Analysis of Dairy M&A: Evidence from Acquisition of Ausnutria by Yili Diary

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Abstract. Nowadays, dairy industry has shown a diversified development trend, all kinds of dairy enterprises not only produce room temperature milk, yogurt, infant formula, goat milk powder track also gradually become the goal of dairy enterprises development. A number of dairy companies have previously implemented acquisitions aimed at developing the goat milk powder, such as Mead Johnson's acquisition of Mercurial. Yili Corporation ("Yili"), as a leading company in China's dairy industry, aims to complete its industrial structure and expand the development of goat milk powder. From 2020 to 2022, Yili, through its wholly-owned subsidiary, Hong Kong Jingang Trade Holding Co ("Jingang"). After the acquisition, Yili became the sole major shareholder. With this acquisition, both parties aim to reap synergies and seek the operational benefits of 1+1>2. The purpose of this paper is to examine the financial impact of this merger on both companies and to make recommendations for future mergers and acquisitions of related dairy companies. According to the analysis, this paper figure out that M&A plays a strategic role for both companies, facilitating the integration and utilization of resources of both companies, bringing a win-win situation for both parties. However, the long-term impact of the M&A will require ongoing attention. These results shed light on guiding further exploration of the M&A of dairy products enterprise.

Keywords: M&A, dairy products, dairy industry.

1. Introduction

The competition in the milk powder market has intensified in recent years, and as the birth rate in China has slowed down (as shown in Fig.1), with the market for infant formula shrinking significantly and the growth rate has decreased. In China, there is overcapacity in milk powder, and the sales of many small brands are gradually declining. However, as some small brands completed registration under the National Infant Formula Requirements promulgated by China in 2017, they are holding the first batch of products that completed registration. Therefore, at the end of the five-year validity period, these small enterprises have the right to gain "second formula registration". If large dairy enterprises want to enrich their product range and broaden their sales channels, acquiring these small dairy enterprises with "secondary formula registration" is a good choice. Small enterprises are forced to survive production pressure, but also have the intention of seeking help from large enterprises.

More and more dairy companies are realizing that Chinese dairy market has changed from being dominated by milk products to a situation where milk and goat milk products are going hand in hand, so many large dairy companies want to enter the goat milk powder track. In the beginning of 2019, many large dairy companies have started to acquire companies with goat milk powder production lines to quickly enter the goat milk powder market through M&A. 2019, Jianhe acquired 100% of the shares of Australian Farmers Dairy in July 2021, Feihe acquired Xi'an Xiaoyang. Following the change of the largest shareholder of Mead Johnson to Primavera Capital at the end of 2021, in February of the same year, Mead Johnson acquired the well-known domestic goat milk powder brand Milkgoat; in March of the same year, Danone subscribed 95% of the shares of Hunan Eurbest, and became the new largest shareholder. Danone aimed to solve the formula registration problem through the acquisition of Chinese factories, as well as the layout production of goat milk powder.

In recent years, most of the acquisitions and M&As among domestic dairy enterprises are strategic in nature to seek synergy effects of 1+1>2. Based on Bright Dairy's acquisition of New Zealand's New Wright Dairy, Li suggests that the horizontal M&A synergy effect of dairy enterprises is divided into operational synergy, R&D synergy and financial synergy [1]. The operational effect is

specifically that large dairy companies with abundant capital provide small dairy companies with benign expansion channels and sales channels; the role of small dairy companies to large dairy companies is to enrich their product range and provide large dairy companies with the most convenient access to the market based on their own existing special product markets. For example, Bright Dairy uses the advantages of New Lite in the mid- to high-end infant product market to accelerate its entry into the mid- to high-end market. R&D synergy is reflected in the fact that large dairy companies use their own high-end technology, together with small dairy companies have the advantage of origin and milk source to complement each other. Financial synergies are reflected in the low-cost access to financing and the expected higher capital premiums. In the case study of COFCO's M&A of Mengniu Dairy, Cao pointed out that strategic M&A is based on their respective resource advantages, and due to strategic needs, such as corporate expansion, M&A and restructuring, by optimizing the allocation of capital, milk sources and markets between the two enterprises, synergistic effects are generated in favor of both parties, creating a greater value than both parties' independent business activities [2]. Saksonova argued that the synergy effect between dairy enterprises should be for the improvement of the business value of the enterprise as well as the creation of new value [3].

