VSB — TECHNICAL UNIVERSITY OF OSTRAVA
FACULTY OF ECONOMICS

DEPARTMENT OF FINANCE

Finanční analýza společnosti Yili

Financial Analysis of Yili Company

Student: Kangyu Wang

Supervisor of the bachelor thesis: Ing. Martina Novotná, Ph.D.

Ostrava 2012

VŠB - Technical University of Ostrava
Faculty of Economics
Department of Finance

Bachelor Thesis Assignment

Student:	**Kangyu Wang**
Study Programme:	B6202 Economic Policy and Administration
Study Branch:	6202R010 Finance
Specialization:	01 Finance
Title:	Finanční analýza společnosti Yili Financial Analysis of Yili Company

Description:

1. Introduction
2. Overview of the financial analysis methodology
3. Description of Yili company
4. Financial analysis of Yili company
5. Conclusion

Bibliography
List of Abbreviations
Declaration of Utilization of Results from the Bachelor Thesis
List of Annexes
Annexes

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Extent and terms of a thesis are specified in directions for its elaboration that are opened to the public on the web sites of the faculty.

Supervisor: **Ing. Martina Novotná, Ph.D.**

Date of issue: 25.11.2011
Date of submission: 11.05.2012

VYSOKÁ ŠKOLA BÁŇSKÁ - TECHNICKÁ UNIVERZITA Ekonomická fakulta OSTRAVA 1

Ing. Iveta Ratmanová, Ph.D.
Head of Department

prof. Dr. Ing. Dana Dluhošová
Dean of Faculty

The declaration

"Herewith I declare that I elaborated the entire thesis, including all annexes, independently."

Ostrava dated…………………..

Kangyu Wang

....

Student's name and surname

Content

1.Introduction

The standard of life had changed a lot with the rapid development of economy in China especially in the area of food. As one of the most essential daily food, dairy products are required by a huge amount and the competition in dairy industry is getting stronger in recent years.

Dairy food including milk, cream, cheese, butter and yoghourt is generally defined as food that is produced from the milk and of mammals which is usually high energy food products.

In this thesis, Yili Industrial Group Co., Ltd. (Yili Company) a producer of dairy food will be analyzed with statements in last five years from 2007-2011 to probe how to keep the competitiveness in the changing market and to discuss the future of the strong company.

As one of the most powerful company in Chinese dairy food industry Yili Group has been studied through various angles. The main objective of this thesis is to study Yili Group`s financial situation by analyzing the financial statements of Yili Group, and also make comparisons among Yili Group with other dairy food producers. To achieve this goal, the vertical analysis and horizontal analysis are being used in the thesis for analyzing financial statements.

As to the research significance of this study, the main points are concluded as follows: Firstly, to expand the research field of dairy food in China from the perspective of the financial statements. Secondly, by adopting the data this thesis tries to get the analysis by using the method mentioned above.

Financial information based on balance sheet, income statement and cash flow statement [1], and interpretation the financial statements in graphs and other forms.

[1] http://www.yili.com/investor/Periodicreports.shtml

The analysis of the financial statements of Yili Company from 2007-2011 will be studied by vertical common-size analysis and horizontal Common-Size Analysis and to get the financial statements and comparison between Yili Company and competitors.

Results and data are questioned from the analysis and solutions achieved from the financial statements. From the questions and solutions, advices can be obtained and looking forward to some new methods to help to develop Chinese dairy food industry.

Data analysis of Yili Company is very important especially in such a rough competition market and enterprises will choose the better development path to improve the production and services for customers. At the same time, it`s the best way to benefit maximization and to build favorable corporate identity which can help Yili Company to stand stable in the fierce prefect competition market of dairy food.

2. Overview of the financial analysis methodology

This chapter is the description of the methods [2] used in this thesis. There are two parts: common-size analysis and ratio analysis. The methods of financial analysis are from book < International Financial Statement Analysis > (2008), chapter 7.

2.1 Common-Size Analysis

In order to identify the development tendency and major differences of companies, common-size analysis can be used to analyze data from financial statements and changes over the selected period. All the data from balance sheet items are shown as percentages of total assets and all income statement items become percentages of sales of total revenues. Common-size analysis includes horizontal common-size analysis and vertical common-size analysis.

Horizontal common-size analysis is a method of financial analysis of the results of operations of the company, as well as the financial condition. The method of horizontal common-size analysis is using the information which can reflect the financial situations to compare with the same information, but at different times. Horizontal common-size analysis is a time-series analysis and is useful for identifying trends and growth in accounts over time [3].

Vertical common-size analysis, as the name suggests, is a method of analysis, it can be used for the analysis of financial information. In order to get the positions, the importance and the changes of the data, using the data to compared with the total in the table. It will be shown as proportions of the total

[2] The methods mentioned in this chapter are all from the book: Thomas R.Robinson, Hennie van Greuning, Elanie Henry, Micheael A. broihahn/ International financial statement analysis/ 1st Edison/ publisher: wiley/ November 10 2008/ 864 pages/ ISBN:978-0470287668

[3] From < International Financial Statement Analysis > P314

which can be total revenues, total assets, total liabilities, etc. It studies each amount from financial statements as a percentage of another item which usually is the total amount.

2.2 Financial Ratio Analysis

Financial ratios are based on financial statements, using the form of ratios to analysis the financial situations. Financial ratios can be used to evaluate an investment in each of the years between the income changes; it can also compare different enterprises in a particular industry at some point. Financial ratio analysis can eliminate the impact of the scale, the benefits and risks to be used to compare different companies.

There are five main categories of financial ratios:

1) Profitability ratios;

2) Liquidity ratios;

3) Solvency ratios;

4) Activity ratios;

5) Other ratios.

Each ratio provides a total different analysis. With all the different categories of financial ratios, it is easy to tell the difference among financial data, also with all the comparisons, which will help with diagnosing of the health of companies.

2.2.1 Profitability Ratios

The profitability ratio refers to the ability of the ordinary course of business to make a profit, is the basis for enterprise survival and development, all aspects are very concerned about the indicators. Whether investors, creditors, or business executives, there is growing attention and concern of corporate profitability. A lot of indicators can reflect the profitability of the business, commonly used in the operating profit margin, gross profit margin, net profit margin, return on equity, return on assets, pretax profit margin.

Margins, there are gross profit margin, operating profit margin, net profit margin and pretax profit margin. Margins are used to compare all kinds of income to revenues; the percentages of the margins show the parts of incomes.

Gross profit margin (can be referred as Gross margin or Gross Profit Rate) is the gross profit divided by the total revenues, gross profit is calculated as the total income minus cost of the goods of services sold. From the margin, it can be got that unit revenue the company obtains, the number of the gross profit from the unit revenue:

$$Gross\ profit\ margin = \frac{gross\ profit}{total\ revenue} \tag{1}$$

Net profit margin is the net profit divided by revenues. Net profit margin indicates how much profit a company makes for every unit money it generates in revenue or sales. The index reflects how much of every dollar of sales revenue in net profit, it expresses sales revenue income level.

$$Net\ profit\ margin = \frac{net\ profit}{total\ revenue} \tag{2}$$

Return-on-Investment ratios also can be referred as return-on-assets ratios are used to compare benefits emerged from investments. We represent the benefit is in the numerator and the resources affecting that benefit, such as the total assets of the company, in the denominator [4]

Return on assets, also known as ROA, indicates the ability to get profits, with the usages of all the funds. ROA is the company's profit after tax divided by total assets. The indicator of ROA reflects the level of income, so ROA is used to evaluate the profitability of the company uses all of its assets. The higher the index value, the higher the benefits of the investment. It

[4] From < International Financial Statement Analysis > p334

compensates for the lack of indicators of profit after tax per share.

$$Return\ on\ assets(ROA) = \frac{net\ profit}{total\ assets} \quad (3)$$

Return on equity also known as ROE is an important indicator of the profitability of different enterprises within the same industry and is a measure of the ability to net asset value relative to shareholders' equity, return on investment indicators, reflecting the company generated net profit. In general, the high index of return on equity, the higher the benefits of investment. Return on equity is the ratio of net profit after tax of equity investment. In general, the higher the capital-intensive industry, barriers to entry, less competition, on the contrary high index of ROE but low assets of the industry were more likely to enter, to encounter greater competition. ROE applies for relatively the same industry.

$$Return\ on\ equity(ROE) = \frac{net\ prfit}{average\ sharehold`s\ equity} \quad (4)$$

And ROE formula can also be divided as:

$$ROE = \frac{net\ profit}{revenues} * \frac{revenues}{average\ total\ assets} * \frac{average\ total\ assets}{average\ shareholds`\ equtiy} \quad (5)$$

This can help with the DuPont Analysis.

DuPont Analysis was first used by DuPont Corporation, USA. DuPont Analysis can be used to analyze ROE and ROA. In this thesis, DuPont Analysis is mainly used to analyze ROE.

As formula 5 shows, ROE is decomposed into three parts: Net profit margin, total assets turnover and financial leverage. Each part can be the reason of the changing of ROE.

2.2.2 Liquidity Ratios

Liquidity ratios indicate the ability of the enterprise to generate cash, it depends on the ability of current assets turns into cash in the near future, so liquidities ratios are used for analyze company's` short-term liabilities and obligations. Liquidity ratio measures the ability of meeting company`s immediate liabilities and obligations. Liquidity ratio mainly includes current ratio and quick ratio, but also Cash ratio and the denominators are both the current liabilities.

Current ratio, current assets divided by current liabilities, and the ratio measures the ability to pay company`s debts in short-term. Current ratio is mainly used to give an idea of the company's ability to pay back its short-term liabilities (debt and payables) with its short-term assets (cash, inventory, receivables). The higher the current ratio, the more capable the company is of paying its obligations.

$$Current\ ratio = \frac{current\ assets}{current\ liabilities} \tag{6}$$

Quick ratio, also known as Acid-test Ratio, quick ratio is the ratio of liquid assets to current liabilities. Liquid assets including money funds, short-term investments, note receivable, accounts receivable, other receivables. Quick ratio is a more stringent measure method of liquidity. This ratio indicates a company`s ability to satisfy current liabilities with its most liquid assets [5]. Quick ratio is the cash, short-term marketable investments plus receivables divided by current liabilities.

$$Quick\ ratio = \frac{cash + short - term\ marketable\ investment + receivables}{current\ liabilities} \tag{7}$$

Cash ratio is also known as liquidity ratio or cash assets ratio. This ratio reflects the payment of current debt capacity without relying on the stock sales or the receivables of a company. In order to measure the liquidity of the assets of a company, cash ratio is the ratio between the company`s cash as well as

[5] From < International Financial Statement Analysis > P328

the cash equivalents of total assets and liabilities of current liquidity.

$$Cash\ ratio = \frac{cash + short - term\ marketable\ investment}{current\ liabilities} \qquad (8)$$

2.2.3 Solvency Ratios

Compared with the liquidity ratios, solvency ratios are used to measure company`s ability to meet its long-term obligations. The solvency ratio is the ratio to judge the security of corporate liabilities and the ability to repay short-term liabilities ratio. The size of the solvency indeed reflects the degree of risk of the business. The common solvency ratios are debt-assets ratio, debt-equity ratio and coverage ratios.

Debt-to-assets ratio is the proportion of assets financed with debt, which refers to the rate of total liabilities to total assets at the end of the year. In other words, debt-to-assets ratio means the proportion of the fund gathered by liabilities of the total assets. The index is a composite indicator for assessing debt levels. Debt-to-assets is calculated as the total debt divided by total assets.

$$Debt - to - assets\ ratio = \frac{total\ debt}{total\ assets} \qquad (9)$$

Debt-to-equity ratio an indicator of measuring company`s solvency and analysis of capital structure. The ratio can show the proportion of source of funds of the company to build assets in equity and debt. The higher the debt-to-equity ratio, the stronger solvency of the company is. It is calculated as the total debt divided by total equity.

$$Debt - to - equity\ ratio = \frac{total\ debt}{total\ equity} \qquad (10)$$

2.2.4 Activity Ratios

Activity ratios can measure the efficiency with a company uses its assets, how well a company uses its assets, the benefit produced by assets, such as accounts receivable, inventories, and fixed assets. Activity ratios include inventory turnover, receivables turnover, total assets turnover, working capital turnover, and so on.

Inventory turnover is the ratio that relates the cost of goods sold to inventory. After producing the goods, goods must be stored in storage because it is not able to sell all the goods in a very short time. Inventory turnover is used to reflect the inventory turnover rate, the ratio means the cost of goods sold to inventory, and inventory turnover is an indication of the resources tied up in inventory relative to the speed at which inventory is sold during the period [6].inventory turnover ratio encourages enterprises to improve efficiency in the use of funds, ensures the continuity of production and operation, also enhances the short-term solvency.

$$Inventory\ turnover = \frac{cost\ of\ goods\ sold}{average\ inventory} \tag{11}$$

Receivable turnover is the ratio of sales revenue divided by average accounts receivable, is also the average times when receivables turn into cash, which accounts receivable flow rate. The higher the accounts receivable turnover ratio is, the better situation to the company, because the higher accounts receivable turnover rate, it means the faster the rate of company collecting debts, and the shorter the average collection period, faster of works the assets flow, and the stronger of the solvency.

$$Receivable\ turnover = \frac{total\ revenue}{average\ receivables} \tag{12}$$

Total assets turnover is the rate of net operating income to average total assets ratio of an enterprise in a certain period. The total asset turnover ratio is an important indicator of investigating the assets operational efficiency of an enterprise. Total assets turnover reflects the transfer speed of all the assets from input to output during the period of its operation, and also indicates

[6] From < International Financial Statement Analysis > P322

management quality and efficient use of all of the assets belonging to the enterprise.

$$Total\ assets\ turnover = \frac{total\ revenue}{average\ total\ assets} \tag{13}$$

Payables turnover refers to the turnover of the payable accounts within a year, and it reflects the liquidity of the corporate accounts payable. Payables turnover is the index can reflect the ability to pay the current liabilities.

$$Payables\ turnover = \frac{total\ revenue}{average\ total\ payables} \tag{14}$$

2.2.5 Other Ratio

Earnings per share also known as EPS, can be also understood as after-tax profit per share, is one of the most important indicators of the determination of the value of equity investments, and is the most basic indicator to analyze the per share value. EPS is an important indicator of a comprehensive reflection of company profitability, is the ratio of net income and the number of shares of a certain period of the company. EPS is helped with evaluating the profitability of the business, forecasting business growth potential by investors.

$$Earnings\ per\ share = \frac{net\ income\ available\ to\ common\ shareholders}{number\ of\ common\ shares\ outstanding} \tag{15}$$

3. Description of Yili Company

This chapter is the description of Yili Group, and this chapter mainly includes two parts. One is the information about Yili Company, including the short history of Yili Company, the strategies. Another one is about Chinese dairy market, including the description of Chinese dairy market and also the foreign and domestic competitors. The data in this chapter are mainly from the official websites (http://www.yili.com) and internet sources (footnote the source if it is).

