Bellamy's Australia

BAL

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BAL Snapshot +

Delicious offer

Organic infant formula maker, **Bellamy's Australia** (ASX.BAL) has just clinched itself a delicious offer all the way from China, which has pushed the shares up dramatically from last Friday's close. This was timely given that the company issued a weaker-than-expected FY19, whilst some regulatory approvals remain uncertain.

China Mengiu Dairy Company has launched an offer for Bellamy's pitched at $13.25 per share, comprising a $12.65 cash component and a franked special dividend of 60 cents per share, paid by Bellamy's. The cash offer values Bellamy's at $1.5 billion and is at a 59% premium to Friday's closing price of $8.32. The stock finished yesterday's session some 55% higher on the announcement at $12.89, not far away from the cash offer, with the market seemingly of the view that it is a 'done deal' or that a higher offer may be forthcoming.

The takeover is a good outcome for shareholders, however **we believe there are risks to the deal going through, including regulatory/government approval**. As outlined in yesterday's mid-week alert, and in the interests of prudence, we are recommending Members sell half their shares to take some profits off the table.

What's new?

At the end of July (FAT-AUS-932) we revisited the company and focussed on the drivers tł pushed its share price back towards the $10 level, and away from the June lows around $8 (where we also reiterated our buy recommendation). The primary driver, at that point, was a tailwind from its rival *Bubs Australia* which reported its 'strongest June quarter ever' and prompting the market to rerate the entire sector.

That aside, we also highlighted the fact that the company maintained a positive outlook on its targets for fiscal 2019 (FY19) on the back of solid completion in both revenues and EBITDA (>50%) in the first half. It was also a pleasing fact the company sustained its marketing push using social media channels.

Schedule 4 - Timetable

Event	Date
Execution of this deed	15 September 2019
Bellamy's submits draft Scheme Booklet to ASIC	14 October 2019
Mengniu to execute Deed Poll	25 October 2019
First Court hearing for Scheme	29 October 2019
Bellamy's sends Scheme Booklet to Bellamy's Shareholders	1 November 2019
Scheme Meeting	4 December 2019
Second Court hearing for Scheme	6 December 2019
Effective Date	9 December 2019
Scheme Record Date	17 December 2019
Implementation Date	24 December 2019

Source: 28 August 2019 Company Presentation

Since then, Bellamy's reported FY19 results which disappointed as revenues fell short of the $275-300 million target at $266.2 million. Management noted that the drag was due to a mix of factors from delays to the SAMR (State Administration for Market Regulation) accreditation, a lower birth rate in China and increasing competition, among other things.

Profitability also took a hit as Normalised Group EBITDA margins came in at 17.6% which also below that of the 18-22% target, with the company spending more on marketing and distributor discounts.

However, this is all very much in the rear-view mirror for now, with the shares surging to levels last seen in 2018 following the $1.5 billion tilt from China Mengniu Dairy (Mengniu), one of China's leading dairy manufacturers.

Mengniu, headquartered in Inner Mongolia, is the second-largest dairy company in Asia, with a market capitalisation of HK$119 billion (~A$22.05bln) but is currently facing some struggles locally, especially in infant milk formula, given the lower birth rate and its past when it was linked to the melamine scandal which claimed the lives of six infants and poisoned over 300,000.