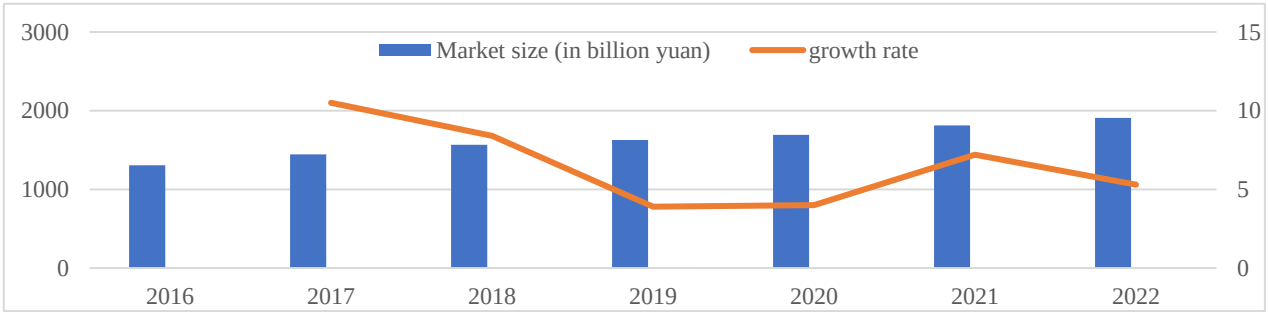


Figure 1. China infant formula market size, 2016-2011.

In Du's analysis of the case of New Hope Dairy's M&A of Huanmei Dairy, she concluded that mergers and acquisitions between dairy enterprises can reduce geographical barriers and expand the dairy market in different segments of the country and even globally [4]. What's more, merging small dairy enterprises can provide new business growth points for large dairy enterprises in specific commodities; sharing dairy processing equipment, milk sources, and dairy production technology between enterprises is beneficial to saving operating costs. Due to the adjustment of the capital model after the M&A, the solvency and capital turnover of enterprises will be affected to a certain extent. Wang analyzed the globalization of dairy enterprises' M&A, pointing out that: along with Mengniu, Yili, Guangming and other large domestic dairy companies merging and acquiring foreign dairy enterprises and farms, the supply of domestic dairy products will further increase; at the same time, the survival space for small and medium producers will be further squeezed [5]. Therefore, small, and medium dairy enterprises may inevitably face the fate of being reorganized by M&A. Afterwards, optimizing the enterprise structure, the technical capacity, output level, capital acquisition, etc. will be improved in the future. The competition among dairy enterprises will be more intense in the future. Chen concluded from a study of M&A of Chinese local dairy companies that Chinese acquirers significantly enhance corporate social responsibility, as the acquisition of farms and dairies in overseas countries is subject to the laws of different countries and is an effective way to improve corporate reputation; and the acquisition of overseas dairy companies by Chinese dairy companies also stimulates green innovation [6]. However, Grau in the study of M&A among German dairy enterprises, analyzed that German dairy enterprises still face difficulties in raising capital after M&A currently; the lack of external capital investment makes the enterprises lack the corresponding financial support in establishing big brands and entering foreign markets [7].

Saksonova in Mergers and acquisitions: examples of best practice in Europe and Latviastates that dairy companies have the following characteristics: global dairy companies are unevenly distributed; some dairy products are perishable and generally dairy companies have international markets (selling

perishable dairy products) and domestic markets (selling fresh dairy products). The dairy market is not a monopoly market, and large and small dairy companies coexist; the demand for dairy products is high and the supply is limited, and the number of M&A between dairy companies has increased in the last decade. Therefore, the study of M&A among dairy companies is relevant to analyze the changes in the origin of dairy products, application of dairy technology, and market structure of dairy companies after their M&A. It is useful to assess the future development prospects of the dairy industry and to observe the economic effects of dairy enterprises after M&A.