3.1 Overview of Yili Company

Inner Mongolia Yili Industrial Group Co., Ltd. (Yili Company or Yili Group stock code: 600887) established in 1993, Hohhot Xinjiang Province, is a dairy food manufacturer with the broadest product line in China. As the only dairy producer which can meet the stringent specification, Yili Company was appointed as the exclusive supplier of the 2008 Beijing Olympic Games and the 2010 Shanghai Expo. Yili Company is a big company with five main business units: liquid milk, ice cream, milk powder, yogurt and raw milk. It also has more than 130 branches and subsidiaries all over China with over 1,000 varieties of Yili brand products such as popsicles, ice cream, milk powder, milk and tea powder, asepsis milk yoghurt and cheese. And now Yili Group have staff 22,000 in total, also 20 subsidiary corporations working at the same time.

3.2 Brief History of Yili Company

At the very beginning, Yili was a state-owned enterprise. With the 30 years of developing, now days, Yili becomes one of the most powerful dairy companies.

3.2.1 Establishment of Yili

Inner Mongolia Yili Industrial Group Co., Ltd., formerly known as the Hohhot Hui milk Food Factory, obtained the business license at April 1982.

But in November 1983, the Hohhot government decided to divide the company Hohhot Hui milk Food Factory into two parts, one was Muslims Cow Pasture, and another one is Muslims Milk Food Processing Factory. The separation finished before 1984.In March 1984, Muslims Milk Food Processing Factory was officially registered.

After several times of changing names, in November 1991, the name changed to the Hohhot Hui Milk Food Factory, and got the business license at June 1992.

In December 1992, Hohhot People's Government agreed to put the Hohhot Hui milk Food Factory into a list of joint-stock reform pilot enterprises. February 1993, approved by the Hohhot Economy Commission of Restructuring, transformed on the basis of Hohhot Hui Milk Food Factory, Initiated by the 21 promoters, the Inner Mongolia Yili Industrial Group Co., Ltd. official established, and registered at 14th June 1993.

3.2.2 Development of Yili

Approved by the Inner Mongolia Autonomous Region, Securities and Exchange Commission on September 4 1995, and then agreed by China Securities Regulatory Commission, Yili Company had its initial public offering of 171.5 million shares of common stock. March 12, 1996, the Yili shares listed in the Shanghai Stock Exchange.

Since listing, Yili has been named as one of the “Most Potential Top 50 Listed Chinese Companies”. As the only national dairy food listed company, in 2000, Yili become the leader in Chinese dairy food industry [7]. Yili shares become market-recognized merit-based shares with the good performance and high-speed growth.

[7] From http://info.womai.com/baike/yinliao/201202033491.html

In 2001, the main business income of Yili Group was more than 2.7 billion Yuan, profits and taxes totaling 3.4 billion Yuan. The earnings per share of Yili stock was 0.82 Yuan, ranked 8th in the 1175 listed companied. 2001 is also the third consecutive year of Yili Company being named the "Most Potential Top 50 Listed Chinese Companies", and ranked 5th [8].

In the first half of 2002, Yili Company achieved the main business income of more than 2 billion Yuan, increased by 54% compared with the same period last year. In 2004, the main business income of Yili Group was 8.735 billion Yuan, increased by 38.67 percentage points over the previous year. Total assets reached 4.85 billion Yuan, an increase of 19.86% compared with last year. Total profit was 379 million Yuan, an increase of 18.81% over the previous year. Net profit was 239 million Yuan, an increase of 19.81% over the same period last year [9].

In 2004, Yili and Haier were the only two domestic companies, ranked among the Chinese market as the most popular brand of top ten.

3.2.3 Olympic, Melamine and World Expo

There are three main events that had great impacts on the development of Yili Company.

- Being the sponsor of Olympic Games.

On November 16th 2005, Yili Company signed an agreement with Beijing Olympic Organizing Committee, and was announced to be the exclusive sponsor of dairy products for the 2008 Beijing Olympic Games. Yili Company was the first Chinese brand in food industry to sponsor the Olympic Games.

- Melamine incident.

Melamine is a kind of chemical material, and melamine is not allowed to be the material of food. But in 2008, a lot of dairy foods were found to have

[8] From http://www.yili.com/about_yili/history.shtml
[9] From http://www.022net.com/2006/9-3/514963133010167.html

melamine in them. Not only domestic producers, but also foreign producers had been checked out to have melamine. But most of the polluted products are Chinese products, including products from Yili. So Yili`s products were rejected by the market, which made Yili lost a lot of money.

On one hand, all the polluted products were destroyed. On the other hand, people were not willing to buy Yili`s products and the products sold were recalled.

All in all, in 2008, Yili Company lost 1.687 billion Yuan.

- World EXPO.

In 2010 Yili was one of the EXPO sponsor. In that year, Yili achieved total revenue of 23.525 billion Yuan from January to September, an increase of 22% compared to last year. And the number of the total revenue had surpassed the sum of the Yili 2008 Olympic Games the year of the main business income.

Jun. 24th, 2010, Dutch Rabobank Banking issued a report[10], which pointed out that Yili Group was one of the first group of large enterprises in world dairy market and was very near to be listed in the Top 10 Dairy Enterprises. With the brand value of near 30 billion Yuan, Yili Group became the company which had the fastest growing of brand value in dairy food industry worldwide.

3.3 Business Strategies of Yili Company

3.3.1 Raw Materials Strategies

The source of dairy food is the most important factor related the quality of the production. Besides the best milk source bases, Yili Group has four-steps-strategies [11]:

1. Applying the mode of “Enterprise + Farmer”, Yili obtains the dairy source not only from the pastures which belongs to Yili Company, but

[10] From http://www.rabobank.com/content/images/DairyMap_tcm43-121111.jpg
[11] From http://www.mianfeilunwen.com/Jingji/hangyejingji/57139.html

also from the farmers union, in which, farmers can cattle and then provide the dairy source to Yili Group.

2. In 2000, Yili Group applied the mode of “Enterprise + Pasture Areas + Private Material Producer”.
3. In 2005, Yili built their seventh pasture, and came up with the new mode of “Enterprise +Standardization Pasture Areas”.
4. Yili Company signed a contract with Inner Mongolia Tumed Left Banner government, aiming at promoting the Cow Cooperation including dairy farmers, government and milk station operator and so on.

So far, Yili Company owns nearly 200 pastures and over 2 million controllable thoroughbred cows, and is supported by a lot of dairy farmers as well. And the modes applied by Yili Company were called “Yili Mode” and studied by dairy competitors.

3.3.2 Selling Strategies

First of all, Yili has 5 main business units and over 1000 kinds of different products in Chinese dairy food market. Yili Group keeps adjusting product structures to meet the demands of the market. From infant to the aged, everyone can find at least one product from Yili Company which is able to meet one’s needs. Yili Group continues to preserve high profit, high sales volume productions, and keeps getting new products off the ground at the same time. Liquid milk is the pillar product of Yili Group and the series of pure milk are the leading products.

Then, Yili Group had a big reform and integrated the distribution channels from 2001. Yili Company redefined the concept of customers.
Agents, wholesalers and consumers were all ranged to Customers. Yili Group changed the selling mode and at the same time, built modernized dairy production based on middle and western area of Inner Mongolia, and then in Beijing, Tianjin, Shanghai, Heilongjiang, Shanxi, Guangdong, Xinjiang, Henan

and so on. Till 2005, there were over 600 sales offices all over China. It's exactly this kind of approach that enabled Yili Company to have products cover all over China at the same from 2006, and the products were able to send to customers within the shortest possible time.

Third, facing with the two big problems as products without differentiation among manufacturers and trust crisis of dairy products, the authority and reliability of the brand become seriously important. Yili Group not only has strict inspection of their products, but also has cooperation with national authorities like China Railway to gain public trust again.

3.3.3 Brand Strategies

There was a research report pointed out that in China, the percentage of consumers who are willing to pay only for the products or services of trustworthy brand reaches up to 78%, which is 37% higher than the average proportion of all over the world[12].

In order to achieve brand strategies, Yili Company keeps inviting celebrities in China to be advertising endorsers. From the field of entertainment to sports, Yili Group rocked all over the country. With the celebrity effect and the excellent brand appeal, Yili maintains rapid development and becomes widely known. In 2011.7, when the movie <Transformers> wrap around the globe, the brand of Yili was remembered by all the people who watched the movie since the product placement in this popular movie. At the same time, Yili created a new path for Chinese local brand to join the competition in the international market, and made their products fashion.

3.4 Description of China's Dairy Industry

From 1998 to 2008, there was a very stable increasing rate of the dairy food output. Especially in the period of 2005 to 2007, the average growth rate

[2] http://cn.made-in-china.com/info/article-2845254.html

was about 16%, and the total output was over 17 million tons in 2007.

3.4.1 Market Concentration Rate

Liquid milk: including normal temperature milk and low temperature milk, Yili and Mengniu are two brands that leading in the market of milk at room temperature. Market share add up to more than 70%, the highest occupation of the market concentration。

Yogurt: three kinds of yogurt are popular in the market. The first kind is to meet the demand of the nutrition based yogurt; the second is the yogurt with fruit and grain; the third type is health function yogurt, such as unobstructed, immune, children's growth, etc. As to the market, the first category accounts for more than 60 percent of the market, while the 2nd and the 3rd get the relatively low proportion. But the growth rate of fruit (grain) yogurt is as high as 40%, which arouse great interest among the yogurt enterprise.

Milk Powder: the milk powder for infants and adults should be divided into three categories: High Grade, Middle Grade and Low Grade. High grade milk powder for infants in the market is mainly monopolized by foreign brands such as Mead Johnson, Wyeth, Dumex, Nestle and Abbott. Middle and low infant milk powder is mainly occupied by Yili, Ashley and San-Yuan of domestic enterprises. The adult milk powder market mainly includes Yili and Nestle.

Cheese: cheese is a relatively new category in China, and Chinese cheese market is in its infancy. The overall size of the market is about 8000 tons per year, and domestic production is only about 2000 tons, while all the rest relies on imports. The brand “Milkana” from France takes the leading position which accounting for more than 60% shares of the entire category, followed by Guangming, Yili, Kraft, San-Yuan, and other brands.

3.4.2 Products Selling

Dairy products are fast moving consumer goods, so the sales channels must rely on retails, such as convenience stores, supermarket chains, supermarkets, Internet sales. Liquid milk, yogurt and cheese, rely on the supermarket chains and convenience stores, while the milk powder is increasingly concentrated in supermarkets and large supermarket chains. But as to the development of infant formula milk powder for infants, there are two other channels to consider, one is infant supplies stores, the other is network shops.

And it is also about the scales of the cities. The classification is based on political status, economic strength and size of the city.

First-tier Cities: including Beijing, Shanghai, Guangzhou, and Chengdu etc. Channel penetration is relatively full, and top-level products are much more popular in these cities.

Second-tier cities: including Wuhan, Qingdao and Jinan etc. The growth rate of sales amount is increasing relatively steady. The huge market capacities and relatively strong purchasing power made the cities as the core markets of the dairy industry.

Third-tier cities and rural areas: the solutions are complex since the competitions are relatively intense and fake and shoddy products also exist in these places

3.4.3 Potential Problems

The first problem is related with “Consumers Confidences”. Half of the milk producers on the planet have or had problems with quality. For example, Nestle infant formula had been recalled for five times; Japan's Morinaga milk powder, mixed with arsenic, caused the death of more than 180 infants, etc. The same kind of things happen in China as well which was known as the 2008 Chinese milk scandal. It was a food safety incident involving milk, infant formula and other food materials and components, which are adulterated with melamine. Even till 2011, there were still 70% Chinese people dare not to buy domestic dairy products.

Secondly, the price of raw milk keeps increasing. In 2011, the main area in

China which products raw milk has a relatively stable increasing rate of the price, and the annual average price is 3.20 Yuan / kg [13]. But it has still increased by 10.9% compared with the corresponding period last year. In December, the raw milk price rose to a record high of 3.25 Yuan / kg, an increase of 3.8%, had increased by 2.2% compared with the beginning of the year. With the increasing of raw milk price, the price of domestic dairy products keeps rising. While at the same time, the price of raw milk of the international keeps decreasing, it causes the price import milk depreciating.

3.4.4 Brief Introduction of Chinese Dairy Industry

Since the milk scandal in 2008, creating the confidence of consumers has become the most important goal of the dairy industry. The consumptions are indeed showing a recovery trend, and the dairy products made in China are becoming popular in every supermarket. Consumers now tend to believe in domestic brands, and this will lead to the trend of growth in dairy consumptions. But in the field of milk powder for infants, foreign brands will still own a big part of the market, since Chinese parents care only about quality, but not price.

The fact that the milk at room temperature gets more than 80% share in the market is hard to change, at least in the next three years [14]. It will still occupy most of the market share, and this pattern is stable.

In these years, all the producers introduced their high-end products into the market, and these products are much welcomed. After the milk quality problems, consumers are willing to pay more for high quality dairy products. So the high-end products in the dairy industry grow rapidly and will become the mainstream of the future dairy consumption.

More new categories of milk will be brought up in the market. In recent years, the dairy giant such as Yili, Mengniu, and Guangming have started to launch new categories of milk. For instance, low-lactose milk, cereal milk, fruit

[13] From http://commfcscyxs.mofcom.gov.cn/html/total/_news/2012/2/1329361311053.html

[14] From http://www.sn110.com/news/Dairy/20120306/show_140993.html

cube milk, living bacterium milk, and so on. At the same time, some local enterprises also try their best to develop new kinds of milk such as, wolfberry milk, red jujube yogurt and so on.

3.5 Competitors

There are a lot of competitors in the dairy market. Domestic competitors are mainly Mengniu and Guangming, and competitions include almost all kinds of dairy products. But as to foreign competitors, infant formula mike powder is the most competitive product.