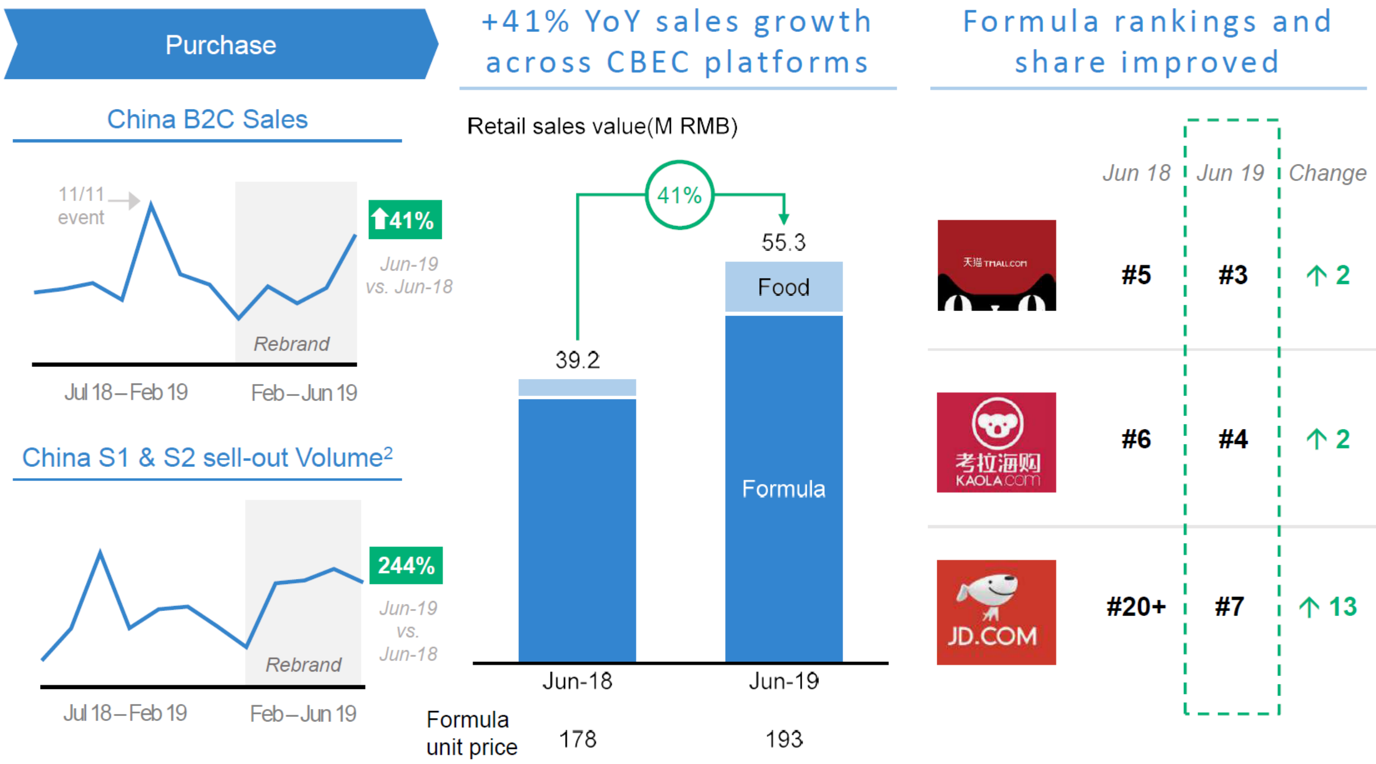
Today, we look at the deal in greater detail:

Acquisition offer

First off, both **Bellamy's** and **Mengniu** entered into a Scheme Implementation Deed where the latter offered to wholly acquire Bellamy's for $12.65 a share in cash as well as a fully franked (up to A26c in credits) Special Dividend of A60 cents which **values the company at a total $1.502 billion** (though there are Options issued to executives and employees but, after closer inspection, should not impact the average shareholder).

This offer is also pleasingly a whopping 59% premium from last Friday's close of $8.32, though is still a far cry from the shares peak in March 2018 at circa $22.08 – though, to be fair, this figure did include substantial optimism from an expected smooth entry to China. More importantly, the offer level is well ahead of our initial entry price of $10.80.

This surge in price makes it an opportune time to take some profits in our view (as covered in yesterday's Mid-Week Alert) but also means that Members holding shares will sacrifice exposure to the Special Dividend which has yet to be finalised. Note per the indicative timetable below, this may not happen till December at the earliest.