Yili's acquisition of Ausnutria is the largest acquisition of a dairy company in the last decade. Yili is a well-known Chinese dairy company, and its acquisition of Ausnutria, which has a complete goat milk powder industry chain, is a strong combination with significant strategic significance. Yili can use the existing production line of Ausnutria to broaden the production and sales of goat milk powder, and Ausnutria can use Yili's large platform to seek development. The analysis will help to understand the impact of M&A between dairy companies on the development of dairy companies, and to understand the changes in the sales of goat milk powder after the acquisition of Auyou Dairy by Yili, which will give a glimpse of the development prospects of goat milk powder in the Chinese market. This paper will introduce the corporate background of Yili and Ausnutria, describe the background of the acquisition case and the acquisition process, then analyze the results of the acquisition, and finally provide suggestions and opinions on future acquisitions of dairy companies.

2. Case Description

2.1. Company Introduction

Founded in 1993, with a long history, Yili is the largest and most complete dairy company in China which was listed on the SSE in 1996. Over the years, Yili Group has steadily ranked as the number one dairy company in the world and the number one dairy company in Asia for eight consecutive years.Bothe its international and domestic status is equally remarkable.

Ausnutria was established in 2003 and listed on the HKEx in 2009, making it the first domestic infant formula company to be listed in Hong Kong. Ausnutria has processing plants around the world and has completed its R&D layout in the Netherlands and New Zealand. Ausnutria ranks fifth in the share of infant formula in China, and the sales of Ausnutria ' s formula goat milk powder have accounted for more than 60% of the total imports of domestic infant formula goat milk powder for many years, ranking first in global sales of goat milk powder.

2.2. Background of the Acquisition

At the end of 2020, CITIC Agricultural Industry Fund, the largest shareholder of Ausnutria, released news declaring its intention to sell its stake in Ausnutria and had previously contacted with several famous dairy companies such as Yili, Mengniu and Junlebao [8]. In 2021, Reckitt Benckiser, LSE: RB, the largest shareholder of Mead Johnson, chose to sell its entire stake in the company. When the news was released, it attracted investment institutions including CITIC, and dairy companies such as Junleb, New Hope and Yili were interested in acquiring it. However, the shares of Mead Johnson were eventually taken by Primavera Capital alone, and Yili lost its opportunity in the acquisition. Then, the market of goat milk powder boomed, and Yili turned its attention to Ausnutria in order to improve its product line. On October 27, 2021, Yili and Ausnutria made a joint announcement that Yili's subsidiary Jinggang had acquired Ausnutria's shares, becoming the sole majority shareholder of Ausnutria, completing the largest transaction in the history of Chinese domestic dairy M&A.

2.3. M&A Process

Yili's acquisition of Ausnutria is divided into two aspects: first, Jingang purchased all shares from CITIC Agricultural Industry Fund, the largest shareholder of Ausnutria, at a price of HK$10.06 per share, totaling 530 million shares; second, Jingang subscribed for 90 million new shares of Ausnutria

at a price of HK$10.06 per share in Ausnutria's targeted issuance program. The total transaction amount reached over HK$6 billion. After the acquisition is completed, Yili subsidiary Jingang holds 34.33% of Ausnutria's shares and will become the sole major shareholder. The top 5 shareholders of Ausnutria will be changed to: 34.33% held by Jingang; 7.23% held by Shengde Pharmaceuticals; 6.71% held by Ausnutria Chairman Yan Weibin; 5.23% held by Ausnutria CEO Bartle van der Meer and his wholly owned subsidiary; and 5.23% held by Citagri Easter Ltd, a wholly owned subsidiary of CITIC Agricultural Industry Fund, holds 5.11% of the shares. In March 2022, Ausnutria and Golden Harbor Holdings made a joint announcement that Yili had launched a new round of offer with Ausnutria. Specifically, on March 3, 2022, Golden Harbor Holdings received 18.39% of the shares accepted by Ausnutria, which, together with the 34.33% previously acquired, will result in Golden Harbor Holdings holding 52.7% of Ausnutria's issued shares upon the conclusion of the general offer. On March 17, 2022, Golden Harbor Holdings officially became a shareholder of Ausnutria Dairy and completed the general offer (as depicted in Fig.2).