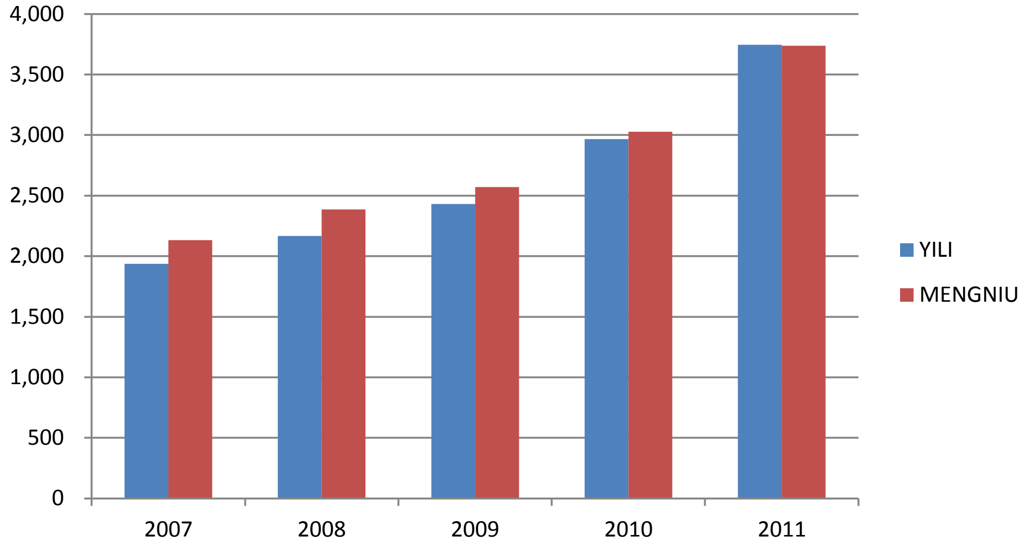
3.5.1 Domestic Competitors

There are a lot of domestic and foreign companies in the dairy industry, but the most competitive ones are just some famous producers and the well-known brands. Mengniu, Guangming are the biggest domestic competitors.

Mengniu and Guangming are the strongest competitors in the domestic market. In August 1999, Mengniu , Inner Mongolia Mengniu Dairy (Group) Co., Ltd. (referred to as Mengniu Dairy Group stock code: 02319), headquartered in the core area of milk - Helingeer economic development zone, with total assets of more than 100 billion Yuan, staff member of about 30,000, dairy annual production capacity of 6 million tons[15]. So far, counting every base, Mengniu Dairy Group has established more than 20 production bases in 16 provinces, autonomous regions and municipalities, with over 400 items of the five series of liquid milk, yogurt, ice cream, milk, and cheese. The product coverage for its excellent quality of the domestic market and exported to the United States, Canada, Mongolia, and Southeast Asia, Hong Kong, Macao and other countries and regions. The following is the comparison graph of Revenue between Yili and Mengniu from 2007 to 2011 (Unit: Billion Yuan).

[15] From http://www.mengniu.com.cn/

Graph 3.1 Revenues between Yili and Mengniu (billion)

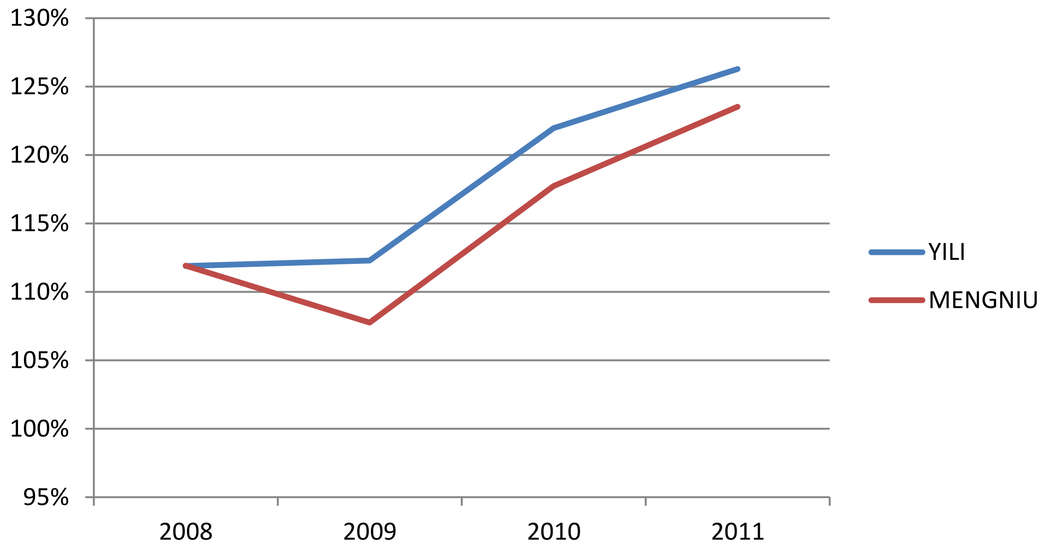


Source: Data are from official annual reports of Yili and Mengniu, 2006 to 2011.

From the graph 3.1 above, it can be seen that the revenues of Mengniu and Yili are equally matched.

The comparison of the growth of revenues between Mengniu and Yili is as follows.

Graph 3.2 Growth rates of revenue between Yili and Mengniu (%)

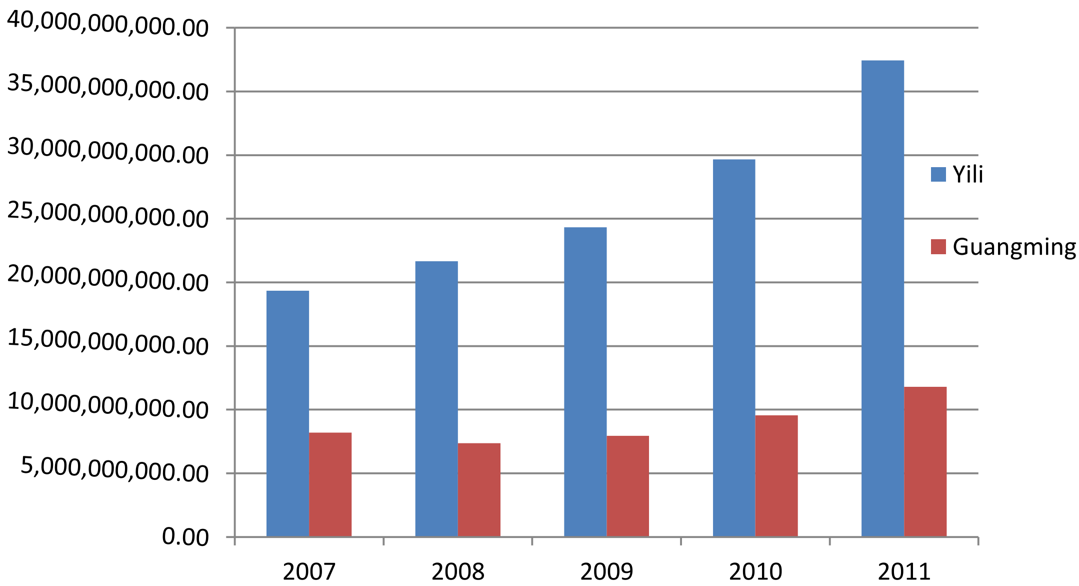


The results of Graph 3.2 are calculated with the data of Graph 3.1. Graph

3.2 shows that in the field of growth rate, Yili is more stable with a higher growth rate. As the revenue of 2011, Yili had already caught up with Mengniu, so it can be predicted that although the competition between the two companies remains tough in the following years, Yili will keep leading.

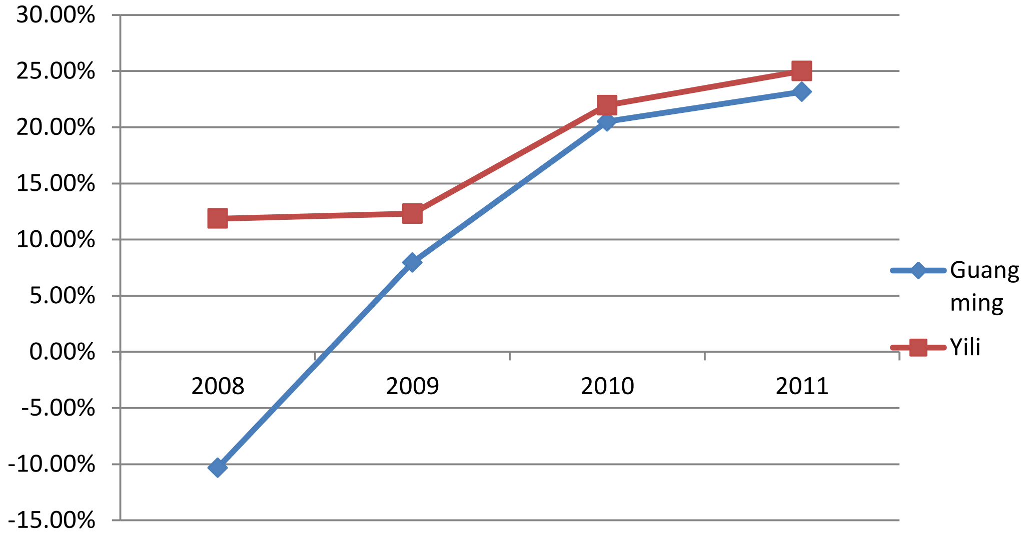
Guangming (referred to as Bright Dairy), another powerful producer, was established in 1949. At present, the fresh milk, fresh yogurt, fresh cheese from Guangming rank first in the market. With the purchasing of Synlait Milk, a brand from New Zealand last year, Bright Dairy took the first step of the overseas business. And in this year, they introduced a high-end products, the products are for babies, they are infant formula milk powder, but what different among this one and other company`s infant formula milk powder is that the raw material of this product is from New Zealand. Guangming wants to occupy the high-end milk powder market by selling this product.

Grahp3.3 Revenues of Guangming and Yili from 2007-2011



Source: Data are from official annual reports of Yili and Guangming, 2006 to 2011

Graph 3.4 Increasing rates of revenue between Yili and Guangming



The results of Graph 3.4 are calculated with the data of Graph 3.3. In Graph 3.4, from 2007-2011, the increasing rate of Guangming had a little decrease of revenue, but these years from 2009 to now, the revenue keeps increasing as well as the increase rate.

In Graph 3.4, in 2008, Guangming had an increasing rate of revenue of -10.33%, it means the company profited less than last year .while Yili, although the China's dairy crisis exploded, still had a stable increasing rate around 12.00% and kept gaining, but the increase rate was a stable number.

In 2009, Guangming started developing at a very fast speed, till 2011, the increasing rate of Guangming was 23.16% while 25.00% of Yili. In all the graphs above, it is clear to tell that in the recent years, Yili Guangming and Mengniu, as three giant domestic dairy producers, are regaining the faith of the public and keep developing. They will have more shares of the market in the recent years. But as to Guangming, it’s very hard to catch up with Yili and Mengniu, although Guangming have a huge potential of expansion the market share.

Other domestic competitors, such as Sanyuan, Robust and Wandashan and so on, compared with Yili, Mengniu and Guangming, their share of the market of whole China are too small to tell them separately.

3.5.2 Foreign Competitors

Foreign competitors were mainly milk powder producers. But after 2008 other milk products also had chances to enter Chinese market. Most competitive companies are Mead Johnson, Dumex, Wyeth, Abbott, and Nestle.

Mead Johnson is a company developing of all types of nutrition products for infants, young children and old people.

Dumex is a brand from France. Dumex’s parent company is Europe's largest infant nutrition company. It`s high-end product Gold Dumex sold in China with the unified global formula, so Dumex is one of the most popular high-end infant formula in Chinese infant formula market, and always ranked at good places of the foreign infant formula selling list.

Wyeth is from USA. Wyeth is one of the world's largest research-based pharmaceutical and health care products companies. Wyeth was the inventor of the infant formula, and milk powder raw materials of Wyeth are from New Zealand, where provides the best raw materials cause of the best nature environment.

Abbott was established in 1888, Illinois, the United States. Abbott has products including nutrition, drugs, medical devices, diagnostic instruments and reagents.

Nestle is not only the best coffee producer but also one of the best infant formula producers. Nestle is from Swiss, and the Nestle Infant Nutrition was since 1867.

Not only the producers above but also some not mentioned occupied Chinese infant formula market. Here is the market share of infant formula in

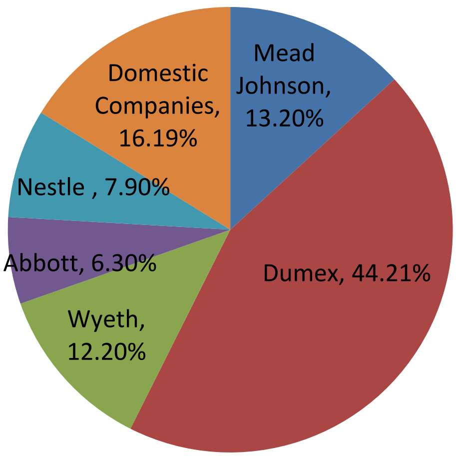
2007 [16].

Table 3.1 Market share of infant formula

Brands	Mead Johnson	Dumex	Wyeth	Abbott	Nestle	Domestic Companies
Percentage	13.20%	44.21%	12.20%	6.30%	7.90%	16.19%

Source: Data are from <Chinese Infant Milk Powder Market Research and Investment Report >, Page 3, published by Beijing Huajingshidian Information Consulting Co., LTD

Graph 3.5 Market share of infant formula



Data of Graph 3.5 are from Table 3.1. It is shown from the graph 3.5, that foreign producers of infant formula occupy most of the market, from which Dumex is the biggest seller of the market. And Chinese domestic producers occupy only 16.19%, very small share.

[16] From http://doc.mbalib.com/view/963a6e2fbef0821b46f426e69993bca5.html

4. Financial analysis of Yili Company

This chapter is the financial analysis of Yili Company. This chapter can be divided into two parts, the first one is the common-size analysis and another one is the ratio analysis. The methods used in this chapter are all from Chapter 2, and all the data are from official websites and annual reports with income statements, balance sheet and cash flow included in annexes.

4.1 Common-Size Analysis

This part is about the common-size analysis, includes horizontal analysis and vertical analysis. The objects of the study are balance sheet, income statement, and cash flow. The data are all from the annual reports from 2007 to 2011.

