Private Client Research

8 August 2019

Infant Formula Sector

a2 Milk and Bellamy's – initiation of coverage

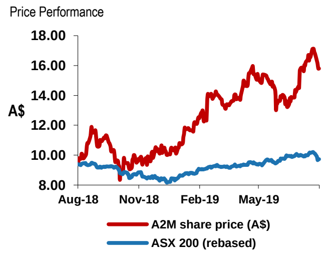
The Australia and New Zealand (ANZ) infant formula industry has been transformed by demand from China, with key drivers being attributes of product, brand, usage and provenance.

Ord Minnett initiates coverage of a2 Milk Company (A2M) with an Accumulate recommendation and a $17.23 target price, as we are confident of further market share gains assisted by expanding its addressable market. We also **initiate coverage of Bellamy's Australia (BAL) with a Hold recommendation and a $9.50 target price**, with business enhancement underpinning its $500 million revenue ambition, although execution risk remains.

- **ANZ infant formula industry –** The dramatic rise in demand from China has been transformational. The premiumisation trend is a key driver of demand for ANZ product, with its ANZ provenance and usage resulting in market share gains by selected ANZ-sourced infant formula companies. As part of a global collaboration with our European consumer goods counterparts, we find the outlook for the China infant formula market is robust, but less attractive than the 10% growth rate seen in 2017 and 2018.
- **a2 Milk Company –** Product (A1-free), brand (aspirational, health and wellness), ANZ provenance, ANZ usage and the deep engagement with core consumers are key demand drivers. a2 Milk has a nimble route to market that is able to adjust to changing points of purchase, while its understanding of daigou (personal shopper) channel economics is a competitive advantage. We see some increasing industry risks, but we are confident further market share gains will be achieved. a2 Milk could expand its addressable market (geographically, greater mother and baby store [MBS] presence) and has continued to perform well when competitors have entered the a2 category. Despite share price outperformance, we see valuation support, while we believe its premium price-to-earnings (P/E) multiple is justified given the strong forecast revenue, operating earnings (EBITDA) and EPS growth, based on a forecast three-year compound annual growth rate (CAGR) of 23.2%.
- **Bellamy's Australia –** Product (predominantly organic, a fast-growing category where Bellamy's has sourcing capability), brand (known and trusted for organics) and Australian provenance are key drivers. Bellamy's has set a $500m revenue target predicated on new branding and product formulation, new product development (including China-label, subject to SAMR approval) with these initiatives supported by investments in marketing and its China team. There are increasing industry risks, especially the desire from China for domestic production to grow to 60% (47% currently), which for Bellamy's could impact the timing of State Administration for Market Regulation (SAMR) approval. There is modest valuation support and the prospect for P/E multiple expansion if earnings growth can be achieved. We are cautious, however, about the pace of multiple expansion given execution risk and the less established position that makes Bellamy's more vulnerable to industry risks.

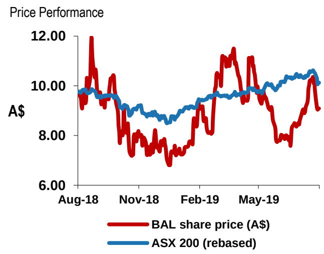
a2 Milk Company (A2M)

Recommendation
Accumulate
Risk
Higher
Target price
$17.23
Last price
$15.79



Bellamy's Australia (BAL)

Recommendation
Hold
Risk
Higher
Target price
$9.50
Last price
$9.13



Executive Summary

Australia and New Zealand infant formula industry

- The Australia and New Zealand (ANZ) infant formula industry has been transformed. China infant formula demand, especially foreign-sourced and premium formula, has increased rapidly following a milk product safety scandal in 2008, with market growth over the past 2 years benefitting from improved demographics and an acceleration of premiumisation.
- The premiumisation trend is a key driver of demand for ANZ product, with its ANZ provenance and usage resulting in market share gains by selected ANZ sourced infant formula companies. Further, product specifications have also found appeal from consumers in China, with A1 free (A2M) and organic (BAL), as well as goat, product innovation that can drive further market share gains.
- The route to market and the regulation of route to market is dynamic, requiring nimble operators with sound inventory management, while an understanding of daigou (personal shopper) channel economics has also been required to access the market share gains available.
- Looking forward, as detailed in a global collaboration report with the European Consumer Goods team led by Celine Pannuti, the outlook for the China infant formula market is robust but less attractive than the ~10% growth rate across 2017 and 2018. Volume growth will be constrained by demographics (birth rate and kilos consumed), while the current pace of premiumisation may not be able to be sustained. In that environment, market share growth will be required to achieve rates of growth near historic levels, intensifying competition.
- Against this backdrop we initiate on A2M at Accumulate and BAL at Hold noting confidence that these companies will be able to grow market share from the current levels by expanding distribution reach while emphasising brand & product differentiation, as well as provenance & usage. We are more confident on A2M given its established position and route to market, while we await SAMR approval for BAL for its China label product although operational improvements are being deployed to take advantage of the market opportunity.

Initiate on a2Milk Company with Accumulate, $17.23 PT

- **We initiate on A2M with an Accumulate recommendation** and a 30 June 2020 share price target of NZ$18.00 ($17.23 for A2M AU). The summary of investment drivers and risks are outlined in the table below.

Table 1: A2M – Summary of investment drivers and investment risks

Investment Drivers	Investment Risks
Driver #1: A2 infant formula product, brand, provenance, usage, and engagement with core consumers drive demand	Risk #1: China infant formula market could see volume growth constrained by demographics with premiumisation to remain a driver but the pace could moderate
Driver #2: An advantaged route to market to the key China consumer with daigou a positive and A2M able to expand its addressable market	Risk #2: Competition within the China infant formula market could intensify which would require market share gains to sustain growth rates
Driver #3: US liquid milk an attractive market opportunity	Risk #3: Significant organisational change is occurring

Source: Ord Minnett.

- **A2M has several key drivers.** Product (A1 free), brand (aspirational, health & wellness), ANZ provenance, ANZ usage and a deep engagement with core consumers. A2M has a nimble route to market which is able to adjust to changing points of purchase, while its understanding of daigou channel economics is a competitive advantage. Looking forward, further growth in China is forecast as A2M can continue to expand its addressable market, geographically and by channel, especially Mother & Baby Stores (MBS) where it is somewhat under-represented.
- **A2M is exposed to some industry risks but we are confident further market share gains will be achieved.** The outlook for the China infant formula market is less robust as demographics constrain volume growth and questions exist on the pace of ongoing premiumisation. This could see greater level of competition for access to MBS, while China has indicated a desire to grow domestic production of infant formula to 60%. For A2M, it is able to expand its addressable market (geographically, greater MBS presence) and it has performed well when competitors have entered the A2 category.
- **A2M is evolving with significant organisational change.** Such management changes are not unexpected yet these must not upset the culture that has driven the significant growth of the business.
- **Valuation support exists despite strong share price performance.** A2M has outperformed the ASX 100 by 37.9% since 1 January 2019 and is trading at high earnings multiples. Yet there is valuation support (DCF NZ$17.40) while we suggest the premium multiple is justified given the strong forecast revenue, EBITDA and EPS growth over the next 3-6yrs.

Table 2: A2M – Sales, EBITDA and EPS growth and P/E multiple (OMLe)

	2016	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Sales growth	127.7%	55.8%	67.9%	42.1%	26.8%	19.1%	13.6%	11.1%	10.8%	10.0%
EBITDA growth	Na	158.6%	100.5%	48.1%	24.9%	24.2%	18.5%	16.5%	13.4%	12.9%
EPS growth	Na	185.2%	114.0%	50.2%	26.3%	24.7%	18.8%	16.8%	13.7%	13.2%
P/E	Na	134.7x	63.0x	41.9x	33.2x	26.6x	22.4x	19.2x	16.9x	14.9x

Source: Company reports, Ord Minnett estimates and Bloomberg. June year end. P/E as of 6-Aug-19.

Initiate on Bellamy's Australia with Hold, $9.50 PT

- **We initiate on BAL with a Hold recommendation** and a 30 June 2020 share price target of $9.50 per share. The summary of investment drivers and risks are outlined in the table below.

Table 3: BAL – Summary of investment drivers and investment risks

Investment Drivers	Investment Risks
Driver #1: Well positioned in the attractive and high growth organic food and infant formula market	Risk #1: SAMR approval not yet received, organic infant formula economics not yet attractive, and execution risk
Driver #2: $500m medium term revenue ambition a function of new branding, new product launches and SAMR approval for China label product	Risk #2: China infant formula market could see volume growth constrained by demographics with premiumisation to remain a driver but the pace could moderate
Driver #3: Baby food is a complementary stable growth avenue with halo benefits	Risk #3: Competition within the China infant formula market could intensify which would require market share gains to sustain growth rates

Source: Ord Minnett.

- **BAL has a focus on organics with business enhancements occurring.** It is well positioned to leverage the fast growing organic food and infant formula market. It has expertise in sourcing organic product, which is difficult; it has a predominantly organic product range; and it enjoys a known & trusted brand with organic credentials. The company has set a $500m revenue ambition ($275-300m FY19 guidance) predicated on new branding & product formulation and new product development (including China-label, subject to SAMR [State Administration for Market Regulation] approval), with these initiatives supported by investments in marketing and its China team. Finally, its baby food product helps drives brand awareness for the core consumer, introducing and extending the time with the brand.

- **BAL is exposed to some industry risks which we suggest may moderate the rate of market share gains in China.** The outlook for the China infant formula market is less robust as demographics constrain volume growth and questions exist on the pace of ongoing premiumisation. This could see greater level of competition for access to MBS, while China has indicated a desire to grow domestic production of infant formula to 60%. For BAL, these challenges may impact the timing of SAMR approval and require greater investment to regain momentum in China. While the brand & product offering are attractive, the more challenged external environment is more impactful as the business remains in turnaround.

- **BAL faces several company specific risks and uncertainties.** There has been a delay with SAMR approval (for China-label product) and it has not yet been received. The economics of BAL organic formula are less attractive than peers, with higher price points (and volumes) required to offset the higher COGS associated with organic product. Further, there is significant change occurring at BAL, and while there has been sound performance in its new branding & product reformulation, execution risk remains.

- **Valuation support mixed.** BAL has outperformed the ASX 100 by 2.2% since 1 January 2019. There is modest valuation support (DCF $9.03) and the prospect for P/E multiple expansion if earnings growth can be achieved. Yet we are cautious about the pace of multiple expansion given execution risk and the less established position which makes BAL more vulnerable to industry risks.

Table 4: BAL – Sales, EBITDA and EPS growth and P/E Multiple (OMLe)

	2016	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Sales growth	85.4%	2.6%	36.9%	-12.7%	18.0%	21.7%	8.3%	5.6%	5.0%	3.7%
EBITDA growth	299.2%	-21.6%	64.8%	-20.7%	29.6%	16.9%	11.8%	8.8%	8.4%	5.9%
EPS growth	269.1%	-29.6%	50.4%	-24.6%	33.3%	17.0%	13.3%	10.3%	9.7%	7.1%
P/E	Na	Na	Na	29.4x	22.0x	18.8x	16.6x	15.1x	13.7x	12.8x

Source: Company reports, Ord Minnett estimates and Bloomberg. June year end. P/E as of 6-Aug-19.

Valuation

Table 5: A2M and BAL – Compco multiples summary – Bloomberg median consensus estimates

Valuation Metrics	P/E			EV/EBITDA			EV/Sales		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
ANZ Infant Formula	23.8x	15.6x	12.7x	12.2x	9.4x	8.1x	1.9x	1.5x	1.4x
ANZ other Food & Beverages	19.2x	16.6x	13.5x	10.0x	9.1x	8.0x	1.7x	1.5x	1.4x
China Infant Formula & Dairy	22.3x	20.9x	17.8x	14.3x	10.5x	8.5x	1.8x	1.6x	1.4x
Global/MNC Infant Formula	21.7x	19.9x	18.6x	15.6x	14.9x	14.2x	3.9x	3.7x	3.6x
a2 Milk Co Ltd	**41.7x**	**33.5x**	**27.2x**	**28.2x**	**22.8x**	**18.6x**	**9.1x**	**7.3x**	**6.1x**
Bellamy's Australia Ltd	**30.1x**	**23.7x**	**19.5x**	**17.4x**	**13.3x**	**11.2x**	**3.3x**	**2.7x**	**2.4x**
Growth	**EPS Growth**			**EBITDA Growth**			**Sales Growth**		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
ANZ Infant Formula	0.7%	21.6%	23.5%	16.3%	20.4%	15.0%	15.6%	7.4%	6.6%
ANZ other Food & Beverages	0.3%	15.4%	18.5%	11.4%	14.0%	13.9%	12.5%	7.4%	6.7%
China Infant Formula & Dairy	50.7%	16.3%	18.2%	16.2%	15.2%	16.5%	16.7%	11.9%	11.0%
Global/MNC Infant Formula	13.8%	9.4%	6.9%	14.1%	6.6%	5.4%	3.5%	3.9%	3.8%
a2 Milk Co Ltd	**na**	**24.8%**	**22.8%**	**50.3%**	**23.7%**	**22.2%**	**42.2%**	**25.3%**	**19.6%**
Bellamy's Australia Ltd	**-23.5%**	**27.0%**	**21.5%**	**-17.2%**	**30.9%**	**18.6%**	**-13.3%**	**19.2%**	**16.3%**

Source: Bloomberg consensus estimates. As of 6-Aug-19.

a2 Milk Company

Company overview

The a2 Milk Company, headquartered in Sydney, Australia, develops and markets a differentiated, premium and branded portfolio of dairy and infant formula products sourced from naturally occurring cows' milk free of A1 beta-casein protein. A2M has trading activities in Australia, New Zealand, China, the US, UK, and several emerging markets in Asia. It was founded in 2000 by Dr. Corran McLachlan and Howard Paterson to license intellectual property for determining the type of protein a cow produces in its milk. The business model changed in 2007 from licensing to a full-fledged operating company engaged in sourcing and selling branded A2 (or A1 protein-free) milk products. The company listed on the New Zealand Exchange (NZSX) in March 2013 (ATM NZ), and on the Australian Securities Exchange (ASX) in March 2015 (A2M AU).

Table 6: A2M – Product launch timeline across markets

FY	Australia	New Zealand	China	UK & I	USA	Singapore	Vietnam	HK	South Korea
2008	Fresh Milk	Fresh Milk (multiple licensees)							
2009	Yogurt (sold by Jalna)								Exits licensing (Purmil dispute)
2010		Fresh Milk (licensed to Fresha Valley)			Exits licensing				
2011									
2012									
2013				Fresh Milk					
2014	Infant Formula, Cream	Infant Formula	Infant Formula						
2015	WMP	WMP	Fresh Milk, WMP, Long Life Milk		Fresh Milk				
2016	Ice Cream			Long Life Milk					
2017	SMP	Non-exclusive license expires			Flavoured Milk				
2018	Stage 4, Pregnancy Formula, powder with Manuka honey	Stage 4, Pregnancy Formula, powder with Manuka honey	Stage 4, Pregnancy Formula, powder with Manuka honey			Fresh Milk	WMP	Infant Formula	
2019	Smart Nutrition milk drink	Fresh Milk (exclusive license to Fonterra)	Smart Nutrition milk drink		Coffee creamers				Infant Formula, Fresh Milk

Source: Company reports, Ord Minnett. June year end. WMP = Whole Milk Powder; SMP = Skim Milk Powder. Synlait (SML NZ) and Fonterra (FSF NZ) are not covered by Ord Minnett.