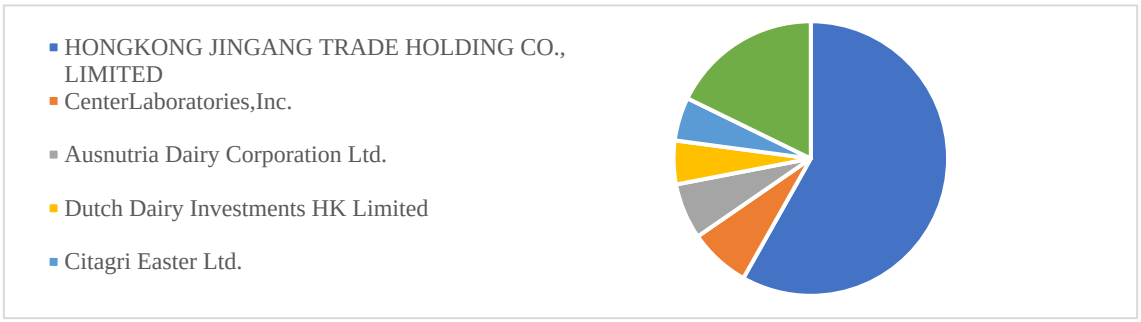


Figure 2. The shareholding ratio of Ausnutria Dairy as of June 2022 (unit: %).

2.4. M&A Follow-up

On September 23, 2022, Yili and Ausnutria signed a series of treaties to clarify Ausnutria's role in Yili's overall production line, including: a framework agreement for processing services, a framework agreement for supply, and a framework agreement for procurement. From supply to procurement to sales, all of these are indicative plans for the next operations of Ausnutria. With effect from 20 April 2022, Qiao Baijun, a former non-executive director of Ausnutria, resigned and Liu Junhui, an independent non-executive director, resigned, among others. Yili has appointed a new team of directors for Ausnutria.

3. Analysis

In 2020, the market share of Ausnutria and Yili by sales of infant formular was 6.3% and 6.2%, respectively (seen from Fig. 3). With a combined market share of 12.5%, they surpassed Nestle (11.7% market share) to become the second in the industry.

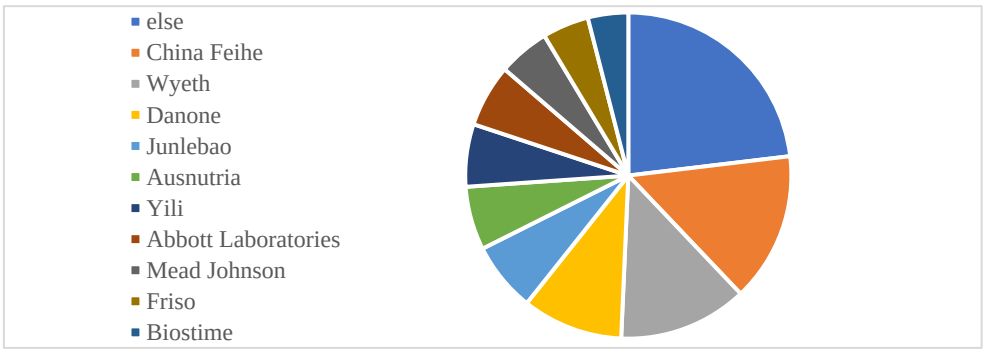


Figure 3. The proportion of Chinese infant formular brands in 2020 (unit: %).

3.1. Analysis of the Financial Structure

Following the M&A in March 2022, Ausnutria's shares began to be consolidated into Yili Group's financial statements in the second quarter of 2022, and the combined size of Yili and Ausnutria exceeded RMB 120 billion after the consolidation. Ausnutria's 2021 financial results given in Table. 1 show that assets totaled HK$11.6 billion and liabilities totaled HK$4,923 million. In the first quarter of 2022, Ausnutria's assets totaled HK$11 billion and liabilities totaled HK$4,002 million (as revealed in Table 1). After the acquisition, the asset-liability ratio of Ausnutria Dairy was significantly reduced, from 42.3% at the end of 2021 to 36.4% in June 2022. However, due to the decrease in debt, the long-term funding to heavy assets ratio of the company fell, indicating that long-term debt is less leveraged to heavy assets. Yili's 2021 financial results show that assets total RMB 102 billion and liabilities total RMB 53.2 billion. By September 2022, Yili's assets reached RMB 125 billion and liabilities increased to RMB 73.3 billion due to the completion of the acquisition of Aussie Dairy. As a result of the increase in liabilities, Yili's financial statement for 2022-9 (as presented in Table 2) shows that Yili's asset-liability ratio reached 58.5%, an increase from 52.1% in 2021, but this fluctuation in gearing can be considered normal as Yili's gearing ratio has been above 50% for the past five years and the capital requirements caused by the acquisition of Ausnutria.