4.1.1 Vertical Common-size Analysis

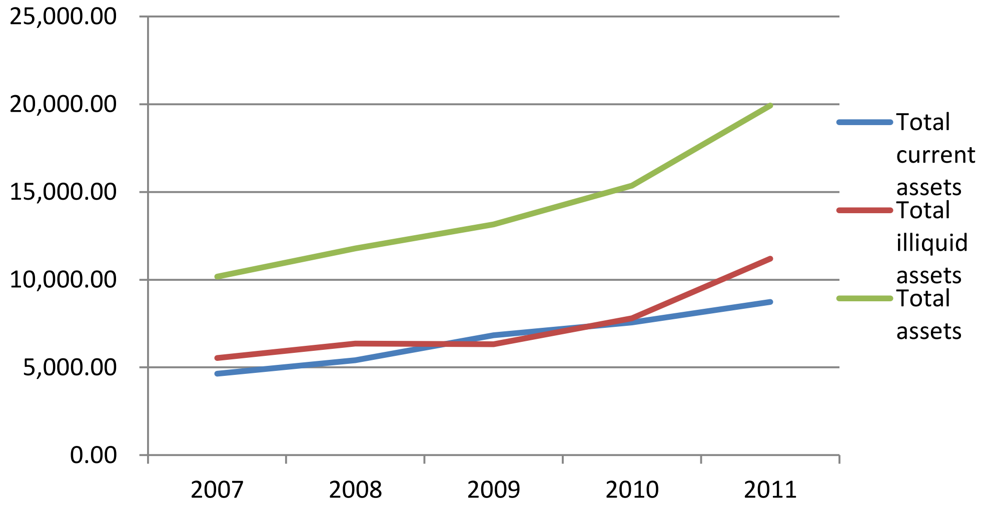
Balance sheet is based on the relations among the assets, liabilities, equity (or shareholders' equity). Each items under asset, debt and owners' equity of a particular date will be arranged properly according to the certain standard and sequence of classification. It reflects the overall size and structure of corporate assets, liabilities and owners’ equity. As an accounting statement, balance sheet can reflect the financial situation of the enterprise at a specific date.

Table 4.1 Vertical Common-size analysis of assets

	2007	2008	2009	2010	2011
Cash	17.41%	23.55%	31.28%	21.75%	19.67%
Notes receivable	1.24%	0.20%	0.01%	0.15%	0.53%
Accounts receivable	2.01%	1.67%	1.66%	1.67%	1.41%
Inventories	17.08%	17.15%	13.96%	16.82%	16.61%
other receivables	7.83%	3.12%	5.02%	8.80%	5.57%
Total current assets	45.57%	45.99%	51.94%	49.20%	43.79%

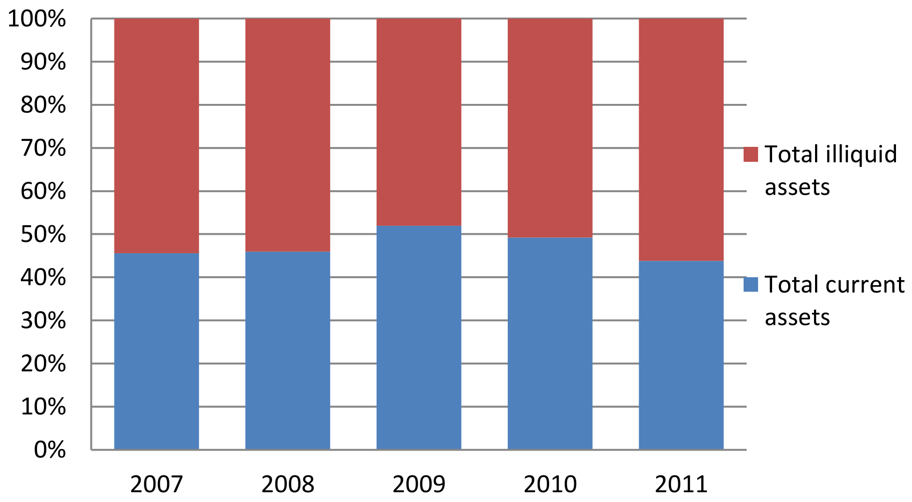
Fixed assets	43.32%	42.50%	38.85%	36.39%	35.26%
Construction in process	4.64%	2.19%	1.72%	4.34%	7.98%
Intangible assets	1.77%	1.91%	2.02%	3.00%	3.39%
other illiquid assets	4.71%	7.41%	5.47%	7.07%	9.58%
Total Illiquid assets	54.43%	54.01%	48.06%	50.80%	56.21%
Total assets	100%	100%	100%	100%	100%

Graph 4.1 Assets from 2007-2011 (unit: million Yuan)

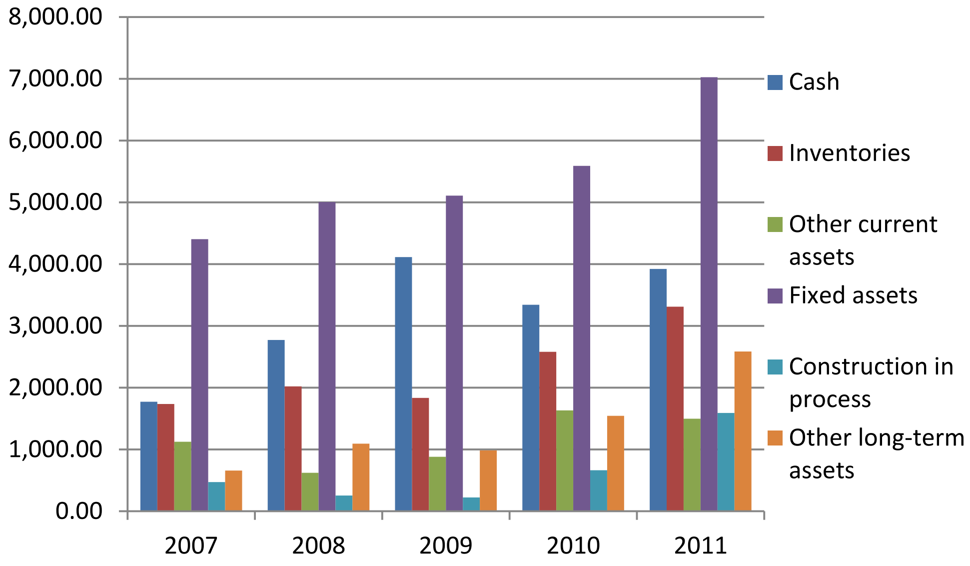


Source: Data are from Yili official annual reports, 2006 to 2011.

Graph 4.2 Assets structure for Yili from 2007 to 2011



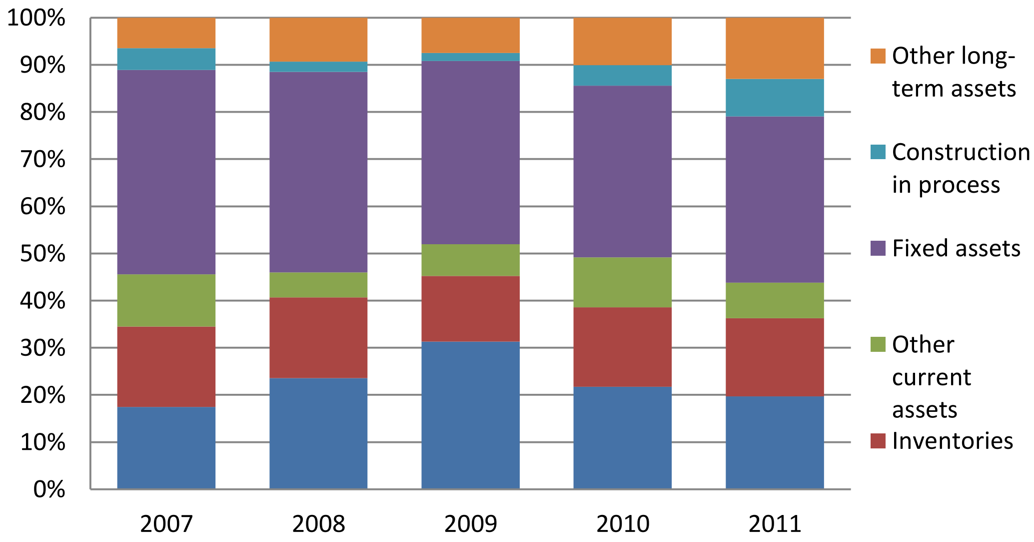
Graph 4.3 Structure of assets (unit: billion Yuan)



Source: data are from Yili official annual reports, 2007 to 2011.

The Graph 4.3 can tell that fixed assets are very high during the last five years, and kept increasing to 7,027 million Yuan in 2011, but 5,591 million Yuan in 2010, increased by 25.69%, because in those years, especially in 2011, variety kinds of new products shown up in the market, Yili had to increase the new producing lines, and to increase yield to meet the demands of the market.

Graph 4.4 Common-size Assets structure for Yili from 2007-2011



Source: data are from Yili official annual reports, 2007 to 2011.

Constructions in process in these years were increasing, because the current investment in new projects. These years Yili paid a lot in constructions, which is also the reason why fixed assets increased a lot.

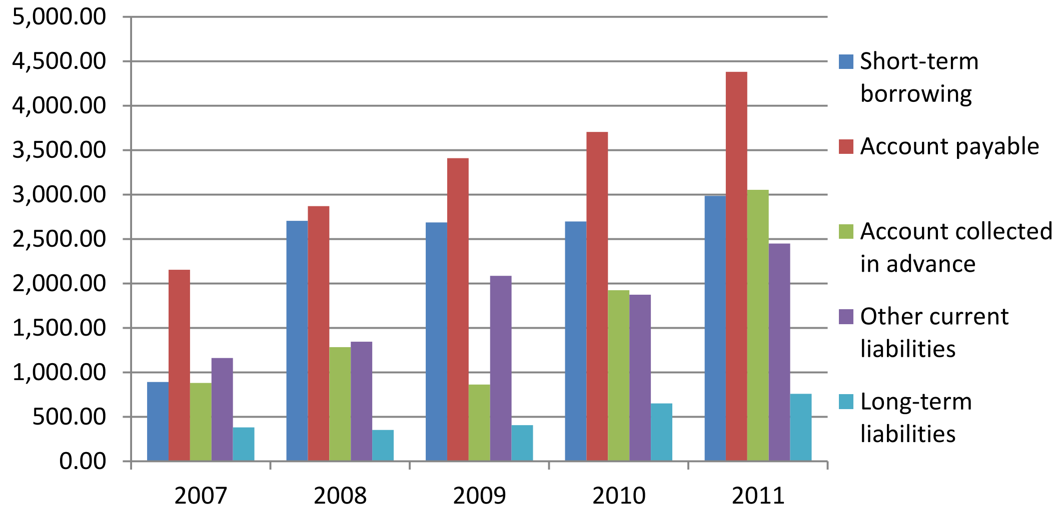
Other long-term assets from 2010 to 2011 increased, firstly, at the beginning of 2011, Intangible assets occupied 3.00% of total assets. But at end of 2011, Intangible assets occupied 3.39%, an increase of 0.39 percentage points, mainly because Yili Group acquired rights some land using. On the other hand, the proportion of the productive biological assets to total assets at the beginning was 0.89%, but at the end of 2011, the proportion the productive biological assets to total assets was 4.37%, increase by 3.48 percentage points, mainly due to the purchase of young cattle and bred cattle for new ranches. From the Graph 4.4, inventory keeps at a very stable level.

Table 4.2 Vertical Common-size analysis of liabilities and equity

	2007	2008	2009	2010	2011
Short-term debt	8.76%	22.94%	20.41%	17.56%	42.26%
Notes payable	0.20%	2.55%	2.73%	1.14%	2.01%
Account payable	21.17%	24.34%	25.90%	24.11%	61.99%
Account collected in advance	8.65%	10.90%	6.56%	12.52%	43.21%
Employee pay payable	3.00%	2.53%	5.27%	5.68%	17.19%
Tax payable	-2.09%	-3.25%	-1.85%	-0.74%	-0.34%
Other payables	9.87%	8.70%	9.07%	5.73%	15.19%
other current liabilities	0.45%	0.89%	0.62%	0.39%	0.62%
Total current liabilities	50.00%	69.62%	68.71%	66.39%	182.14%
Long-term loans	0.93%	0.46%	0.83%	0.39%	0.10%
Long-term payable	1.17%	0.56%	0.19%	0.04%	0.00%
other noncurrent liabilities	1.63%	1.96%	2.06%	3.82%	10.63%
Total noncurrent liabilities	3.73%	2.99%	3.08%	4.24%	10.73%

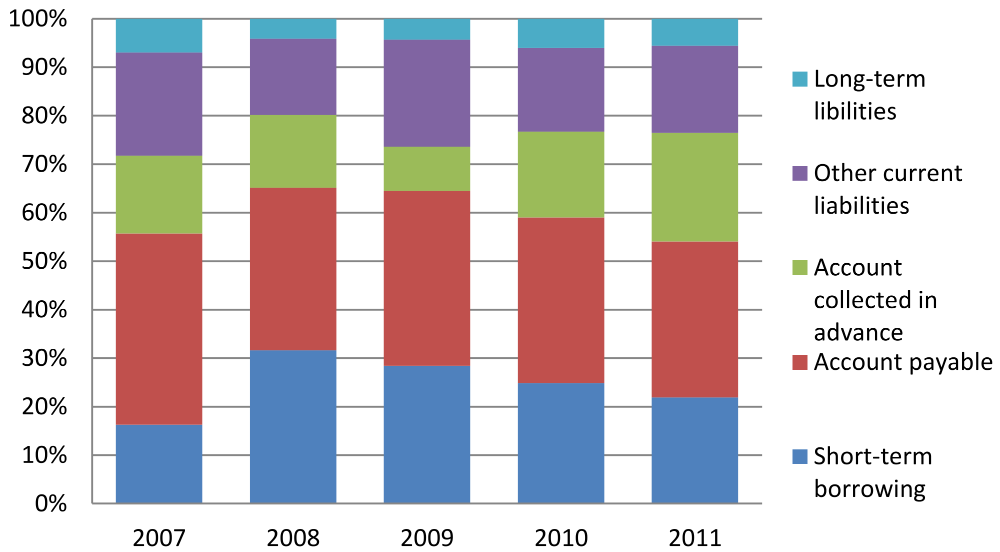
Total liabilities	53.73%	72.60%	71.79%	70.63%	192.87%
Total equity	46.27%	27.40%	28.21%	29.37%	89.27%

Graph 4.5 Structure of liabilities (unit: billion Yuan)



Source: data are from Yili official annual reports, 2007 to 2011.