Value chain

Supply

- A2M has access to supply across Synlait (infant formula) and its own farms in Australia (white milk), it has broadened supply with Fonterra across infant formula and other dairy products in specific markets, reducing risk.

Table 7: A2M – Strategic Supply Partnerships with Synlait and Fonterra

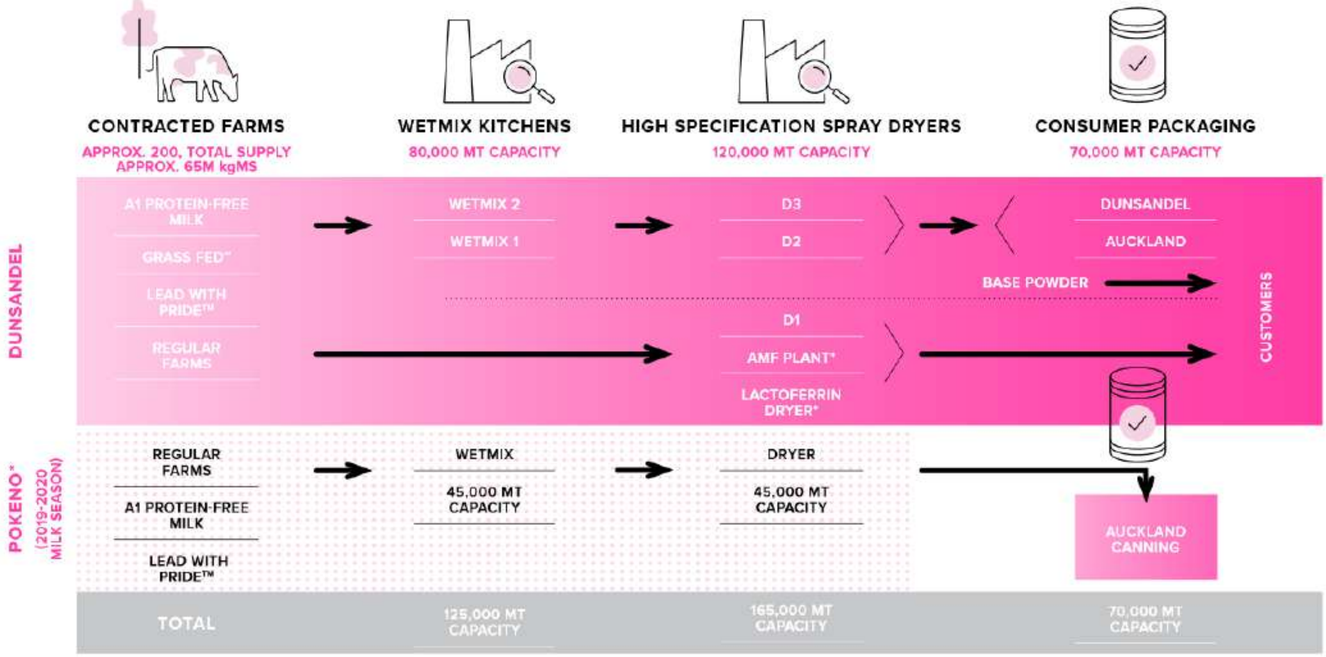
Synlait	Fonterra	White milk sourced from Australian farms
- Foundation infant nutrition partnership	- Emerging markets & multi-products partnership	- Sourcing from 28 certified dairy farms across Australia that produce a2 Milk from specially selected cows
- Exclusive supply rights for infant nutrition into ANZ & China	- Exclusive supply rights for infant formula and other products into new priority markets	- Leppington Pastoral in WA is the largest of these partner farm networks with over 2,000 cows
- 5 year minimum supply agreement signed July 2018	- a2 Milk branded fresh milk launched in NZ (Aug-18)	
- Building capacity to support future growth: (Auckland canning facility, Pokeno facility)	- Building capacity to support future growth with the development of milk pools in ANZ	

Source: Company reports.

Infant formula value chain

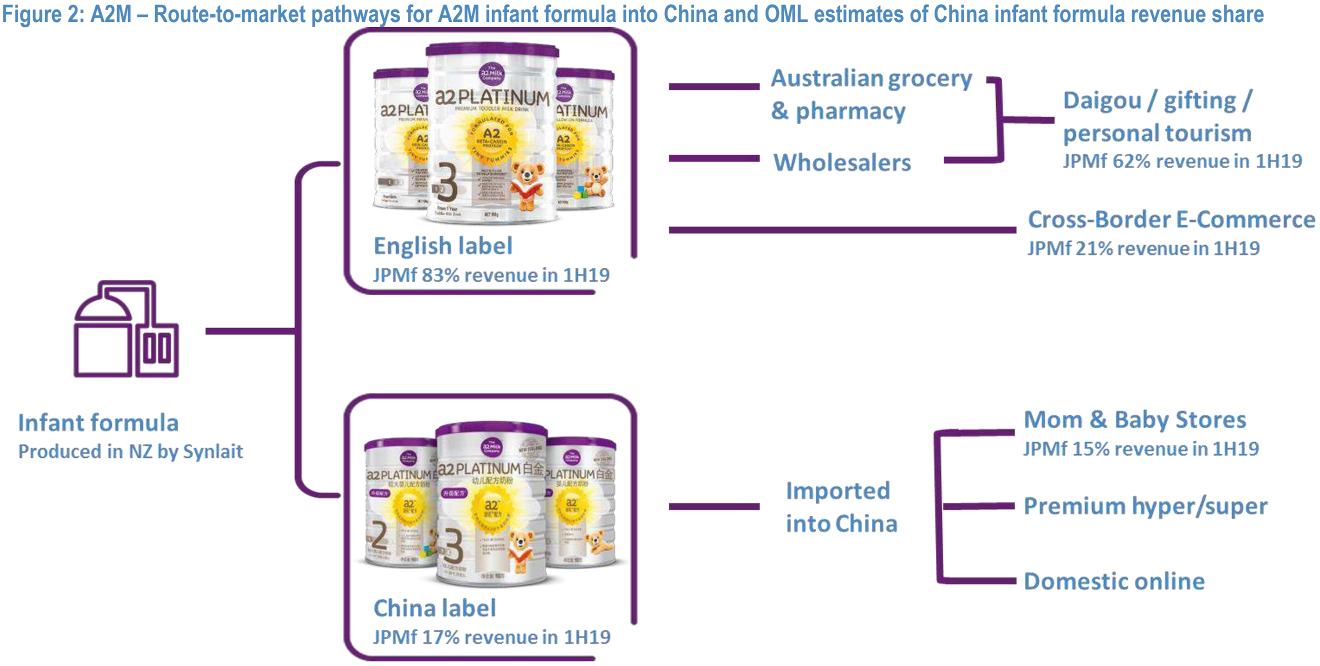
- The current infant formula value chain is reliant on partner Synlait with the consumer base in China and Australia accessed in multiple channels.

Figure 1: A2M – Synlait Infant Formula Manufacturing Facilities and Processing Flowchart



Source: Synlait reports.

Figure 2: A2M – Route-to-market pathways for A2M infant formula into China and OML estimates of China infant formula revenue share

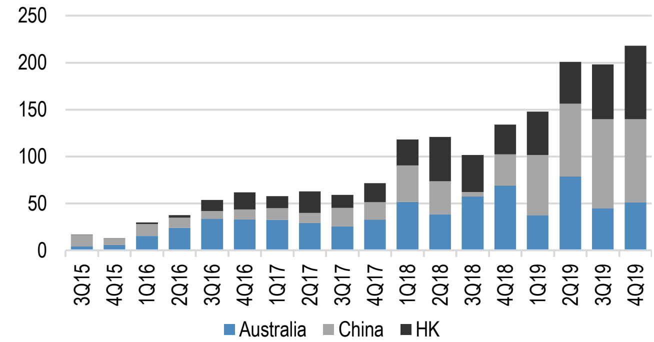


Source: Company reports and Ord Minnett estimates. 1H19 = 6mths to December 2018.

- The route to market advantage has helped contribute to strong infant formula exports from New Zealand to China over the last 5-10 years.

Figure 3: A2M – Infant Formula Exports from Christchurch (Qtrly)

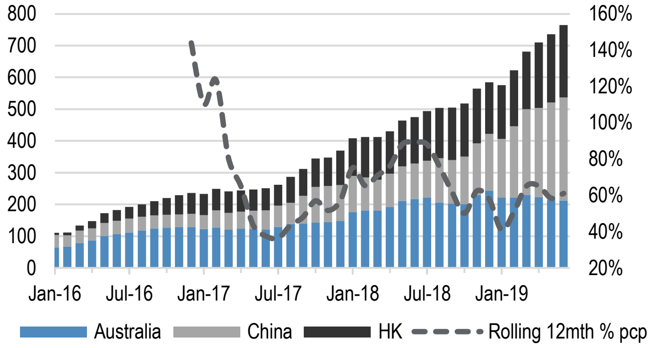
NZ$ in millions



Source: Stats NZ, Ord Minnett. June year end. Exports from Lyttelton Port and Christchurch Airport included.

Figure 4: A2M – Infant Formula Exports from Christchurch (Rolling 12mths)

NZ$ in millions

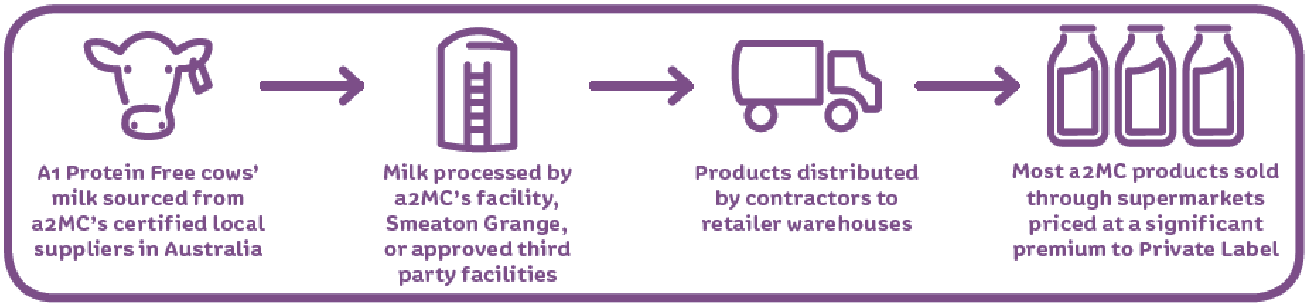


Source: Stats NZ, Ord Minnett. June year end. Exports from Lyttelton Port and Christchurch Airport included.

Liquid Milk:

- The liquid milk value chain is predominantly limited to Australia and the United States but is forecast to expand into New Zealand with the Fonterra partnership while some product is air freighted into China.

Figure 5: A2M – Australia Liquid Milk Value Chain



Source: Company reports.

Table 8: A2M – US Product Launch and Distribution Timeline

Apr-15	**a2 Milk brand launches in the US, initially Southern California, in customers including Sprouts and Whole Foods**
Jul-15 to Aug-15	Distribution growth into The Fresh Market, Ralph's, Whole Foods Mid-Atlantic
Dec-15 to Feb-16	Launch into King Soopers (Denver), Fred Meyer, Meijer, Safeway Norcal
Apr-16	**Blake Waltrip appointed US Chief Executive**
May-16	Dairy supply agreement with second contract processor in the Los Angeles basin agreed
Jul-16 to Aug-16	Target and Whole Foods South ranging
Sep-16 to Dec-16	Significant PR hits; launch of 'Feel Good' digital campaign
Mar-17	a2 Milk Chocolate variant launched
Mar-17	**South East launch in Publix supported by new multi-media 'Love Milk Again' campaign from April**
May-17	Distribution begins in Whole Foods Northeast & Southeast regions
Aug-17	Ranging in Whole Foods Rocky Mountains and South West; significant PR hits
Sep-17	Distribution through Harris Teeter (Carolinas) and Winn Dixie (Florida)
Jan-18	**Expansion into Northeast region, including rollout to Wegmans, Ahold, ShopRite, Safeway, H-Mart, Fairway Market, Market Basket**
Aug-18 to Sep-18	**a2 Milk now sold in select Costco and Walmart stores**
Jun-18 to Dec-18	Distribution expansion driven by increased rollout within Kroger, Costco, Vons, Safeway, and Walmart
Jan-19	Distribution increased to 12,400 stores driven by building brand awareness and new store planogram reset timings within retail chains
End FY19	**Portfolio extension to include premium and natural coffee creamers**

Source: Company reports, Ord Minnett.

Driver #1: A2 infant formula product, brand, provenance, usage, and engagement with core consumers drive demand

- A2 infant formula has been a success due to a variety of factors with different elements important for different customers. Collectively these have supported demand and are forecast to do the same in the future.

Product

- The A1 free, A2 product, is desired by consumers with many finding appeal in its health benefits notably improved digestion. A recent article from the Journal of Pediatric Gastroenterology and Nutrition indicated improved digestion and cognitive performance from A2 milk in Chinese preschool children.

Figure 6: A2M – USP of Product is A2/A2 Cows as Milk Source

Source: Company reports.

- The infant formula product offering is limited (A2 Platinum for pregnancy and stages 1-4) with a Smart Nutrition product for children aged 4-12 y.o.

Brand

- The A2 brand has evolved from a technical feature, lack of the A1 protein, to having broader aspirations on health & wellness and quality attributes. This is delivered in social and physical media (especially outdoor) as well of its daigou route to market channel, which provides more genuine advocacy of the brand.

Provenance

- Being sourced from New Zealand milk farms is a competitive advantage given the strong reputation of its agriculture practices and produce safety. As consumers become more aware of food provenance, and as food safety (or the appearance of food safety) in other countries may not be as high as some consumers desire, the position of New Zealand (and Australian) agriculture becomes more advantaged.

Usage

- Being used by consumers in ANZ supports demand in China. Sourcing from ANZ alone is insufficient to support demand in China, rather usage by consumers (mums) in ANZ is a requirement.

- An example of this is recent efforts by Biostime to sell its products in Australian supermarkets as per the photos below (photo on the left, between Aptamil and Bellamy's on the top row, while A2 in boxes at Chemists Warehouse as it has sold out and is avoiding empty shelves).
- However, the decision to accept stockouts at Australian supermarkets also indicates the popularity of the product in Australia with domestic and daigou consumers (rather than ineffective supply chain) as well as managing inventory in the channel to maintain pricing and daigou economics.

Engagement with core consumer on an ongoing basis

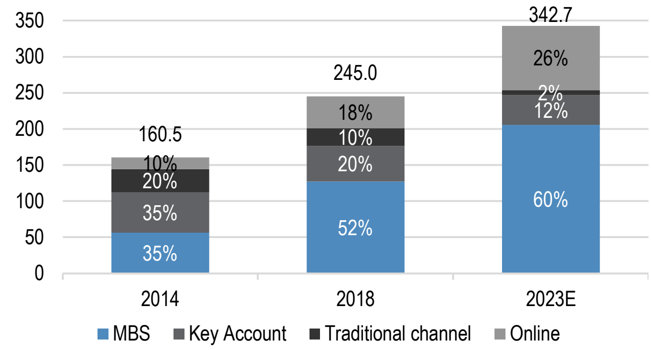
- Delivery of brand & product capabilities required active engagement with the core consumer. This is done in varied ways:
    - A range of outdoor media (e.g. billboards) especially near airports and tourist locations to engage with local but also international consumers.
    - The deep and persistent online content available for consumers which are voracious researchers especially during the pregnancy phase
    - The liquid milk product which serves to engage with consumers when they are not pregnant, all the while building brand and product awareness.