Table 1. Ausnutria Balance Sheet Analysis in Hong Kong dollars

Numble	2021	2022-6
Total assets	11.6billion	11billion
Total liabilities	4,923million	4,002million
Total Stockholders‘ equity	6,727million	6,000million
Asset-liability ratio (%)	42.3	36.4
RATE (%)	849.6	278.8

Table 2. Yili Balance Sheet Analysis

Numble	2021	2022-9
Total assets	102billion	125billion
Total liabilities	53.2billion	73.3billion
Total Stockholders‘ equity	48.8billion	52billion
Asset-liability ratio (%)	52.1	58.8
RATE (%)	177.2	186.2

Table 3. Yili Balance Sheet Analysis in RMB

Numble	2021	2022-9
Operating revenue	10.90billion	9.89billion
Operating profit	1.70billion	1.12billion
Profit before tax	1.51billion	0.92billion
Net profit	1.27billion	0.80billion
Operating profit ratio (%)	15.7	11.4
Asset-liability ratio (%)	0.74	046
RATE (%)	19.8	11.7

3.2. Analysis of the Profitability

The acquisition of Ausnutria also had an impact on Yili's performance (as listed in Table 3). Unlike the expected strong combination and high growth in performance, Yili's performance did not meliorate after the incorporation of Ausnutria shares into the scope of the merger, with a high increase in inventory size and a decline in inventory turnover, and the third quarter net profit attributable to the mother company also showed a decline. The 2022 interim financial report shows that after the consolidation of Ausnutria, Yili's asset impairment loss and inventory balance showed a significant increase, with inventory balance of about 11.4 billion RMB, up 2.507 billion RMB from the beginning

of the period; provision for inventory impairment/impairment of contract performance costs was 233 million RMB, up 72 million RMB from the beginning of the period; inventory impairment loss and impairment loss of contract performance costs was 118 million, an increase of RMB 0.8 billion from the beginning of the period. Ausnutria achieved full-year revenue of RMB 8.87 billion in 2021, an increase of 11.1% year-over-year, and net profit attributable to the mother company was RMB 1.04 billion, an increase of 3.6% year-over-year. Although Ausnutria 's revenue and net income appear to be "double growth", the lower growth rate compared to previous years indicates that Ausnutria 's profitability is weakening. The main reason is that in 2020, due to the epidemic reasons, the market demand for Ausnutria's own branded goat milk powder, kabrita, surged, resulting in inflated sales; in 2021, the sales of kabrita decreased, affecting Ausnutria's overall sales. In addition, due to limited marketing activities, kabritas' marketing revenue only recovered in the first half of fiscal 2021.

Unlike the "double growth" achieved in 2021, the report shows that Ausnutria's revenue and net profit both decreased, with revenue down 14.88% and net profit down 62.94% year-over-year. The report showed that both revenue and net profit of Ausnutria had negative growth, with revenue decrease 14.88% and net profit down 62.94%. In addition, due to the decline in demand for infant milk powder, the operating income of Ausnutria and the biggest challenge facing Ausnutria is the high inventory turnover days, indicating in Fig.4, which reached an all-time high of 201.7 days in June 2022, with inventory size accounting for 24.23% of all assets. Compared to dairy companies in the same industry, the ratio of inventory to all assets for Beingmate and Feihe is only 9.28% and 4.83%, respectively. Owing to the multiplication of inventory pressure, Ausnutria can only make concessions to consumers and sellers in order to expand sales channels, resulting in Ausnutria's profit margin being at a disadvantage compared to its peers in the industry in recent years. And due to the shelf life of milk powder, consumers are hesitant about the high inventory status of Ausnutria.