Graph 4.6 Common-size Assets structure for Yili from 2007-2011

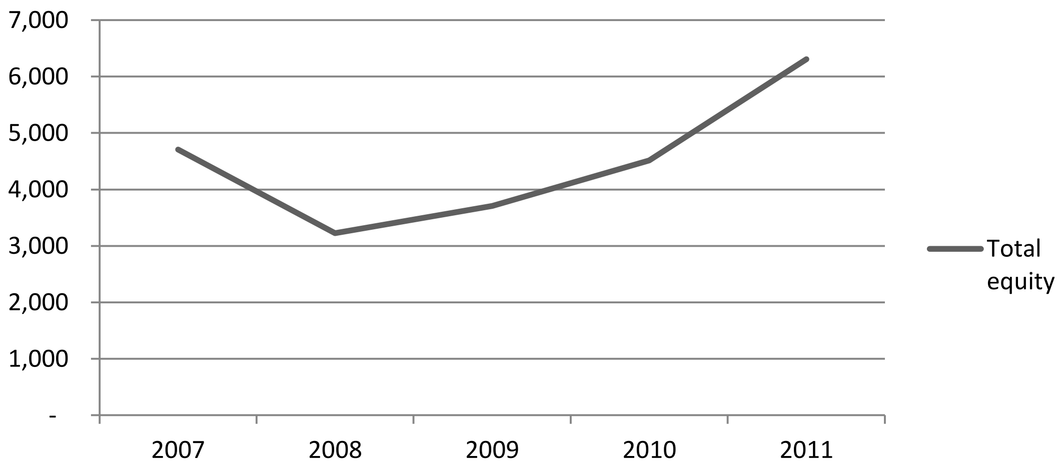


Source: data are from Yili official annual reports, 2007 to 2011.

Graph 4.6 is the structure of liabilities. Liabilities are mainly made up by current liabilities, including short-term borrowing, account payable and account collected in advance, other liabilities and, long-term liabilities. Long-term liabilities just occupy about 5.4% of all liabilities. Account payable occupied the most of the liabilities, and in 2011, it took 32.14% of all the liabilities. At the beginning of 2011, short-term borrowings occupied 17.56% to the total liabilities, but at the end of 2011, the proportion of short-term borrowings to total liabilities was14.98%, a decrease by 2.58 percentage points, mainly because that total liabilities increased.

From graph 4.8, it can be told that the paid-up capital doubled to 1,599 million in 2011, but from 2007 to 2010, paid-up capital was kept to be 799 million, company implemented the schemes of accumulation fund turning to increase subscribed capital, which means every shareholder`s shares were doubled.

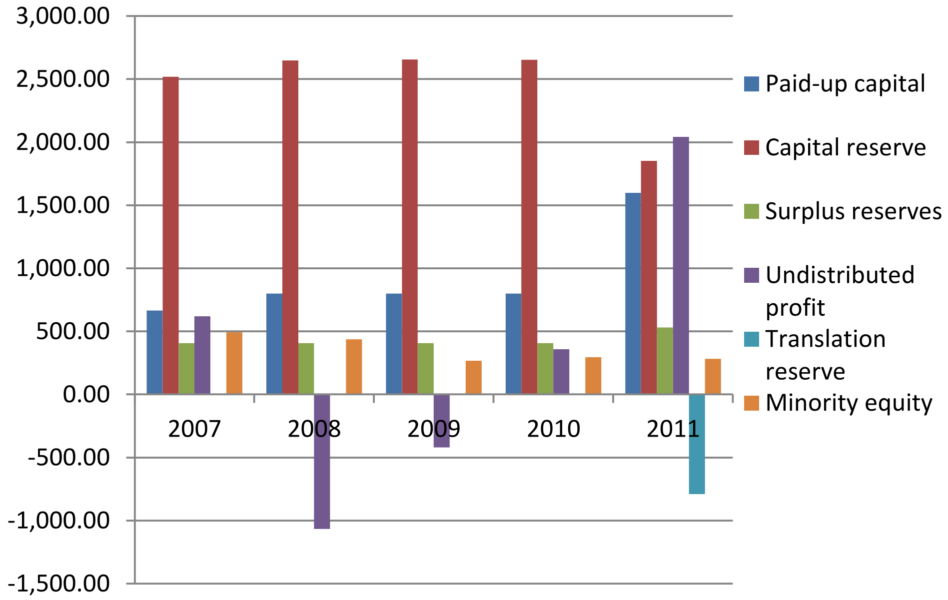
Graph 4.7 Total equity for Yili from 2007 to 2011 (unit: million Yuan)



Source: data are from Yili official annual reports, 2007 to 2011.

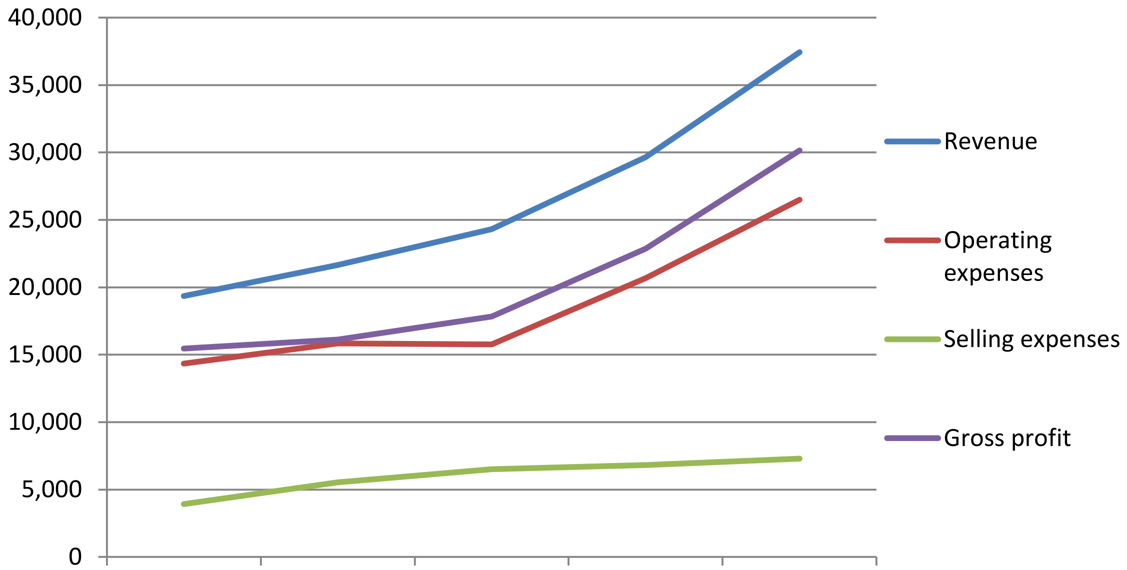
Total number of shares outstanding increased from 799,322,750 shares to 1,598,645,500 shares, earnings per share according to the original share capital was 2.26 Yuan, but was calculated according to the new equity to 1.13 Yuan. The original per share price was7.54 Yuan, but changed to 3.77 Yuan by the new equity. Among total share capital, there are 11,304,046 shares circulation stock with limited sales conditions, which takes 0.71% the proportion of the total share capital. Another 99.29% was circulation stock without limited sales conditions, and the number is 587,341,454 shares.

Graph 4.8 Structure of equity (unit: billion Yuan)



Source: data are from Yili official annual reports, 2007 to 2011.

Graph 4.9 Income statements for Yili from 2007 to 2011 (unit: billion Yuan)



Source: data are from Yili official annual reports, 2007 to 2011.

Table 4.3 Vertical Common-size Analysis of Income Statement

	2007	2008	2009	2010	2011
Revenue	100.00%	100.00%	100.00%	100.00%	100.00%
Selling expenses	20.20%	25.54%	26.71%	22.95%	19.47%
Gross profit	79.80%	74.46%	73.29%	77.05%	80.53%
Administrative, Financial and other expenses	79.36%	83.92%	70.56%	75.01%	75.87%
Operating profit	0.44%	-9.47%	2.74%	2.04%	4.66%
Non-operating income	0.63%	1.01%	0.86%	1.02%	1.12%
Non-operating expenditures	0.52%	0.57%	0.26%	0.18%	0.08%
EBT	0.55%	-9.03%	3.34%	2.88%	5.70%
Income tax	0.57%	-1.01%	0.60%	0.20%	0.81%
Net profit	-0.02%	-8.02%	2.74%	2.68%	4.89%

Source: data are from Yili official annual reports, 2007 to 2011.

From table 4.3 and graph 4.9, it can be told that actual gross profit was kept increasing from 2007 to 2011. The reason of the increasing of gross profit was because in the 5 years, the revenue was kept increasing, especially in 2010 and 2011, In 2009, the revenue was 24,324 million Yuan, but in 2010, it was 29,665 million Yuan, the increasing rate was 21.96% in 2010, and 26.25% in 2011. The reason of the increasing was mainly because of the new products, the series “QQ Star Children's growing milk (referred as QQ star)”. QQ star was introduced in 2009, and in 2009, the market share of QQ star in children's milk market was 38.87% [17]. In 2010, the amount of QQ star sold increased by 207% [18].

As to the increasing rate of other products sold in 2010, the amount of “Smooth Light Yogurt” increased by 180%. The Yili milk powder achieved over

[17] From http://finance.qq.com/a/20100304/002550.htm
[18] From http://money.163.com/11/0429/18/72QVQKTQ00254L67.html

4.6 billion Yuan in 2010, “Jinling infant formula” one kind of infant formula, increased by over 126%.

4.1.2 Horizontal Common-size Analysis

Table 4.4 Horizontal Common-size Analysis of Balance Sheet

	2007	2008	2009	2010	2011
Cash	100.00%	156.61%	232.19%	188.63%	221.33%
Notes receivable	100.00%	18.26%	0.79%	17.88%	84.10%
Accounts receivable	100.00%	96.11%	106.35%	125.50%	137.23%
other receivables	100.00%	46.10%	82.95%	169.87%	139.37%
Inventories	100.00%	116.29%	105.66%	148.71%	190.49%
Total current assets	100.00%	116.87%	147.36%	163.02%	188.26%
Fixed assets	100.00%	113.61%	115.92%	126.85%	159.43%
Construction in process	100.00%	54.70%	48.00%	141.18%	336.98%
Intangible assets	100.00%	125.06%	147.60%	256.61%	376.24%
other illiquid assets	100.00%	182.20%	150.32%	226.92%	398.55%
Total Illiquid assets	100.00%	114.89%	114.14%	140.93%	202.28%
Total assets	100.00%	115.79%	129.27%	151.00%	195.89%

From the chart, total assets keep increasing from 10,174 million Yuan in 2007 to 19,930 million Yuan in 2011. In 2010 and 2011, the line shows a sharp increase and the number between the two years was 4.567 billion Yuan.

Yili Group has businesses involve almost all kinds of dairy food, although melamine incident in 2008 had a huge affection, but with the variety of productions and the reasonable prices, Yili Group developed rapidly. Illiquid assets, from 2007 to 2011, Yili Group have invested 6 billion Yuan in constructing and developing the infrastructure and raw materials source.

Yili Group had constructions in process with the value of 924 million Yuan from 2007 to 2011. And from 2008 Yili Group had a huge amount of productive biological assets with 51 billion Yuan, and the number kept increasing to 871 billion Yuan at 2011, increased by 539.68% during the 3 years. From 2008 to 2011, Yili Group was during a rapid developing period, Yili group got more pastures and developed the farming techniques, and Yili Group also had big investments in his dairy cows.

Table 4.5 Horizontal Common-size Analysis of Liabilities and owners' equity

	2007	2008	2009	2010	2011
Short-term debt	100.00%	303.40%	301.37%	302.82%	335.09%
Notes payable	100.00%	1476.88%	1762.85%	861.92%	696.91%
Account payable	100.00%	133.16%	158.19%	172.01%	203.32%
Account collected in advance	100.00%	146.02%	98.00%	218.63%	346.97%
Employee pay payable	100.00%	97.93%	227.19%	285.98%	398.36%
Tax payable	100.00%	180.25%	114.38%	53.92%	11.22%
Other payables	100.00%	102.01%	118.83%	87.71%	106.82%
other current liabilities	100.00%	229.27%	178.69%	129.87%	96.26%
Total current liabilities	100.00%	161.21%	177.65%	200.48%	252.91%
long term loans	100.00%	57.73%	115.96%	63.12%	7.59%
Long term payable	100.00%	55.72%	20.52%	4.55%	0.00%
Total noncurrent liabilities	100.00%	92.72%	106.66%	171.75%	199.80%
Total liabilities	100.00%	156.46%	172.72%	198.48%	249.22%
Total equity	100.00%	68.57%	78.81%	95.85%	133.95%
Total liabilities and owners' equity	100.00%	115.79%	129.27%	151.00%	189.63%

In table 4.5, Note payable in 2008, is 1467.88% to 2007. It can be told that in 2008, because of the melamine incident, Yili Company didn’t have enough current assets to cover the current debts, which made the huge increase of notes payable.

And we can see, in 2008 the increase of the liabilities was very impressive, but Yili Company controlled very well, and from 2009, the liabilities are controlled. Yili Company developed at a very stable level.

Table 4.6 Horizontal Common-size Analysis of Income Statement

	2007	2008	2009	2010	2011
Revenue	100.00%	111.87%	125.64%	153.23%	193.45%
Selling expenses	100.00%	141.45%	166.09%	174.04%	186.41%
Gross profit	100.00%	104.39%	115.40%	147.96%	195.23%
Administrative, Financial and other expenses	100.00%	118.31%	111.70%	144.84%	184.94%
Operating profit	100.00%	-2420.83%	785.78%	715.25%	2061.83%
Non-operating income	100.00%	180.10%	172.30%	248.99%	346.95%
Non-operating expenditures	100.00%	124.68%	62.94%	54.58%	31.00%
EBT	100.00%	-1838.15%	763.10%	802.34%	2008.06%
Income tax	100.00%	-197.32%	132.13%	52.15%	273.96%
net profit	100.00%	38058.30%	-14578.70%	-17438.35%	-40156.06%

4.2 Financial Ratio Analysis

This part is about financial ratio analysis. Yili Group will be analyzed by studying the financial ratios. This part includes four main kinds of ratios: profitability ratios, liquidity ratios, solvency ratios and activity ratios. The resources of this part are all from the official annual reports. The methods and formulas are all mentioned in Chapter 2.