Driver #2: An advantaged route to market to the key China consumer with daigou a positive and A2M able to expand its addressable market

The points of purchase in China are varied and changing rapidly

- According to Frost & Sullivan, the points of consumption for China infant formula are expected to continue to evolve with MBS and online to grow at the sense of key accounts and the traditional channel. The mix of MBS was detailed by BAL in its November 2018 investor presentation.

Figure 7: A2M – Chinese infant formula market value by channel



Source: Frost & Sullivan from Feihe Prospectus. Key account primarily represented by supermarkets and hypermarkets.

Table 9: A2M – Types of Mom & Baby Stores in China

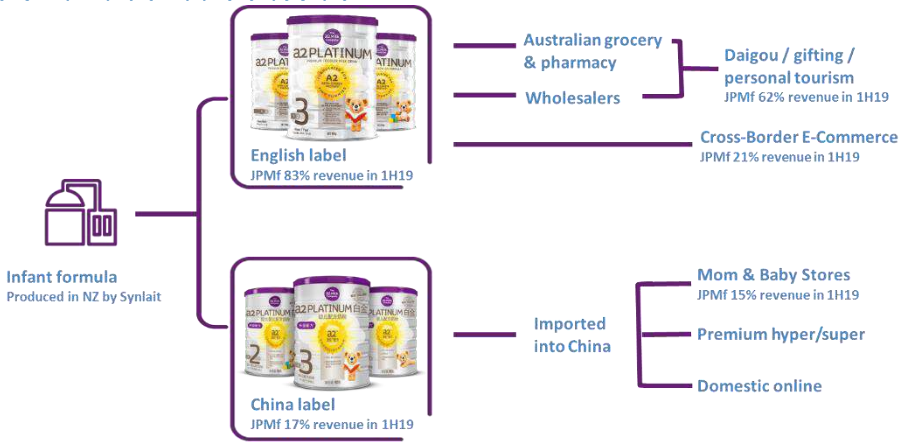
	National Key Accounts	Regional Key Accounts	Independents
Tier focus	Tier 1 & 2	Tier 3 & 4	Tier 3 & 4
% of total market	25%	50%	25%
Store count	Low	Medium	High
Typical brand portfolio	Imported renowned brands	Domestic or imported niche brands	
Key brands	Enfamil (RB), Beingmate, Friso (Friesland Campina)	Kabrita (Ausnutria), Yili, Feihe	Anike

Source: Bellamy's Organic investor presentation, November 2018.

Route to market to China is a competitive advantage for A2M

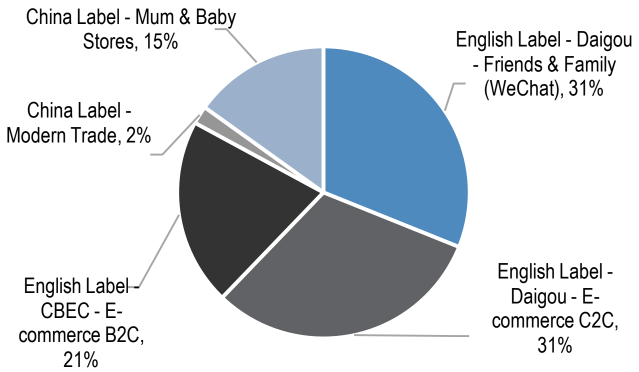
- A2M is a nimble company not weighed down by historical routes to market. This results in a fluid route to market able to adapt to changing regulations of having product accessed by the Chinese consumer. The A2M route to market is estimated as follows, and is somewhat different to peers especially the reliance on the daigou channel.

Figure 8: A2M – Route-to-market pathways for A2M infant formula into China and OML estimates of China infant formula revenue share



Source: Company reports and Ord Minnett estimates. 1H19 = 6mths to December 2018.

Figure 9: A2M – China Infant Formula Channel Mix (1H19)



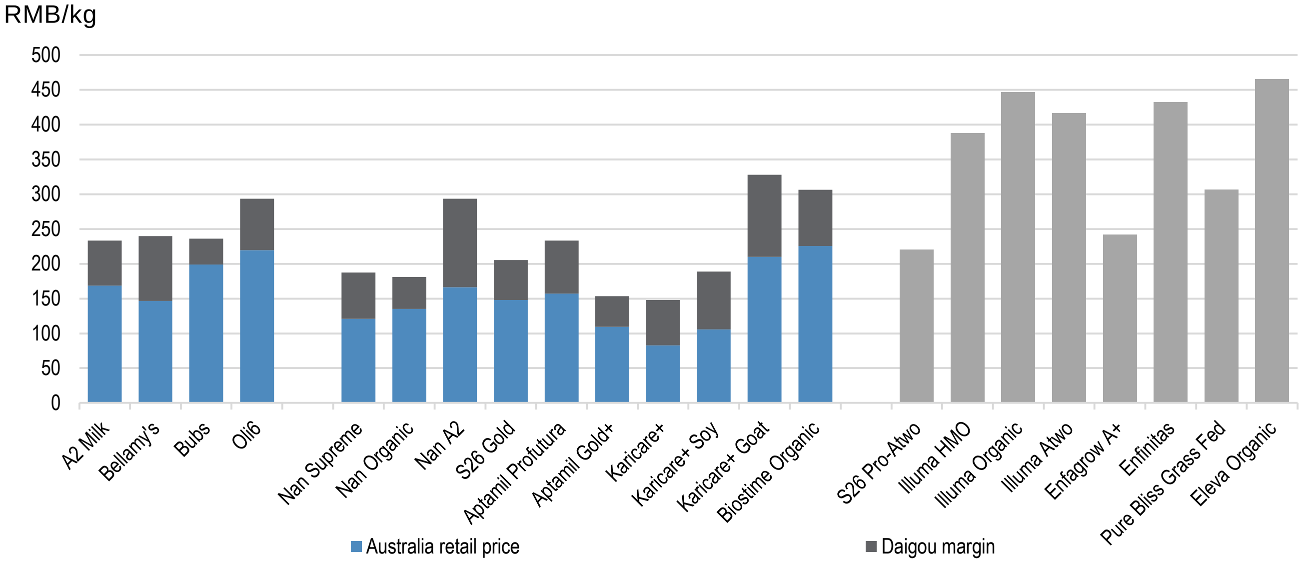
Source: Ord Minnett estimates for December 2018.

- A2M has a small share of MBS compared to peers yet this is a growing channel. The number of MBS selling A2M product in China has grown significantly and is forecast to grow further still in the coming years.

Daigou channel as a source of competitive advantage

- A2M has a strong understanding of the daigou channel. It has been a difficult channel for some to manage (e.g. BAL) or develop (e.g. BKL in infant formula) yet A2M has been able to drive growth with daigou despite changing regulatory dynamics. The key executive we suggest is Peter Nathan, Chief Executive Asia Pacific, but recognise there is a breadth of relationships from A2M, in particular engaging with a limited number of corporate daigou partners.
- Daigou economics are maintained with a stable retailer price and controlled supply & broader inventory management by channel.

Figure 10: Infant Formula Prices in Australian Retail vs China Online Channels, and Implied Daigou Margin



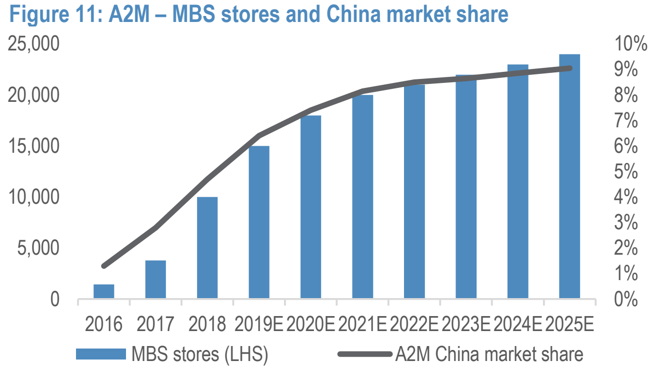
Source: Australian prices are average of prices on Chemist Warehouse, Woolworths and Coles online websites, with AUDCNY as of 5-Aug-19 (4.7552). China prices are the mode price for the products on JD.com. The products in grey were not available in Australian online retail.

- A single source of product removes the challenge global peers may face where there are multiple sources of product which could see varied end consumer demand and product experience.
- The daigou channel is an inexpensive way of brand marketing. This channel provides a multiple of brand exposure to existing marketing given its nature and there is genuine advocacy given the existing relationship of the daigou with the customer.

The addressable market for A2M is growing

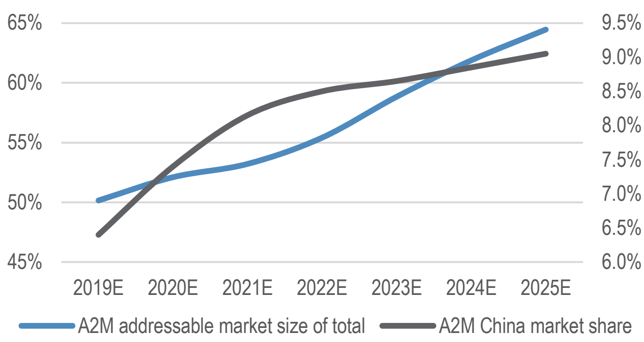
- The addressable market for A2M is forecast to grow from ~50% of the total China infant formula market to over 60% by 2025. This extension of distribution reach is being achieved by geographic expansion, with the opportunity to expand the number of cities in which A2M product is available, assisted by an increase in the number of MBS where its product is being distributed a key driver.

Figure 11: A2M – MBS stores and China market share



Source: Company report, Ord Minnett estimates. June year end.

Figure 12: A2M – Addressable market size and China market share



Source: Company report, Ord Minnett estimates. June year end.

- A2M market share is also expected to increase in existing channels and markets due to gains from peers due to the product capabilities, brand, provenance, usage, and engagement with core consumers.

Driver #3: US liquid milk an attractive opportunity

The US dairy market is large with flavoured and low fat milk gaining share

Size

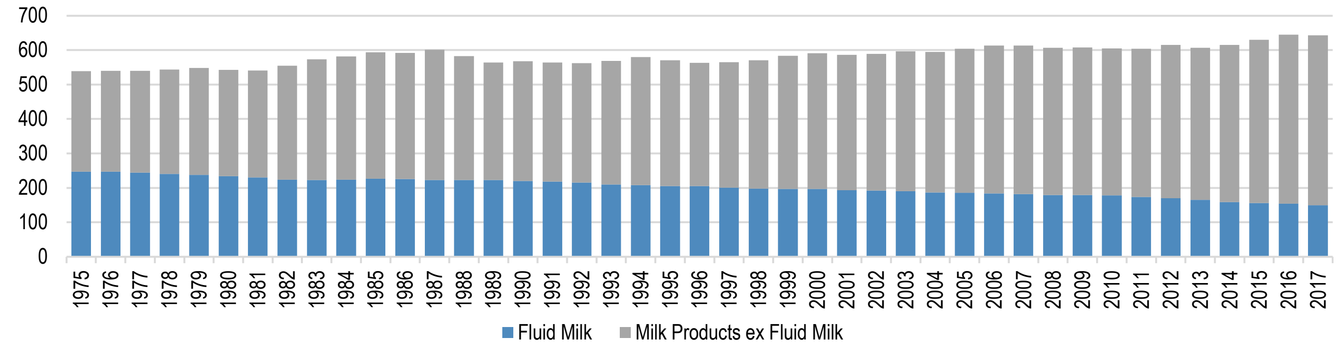
- The United States (US) dairy milk market was US$13.6bn in 2018 as per Dairy Farmers America, down 8% on the pcp, while the US coffee creamer market is ~US$3.4bn as per IBIS.

Consumption

- US liquid milk consumption has been steadily declining over recent decades.

Figure 13: A2M – US Dairy Consumption per Capita

Pounds per person

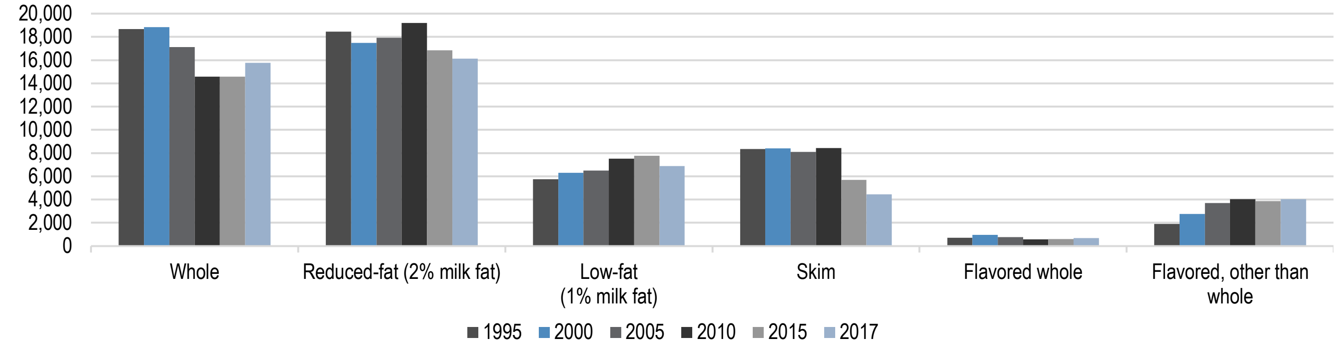


Source: USDA.

- Within liquid milk categories, it appears flavoured and low-fat milk are gaining share from whole, skimmed and reduced-fat milk.

Figure 14: A2M – US Fluid Milk Sales Volumes by Product

Millions of pounds



Source: USDA.

Consumer trends away from dairy based liquid milk

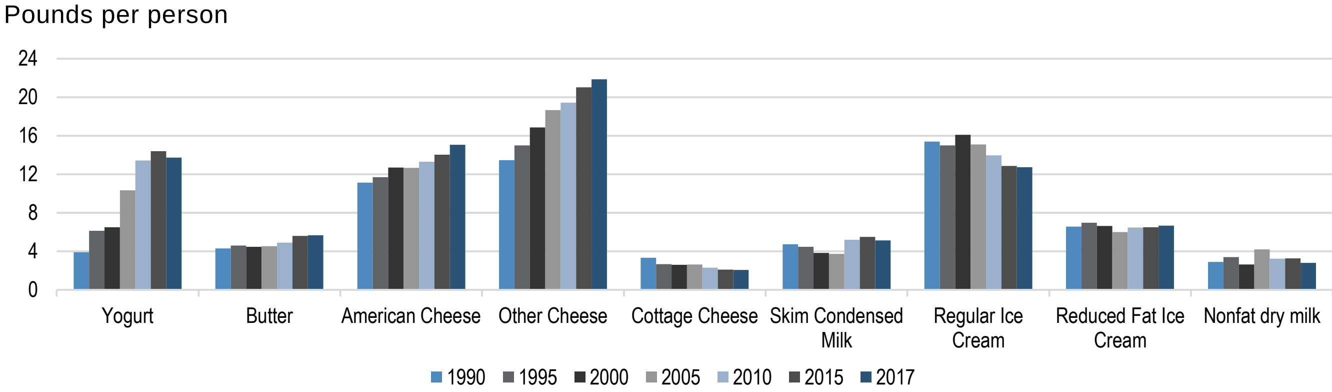
- Growth of substitute products. More alternative protein sources are being sold including plant-based milks, sport beverages, energy drinks. In the US, non-dairy milk sales grew 61% between 2012 and 2017, driven by almond milk growing 250% from 2010-2015.
- Changing health perceptions. When per capita milk consumption was at its highest in the 1970s, milk was widely perceived as a necessary part of a healthy diet. Mintel 2018 survey suggests ~20% of Americans have cut back on dairy for health reasons, and the lactose intolerance treatment market is expected to grow at a CAGR of 7.2% between 2010 and 2023.