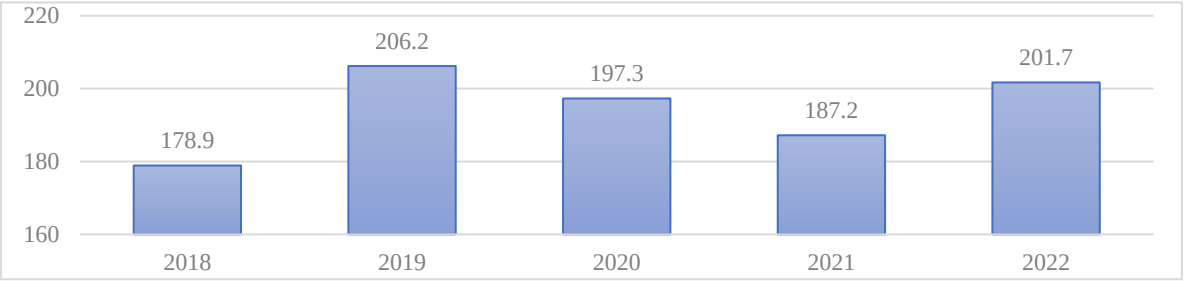


Figure 4. Days sales of inventory of Ausnutria

However, in the first half of 2021, Yili's infant formula business achieved a year-over-year growth rate of 20%, and for the full year of 2021, Yili's total operating revenue reached 111 billion RMB and operating profit was 10.2 billion RMB (as presented in Table 4). As of the third quarter of 2022, Yili's 2022 total revenue was 119 billion RMB and operating profit was 10.4 billion RMB. By the third quarter, it had already surpassed the previous year's net profit, indicating good profitability.

Table 4. Yili Balance Sheet Analysis in RMB

Numble	2021	2022-9
Operating revenue	111billion	119billion
Operating profit	101billion	110billion
Profit before tax	0.83billion	0.82billion
Net profit	10.2billion	10.4billion

Table 5. Solvency Analysis of Ausnutria

	2021	2022-6
Current ratio(%)	169.8	203.2
Quick ratio(%)	103.5	115.9

Table 6. Solvency Analysis of Yili

	2021	2022-6
Current ratio(%)	115.8	109.0
Quick ratio(%)	95.2	88.8

3.3. Analysis of the Solvency

The current ratio of Ausnutria has improved significantly (seen from Table 5), which previously stood at 158.1% in 2020 and 169.8% in 2021, rising to 203.2% in mid-2022, indicating that Ausnutria's short-term solvency has been effectively improved. However, Yili is facing a dilemma (as listed in Table 6). At the end of 2021, Yili's total debt reached its highest value (presented in Fig. 5) in the past three years because of the large amount of money borrowed to buy shares of Ausnutria. And the high debt operating condition is maintained until now, how Yili will solve the capital problem in the future is a matter of concern.