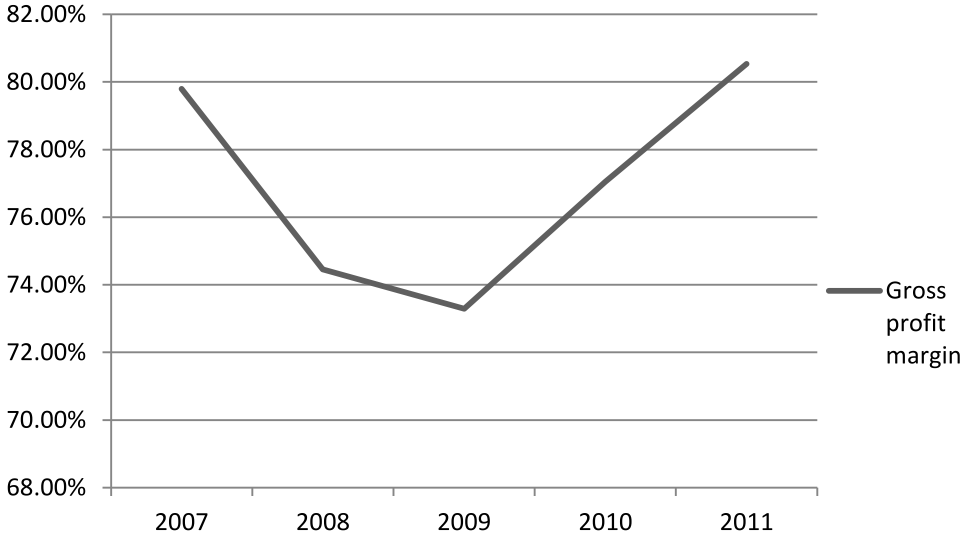
4.2.1 Profitability Ratios

Profitability ratios are used to study the ability of a company to make a profit.

Gross Profit Margin

According to the formula 1, gross profit margin is a ratio of gross profit divided by revenues.

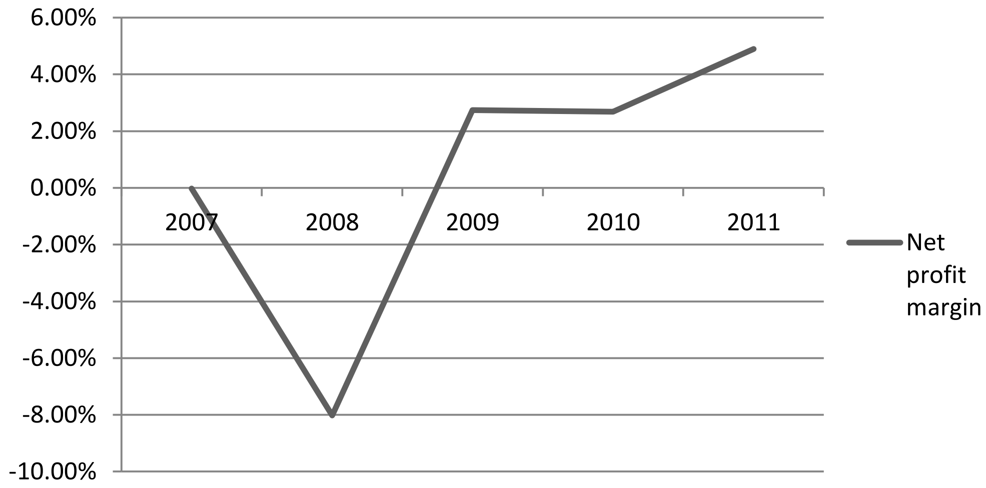
Graph 4.10 Gross profit margin



Gross profit margin decreased from 2007 to 2009, but then, kept increasing from 2009 to 2011. As the increasing of revenue every year, gross profit margin should be increased all the five years. But in 2008, the melamine incident made the selling expenses increased, which made gross profit margin decreased in 2008.

Net Profit Margin

Graph 4.11 Net profit margin

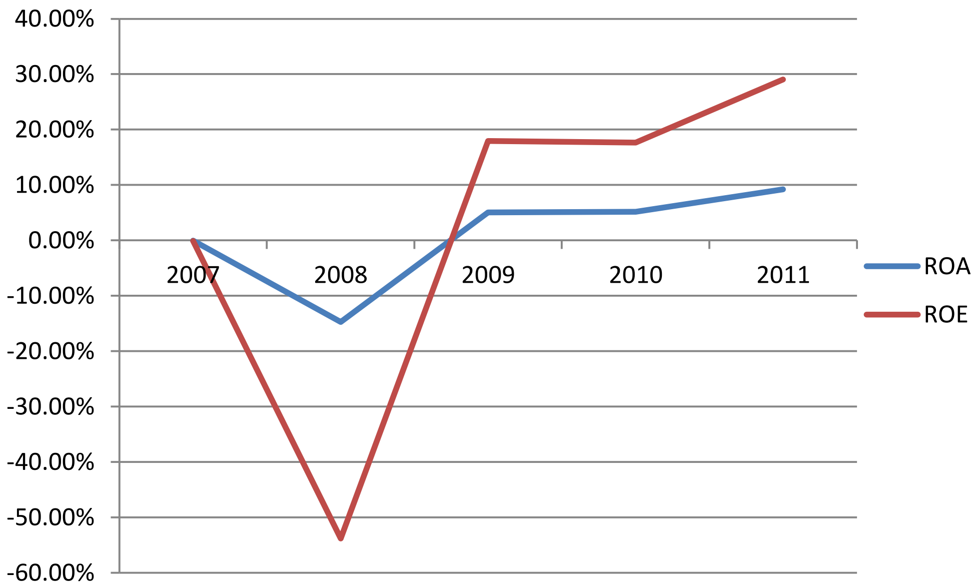


Formula 2 can be used to calculate the net profit margin. Net profit margin that years before 2009 was negative, in 2008, the net profit margin was -8.02%. The reason was that in 2008, Yili Group dealt with crisis of melamine incident, which led to the sharp increase in administrative expenses. The expenses reached 1,915 million Yuan in 2008 while they were just 884 million Yuan in 2007.

In 2007, the net profit margin was -0.02%.But in fact, Yili generated profit in 2007 and profited 3,306 million Yuan in the first three quarters of the year, the reason of the negative net profit margin was because in 2007, Stock option incentive plan brought negative influence on accounting process which could not be covered by the normal business operations. So it couldn`t be avoid of the losing.

Return on Assets (ROA) & Return on Equity (ROE)

Graph 4.12 ROA and ROE for Yili from 2007 to 2011



According to formula 3 and 4, ROA and ROE are calculated in table 4.7.

Compared between ROA curve and ROE curve in Graph 4.12, the ROA curve is more changed than ROE, especially in 2008, and from 2009, Yili starts to profit again, it`s more slope of ROE than ROA.

Table 4.7 ROE & ROA (unit: million Yuan, not include ROA and ROE)

	2007	2008	2009	2010	2011
Net profit	-4.56	-1,736.71	665.27	795.76	1832.44
Total assets	10,173.90	11,780.49	13,152.14	15,362.32	19,929.50
Total equity	4,707.23	3,227.57	3,709.94	4,512.04	6,305.47
ROA	-0.04%	-14.74%	5.06%	5.18%	9.19%
ROE	-0.10%	-53.81%	17.93%	17.64%	29.06%

Source: data are from Yili official annual reports, 2007 to 2011. ROA and ROE are calculated from the data.

ROA in 2007 and 2008 were negative, because of the net profit in the two years were negative. In 2009 and 2010, ROA was kept in a stable index, because those two years, the net profit and assets were both increased at a relatively stable rate, and in 2011, varieties of new dairy products shown in the market such as yogurt with all kind of fruits, different kinds of flavors yogurt. In order to launch new products, Yili invested in new assets, to meet the needs of the market, at the same time Yili had to enlarge its production capacity.

ROE was -0.10% in 2007 , but -53.81% in 2008, decreased a lot, which was mainly because in 2007, the net profit was -4,563,290 Yuan, but in 2008, the number was -1,736,710,919 Yuan, because of the melamine incident and almost all of the products were destroyed, and the increasing rate was as high as 37958.30% while at the same period, the total equity was not changed a lot, which was 4,707 million Yuan in 2007 as well as 3,228 million Yuan in 2008, the increasing rate was just -31.43%.

DuPont analysis

Results are calculated from formula 5.

Table 4.8 ROE ratio decomposition

	2007	2008	2009	2010	2011
Net profit margin	-0.0002	-0.0802	0.0274	0.0268	0.0489
Assets turnover	1.9029	1.8385	1.8494	1.9310	1.8792
Financial leverage	2.1613	3.6500	3.5451	3.4047	3.1607
ROE	-0.00	-0.54	0.18	0.18	0.29

Source: data are from Yili official annual reports, 2007 to 2011. ROE are calculated from the data.

According to formula 5, ROE can be decomposed into three parts, and each part can lead to the change of ROE. From table 4.8, the changes of ROE over 2007 to 2011 were very clear. In 2008, although financial leverage increased, but decrease of net profit margin led to the decrease of ROE. In 2011, net profit margin increased, made ROE increased to 0.29.

4.2.2 Liquidity Ratios

This part includes current ratio, quick ratio, and cash ratio.

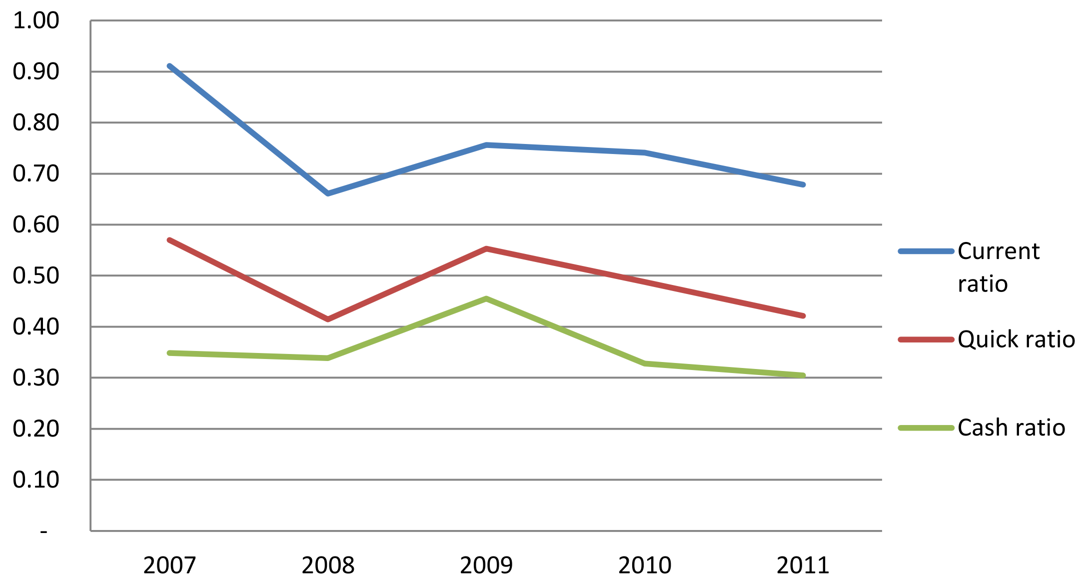
According to formula 6, current ratio is calculated in table 4.9.

Table 4.9 Current ratio (unit: million Yuan, not include current ratio)

	2007	2008	2009	2010	2011
Total current assets	4,636	5,418	6,831	7,558	8,727
Total current liabilities	5,087	8,201	9,037	10,198	12,866
Current ratio	0.91	0.66	0.76	0.74	0.68

Source: data are from Yili official annual reports, 2007 to 2011. Current ratio is calculated from the data.

Graph 4.13 Current ratio, quick ratio and cash ratio for Yili from 2007 to 2011



Source: data are from Yili official annual reports, 2007 to 2011. Current ratio, quick ratio and cash ratio are calculated from the data.

The **current ratio** was decreasing during the five years, and in 2008 is the button of the curve. Yili`s current ratio was low, and to some extent, it shows that its short-term debt paying ability was relatively weak. By the impact of the melamine incident in 2008, the rate of increase of liabilities was greater than the rate of increase of assets.

All in all, current ratio was all less than 1. It means Yili Company had financial risk because in these years, current assets were unable to cover the current liabilities.

According to formula 7, **quick ratio** calculated in table 4.10.

Table 4.10 Quick ratio and cash ratio (unit: million Yuan, not include quick ratio or cash ratio)

	2007	2008	2009	2010	2011
Cash	1,772	2,774	4,113	3,342	3,921
Receivables	1127	623	882	1632	1497
Inventory	1,737	2,020	1,836	2,584	3,310
Total current liabilities	5,087	8,201	9,037	10,198	12,866
Quick ratio	0.57	0.41	0.55	0.49	0.42
Cash ratio	0.35	0.34	0.46	0.33	0.30

Source: data are from Yili official annual reports, 2007 to 2011. Current ratio, quick ratio and cash ratio are calculated from the data.

From graph 4.13, the quick ratio curve is around 0.5 during the five years. It means the short-term debt paying ability need to be improved. There are similarities between quick ratio and current ratio, and both of the ratios are at low levels. From the annual report, in 2008, the inventory took up about 37% of current assets, and the inventory was substantially increased by the "melamine incident". In 2009 the inventory decreased.

According to formula 8, **cash ratio** is calculated in table 4.10. From Graph 4.13, cash ratio shows a trend of decreasing. But in 2009, it increased to 0.46, which was because in 2009, cash generated from operating activities was 2.029 billion Yuan.

From the three ratios, Yili`s liquid assets can hardly cover the liquid liabilities, the financial risks exist.