- Ethics and sustainability concerns. According to Nielsen's 2015 health and wellness survey, 38% of Millennials and 34% of Gen X rated sustainably sourced ingredients as 'very important' in their purchase decisions, with ethics over treatment of cows and concerns over the environment leading to a switch from traditional dairy-based liquid milk.

A2M product range

- The A2M product offering is across varied white milk, reduced fat chocolate milk and now the coffee creamer product range launched at the end of FY19.
- In addition to the recent expansion of coffee creamers, A2M can further extend its product offering off its liquid milk base. Yogurt, butter and cheese, which are growing in terms of per capita consumption.

Figure 15: A2M – US Dairy Consumption per Capita (Categories ex Liquid Milk)

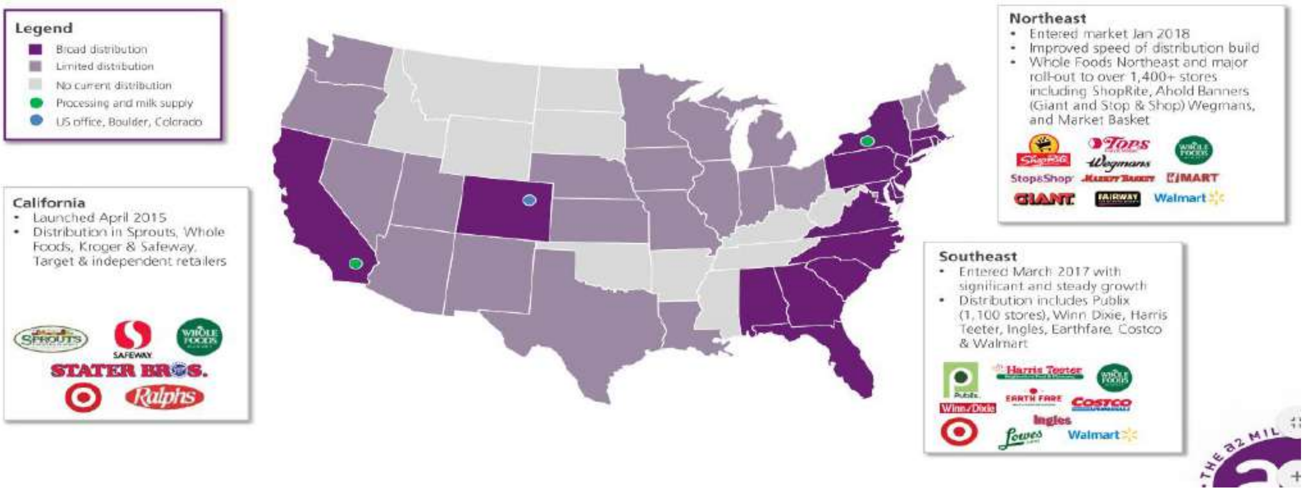


Source: USDA.

A2M US milk is well located in store and distribution reach is expanding

- A2M liquid milk was offered across 12,700 retailers at the end of March 2019 with the history of its distribution in late 2018 detailed in the figure below. The number of stores where A2 milk is sold is expected to increase further.

Figure 16: A2M – US Distribution Expansion late 2018



Source: Company reports, October 2018 investor presentation.

- In store visits, the product is well positioned with its comparison products often being organic and lactose free product. Brand awareness is being driven by television and mass-media, while trial in store is being driven by coupons.

- While EBITDA positive outcome will not be achieved until FY21 as brand investment and reach are greater priorities, the market is large and the opportunity to participate in a niche segment of the market is attractive.

Risk #1: China infant formula market could see volume growth constrained by demographics with premiumisation to remain a driver but the pace could moderate

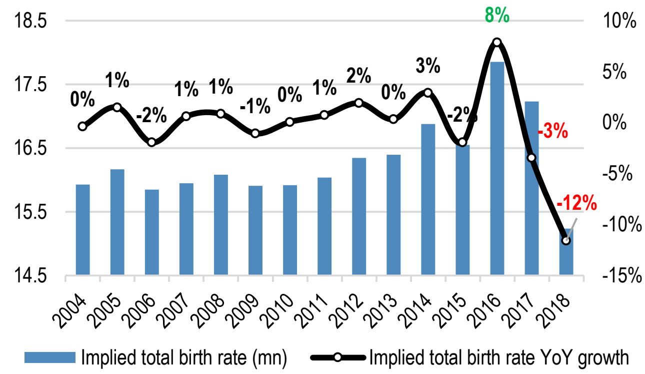
- The content below is from a global collaboration report on the China Infant Milk Formula market with our European Consumer Goods team led by Celine Pannuti.

Volume growth to be constrained by demographics

Birthrate

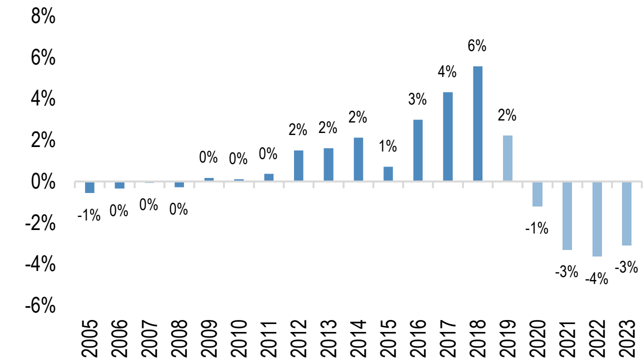
- According to Chinese statistics, the number of newborns hit a 15 year low in 2018 at 15.2m, after two consecutive years of decade-record births in 2016 and 2017 (boosted by the relaxation of China's one child policy). Further, the drop in new births in China is set to continue as the female population in China aged between 15 and 49, which the NBS defines as "child-bearing age", fell by 4 million in 2017 and 7m in 2018, down 7%. Euromonitor forecasts the 0-3 y.o. cohort to shrink by 1% by 2020 and -3%-4% thereafter.

Figure 17: Annual births in China, YoY Growth (%)



Source: National Bureau of Statistics.

Figure 18: Number of babies aged 0-3 y.o., YoY

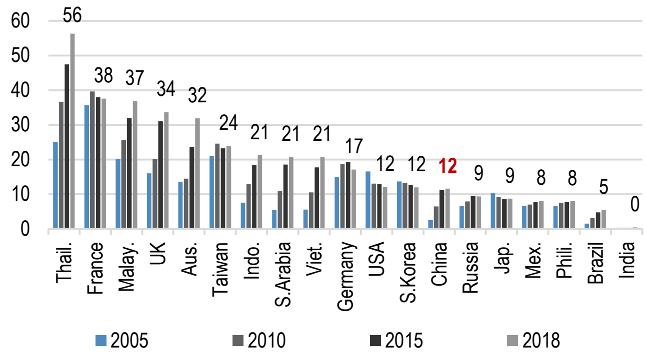


Source: Euromonitor.

Volume

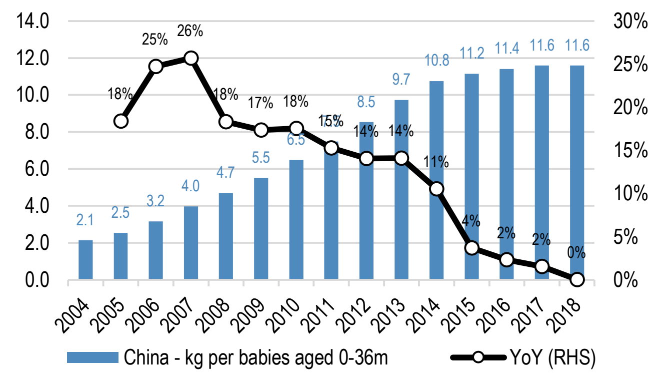
- At a global level per capita consumption in China remains low at c12kg/pa, c25% below the emerging markets average despite the high participation of females in the labor force (69% of female population aged 15-64 y.o. in 2018 vs 54% worldwide and 65% in high income countries). Yet volume penetration per capita has stagnated at c11-12kg since 2016.

Figure 19: Infant formula volume (kg) per baby aged 0-3 y.o., 2018



Source: Euromonitor.

Figure 20: China, kg of infant formula per babies aged 0-36 months

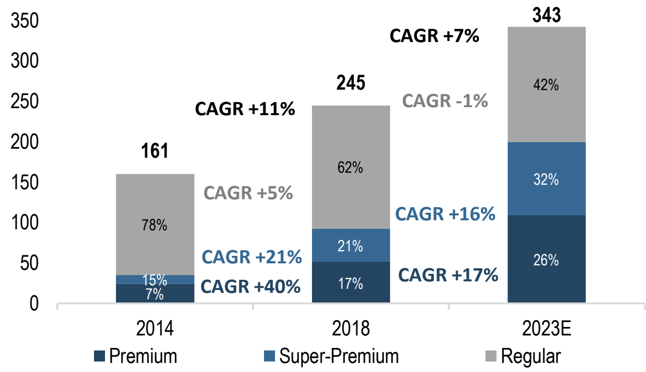


Source: Euromonitor.

Premiumisation has been a key driver and is expected to remain supportive although the pace could moderate

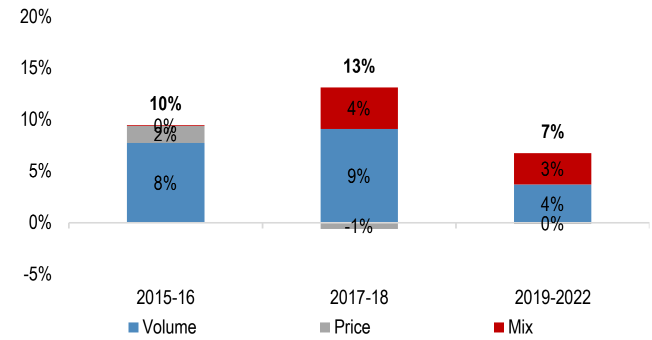
- According to Frost & Sullivan, High Premium products (retail price point above 350RMB per kg, c1.7x average market price) now represent c40% of market value, up from 22% in 2014. It expects premium products share to keep expanding; it forecasts the segment to grow at a 16.6% CAGR 2018-2023E, down from 27% CAGR 14-18. This implies that mix boosted industry growth by 4% historically and is forecast to contribute 3% to growth going forward.

Figure 21: Chinese infant formula market, Historical and Future growth per Segment (RMB bn, % CAGR14-18, % CAGR18-23E)



Source: Frost & Sullivan from Feihe Prospectus.

Figure 22: Chinese infant formula market growth, Building blocks

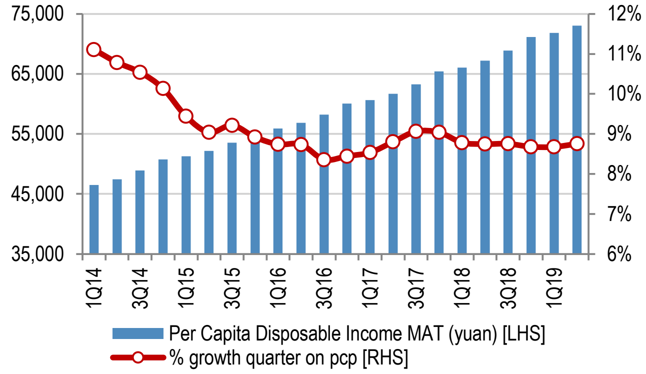


Source: Frost & Sullivan from Feihe Prospectus; Ord Minnett estimates.

- Yet there are challenges that could moderate the pace of premiumisation growth.
  - Premium products, priced RMB290+, 1.4x above category average, already represent 64% of the category. We believe the Frost & Sullivan definition above fails to take into account the 'Premium' segment of IMF priced at RMB290-350. According to Health & Happiness, Premium product (RMB290+) share has increased from 47% in 2016 to 64% in 2018, driven by the development of Super Premium (RMB350+) and Ultra / Super High Premium with prices of up to RMB550-600. Accounting for Premium products share to increase to 80% by end 2021, it would imply growth rate of the premium segment to decelerate from 30% to a still healthy low double-digit.

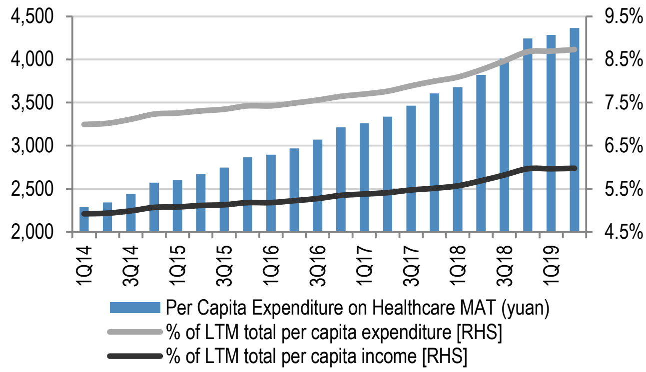
- Down trading or deflation risks exist. (1) The acceleration in premiumisation in 2017-2018 has been concomitant to the surge on premium consumption across many categories (e.g. spirits, cosmetics, apparel) despite no upsurge in disposable income growth. It is unclear how long this consumption boom will continue should the economy slow down. (2) Regulatory measures could also influence consumption and price points with a 2013 investigation by the National Development and Reform Commission resulting in large MNCs voluntarily cutting prices (by an average of 10%).

Figure 23: China Per Capita Disposable Income MAT



Source: National Bureau of Statistics of China. Calendar year quarters.

Figure 24: China Per Capita Expenditure on Healthcare and as % of total per capita expenditure and income



Source: National Bureau of Statistics of China. Calendar year quarters.

Regulation is evolving to improve compliance and encourage domestic production

- The industry is highly regulated, which is understandable given the vulnerability of the end customers, and recent changes have modified the route to market and provided an advantage to larger players (corporate daigou, those able to secure registration).
- International players are negatively impacted by the 60% self-sufficiency plan with the potential for market share losses especially for those outside the premium categories.

A2M implications

- For A2M, it is able to expand its addressable market (geographically, greater MBS presence vs a greater skew to daigou and online than peers) and we are confident as when it has been required to compete with peers it has been able to perform well.

Risk #2: Competition within the China infant formula market could intensify, which would require market share gains to sustain growth rates

Market share gains may be required to sustain elevated rates of growth

- As noted in the risk above, the China infant formula market could see volume growth constrained by demographics while the pace of premiumisation could moderate.
- This could require market share gains to be achieved for participants to sustain historical rates of growth. Heightened competition could materialise in greater costs to access the MBS channel, or product innovation.
- For A2M, we remain confident in its unique features and ongoing investment in brand to sustain growth. Further, it has been able to address competitors entering into the A2 category.

Competitors have launched A2 product with limited success

- Despite initial skepticism from peers regarding the merits of A1 free product, several dairy competitors have launched their own A1 free products recently.

Table 10: A2M – Competitor Launches of A2 Type Products since 2018

Company	Brand	Launch region	Launch date
Nestle/Wyeth	Illuma Atwo	China	Feb-18
Freedom Foods	Australia's Own A2 Protein Milk	Australia	Mar-18
Nestle	NAN A2	Australia	Oct-18
Nestle/Wyeth	S-26 Atwo	New Zealand	Nov-18
Danone/Nutricia	Cow & Gate A2	Hong Kong	Jul-19

Source: Media articles, Ord Minnett.