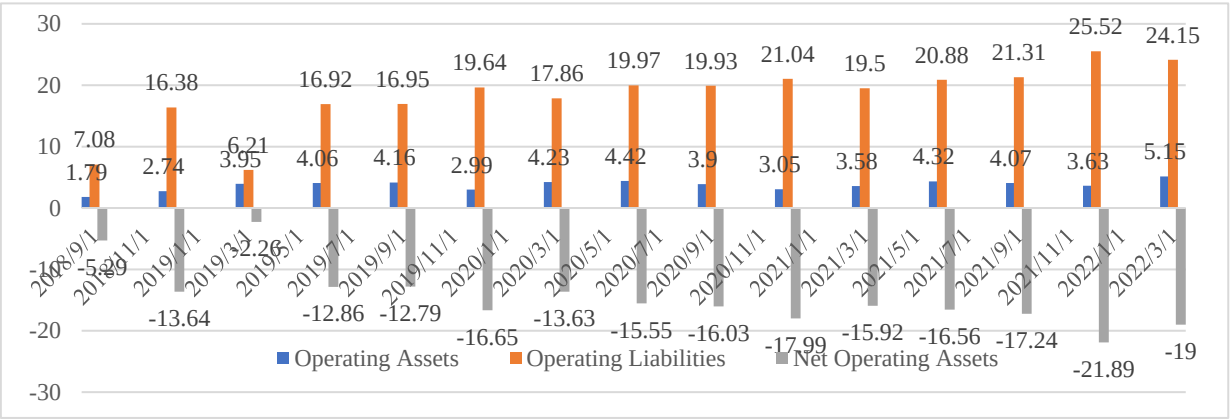


Figure 5. Single-quarter change in net assets of Yili

4. Suggestions

Dairy firms should perfect the layout of the entire category. Expanding into the goat milk market by M&A is a fast and efficient choice.M&A between dairy companies can reduce investment costs and time costs. In this case, Yili directly owned a full set of goat milk powder production line through the acquisition of Ausnutria, which greatly reduced the cost of R&D investment. Qu, in the case study of Yashili's acquisition by Mengniu, claimed that Mengniu acquired a large number of production equipment and two large plants at a price lower than the replacement cost, which reduced Mengniu's financial pressure [9]. Most of the China's dairy industry has still not reached economies of scale, and the integration of some small dairy enterprises whose development is hindered is strategic for the development of China's dairy industry. Through acquisitions and mergers, market concentration can be increased and resource allocation efficiency can be improved.

In addition, both parties should seek long-term cooperation after the merger and acquisition to maximize profits through complementary resources. Dairy companies should take advantage of the resources of both sides after the merger to develop new markets or to expand existing markets. For example, large dairy companies can use their international status and industry goodwill to pave the way for the development of new dairy companies. Smaller dairies can use their milk sources and existing brand advantages to assist the merging party in upgrading their products. In today's unbalanced market environment of supply and demand in the dairy industry, it is important to pay more attention to food safety, especially for dairy companies involved in infant formula. As regulation is gradually being strengthened, companies must not only produce a delicious and nutritious infant formula, but also have strict controls over food safety. Therefore, the acquirer and the acquired party should monitor each other in order to seek win-win cooperation.

Wang, in predicting the development trend of the dairy feed market, mentioned that domestic dairy feed companies will have more in-depth cooperation with large dairy enterprises in the future, and the merger and acquisition activities between dairy enterprises will be more frequent [10]. This includes not only acquisitions between dairy enterprises, but also mergers and acquisitions of large dairy farms by dairy enterprises. Hence, dairy companies should be clear about their strategic position in the future, whether to develop milk products or goat milk products, market priority or consumer reputation priority, etc. If they focus on a certain area of development, grabbing the right milk sources and cooperating with good dairy farms is also an essential part of the process. Capital-rich dairy companies should also focus on independent research and development, including not only the improvement of production technology but also the improvement of product quality. Companies should focus on the development of high value-added products, low-cost, low-margin products should gradually reduce the scale of production to meet the intensity of demand for high-quality products in the new era.

5. Conclusion

In summary, this study investigates Dairy M&A based on a case study of the acquisition of Ausnutria by Yili. Contemporarily, the dairy industry enterprises occurred in the case of mergers and acquisitions is not uncommon. Starting from 2007, Danone acquired Nudisia; then in 2012 Nestle acquired Wyeth, in 2014 Mengniu, Shengyuan, Nestle and other well-known dairy companies in the global M&A investment in dairy farms, the last three years 2021 Chunhua Capital acquired Mead Johnson, Feihe acquired Little Sheep Miaoke and Shaanxi Green Energy Ecological Animal Husbandry, and 2022 Mead Johnson acquired Mecogote, Danone acquired Obika, Yili acquired Auyu Dairy as the sole majority shareholder, etc. Chinese dairy companies are being characterized by vertical integration, horizontal integration, and vertical integration, with strategic M&A restructuring as the main purpose, in order to seek the complementary resources of both parties after M&A and achieve the operational production effect of 1+1>2. Today is a good time for dairy enterprises to acquire, the market to obtain the formula registration of milk powder enterprises are facing the "second formula registration", the amount of liquid production or development policy is being adjusted, if the dairy enterprises to strengthen cooperation and exchange, is not a suitable strategy.

The future of China's major dairy enterprises will still be the layout of the full quality dairy market by way of mergers and acquisitions, making full use of the different advantages of each dairy enterprise to complement each other's strengths and weaknesses in order to seek longer-term development. Nevertheless, this study is an analysis of the latest statements of the two companies. Since the 2022 statements have not yet been published, the article has limited data available for comparison or there is an inability to fully analyze the impact of the merger on the companies. In the future, further study will be needed to continue to focus on the latest financial statements in order to explore the deeper impact of M&A on companies. Overall, these results offer a guideline for dairy M&A and give suggestions for the companies who wants to M&A in the future.

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