4.2.3 Solvency Ratios

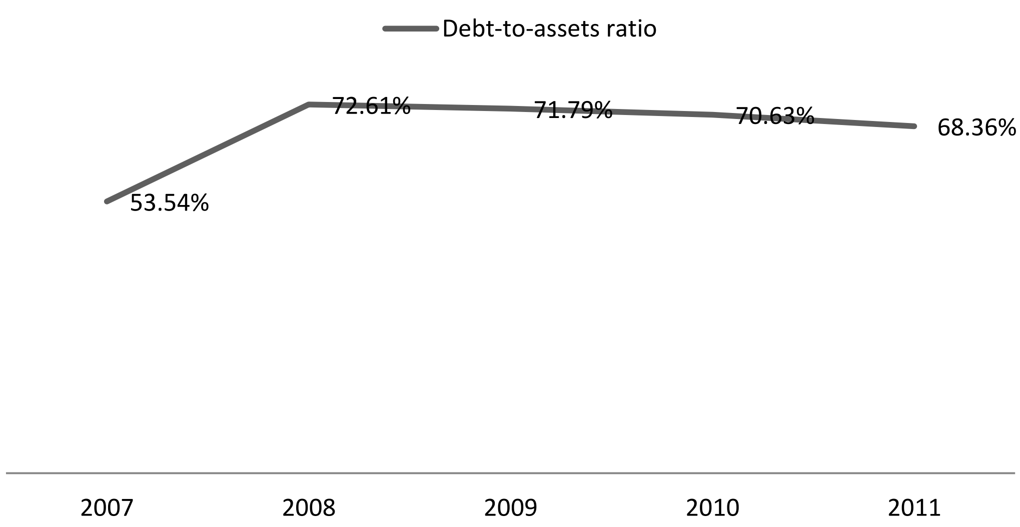
Solvency ratios include debt-to-assets ratio, debt-to-equity ratio and interest coverage. In this part, debt-to-assets ratio and debt-to-equity ratio are used to analyze Yili Group, and the entire formulas are from Chapter 2, all the data are from official annual reports.

According to formula 9, debt ratio is calculated and shown in Graph 4.14.

Debt-to-assets ratio reflects the proportion between assets and debt. In 2007, debt-to-assets ratio was 53.54%, but the next four years, the numbers were above the index of 2007 and kept decreasing from 2008. The increase in 2008 was because liabilities were rising faster than the rate of increase of total assets. In 2008, the liability increased to 8,553 million Yuan from 5,467 million Yuan, increased by 57.02%.

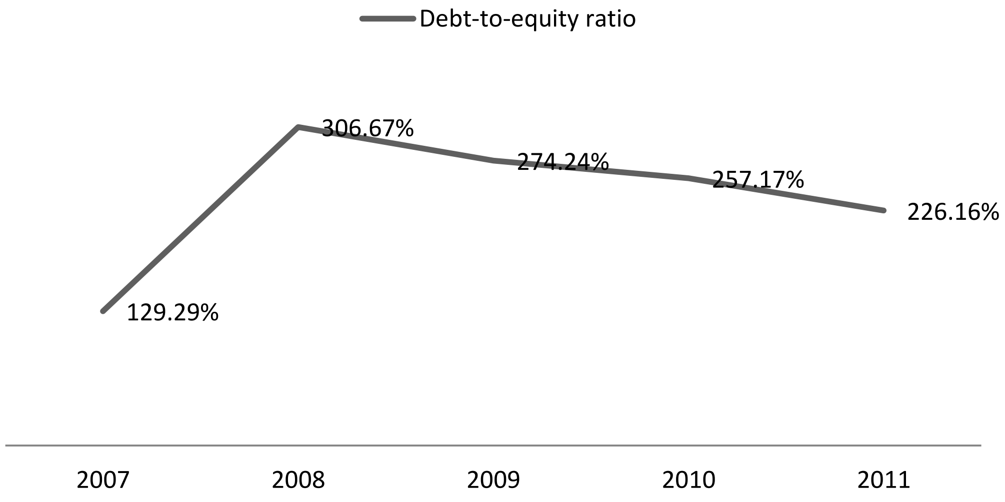
The liabilities of Yili Group increased rapidly in 2008, after the "Melamine Incident". Yili alleviated the negative impacts of the business by increasing liabilities. But which also made Yili Group at a high level of liability, Yili Group should try to reduce financial risks.

Graph 4.14 Debt-to-assets ratio for Yili from 2007 to 2011



According to formula 10, debt ratio is calculated and showed in Graph 4.15.

Graph 4.15 Debt-to-equity ratio for Yili from 2007 to 2011



Debt-to-equity ratio was at 129.29% in 2007 but suddenly increased to 306.67% in 2008, but kept decreasing from 2008. And then, debt-to-equity ratio was decreased to 226.16% in 2011.

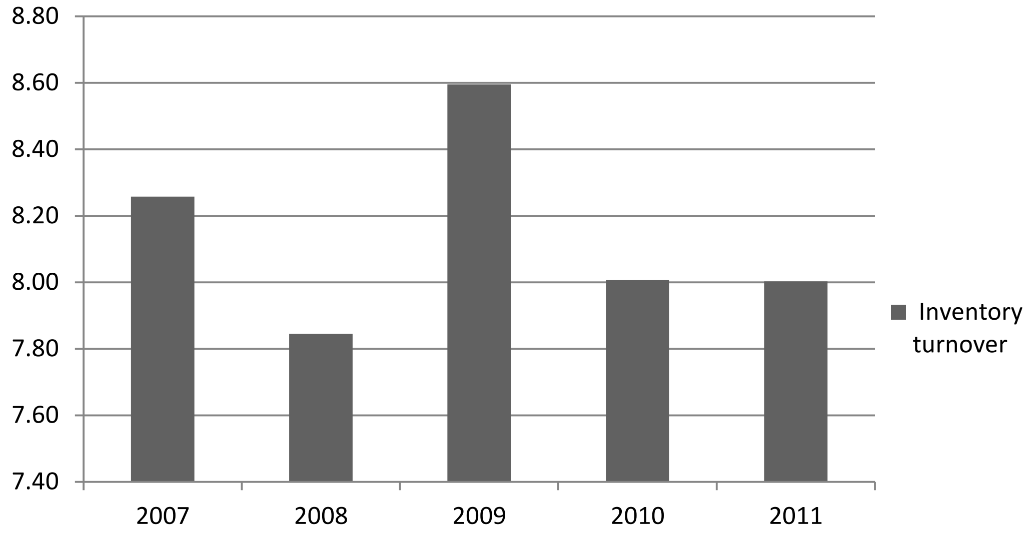
The reason of the increasing in 2008 was because in 2008, the total liability increased by 57.02% while the total equity decreased to 2,789 million Yuan from 4,213 million Yuan. The decreasing of equity and the increasing of liability, led to a loss of profit, but the 3 years later, the index of debt-to-equity kept decreasing which was because the total equity was increasing and the increasing rate was higher than every front year and was 25.57% at 2011. While the increasing rates of total equity were 23% at both 2009 and 2010, and in 2011, the rate was 42.78%.

4.2.4 Activity Ratios

Activities ratios include inventory turnover, total assets turn over, account receivables and payables turnover.

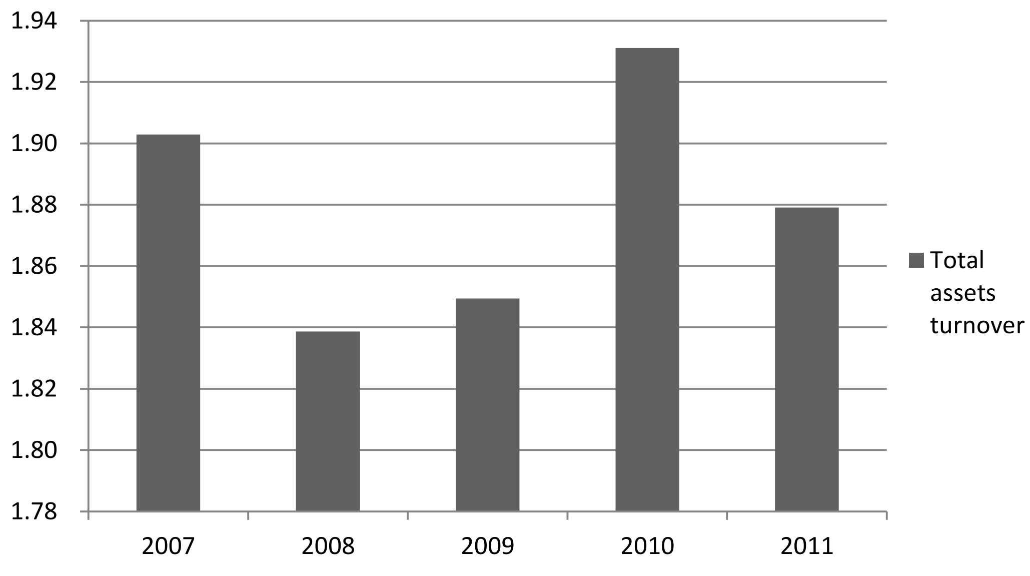
Inventory turnover was relativity stable during the five years. In 2008, because the products were resisted, so, it needed more expenses to sell the products.

Graph 4.16 Inventory turnover for Yili from 2007 to 2011



The inventory increased to 2,020 billion Yuan in 2008, increased by 16.29%, and the operating expense increased 10.47%. And in 2009 the inventory decreased, so the inventory turnover increased, which was good for Yili Group. But in 2010 and 2011, the inventory turnover was decreased, is bad for Yili. Because it meant that Yili sold their products at a very slow speed. In 2008, it needed over 47 days.

Graph 4.17 Total assets turnover for Yili from 2007 to 2011

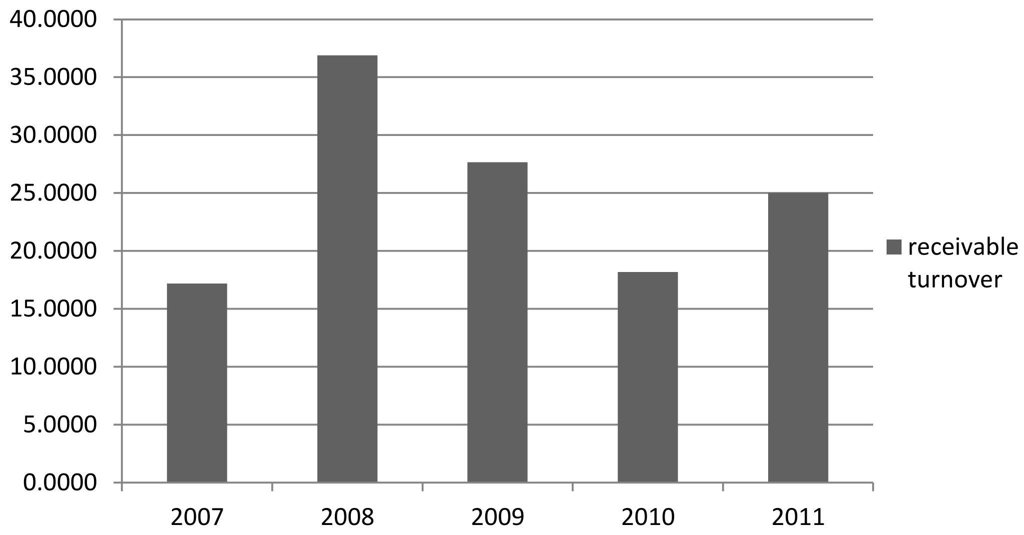


From Graph 4.17, **total assets turnover** during the five years was around

1.88 and the lowest was 1.84 in 2008. The total assets turnover is very low. It means the ability of selling products is very low of Yili Group. But in 2010, the total assets turnover is about 1.93, it was relatively high, it meant the operational capacity enhanced. Overall, Yili`s total assets turnover is not at a high level.

Receivables turnover is calculated by formula 12. And the result is in Graph 4.18.

Graph 4.18 Receivable turnover for Yili from 2007 to 2011

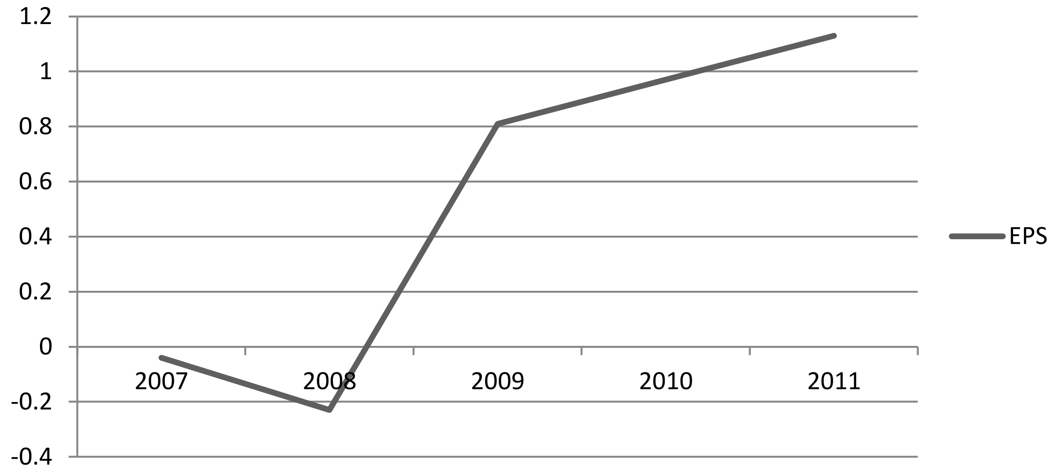


From graph 4.18, receivable turnover in 2008 increased to 37, it means that in 2008, it was very fast to collect the receivable accounts. But in 2008, at the same time, receivables decreased a lot. In 2010, receivable turnover decreased a lot, it was because the receivables increased by 85.61%.

4.2.5 Other Ratio

Earnings per Share

Graph 4.19 Earnings per share for Yili from 2007 to 2011



Earnings per share continued to rise from 2008 to 2011, but were decreased to negative from 2007 to 2008. The company`s revenue was negative in 2008, -0.23 while was -0.04 in 2007. It was bad in the two years of 2007 and 2008. But to 2009, the EPS index went up to 0.81 and kept increasing to 1.13 in 2011. The ability of profiting was kept increasing, it is good for Yili Group.

5. Conclusion

This thesis is the financial analysis of Yili Industrial Group Co., Ltd. from 2007 to 2012. And Yili Company is one of the biggest Chinese dairy food producers. By combining the analysis of data from Yili official annual reports and the actual operation situation of Yili Company, there are some results.

From the structure of assets over the years, fixed assets take the main proportion of total assets and keeps increasing, as well as other long-term assets. Yili Company has a good foundation, and Yili Company is at a stage of stable development. As to current assets, inventories take the most proportion of current assets, which is bad for the short-term solvency, because inventories are not the most liquidity current assets. And on the other hand, as a dairy food producer, the products are not able to be stored for a very long time. So, the high amount of inventory will increase the operating expenses and the sales costs.

The analysis of capital structure shows that the main source of financing is debts. The solvency ratios show that the liabilities take about 70% of total assets, and the solvency ratios show that Yili Company has tried to keep the ratio decreased at a very slow speed, which is good for Yili Company, because Yili Company doesn't have a big amount of current assets to pay for the liabilities for emergencies. But at the same time, Yili Company should try to keep the ratio at a stable position, use the liabilities to maximize the output and invest in fixed assets or other long-term assets.