- While this is a competitive threat, it also provides credibility to the A2 product and some of its attributes, which competitors may not be able to pursue fully as they have A1 and A2 product.
- The effectiveness of recent competitor launches has been mixed. Australian supermarket visits indicate discounting of Nestle NAN A2, which is very uncommon for A2M product. This suggests modest sell-through, compared to many instances of A2M product being sold-out, while discounting also disrupts daigou economics and reduces the likelihood of advocacy from this channel.

Risk #3: Significant organisational change is occurring

- A2M has enjoyed significant growth with a modest workforce (~200), but under new CEO Jayne Hrdlicka the company is evolving. Growth remains paramount, but A2M is putting elements of structure around the organisation.

Table 11: A2M – Management Changes since December 2017

Departing			Joining		
Date	Name	Role	Date	Name	Role
Jul-18	Geoffrey Babidge	MD & CEO	Dec-17	Jayne Hrdlicka	MD & CEO
May-18	Dr Andrew Clarke	Chief Scientific Officer	Nov-18	Lisa Burquest	HR Director
Aug-18	Scott Wotherspoon	Chief Executive UK & Europe	Jan-19	Melanie Kansil	Chief Commercial Officer
Dec-18	Simon Hennessy	GM International Development	Jan-19	Phil Rybinski	Chief Technical Officer
Dec-18	Michael Bracka	Head of BD – Emerging Markets	Apr-19	Li Xiao	Chief Executive Greater China

Source: Company reports.

- The appointments see a change of several long standing executives (Babidge and Clarke) as well as those associated with regions where performance was not tremendously strong. Moreover, we suggest A2M was seeking to heighten its focus on the core markets of ANZ, China and the United States, and provide broader structure around its operations (e.g. HR, Commercial and Technical) as it seeks to leverage the growth opportunities available. These are sound, in our view.
- However, the challenge for A2M is to codify certain practices and add structure where appropriate, yet not lose the unique features that made it a disruptive and innovative business. Achieving this balance is difficult given the scrutiny the company faces and the size of its business after successive periods of extraordinarily strong growth.

Financials

Divisional metrics

Table 12: A2M – Divisional Revenue and EBITDA

NZ$ in millions

	2016	2017	1H18	2H18	2018	1H19	2H19E	2019E	2020E	2021E	2022E
Revenue by Product											
English Label	210.1	370.4	300.0	337.3	637.3	420.8	485.7	906.5	1,167.4	1,400.9	1,605.1
Chinese Label	4.3	23.6	40.9	46.0	86.9	74.7	82.1	156.8	200.2	237.9	264.9
Infant Formula	**214.4**	**394.0**	**341.0**	**383.3**	**724.2**	**495.5**	**567.8**	**1,063.3**	**1,367.5**	**1,638.8**	**1,870.0**
ANZ	101.7	104.1	61.1	64.5	125.6	67.1	68.8	135.9	142.0	146.1	150.3
China & other Asia	0.4	0.8	0.8	0.6	1.3	1.1	0.9	2.0	2.4	2.6	2.7
US & UK	18.3	21.0	7.5	7.9	15.4	15.2	17.3	32.5	49.7	69.9	90.5
Liquid Milk	120.3	125.9	69.4	73.0	142.4	83.4	87.0	170.4	194.1	218.6	243.5
Other Dairy Products	17.8	29.3	24.3	31.5	55.7	34.0	43.3	77.3	101.3	122.3	134.6
Royalties, License Fees & Other	0.3	0.3	0.1	0.2	0.3	0.2	1.3	1.5	2.8	3.0	3.1
Total Revenue	**352.8**	**549.5**	**434.7**	**487.9**	**922.7**	**613.1**	**699.4**	**1,312.5**	**1,665.8**	**1,982.7**	**2,251.2**
Revenue by Geography											
ANZ	296.1	439.3	304.2	352.1	656.3	418.2	487.2	905.4	1,121.6	1,301.1	1,455.0
China & Asia	38.2	88.9	114.4	119.3	233.6	171.7	185.5	357.2	479.8	600.5	698.5
UK & US	18.3	21.0	16.1	16.3	32.4	23.0	25.3	48.3	61.5	78.2	94.6
Corporate & Other	0.3	0.3	0.1	0.2	0.3	0.2	1.3	1.5	2.8	3.0	3.1
Total Revenue	**352.8**	**549.5**	**434.7**	**487.9**	**922.7**	**613.1**	**699.4**	**1,312.5**	**1,665.8**	**1,982.7**	**2,251.2**
% growth	127.4%	55.8%	69.7%	66.3%	67.9%	41.0%	43.3%	42.3%	26.9%	19.0%	13.5%
EBITDA by Geography											
ANZ	84.7	155.3	116.4	145.8	262.2	192.0	202.6	394.6	466.2	547.9	624.2
China & Asia	9.2	32.7	48.3	33.0	81.3	68.4	51.4	119.9	160.5	200.5	240.2
UK & US	(20.5)	(22.5)	(8.4)	(19.3)	(27.6)	(14.6)	(24.2)	(38.8)	(35.4)	(23.4)	(15.6)
Corporate & Other	(18.8)	(24.4)	(13.4)	(19.4)	(32.8)	(27.4)	(29.1)	(56.6)	(67.9)	(74.7)	(78.4)
Group EBITDA	**54.6**	**141.2**	**143.0**	**140.0**	**283.0**	**218.4**	**200.7**	**419.1**	**523.5**	**650.2**	**770.4**
% margin	15.5%	25.7%	32.9%	28.7%	30.7%	35.6%	28.7%	31.9%	31.4%	32.8%	34.2%

Source: Company reports and Ord Minnett estimates. June year end.

Profit & Loss

Table 13: A2M – Summary Profit & Loss Statement

NZ$ in millions

	2016	2017	1H18	2H18	2018	1H19	2H19E	2019E	2020E	2021E	2022E
Sales	**352.5**	**549.2**	**434.6**	**487.7**	**922.4**	**612.9**	**698.1**	**1,311.0**	**1,662.9**	**1,979.8**	**2,248.2**
% growth	127.7%	55.8%	69.8%	66.3%	67.9%	41.0%	43.1%	42.1%	26.8%	19.1%	13.6%
Other revenue	0.3	0.3	0.1	0.2	0.3	0.2	1.3	1.5	2.8	3.0	3.1
Group revenue	352.8	549.5	434.7	487.9	922.7	613.1	699.4	1,312.5	1,665.8	1,982.7	2,251.2
COGS	(201.5)	(285.7)	(218.2)	(239.8)	(458.0)	(272.3)	(330.3)	(602.5)	(780.6)	(917.9)	(1,032.6)
Gross Profit	151.3	263.8	216.6	248.1	464.7	340.9	369.1	710.0	885.1	1,064.8	1,218.6
% gross margin	42.9%	48.0%	49.8%	50.9%	50.4%	55.6%	52.9%	54.2%	53.2%	53.8%	54.2%
CODB (ex D&A)	(96.7)	(122.6)	(73.6)	(108.1)	(181.6)	(122.4)	(168.5)	(290.9)	(361.7)	(414.6)	(448.2)
% of sales	27.4%	22.3%	16.9%	22.2%	19.7%	20.0%	24.1%	22.2%	21.7%	20.9%	19.9%
Underlying EBITDA	**54.6**	**141.2**	**143.0**	**140.0**	**283.0**	**218.4**	**200.7**	**419.1**	**523.5**	**650.2**	**770.4**
% margin	15.5%	25.7%	32.9%	28.7%	30.7%	35.6%	28.7%	32.0%	31.5%	32.8%	34.3%
D&A	(2.7)	(2.7)	(1.1)	(1.1)	(2.2)	(1.0)	(1.7)	(2.7)	(3.3)	(3.9)	(4.4)
Underlying EBIT	**51.8**	**138.5**	**141.9**	**138.9**	**280.9**	**217.4**	**199.0**	**416.4**	**520.1**	**646.3**	**766.0**
% margin	14.7%	25.2%	32.7%	28.5%	30.5%	35.5%	28.5%	31.8%	31.3%	32.6%	34.1%
Net interest	0.5	0.9	0.8	1.6	2.4	1.6	1.4	3.1	4.1	7.2	10.3
Tax expense	(21.9)	(48.7)	(44.3)	(43.3)	(87.5)	(66.4)	(60.1)	(126.5)	(157.3)	(196.1)	(232.9)
Underlying NPAT	**30.4**	**90.6**	**98.5**	**97.2**	**195.7**	**152.7**	**140.3**	**293.0**	**367.0**	**457.5**	**543.5**
% growth		197.8%	150.0%	89.6%	115.9%	55.1%	44.3%	49.7%	25.3%	24.7%	18.8%
Statutory NPAT	30.4	90.6	98.5	97.2	195.7	152.7	140.3	293.0	367.0	457.5	543.5
Underlying dil. EPS (NZcps)	4.3	12.3	13.3	13.1	26.3	20.5	19.0	39.5	49.9	62.2	73.9
% growth		185.2%	146.7%	88.6%	114.0%	54.9%	45.5%	50.2%	26.3%	24.7%	18.8%
DPS (NZcps)	-	-	-	-	-	-	-	-	-	15.0	19.0

Source: Company reports and Ord Minnett estimates. June year end.

Balance Sheet

Table 14: A2M – Summary Balance Sheet

NZ$ in millions

	2016	2017	1H18	2H18	2018	1H19	2H19E	2019E	2020E	2021E	2022E
Cash & Equivalents	69.4	121.0	240.2	340.5	340.5	287.9	421.7	421.7	783.9	1,188.3	1,609.2
Receivables	45.4	72.9	75.4	59.1	59.1	76.4	88.7	88.7	100.7	108.8	111.7
Inventories	52.6	28.4	53.6	64.1	64.1	72.7	81.0	81.0	96.0	107.7	116.3
Other	15.1	36.0	46.4	36.0	36.0	48.1	48.1	48.1	48.1	48.1	48.1
Total Current Assets	**182.4**	**258.3**	**415.6**	**499.7**	**499.7**	**485.2**	**639.6**	**639.6**	**1,028.8**	**1,452.8**	**1,885.3**
PP&E	8.1	8.4	9.6	9.7	9.7	10.3	11.5	11.5	13.8	16.3	18.7
Intangibles	16.3	13.3	13.9	15.1	15.1	15.2	15.5	15.5	16.0	16.6	17.2
Investments	-	62.0	105.4	186.9	186.9	280.6	286.8	286.8	314.9	314.9	314.9
Other	3.3	2.0	3.2	4.9	4.9	3.9	3.9	3.9	3.9	3.9	3.9
Total Non-Current Assets	**27.7**	**85.6**	**132.0**	**216.5**	**216.5**	**310.0**	**317.6**	**317.6**	**348.6**	**351.7**	**354.7**
TOTAL ASSETS	**210.2**	**343.9**	**547.7**	**716.2**	**716.2**	**795.2**	**957.2**	**957.2**	**1,377.4**	**1,804.5**	**2,240.0**
Payables	66.2	71.4	123.5	108.9	108.9	108.3	123.7	123.7	148.9	170.0	187.1
Borrowings	-	-	-	-	-	-	-	-	-	-	-
Other	10.6	31.0	34.4	51.5	51.5	42.8	42.8	42.8	42.8	42.8	42.8
Total Current Liabilities	**76.8**	**102.3**	**157.9**	**160.4**	**160.4**	**151.1**	**166.5**	**166.5**	**191.7**	**212.8**	**229.8**
Payables	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Borrowings	-	-	-	-	-	-	-	-	-	-	-
Other	0.0	-	-	-	-	-	-	-	-	-	-
Total Non-Current Liabilities	**0.3**	**0.1**	**0.1**	**0.1**	**0.1**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
TOTAL LIABILITIES	**77.1**	**102.4**	**158.0**	**160.5**	**160.5**	**151.2**	**166.7**	**166.7**	**191.9**	**212.9**	**230.0**
SHAREHOLDER'S EQUITY	**133.1**	**241.5**	**389.6**	**555.7**	**555.7**	**644.0**	**790.5**	**790.5**	**1,185.5**	**1,591.5**	**2,010.0**
Net Debt	(69.4)	(121.0)	(240.2)	(340.5)	(340.5)	(287.9)	(421.7)	(421.7)	(783.9)	(1,188.3)	(1,609.2)
ND / ND + E	-109%	-100%	-161%	-158%	-158%	-81%	-114%	-114%	-195%	-295%	-401%
ND / EBITDA	-1.3x	-0.9x	-1.7x	-2.4x	-1.2x	-1.3x	-2.1x	-1.0x	-1.5x	-1.8x	-2.1x
Net Working Capital	31.8	30.0	5.5	14.3	14.3	40.9	46.0	46.0	47.8	46.5	41.0

Source: Company reports and Ord Minnett estimates. June year end.

Cash Flows

Table 15: A2M – Summary Cash Flow Statement

NZ$ in millions

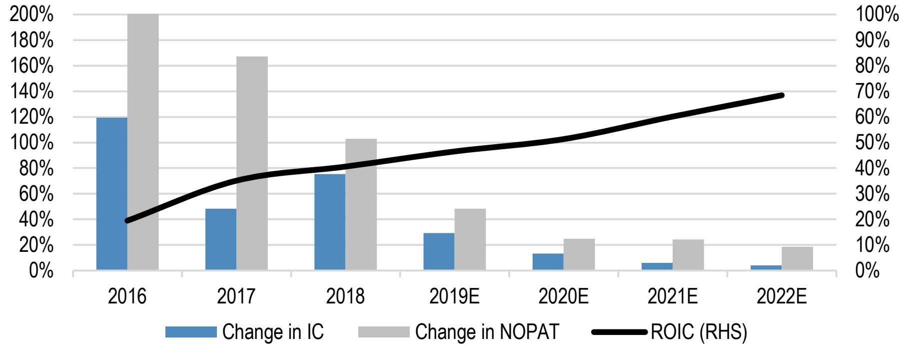
	2016	2017	1H18	2H18	2018	1H19	2H19E	2019E	2020E	2021E	2022E
Cashflow From Operations	**21.5**	**99.9**	**116.4**	**114.7**	**231.1**	**112.3**	**136.9**	**249.2**	**368.5**	**462.7**	**553.4**
Capex	(2.1)	(2.5)	(2.1)	(2.7)	(4.8)	(2.4)	(3.1)	(5.5)	(6.3)	(6.9)	(7.5)
Free Cash Flow	**19.4**	**97.5**	**114.3**	**112.0**	**226.3**	**109.9**	**133.8**	**243.7**	**362.2**	**455.8**	**545.9**
Investments & Acquisitions	-	(48.7)	-	(16.1)	(16.1)	(162.3)	-	(162.3)	-	-	-
Asset Sales	-	-	-	-	-	-	-	-	-	-	-
Investing Cashflows	**(2.1)**	**(51.1)**	**(2.1)**	**(18.8)**	**(20.9)**	**(164.7)**	**(3.1)**	**(167.8)**	**(6.3)**	**(6.9)**	**(7.5)**
Borrowings	-	-	-	-	-	-	-	-	-	-	-
Equity	44.2	3.8	2.9	4.3	7.3	1.8	-	1.8	-	-	-
Distributions	-	-	-	-	-	-	-	-	-	(51.5)	(125.0)
Financing Cashflows	**44.2**	**3.8**	**2.9**	**4.3**	**7.3**	**1.8**	**-**	**1.8**	**-**	**(51.5)**	**(125.0)**
FX effect on cash	(0.4)	(0.9)	1.9	0.1	2.0	(1.9)	-	(1.9)	-	-	-
Net Change in Cash	63.3	51.7	119.2	100.3	219.4	(52.5)	133.8	81.3	362.2	404.3	421.0
Cash Conversion %	**56.2%**	**92.2%**	**113.4%**	**97.0%**	**105.3%**	**87.3%**	**97.4%**	**92.1%**	**99.7%**	**100.2%**	**100.7%**

Source: Company reports and Ord Minnett estimates. June year end.