Source: 16 September 2019 Company Filing

Given that fact and considering that the current Market Price (circa $12.90) is slightly over the Offer Price, the upside from the dividend is fairly immaterial at 2.8%. This is while the deal is still subject several hurdles. In fact, it requires approval from (i) Bellamy's shareholders, (ii) an independent expert and (iii) the Supreme Court of New South Wales as well as (iv) the Foreign Investment Review Board (FIRB).

Looking closely at each 'actor', the shareholders' approval may be the most straightforward. First, the Board of Directors unanimously recommend voting in favour of the takeover and covers circa 8% of the total vote. The Board asserts that the offer is a 'fair' and 'compelling' deal and cited internal estimates including gaining a China licence. This might be as good as it gets from the Board's perspective.

From the look of it, the Board will also have the backing of Bellamy's largest shareholder, Black Prince Private Foundation (likely under control of Kathmandu founder, Jan Cameron) which has almost 12% of vote **making it an easy 20% of all votes**. Note that Black Prince is likely aligned with the board given its deep relationship with Rodd Peters, one of the Directors in Bellamy's which Black Prince voted in.

Consider also that a number of shareholders may be disgruntled from the delays with the SAMR registration which has forced the company to lose ground to rivals a2 Milk and Aptamil. **The delay is already 20 months and counting**. <u>This may convince quite a number to lock in the value offered by Mengniu</u>.

Next up, the government side (courts and FIRB) might be a bit more complicated. The courts may be more straightforward considering that it may not lead to any antitrust issues and is likely procedural whereas FIRB might have a differing view given geopolitical issues between Australia and China, not to mention some political actors making some noise on the deal.

In fact, we're already hearing about this issue with a case in point from Greens Tasmanian Senator Peter Whish-Wilson who is commenting on possible market manipulation given that "*the Chinese government makes a decision which impacts negatively against an Australian company, then a Chinese company comes in and buys them out.*" He also qualifies his statement noting that **it could also just be a coincidence** but does "*warrant a closer investigation.*"

On the other hand, Bellamy's doesn't own any key agricultural infrastructure (not even a single cow) but mainly sources the milk from farmers and converts it to its various product offerings – hence, unlikely a food security risk. Furthermore, Bellamy's share in the local Australian market is negligible. Never be surprised by the bureaucrats, but there is however a good chance that the deal will go through.

With Bellamy's in play, there is some slight upside risk due to competing offers. That said, an EBITDA multiple of more than 25 times is fairly full to say the least.

