would be able to get the required SAMR approvals for BAL's Chinese business.
- We note that BAL is a premium brand and Mengniu want to get hold of the brand to capitalise on the trend of increased luxury spending in China.

CBR View

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LBO

In our base case scenario, we assume:

- Bid price at \$13.25 per share;
- Net debt as per BBG;
- EBIT FY1, FY2, FY3 based on BBG estimates;
- Tax rate: 30%;
- WACC: 6%;

Deal value (AUDm)	FY1	FY2	FY3
<i>Bid price (AUD/sh.)</i>	13.25	13.25	13.25
<i>O/S (m)</i>	113	113	113
Market value (AUDm)	1503	1503	1503
Net Debt (AUDm)	-112	-112	-112
Deal value (AUDm)	1390	1390	1390
ROIC calculation			
BEST Operating Profit	46	59	71
<i>Synergies</i>	0	0	0
Adj. Operating Profit	46	59	71
<i>Tax (30%)</i>	14	18	21
NOPAT	32	41	50
ROIC	2.3%	3.0%	3.6%
WACC	8.0%	8.0%	8.0%

Source: Bloomberg, CBR

Disclosures:

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