Returns Profile

- A2M is capital light. Hence, modest rates of invested capital growth and strong earnings (NOPAT) growth drive strong ROIC. The ability to reinvest capital at a high ROIC also supports valuation (DCF, high earnings multiples).

Figure 25: A2M – ROIC and Change in Invested Capital and NOPAT



Source: Ord Minnett. June year end.

Dividend policy

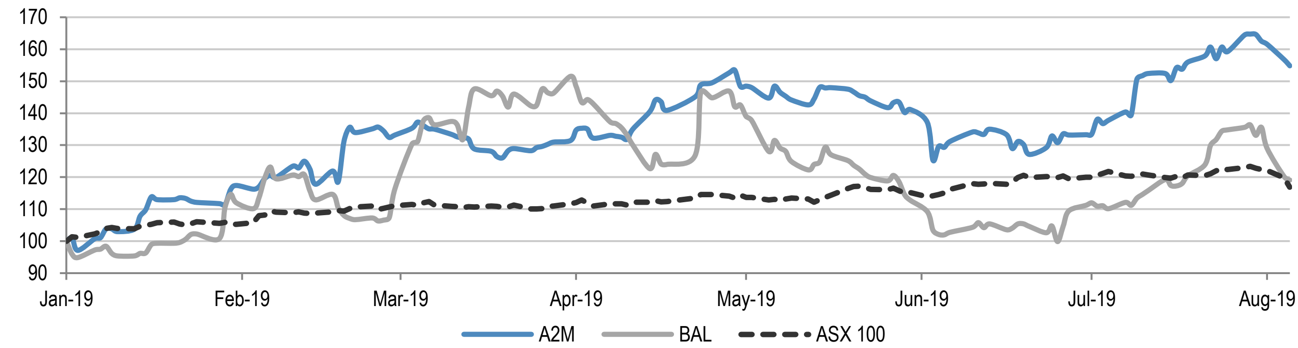
- We have incorporated a dividend to be paid from FY21 onwards using a 25% dividend payout ratio. A2M has not guided to future dividend payments and we suspect any dividend will remain low, yet recognise that the cash build may be returned to shareholders in the medium to longer term.

Valuation

Share price performance

- As of market close on 6 August 2019, the A2M share price has risen 54.8% YTD in 2019, outperforming the ASX 100 (up 16.9%).

Figure 26: A2M – Share Price Performance vs BAL and ASX 100 in CY19



Source: Bloomberg. Normalised with price on 2-Jan-19 = 100.

WACC parameters

- We have assumed a 15-year forecast period to 2035.

Table 16: A2M – DCF Valuation Parameters

Parameter	Assumption
Risk free	3.0%
Market risk premium	6.0%
Unlevered beta	0.90
Levered equity beta	1.11
Cost of equity(levered)	9.7%
Cost of debt (pre-tax)	5.0%
Tax rate	30%
Gearing D/(D+E)	25%
WACC	8.1%
Terminal growth rate	3.0%

Source: Ord Minnett estimates.

- The risk free rate and equity market risk premium are consistent across our coverage universe.

- The unlevered beta is 0.90x due to risk not associated with the equity market and target gearing of 25%.

DCF valuation

- Our DCF valuation is detailed in the table below. Associates are included based on the market value of Synlait (SML NZ).

Table 17: A2M – DCF Valuation
NZ$ & $ in millions

	NZ$	$
PV of Cashflows	$7,121	$6,765
Terminal Value	$4,919	$4,673
Value of Associates	$291	$276
Enterprise Value ($m)	**$12,331**	**$11,714**
Net debt	($460)	($437)
Valuation ($m)	**$12,790**	**$12,151**
Per Share ($)	**$17.40**	**$16.53**

Source: Ord Minnett.

Comparable peer metrics

- A2M trades at elevated P/E and EV/EBITDA multiples yet enjoys +20% rates of EPS and EBITDA growth for the next 3yrs and over 15% for the next 6yrs.

Table 18: A2M – Compco Multiples Summary

Valuation Metrics	P/E			EV/EBITDA			EV/Sales		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
ANZ Infant Formula	23.8x	15.6x	12.7x	12.2x	9.4x	8.1x	1.9x	1.5x	1.4x
ANZ other Food & Beverages	19.2x	16.6x	13.5x	10.0x	9.1x	8.0x	1.7x	1.5x	1.4x
China Infant Formula & Dairy	22.3x	20.9x	17.8x	14.3x	10.5x	8.5x	1.8x	1.6x	1.4x
Global/MNC Infant Formula	21.7x	19.9x	18.6x	15.6x	14.9x	14.2x	3.9x	3.7x	3.6x
a2 Milk Co Ltd	**41.7x**	**33.5x**	**27.2x**	**28.2x**	**22.8x**	**18.6x**	**9.1x**	**7.3x**	**6.1x**
Bellamy's Australia Ltd	**30.1x**	**23.7x**	**19.5x**	**17.4x**	**13.3x**	**11.2x**	**3.3x**	**2.7x**	**2.4x**
Growth	**EPS Growth**			**EBITDA Growth**			**Sales Growth**		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
ANZ Infant Formula	0.7%	21.6%	23.5%	16.3%	20.4%	15.0%	15.6%	7.4%	6.6%
ANZ other Food & Beverages	0.3%	15.4%	18.5%	11.4%	14.0%	13.9%	12.5%	7.4%	6.7%
China Infant Formula & Dairy	50.7%	16.3%	18.2%	16.2%	15.2%	16.5%	16.7%	11.9%	11.0%
Global/MNC Infant Formula	13.8%	9.4%	6.9%	14.1%	6.6%	5.4%	3.5%	3.9%	3.8%
a2 Milk Co Ltd	**na**	**24.8%**	**22.8%**	**50.3%**	**23.7%**	**22.2%**	**42.2%**	**25.3%**	**19.6%**
Bellamy's Australia Ltd	**-23.5%**	**27.0%**	**21.5%**	**-17.2%**	**30.9%**	**18.6%**	**-13.3%**	**19.2%**	**16.3%**

Source: Bloomberg consensus estimates. As of 6-Aug-19.

Table 19: A2M – Compco Multiples (P/E, EV/EBITDA, EV/Sales) and Growth Forecasts (EPS, EBITDA, Sales)

		MCap	P/E			EV/EBITDA			EV/Sales		
Company name	**Ticker**	**NZ$m**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**
a2 Milk Co	**A2M AU**	**12,274**	**41.7x**	**33.5x**	**27.2x**	**28.2x**	**22.8x**	**18.6x**	**9.1x**	**7.3x**	**6.1x**
Bellamy's Australia	**BAL AU**	**1,063**	**30.1x**	**23.7x**	**19.5x**	**17.4x**	**13.3x**	**11.2x**	**3.3x**	**2.7x**	**2.4x**
ANZ Infant Formula											
Blackmores	BKL AU	1,491	23.8x	21.1x	18.3x	15.2x	13.3x	11.6x	2.2x	2.0x	1.9x
Fonterra Co-operative Group	FSF AU	6,039	26.0x	13.1x	10.1x	10.8x	9.0x	8.1x	0.7x	0.6x	0.6x
Synlait Milk	SML NZ	1,670	19.0x	15.6x	12.7x	12.2x	9.4x	8.0x	1.9x	1.5x	1.4x
Median			**23.8x**	**15.6x**	**12.7x**	**12.2x**	**9.4x**	**8.1x**	**1.9x**	**1.5x**	**1.4x**
ANZ Other F&B											
Bega Cheese	BGA AU	878	20.6x	17.3x	13.6x	11.2x	10.0x	8.7x	0.8x	0.8x	0.7x
Coca-Cola Amatil	CCL AU	7,561	19.6x	18.7x	18.0x	10.1x	9.7x	9.4x	1.8x	1.8x	1.7x
Huon Aquaculture Group	HUO AU	401	19.7x	11.2x	9.3x	9.9x	6.3x	5.6x	1.8x	1.5x	1.3x
Freedom Foods Group	FNP AU	1,209	51.4x	25.9x	15.5x	24.1x	13.8x	9.1x	2.7x	2.0x	1.6x
Inghams Group	ING AU	1,496	13.8x	12.8x	12.2x	7.9x	7.5x	7.2x	0.7x	0.7x	0.6x
Select Harvests	SHV AU	703	17.6x	18.6x	16.6x	10.2x	10.4x	9.5x	3.1x	2.9x	2.8x
Tassal Group	TGR AU	909	15.2x	13.5x	11.8x	8.4x	7.4x	6.5x	1.7x	1.5x	1.4x
Treasury Wine Estates	TWE AU	12,216	26.7x	22.3x	18.9x	16.6x	14.1x	12.3x	4.4x	4.0x	3.6x
Median			**19.7x**	**18.0x**	**14.5x**	**10.1x**	**9.9x**	**8.9x**	**1.8x**	**1.7x**	**1.5x**
China Infant Formula & Dairy											
Ausnutria Dairy Corp	1717 HK	3,995	20.0x	15.6x	12.1x	14.3x	10.5x	8.3x	2.5x	1.9x	1.6x
China Mengniu Dairy Co	2319 HK	22,693	22.3x	22.2x	18.8x	16.0x	13.9x	12.2x	1.4x	1.3x	1.1x
Health & Happiness International	1112 HK	5,382	17.5x	14.2x	12.2x	10.7x	9.3x	8.5x	2.5x	2.2x	1.9x
Inner Mongolia Yili Industrial	600887 CH	37,222	24.3x	20.9x	17.8x	16.7x	14.3x	12.3x	1.8x	1.6x	1.4x
Yashili International Holdings	1230 HK	851	30.6x	29.5x	18.8x	9.6x	8.8x	5.0x	0.5x	0.4x	0.4x
Median			**22.3x**	**20.9x**	**17.8x**	**14.3x**	**10.5x**	**8.5x**	**1.8x**	**1.6x**	**1.4x**
Global Infant Formula											
Abbott Laboratories	ABT US	224,529	25.6x	23.0x	20.5x	19.7x	17.3x	15.9x	5.1x	4.8x	4.5x
Danone	BN FP	89,948	20.0x	18.1x	16.9x	14.0x	13.0x	12.3x	2.6x	2.5x	2.4x
Nestle	NESN SW	483,507	23.4x	21.6x	20.2x	17.1x	16.3x	15.5x	3.7x	3.6x	3.5x
Reckitt Benckiser Group	RB/ LN	79,071	17.3x	16.6x	15.9x	13.8x	13.5x	13.0x	4.0x	3.9x	3.8x
Median			**21.7x**	**19.9x**	**18.6x**	**15.6x**	**14.9x**	**14.2x**	**3.9x**	**3.7x**	**3.6x**

		MCap	EPS Growth			EBITDA Growth			Sales Growth		
Company name	**Ticker**	**NZ$m**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**
a2 Milk Co	**A2M AU**	**12,274**	**na**	**24.8%**	**22.8%**	**50.3%**	**23.7%**	**22.2%**	**42.2%**	**25.3%**	**19.6%**
Bellamy's Australia	**BAL AU**	**1,063**	**-23.5%**	**27.0%**	**21.5%**	**-17.2%**	**30.9%**	**18.6%**	**-13.3%**	**19.2%**	**16.3%**
ANZ Infant Formula											
Blackmores	BKL AU	1,491	-14.6%	12.5%	15.5%	-10.7%	13.5%	15.0%	16.3%	7.4%	6.6%
Fonterra Co-operative Group	FSF AU	6,039	na	97.9%	30.0%	58.1%	20.4%	10.3%	-0.3%	4.8%	4.1%
Synlait Milk	SML NZ	1,670	15.9%	21.6%	23.5%	16.3%	29.4%	17.4%	15.6%	24.5%	14.0%
Median			**0.7%**	**21.6%**	**23.5%**	**16.3%**	**20.4%**	**15.0%**	**15.6%**	**7.4%**	**6.6%**
ANZ Other F&B											
Bega Cheese	BGA AU	878	-22.6%	19.3%	27.5%	32.0%	11.3%	15.0%	11.8%	7.2%	5.2%
Coca-Cola Amatil	CCL AU	7,561	-3.2%	4.9%	4.3%	0.9%	4.3%	3.4%	4.4%	2.9%	3.2%
Huon Aquaculture Group	HUO AU	401	-26.2%	75.6%	20.3%	-10.3%	57.1%	12.9%	-8.9%	23.0%	10.2%
Freedom Foods Group	FNP AU	1,209	14.7%	98.8%	66.7%	82.0%	75.0%	50.8%	37.0%	35.8%	27.8%
Inghams Group	ING AU	1,496	3.4%	7.5%	5.3%	0.5%	5.2%	4.2%	3.4%	3.1%	2.6%
Select Harvests	SHV AU	703	74.1%	-5.7%	12.1%	46.7%	-2.0%	9.0%	17.6%	7.6%	3.5%
Tassal Group	TGR AU	909	-2.8%	12.7%	14.3%	5.5%	14.3%	13.3%	17.5%	10.3%	8.2%
Treasury Wine Estates	TWE AU	12,216	31.2%	19.7%	18.0%	27.1%	17.3%	15.4%	15.3%	10.4%	11.0%
Median			**0.3%**	**16.0%**	**16.2%**	**16.3%**	**12.8%**	**13.1%**	**13.5%**	**8.9%**	**6.7%**
China Infant Formula & Dairy											
Ausnutria Dairy Corp	1717 HK	3,995	21.4%	28.1%	29.3%	28.5%	35.9%	26.9%	29.4%	31.4%	24.8%
China Mengniu Dairy Co	2319 HK	22,693	50.7%	0.4%	18.2%	16.2%	15.2%	14.4%	11.5%	8.5%	10.9%
Health & Happiness International	1112 HK	5,382	60.2%	22.8%	16.5%	11.8%	14.7%	10.2%	16.7%	14.1%	12.4%
Inner Mongolia Yili Industrial	600887 CH	37,222	8.0%	16.3%	17.1%	7.2%	16.5%	16.5%	14.5%	11.9%	11.0%
Yashili International Holdings	1230 HK	851	135%	3.7%	57.1%	283%	8.6%	77.0%	16.8%	11.5%	8.7%
Median			**50.7%**	**16.3%**	**18.2%**	**16.2%**	**15.2%**	**16.5%**	**16.7%**	**11.9%**	**11.0%**
Global Infant Formula											
Abbott Laboratories	ABT US	224,529	79.3%	11.5%	11.9%	19.6%	13.5%	9.4%	4.5%	7.2%	7.1%
Danone	BN FP	89,948	-20.3%	10.6%	6.9%	9.7%	8.4%	5.5%	2.9%	3.8%	4.2%
Nestle	NESN SW	483,507	22.7%	8.2%	6.9%	14.9%	4.8%	5.3%	2.9%	2.2%	3.5%
Reckitt Benckiser Group	RB/ LN	79,071	4.8%	3.8%	4.9%	13.4%	2.3%	3.6%	4.0%	4.1%	3.5%
Median			**13.8%**	**9.4%**	**6.9%**	**14.1%**	**6.6%**	**5.4%**	**3.5%**	**3.9%**	**3.8%**

Source: Bloomberg consensus estimates. As of 6-Aug-19.