From activity ratios, the inventory turnover and total assets turnover of Yili Company are not very high. As a dairy food producer, inventory turnover must be high, because higher the index of inventory turnover, the more profit will be generated. On the other hand, low level of inventory turnover not only means the profit is hard to generated, but also means loss. Because dairy foods are

FMCG [19], the longer the goods stored, the higher the expenses will be cost and the goods can`t be stored too long with the shelf fife. So, Yili Company should increase the inventory turnover.

All in all, firstly, Yili Company should decrease debts, which will help to decrease the financial risk. Secondly, Yili Company should try to increase the inventory turnover. On one hand, Yili Company can decrease the output volume. On the other hand, Yili Company can improve the sales volume by developing sales channels.

In the future of Chinese dairy food market, Yili Company will still be a very competitive force. The debt of Yili Company will keep at a stable level. But the inventory of Yili Company may keep increasing, but then, stop at a stable level, because of the maximized output volume. But as to the infant formula market, foreign competitors will still take the most share of market.

[19] Fast Moving Consumer Goods

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List of Abbreviations

CHN	China
ROA	Return on Assets
ROE	Return on Equity
FMCG	Fast Moving Consumer Goods
IPO	Initial Public Offering

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List of Annexes

Annex 1

Balance Sheet of Yili Company from 2007 to 2011

(Unit： Yuan)

	2007	2008	2009	2010	2011
Current assets					
Cash	1,771,591,888.52	2,774,432,558.38	4,113,466,057.89	3,341,742,647.44	3,921,128,772.64
Notes receivable	125,809,910.00	22,978,071.88	1,000,000.00	22,500,000.00	105,810,000.00
Accounts receivable	204,955,385.89	196,978,423.69	217,978,370.09	257,222,847.09	281,270,491.14
Prepaid receivable	497,010,521.03	283,946,051.86	568,839,075.36	1,239,509,229.17	834,925,418.09
Interest receivable	0.00	0.00	0.00	0.00	10,280,139.94
Other receivables	299,179,263.20	83,111,155.39	91,568,167.90	112,983,445.95	264,442,578.89
Inventories	1,737,371,120.52	2,020,365,899.75	1,835,651,029.35	2,583,654,422.61	3,309,585,543.63
Non-current asset(expire in a year)	0.00	37,859.93	0.00	0.00	0.00
Other current assets	0.00	36,012,793.06	2,782,722.30	0.00	0.00
Total current assets	4,635,918,089.16	5,417,862,813.94	6,831,285,422.89	7,557,612,592.26	8,727,442,944.33
Long-term assets					
Available for sale financial assets	21,334,400.00	7,409,296.00	13,351,088.00	17,735,872.00	14,316,800.00
Long-term equity investments	390,432,626.62	515,972,399.82	386,835,644.47	605,602,432.83	566,779,673.46
Fixed assets	4,407,399,561.42	5,007,185,518.62	5,109,208,919.26	5,590,570,496.64	7,026,827,944.50
Construction in process	472,011,721.12	258,200,327.58	226,579,839.09	666,373,112.55	1,590,594,865.86

Project goods and material	31,679,887.28	1,587,051.11	1,235,042.74	54,211,543.96	44,686,645.29
Disposal of fixed assets	305,100.00	479,839.99	15,430.64	0.00	0.00
Productive biological assets	0.00	50,751,016.38	87,290,324.96	136,219,033.34	871,363,646.55
Intangible assets	179,692,331.42	224,722,577.91	265,229,690.82	461,106,169.78	676,074,690.79
Deferred assets	16,663,779.54	10,247,118.44	1,932,849.87	4,753,261.12	43,268,710.98
Deferred income tax assets	18,462,904.29	286,070,975.29	229,179,393.77	268,139,572.09	368,144,679.72
Total Illiquid assets	5,537,982,311.69	6,362,626,121.14	6,320,858,223.62	7,804,711,494.31	11,202,057,657.15
Total assets	10,173,900,400.85	11,780,488,935.08	13,152,143,646.51	15,362,324,086.57	19,929,500,601.48
Current liabilities					
Short-term borrowing	890,904,693.87	2,703,000,000.00	2,684,879,780.10	2,697,833,904.93	2,985,290,639.32
Notes payable	20,350,000.00	300,545,000.00	358,740,000.00	175,400,000.00	141,820,900.00
Account payable	2,153,576,633.07	2,867,701,379.24	3,406,822,604.01	3,704,272,507.32	4,378,729,526.54
Account collected in advance	879,757,711.83	1,284,599,594.60	862,146,325.62	1,923,396,559.33	3,052,494,569.83
Employee pay payable	304,888,016.69	298,589,197.91	692,667,827.31	871,916,067.78	1,214,563,278.95
Tax payable	-212,237,125.07	-382,553,849.11	-242,755,341.32	-114,443,393.87	-23,807,591.98
Accrued interest payable	1,290,749.81	1,656,109.28	1,284,655.00	1,583,297.50	26,818,270.53
Dividends payable	9,443,269.37	9,440,770.42	9,440,770.42	9,440,770.42	9,440,770.42
Other payables	1,004,272,130.33	1,024,475,283.96	1,193,347,879.55	880,832,291.20	1,072,751,648.27
Current liabilities falling due within one year	34,919,494.95	93,574,826.02	70,851,849.18	48,267,979.23	7,689,014.04
Total current liabilities	5,087,165,574.85	8,201,028,312.32	9,037,426,349.87	10,198,499,983.84	12,865,791,025.92
Noncurrent liabilities					
Long-term loans	94,629,000.00	54,629,000.00	109,729,000.00	59,729,000.00	7,179,000.00

Long term payable	118,629,325.23	66,101,468.05	24,340,976.17	5,401,474.11	0.00
Specific payable	33,646,927.80	33,617,566.89	33,553,144.99	69,971,733.02	58,005,124.77
Anticipation liabilities	0.00	0.00	3,000,000.00	0.00	0.00
Deferred income tax liabilities	3,060,360.00	2,155,556.72	1,862,863.20	2,520,580.80	2,007,720.00
Other noncurrent liabilities	129,536,077.50	195,387,006.18	232,292,450.96	514,166,043.55	691,044,893.20
Total noncurrent liabilities	379,501,690.53	351,890,597.84	404,778,435.32	651,788,831.48	758,236,737.97
Total liabilities	5,466,667,265.38	8,552,918,910.16	9,442,204,785.19	10,850,288,815.32	13,624,027,763.89
Owner`s equity					
Paid-up capital	666,102,292.00	799,322,750.00	799,322,750.00	799,322,750.00	1,598,645,500.00
Capital reserve	2,518,594,081.16	2,649,196,237.77	2,655,236,317.71	2,653,626,149.47	1,851,176,038.67
Surplus reserves	406,917,510.69	406,917,510.69	406,917,510.69	406,917,510.69	532,015,115.13
Undistributed profit	621,274,388.67	-1,066,173,178.46	-418,513,471.14	358,683,158.29	2,042,805,093.62
Translation reserve	0.00	-510.00	-1,884.81	-30,403.85	-788,731.15
Total equity(parent company)	4,212,888,272.52	2,789,262,810.00	3,442,961,222.45	4,218,519,164.60	6,023,853,016.27
Minority equity	494,344,972.95	438,307,214.92	266,977,638.87	293,516,106.65	281,619,821.32
Total equity	4,707,233,245.47	3,227,570,024.92	3,709,938,861.32	4,512,035,271.25	6,305,472,837.59
Total liabilities and owners' equity	10,173,900,510.85	11,780,488,935.08	13,152,143,646.51	15,362,324,086.57	7,063,709,575.56

Annex 2

Cash flow of Yili Company from 2007 to 2011 (Unit: Yuan)

	2007	2008	2009	2010	2011
Cash Flow from Operating Activities					
Cash from selling commodities or offering labor	24,166,312,120.59	24,455,848,396.29	28,829,302,331.38	35,048,997,981.99	44,505,054,123.68
Refunds of taxes	89,148,954.67	96,887,891.90	17,342,793.46	0.00	813,721.95
Received other business activities	150,798,948.41	364,810,797.05	393,277,317.48	602,816,119.36	730,716,117.46
Cash inflows from operating activities	24,406,260,023.67	24,917,547,085.24	29,239,922,442.32	35,651,814,101.35	45,236,583,963.09
Cash paid for goods or offering services	20,951,034,160.64	21,935,941,334.62	24,057,019,933.81	30,153,938,960.60	36,128,310,394.68
Cash paid to and on behalf of employees	1,082,945,809.01	1,193,621,434.21	1,430,490,021.82	2,208,691,890.99	2,782,603,131.76
Tax payments	1,073,931,648.70	1,264,468,657.86	1,412,665,156.62	1,405,980,102.16	2,189,540,492.31
Cash paid relating to other operating activities	520,217,611.63	340,940,518.84	310,920,820.18	408,629,290.21	465,754,894.37
Sub-total of cash outflows	23,628,129,229.98	24,734,971,945.53	27,211,095,932.43	34,177,240,243.96	41,566,208,913.12

Net cash flows from operating activities	778,130,793.69	182,575,139.71	2,028,826,509.89	1,474,573,857.39	3,670,375,049.97
Cash Flow from Investing Activities					
Cash from investment withdrawal	800,000.00	0.00	17,265,221.48	0.00	436,210,023.42
Cash from investment income	1,544,573.71	34,264,730.43	1,244,844.00	18,973,682.31	13,879,957.32
Net cash from disposing fixed assets， intangible assets and other long－term ass	20,333,510.81	16,013,755.84	7,605,762.22	15,247,648.42	26,673,964.49
Cash received from disposal of subsidiary or other operating business units	3,919,477.15	2,939,271.92	0.00	0.00	25,822,137.42
Cash inflow from investment activities	26,597,561.67	53,217,758.19	26,115,827.70	34,221,330.73	502,586,082.65
Cash paid for buying fixed assets， intangible assets and other long－term investment	1,041,179,857.92	820,296,460.91	571,454,054.16	1,987,341,331.74	3,788,541,302.42
Cash paid for investment	377,631,600.00	142,500,000.00	92,503,236.04	226,007,700.00	189,689,503.58
Net cash paid for the acquisition of subsidiaries and other business entities	56,345,449.33	0.00	77,580,290.27	2,015,434.69	0.00
Cash outflow for investment activities	1,475,156,907.25	962,796,460.91	741,537,580.47	2,215,364,466.43	3,978,230,806.00

Net cash flows from investing activities	-1,448,559,345.58	-909,578,702.72	-715,421,752.77	-2,181,143,135.70	-3,475,644,723.35
Cash Flow from Financing Activities					
Cash received from accepting investment	1,379,008,611.16	10,823,856.00	14,230,000.00	16,800,000.00	500,000.00
Borrowings	1,166,000,000.00	3,328,000,000.00	2,619,803,828.15	2,637,833,904.93	3,969,727,410.88
Other cash received related to financing activities	73,738,615.63	0.00	0.00	0.00	0.00
Cash Inflow Subtotal	2,618,747,226.79	3,338,823,856.00	2,634,033,828.15	2,654,633,904.93	3,970,227,410.88
Cash paid for debt	1,053,000,000.00	1,555,904,693.87	2,663,000,000.00	2,674,879,780.10	3,775,399,641.68
Cash paid for dividend ， profit or interest	133,963,128.53	67,915,018.44	69,173,051.14	66,542,936.78	87,599,047.67
Other cash paid related to financing activities	2,229,260.94	0.00	0.00	0.00	239,221,211.49
Cash Outflow Subtotal	1,189,192,389.47	1,623,819,712.31	2,732,173,051.14	2,741,422,716.88	4,102,219,900.84
Net cash flows from financing activities	1,429,554,837.32	1,715,004,143.69	-98,139,222.99	-86,788,811.95	-131,992,489.96
Foreign Currency Translation Gains（Losses）	376,947.17	44,924.64	-1,374.81	-28,519.04	-794,946.00
Net Increase Of Cash and Cash Equivalents	759,503,232.60	988,045,505.32	1,215,264,159.32	-793,386,609.30	61,942,890.66

Initial cash and cash equivalents balance	1,012,088,655.92	1,771,591,888.52	2,759,637,393.84	3,974,901,553.16	3,181,514,943.86
The final cash and cash equivalents balance	1,771,591,888.52	2,759,637,393.84	3,974,901,553.16	3,181,514,943.86	3,243,457,834.52

Annex 3

Income statement of Yili Company from 2007 to 2011 (Unit: Yuan)

	2007	2008	2009	2010	2011
Revenue	19,359,694,864.94	21,658,590,273.00	24,323,547,500.31	29,664,987,260.70	37,451,372,248.72
Operating costs	14,347,272,657.06	15,849,142,905.62	15,778,073,722.70	20,686,308,840.42	26,485,666,175.08
Business tariff and annex	82,608,269.22	121,515,778.58	108,832,765.09	87,784,886.57	232,922,278.65
Selling expenses	3,911,268,086.50	5,532,389,959.26	6,496,091,518.77	6,807,067,269.38	7,290,955,387.27
Management expenses	884,390,861.36	1,915,430,908.85	1,190,963,077.55	1,520,809,073.15	1,970,693,655.02
Financial expense	29,153,007.50	14,454,502.28	22,402,705.89	-20,707,549.05	-49,159,439.17
Loss from asset devaluation	17,439,149.70	295,682,527.15	76,895,264.14	-10,195,676.52	28,112,646.07
Investment income	-2,880,525.91	20,014,446.22	15,125,115.64	11,767,494.63	253,824,700.61
Total operating cost	19,272,132,031.34	23,728,616,581.74	23,673,259,054.14	29,071,066,843.95	35,959,190,702.92
Operating profit	84,682,307.69	-2,050,011,862.52	665,413,561.81	605,687,911.38	1,746,006,246.41
Non-operating revenue	121,434,688.07	218,705,100.55	209,232,829.42	302,361,421.60	421,321,005.72
Nonbusiness expenditure	99,724,812.21	124,336,597.68	62,769,541.27	54,425,773.10	30,911,032.14
Disposal loss on noncurrent liability	10,334,120.95	17,176,412.17	15,641,701.48	21,829,444.33	23,478,465.20
Total profit	106,392,183.55	-1,955,643,359.65	811,876,849.96	853,623,559.88	2,136,416,219.99
Income tax expense	110,955,473.80	-218,932,440.78	146,608,521.73	57,860,825.27	303,978,871.28
Net profit	-4,563,290.25	-1,736,710,918.87	665,268,328.23	795,762,734.61	1,832,437,348.71