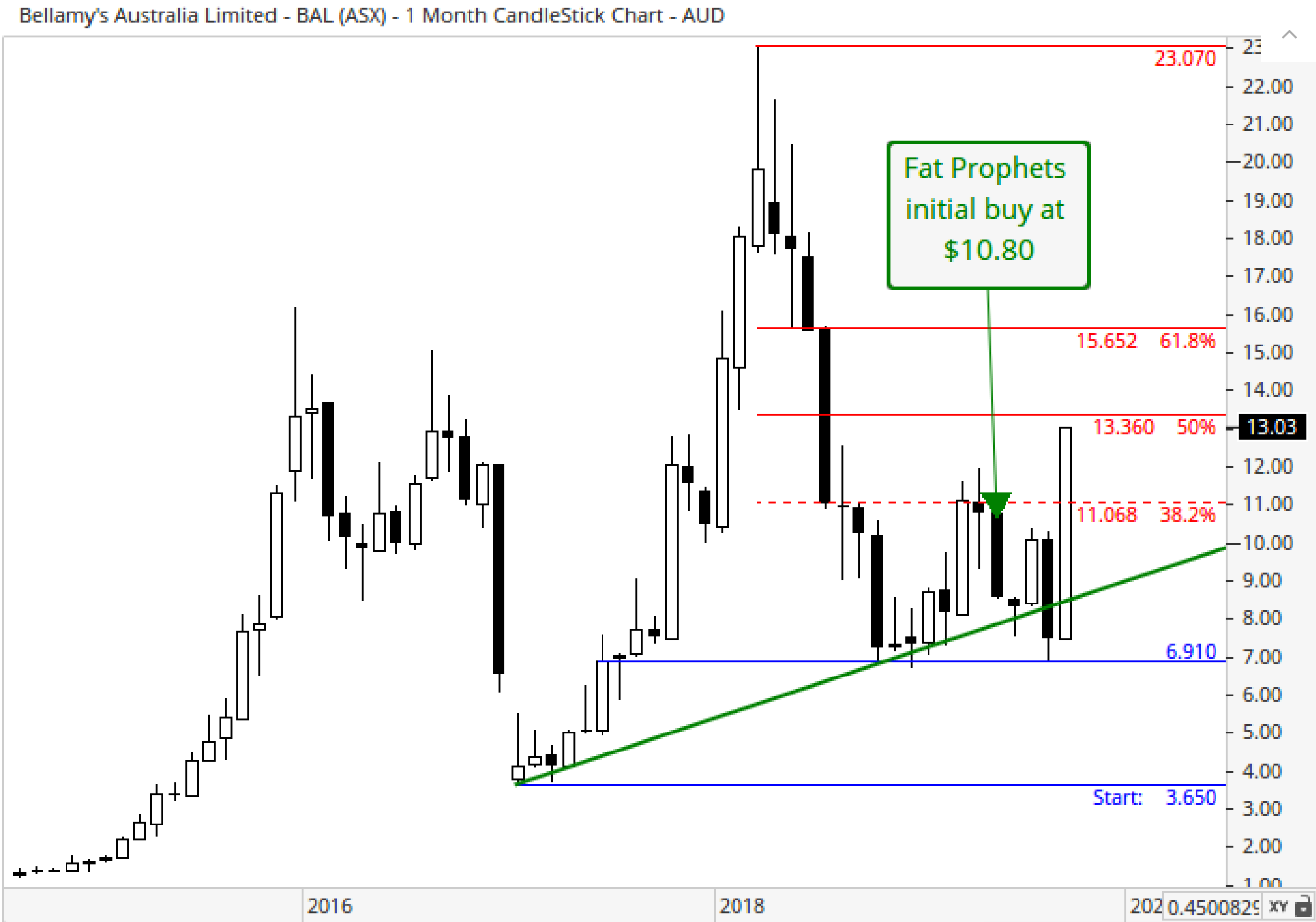
The deal could pave the way for moves on other peers (and as China looks to lock down the sector), but equally, it is also possible that once secured by China, Bellamy's could become the 'favoured one', and it will be companies such as a2 that start encountering 'roadblocks;

Turning to the charts, the recovery witnessed in Bellamy's in 2019, stalled in April, with prices reverting back to the downside. Prices however recaptured support at $9.36 in July, before

reverting back to the downside. The late 2018 lows around $7.00 were not breached in th
recent sell-off, and a move back above prior support at $9.36 and dynamic resistance at the 50 and 200-day moving averages, of course owes to the board backed takeover offer.

Bellamy's Australia Limited - BAL (ASX) - 1 Day CandleStick Chart - AUD

On the monthly chart, the picture is still positive in the overall scheme of things. A fall from grace in 2018 vindicated our decision to stay clear of the shares around $13.50 (July 2018 traffic light report). A termination of the bearish phase at first glance looks to have been premature, with prices moving back beneath the 38.2% Fibonacci retracement at $11.07 in April. This area needs to be reclaimed to reassert the bullish technical thesis, with the impetus provided by the takeover bid. On the other side, and encouragingly, a broader uptrend since early 2017 remains in play.



Summary

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Consequently, we continue to recommend Members sell half their exposure in Bellamy's Australia at the current price levels.