Table 20: A2M – Compco Returns (ROE) and Margin (EBITDA, Gross) Profile

Company name	Ticker	MCap NZ$m	ROE FY19E	ROE FY20E	ROE FY21E	EBITDA Margin FY19E	EBITDA Margin FY20E	EBITDA Margin FY21E	Gross Margin FY19E	Gross Margin FY20E	Gross Margin FY21E
a2 Milk Co	**A2M AU**	**12,274**	**41.4%**	**35.6%**	**32.1%**	**32.5%**	**32.1%**	**32.8%**	**53.9%**	**53.4%**	**53.0%**
Bellamy's Australia	**BAL AU**	**1,063**	**15.8%**	**17.4%**	**17.8%**	**18.8%**	**20.6%**	**21.0%**	**43.2%**	**43.7%**	**44.2%**
ANZ Infant Formula											
Blackmores	BKL AU	1,491	30.3%	31.3%	32.7%	14.2%	15.0%	16.2%	56.8%	56.2%	64.7%
Fonterra Co-operative Group	FSF AU	6,039	3.6%	6.8%	8.5%	6.2%	7.1%	7.5%	15.1%	15.0%	15.8%
Synlait Milk	SML NZ	1,670	18.4%	18.6%	19.0%	15.8%	16.4%	16.9%	na	na	na
Median			**18.4%**	**18.6%**	**19.0%**	**14.2%**	**15.0%**	**16.2%**	**36.0%**	**35.6%**	**40.2%**
ANZ Other F&B											
Bega Cheese	BGA AU	878	5.5%	6.0%	7.4%	7.3%	7.6%	8.3%	18.9%	18.9%	18.9%
Coca-Cola Amatil	CCL AU	7,561	23.4%	23.6%	23.8%	18.0%	18.2%	18.2%	58.9%	73.3%	69.1%
Huon Aquaculture Group	HUO AU	401	7.7%	8.8%	10.1%	18.1%	23.1%	23.6%	na	na	na
Freedom Foods Group	FNP AU	1,209	3.4%	6.2%	9.8%	11.4%	14.7%	17.4%	25.7%	27.0%	27.8%
Inghams Group	ING AU	1,496	51.1%	69.2%	64.4%	8.7%	8.8%	9.0%	19.9%	20.1%	20.0%
Select Harvests	SHV AU	703	9.3%	8.7%	9.3%	30.7%	27.9%	29.4%	25.4%	15.6%	17.8%
Tassal Group	TGR AU	909	9.3%	9.7%	10.4%	20.3%	21.0%	22.0%	40.4%	40.8%	40.7%
Treasury Wine Estates	TWE AU	12,216	12.3%	14.1%	16.1%	26.7%	28.3%	29.4%	45.0%	46.1%	46.6%
Median			**9.3%**	**9.2%**	**10.3%**	**18.0%**	**19.6%**	**20.1%**	**25.7%**	**27.0%**	**27.8%**
China Infant Formula & Dairy											
Ausnutria Dairy Corp	1717 HK	3,995	22.7%	26.8%	28.3%	17.8%	18.4%	18.7%	51.3%	52.0%	52.5%
China Mengniu Dairy Co	2319 HK	22,693	16.3%	14.9%	15.6%	8.5%	9.1%	9.3%	37.9%	38.3%	38.4%
Health & Happiness International	1112 HK	5,382	25.7%	25.7%	25.4%	23.0%	23.1%	22.7%	66.2%	66.0%	65.9%
Inner Mongolia Yili Industrial	600887 CH	37,222	23.4%	24.6%	25.4%	10.6%	11.1%	11.6%	38.0%	38.3%	38.6%
Yashili International Holdings	1230 HK	851	2.3%	2.4%	3.6%	4.9%	4.8%	7.7%	41.5%	43.1%	45.0%
Median			**22.7%**	**24.6%**	**25.4%**	**10.6%**	**11.1%**	**11.6%**	**41.5%**	**43.1%**	**45.0%**
Global Infant Formula											
Abbott Laboratories	ABT US	224,529	18.0%	18.5%	19.4%	26.1%	27.6%	28.2%	59.3%	59.7%	60.0%
Danone	BN FP	89,948	14.6%	15.1%	15.0%	18.8%	19.6%	19.9%	42.2%	43.1%	39.0%
Nestle	NESN SW	483,507	23.8%	25.0%	25.8%	21.5%	22.1%	22.5%	50.3%	50.7%	51.0%
Reckitt Benckiser Group	RB/ LN	79,071	16.0%	15.4%	15.0%	29.4%	28.9%	28.9%	60.5%	60.4%	60.4%
Median			**17.0%**	**17.0%**	**17.2%**	**23.8%**	**24.8%**	**25.3%**	**54.8%**	**55.2%**	**55.5%**

Source: Bloomberg consensus estimates. As of 6-Aug-19.

Estimates vs consensus

- Our forecasts compared to consensus are detailed in the table below.

Table 21: A2M – Earnings estimates vs Bloomberg median consensus

		Median Consensus 2019E	Median Consensus 2020E	Median Consensus 2021E	JPMf 2019E	JPMf 2020E	JPMf 2021E	OML variance (%) 2019E	OML variance (%) 2020E	OML variance (%) 2021E
Total Sales	($m)	1,312.0	1,651.0	1,980.0	1,311.0	1,662.9	1,979.8	-0.1%	0.7%	0.0%
% growth		42.2%	25.8%	19.9%	42.1%	26.8%	19.1%			
EBITDA	($m)	427.0	528.0	642.5	419.1	523.5	650.2	-1.9%	-0.9%	1.2%
% growth		50.9%	23.7%	21.7%	48.1%	24.9%	24.2%			
EBITDA margin	(%)	32.5%	32.0%	32.4%	32.0%	31.5%	32.8%	-0.58ppt	-0.50ppt	0.40ppt
EBIT	($m)	425.0	525.0	637.0	416.4	520.1	646.3	-2.0%	-0.9%	1.5%
% growth		51.3%	23.5%	21.3%	48.3%	24.9%	24.3%			
EBIT margin	(%)	32.4%	31.8%	32.2%	31.8%	31.3%	32.6%	-0.63ppt	-0.52ppt	0.48ppt
NPAT (pre sig items)	($m)	296.0	372.0	450.0	293.0	367.0	457.5	-1.0%	-1.4%	1.7%
% growth		51.3%	25.7%	21.0%	49.7%	25.3%	24.7%			
NPAT margin	(%)	22.6%	22.5%	22.7%	22.3%	22.1%	23.1%	-0.21ppt	-0.46ppt	0.38ppt
NPAT (post sig items)	($m)	293.0	369.5	448.5	293.0	367.0	457.5	0.0%	-0.7%	2.0%
% growth		49.7%	26.1%	21.4%	49.7%	25.3%	24.7%			
NPAT margin	(%)	22.3%	22.4%	22.7%	22.3%	22.1%	23.1%	0.01ppt	-0.31ppt	0.46ppt
Diluted EPS (pre sig items)	(Acps)	40.0	50.0	61.0	39.5	49.9	62.2	-1.2%	-0.2%	2.0%
% growth		52.1%	25.0%	22.0%	50.2%	26.3%	24.7%			
Diluted EPS (post sig items)	(Acps)	39.5	47.5	59.0	39.5	49.9	62.2	0.0%	5.1%	5.5%
% growth		50.2%	20.3%	24.2%	50.2%	26.3%	24.7%			
DPS	(Acps)	0.0	0.0	16.0	0.0	0.0	15.0	na	na	-6.3%

Source: Bloomberg, Ord Minnett estimates. As of 6-Aug-19. June year end.

Sensitivity

- The A2M valuation is sensitive to estimates of its revenue growth which is led by addressable market growth as well as its EBITDA margins. The table below details the DCF and FY20 EPS (P/E uses the current market price) sensitivity to a change in the addressable market for A2M, reflective of the broader market and its ability to access more/less of that market growth.

Table 22: A2M – DCF and FY20 EPS Sensitivity – Growth Rate of Addressable Market vs JPMf

Acps, $ per share

Bps change	-500	-200	-100	0	+100	+200	+500
FY20E EPS	45.1	48.0	48.9	49.9	50.9	51.9	55.0
DCF	7.3	11.9	14.3	17.4	21.4	26.7	53.7
P/E (market price)	36.7x	34.5x	33.8x	33.2x	32.5x	31.9x	30.1x

Source: Ord Minnett.

- The table below identifies slightly less sensitivity when only changing EBITDA margins, although we recognise evaluating EBITDA margins in isolation is difficult given the operating leverage that can exist, but also the ability to flex operating expenses modest fixed assets.

Table 23: A2M – DCF and FY20 EPS Sensitivity – EBITDA Margin Change vs JPMf

Acps, $ per share

Bps change	-500	-200	-100	0	+100	+200	+500
FY20 EPS	42.0	46.8	48.3	49.9	51.5	53.1	57.9
DCF	15.3	16.6	17.0	17.4	17.8	18.2	19.5
P/E (market price)	39.4x	35.4x	34.3x	33.2x	32.2x	31.2x	28.6x

Source: Ord Minnett.

FY19 Result Preview

- A2M will report its FY19 result on 21 August 2019.
- The current guidance is for 2H19 EBITDA margins to be lower than 1H19 with FY19 EBITDA margins to be ~31-32%, due to: (1) marketing investment in 2H19 to approximately double vs 1H19; (2) continued investment in building organisational capability; and (3) a slightly weaker AUDNZD.
- Looking to FY20, A2M noted that: (1) organisational capability investments in FY19 will continue; (2) marketing investment in China and the United States to continue; and (3) gross margins to be negatively impacted by recent increases in global dairy trade indices.

Bellamy's Australia

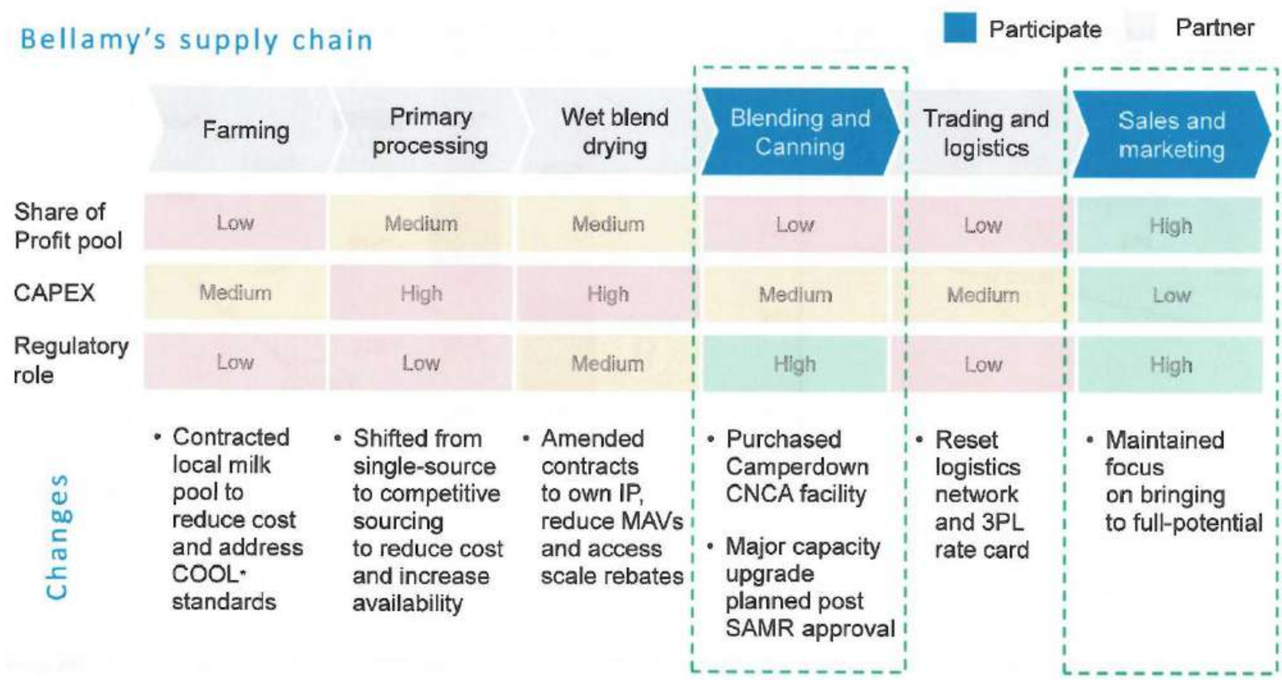
Company overview

Bellamy's Australia, headquartered in Launceston (Tasmania), Australia, is a producer of Australian-origin infant nutrition products. It offers a wide organic product range including infant formula (Stages 1 to 4), pregnancy formula, and baby food (including cereal, fruit & veg pouches, pasta, snacks, rusks), and has trading activities across Australia, China, and a number of emerging markets in Asia. The company was founded in 2004 as Bellamy's Organic by Dooley Crighton-Bellamy, a Tasmanian mother, as a family-operated company. Bellamy's Organic was purchased by Tasmanian Pure Foods in 2007, and the group was renamed Bellamy's Australia in June 2014. The company listed on the Australian Stock Exchange (ASX) on 5 August 2014.

Value chain

- BAL is well positioned in the higher value elements of the value chain, with the value of the Camperdown CNCA facility determined by SAMR approval.

Figure 27: BAL – Supply Chain



Source: Company reports.

Driver #1: Well positioned in the attractive and high growth organic food and infant formula market

- The organic infant formula and food markets have grown at CAGRs of 35% and 13% from 2013-17, respectively, and are sized at US$499m and US$223m.

Figure 28: BAL – China organic infant formula and organic baby food growth and BAL market share (infant formula)

Source: Company reports (2018 Investor Day).

- Organic milk is difficult to source, comprising only 0.9% of the global market for milk, as per KPMG, a theme taken up by BAL in its "1% rare" campaign.
- BAL is well positioned. It has strong market share in the food and infant formula categories, is able to source organic product well, and has a brand that is known as organic and respected by consumers.
- The combination of a high growth market and an attractive brand & product position BAL well for future growth, in our view.

Driver #2: $500m medium term revenue ambition a function of new branding, new product launches and SAMR approval for China label product

- In November 2018 BAL outlined a medium term (FY21) revenue ambition of $500m, which is bold given the FY19 revenue guidance of $275-300m (provided at the 1H19 result). There are 3 key drivers of this revenue ambition.

New branding and product formulation

- BAL has improved its branding with new product presentation, doubling marketing spend in 2H19, doubling the size of its China team in 2H19, and new product formulation (DHA, ARA and GOS, which enhances its organic reputation).
- The successful execution of this new branding and product formulation has been an early win for a new management and Board which needed to rebuild investor trust. The figure below details the new product branding.

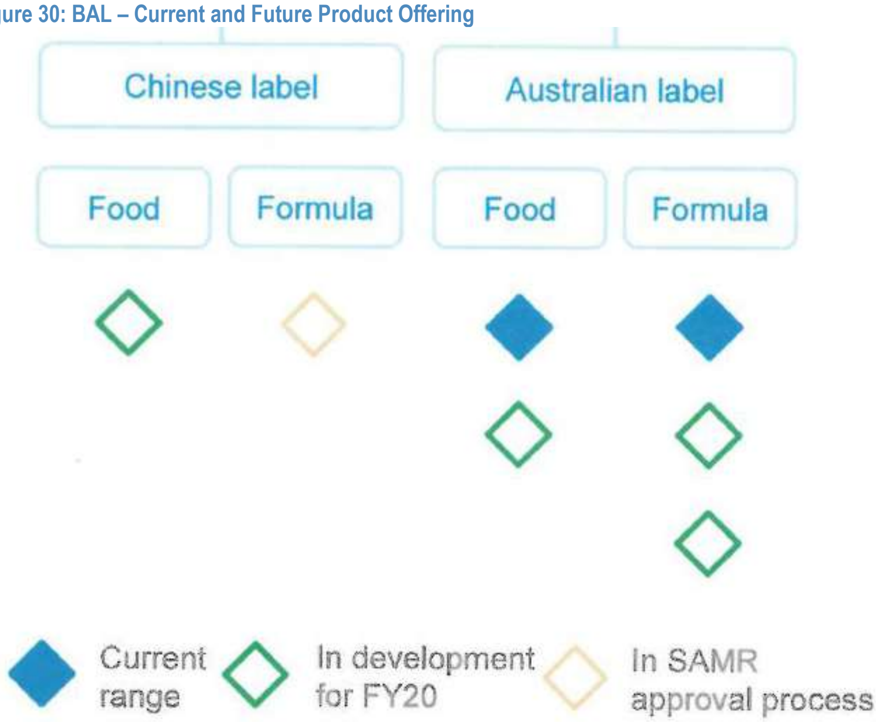
Figure 29: BAL – New Product Branding

Source: Company reports (1H19).

New products

- BAL has identified new product opportunities for FY20 in infant formula and food as detailed in the figure below.

Figure 30: BAL – Current and Future Product Offering



Source: Company reports (1H19).

- A key opportunity is more premium tiers of infant formula, albeit remaining within the organic product range. BAL noted an example of how Danone's Aptamil was able to transition ~47% of its sales to its higher priced product. Emulating this success would be a positive for BAL as its current infant formula product and its current economics are not as attractive as they could be, in our view. The organic process results in high COGS, while the heritage challenges of BAL have resulted in a lower shelf price compared to peers, which has locked BAL into low gross margins.

Figure 31: BAL – Super Premium Example – Aptamil Share of Australian Tin Sales

Source: Company reports (2018 Investor Day).

- A new product announced in April 2019 was the Bellamy's branded infant formula produced at the ViPlus Dairy facility in VIC, which achieved SAMR approval. This product is targeting the China offline channel and is part of the strategy to have a tiered product tiered product portfolio.

Table 24: BAL – China Label Infant Formula Product Portfolio Progress

Brand	Facility	SAMR registration	Formulation	Segment
Bellamy's	Camperdown	Pending	Organic	Super premium
Bellamy's ViPlus	Viplus	Approved	Conventional	Premium

Source: Company reports.

China label product, dependent on SAMR approval

- Another area of growth is China label product, with the SAMR license having previously lapsed and the current SAMR process taking longer than expected.
- We have incorporated SAMR approval into our forecasts from 1H21 yet recognise the timing is uncertain as no guidance is provided to the company. Synlait (SMI NZ, Not Covered) indicated at its Investor Day in July 2018 that Chinese approval processes consider Australia and New Zealand separately, removing the prospect that presence in NZ could indicate future activity in Australia (or vice versa). The ramp up time for revenue to be generated post SAMR approval being granted is ~4-6mths hence our forecasts provide room for a late CY2019/CY20 approval.

$500m targets

- BAL set an ambition of $500m revenue by FY21. Our forecasts do not have BAL achieving this target, and neither does consensus. This is due to execution risks associated with new products and especially SAMR approval (if and when) for China label product (we assume 1H21).
- To assist investors in calibrating the potential EPS and valuation impact of the $500m ambition being achieved, as well as our base case and a downside scenario, we have provided 3 scenarios. The key variable is China label launch date and level of success, with another uncertainty the degree to which operating expenses (marketing and team) can be reduced under a downside scenario.

Table 25: BAL – Earnings and Valuation based on Different SAMR Approval Timing Scenarios

	Bear case	Base case	Bull case
China label launch period	**1H23**	**1H21**	**2H20**
FY21 Aus label revenue	350.7	363.4	447.0
FY19-21 CAGR	11.4%	13.4%	25.8%
FY21 China label revenue	0.0	44.0	48.4
FY21 Camperdown	5.0	5.0	5.0
FY21 total revenue	**355.7**	**412.3**	**500.4**
FY19-21 CAGR	11.3%	19.8%	32.0%
FY21 EBITDA	67.4	84.7	117.6
FY21 EBITDA margin	19.0%	20.5%	23.5%
FY19-21 margin expansion	-52bp	106bp	403bp
FY21 EPS	37.9	48.0	67.3
FY19-21 CAGR	10.9%	24.9%	47.8%
FY21 P/E	**24.1x**	**19.0x**	**13.6x**
DCF	**$7.69**	**$9.03**	**$12.06**

Source: Ord Minnett. June year end. Price as of 5-Aug-19.

Driver #3: Baby food is a complementary stable growth avenue with halo benefits

Food is a small part of group revenue & profit

- Food is estimated to comprise ~8-9% of BAL's group revenue, with similar margins as infant formula but less growth. Food is usually picked up as an ancillary, bundled by shoppers along with the flagship infant formula product.
- Across its product range, rice cereal is very popular especially among Chinese consumers, while the fruit & veg pouches export well. As noted above, new food products are being considered, although the focus for BAL remains skewed to infant formula.

Food lengthens the end consumer time with the product while maintaining brand relevance with the mother

- Some BAL infant formula consumers may have consumed BAL food products while being breast fed. This provides the brand exposure to the mother beyond the infant formula shelves and prior to the transition some make to the product.
- Baby food allows the consumer to remain with the brand for longer, possibly concurrently and then for some for a longer period of time. These complementary products help BAL leverage (or build) its relationship with the mother who may remain with the brand with food for longer or with any other children.

Risk #1: SAMR approval not yet received, organic infant formula economics not yet attractive, and execution risk

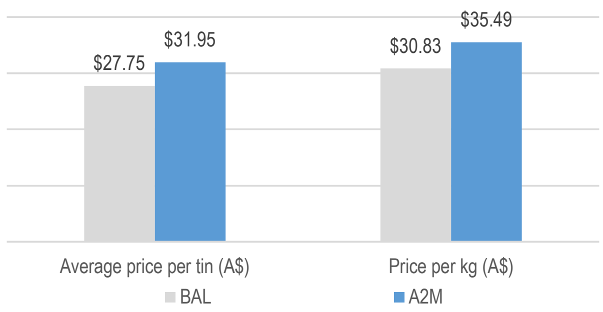
SAMR approval not yet secured

- The evolution of the BAL tiered product portfolio requires a China-label, SAMR approved product that is able to be sold in the offline channel in China.
- SAMR approval has been later than expected and BAL has no visibility into progress or timing of any approval. While BAL continues to invest in its product portfolio, marketing and China team, the limited progress on SAMR is disappointing.
- We struggle to become upbeat on BAL in the absence of SAMR approval as it is a key driver of future growth and the achievement of $500m revenue aspiration (unlikely to be achieved without SAMR).

Economics of BAL organic formula are less attractive vs peers

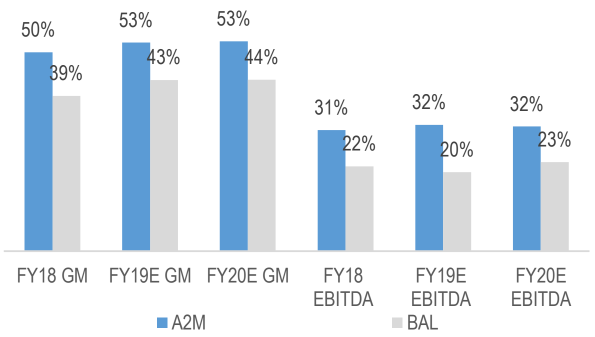
- Organic infant formula has a unique selling proposition yet also a challenged supply chain with only ~1% of dairy organic. Yet BAL fails to convert this into superior retail price which drives a lower gross margin and EBITDA margin.

Figure 32: BAL – Price comparison – BAL vs A2M



Source: Ord Minnett.

Figure 33: BAL – Gross and EBITDA margin – BAL vs A2M



Source: Company reports and Ord Minnett estimates.

- Any efforts by BAL to improve its retail selling price arguably via new products with a more premium position (Bellamy's GOLD perhaps), as well as generate greater scale to fractionalise investment would improve economics for the business, which does possess a sound unique selling proposition.

Execution risk on the strategy remains

- BAL has made significant changes following its issues several years ago (broad distribution, excess inventory and limited control of inventory, price volatility which hindered diagou economics).
- There are significant changes occurring, including new products, new branding, increased ownership of select distribution and efforts to improve daigou economics (hence the higher daigou margin for BAL vs A2M as per the figure earlier in this report), as well as a $500m revenue ambition which requires the execution of these targets as well as achieving SAMR approval.
- There has been sound progress with the product reformulation and brand relaunch well received. Yet there remains a significant amount to do and execution risk.

Risk #2: China infant formula market could see volume growth constrained by demographics with premiumisation to remain a driver but the pace could moderate

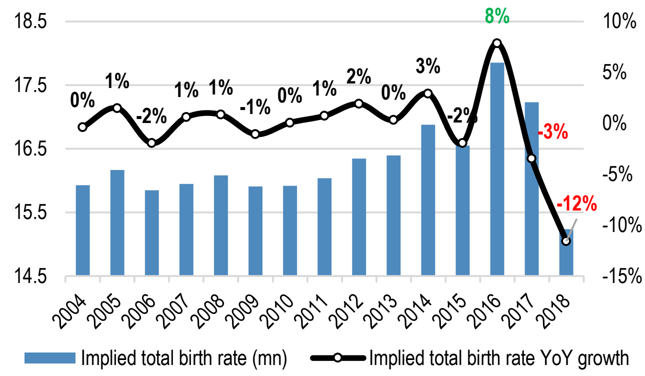
- The content below is from a global collaboration report on the China Infant Milk Formula market with our European Consumer Goods team led by Celine Pannuti.

Volume growth to be constrained by demographics

Birthrate

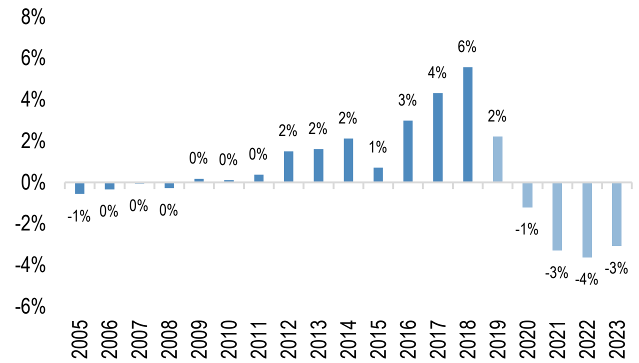
- According to Chinese statistics, the number of newborns hit a 15 year low in 2018 at 15.2m, after two consecutive years of decade-record births in 2016 and 2017 (boosted by the relaxation of China's one child policy). Further, the drop in new births in China is set to continue as the female population in China aged between 15 and 49, which the NBS defines as "child-bearing age", fell by 4 million in 2017 and 7m in 2018, down 7%. Euromonitor forecasts the 0-3yo cohort to shrink by 1% by 2020 and -3%-4% thereafter.

Figure 34: Annual births in China, YoY Growth (%)



Source: National Bureau of Statistics.

Figure 35: Number of babies aged 0-3 y.o., YoY

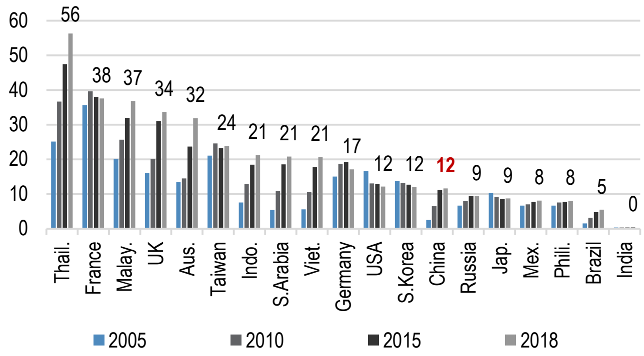


Source: Euromonitor.

Volume

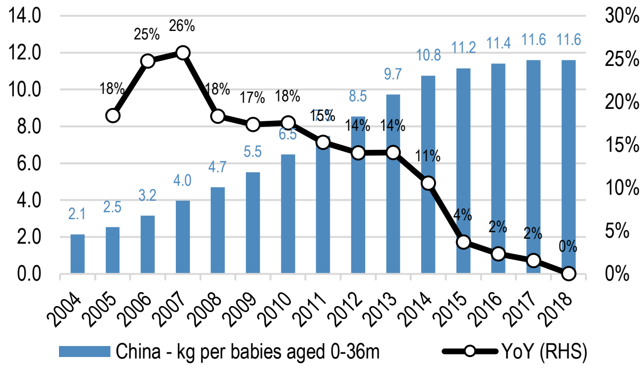
- At a global level per capita consumption in China remains low at c12kg/pa, c25% below the emerging markets average despite the high participation of female in the labor force (69% of female population aged 15-64 y.o. in 2018 vs 54% worldwide and 65% in high income countries). Yet volume penetration per capita has stagnated at c11-12kg since 2016.

Figure 36: Infant formula volume (kg) per baby aged 0-3 y.o., 2018



Source: Euromonitor.

Figure 37: China, kg of infant formula per babies aged 0-36 months

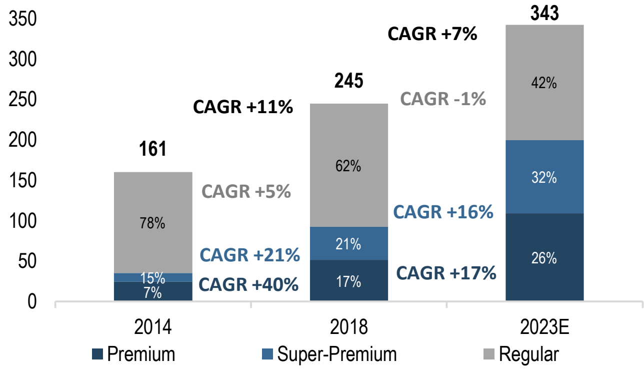


Source: Euromonitor.

Premiumisation has been a key driver and is expected to remain supportive although the pace could moderate

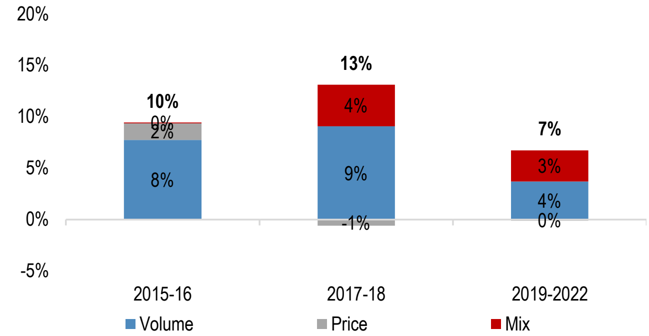
- According to Frost & Sullivan, High Premium products (retail price point above 350RMB per kg, c1.7x average market price) now represent c40% of market value, up from 22% in 2014. It expects premium products share to keep expanding, it forecast the segment to grow 16.6% CAGR 2018-2023E) down from 27% CAGR14-18. This implies that mix boosted industry growth by 4% historically and is forecast to contribute 3% to growth going forward.

Figure 38: Chinese infant formula market, Historical and Future growth per Segment (RMB bn, % CAGR14-18, % CAGR18-23E)



Source: Frost & Sullivan from Feihe Prospectus.

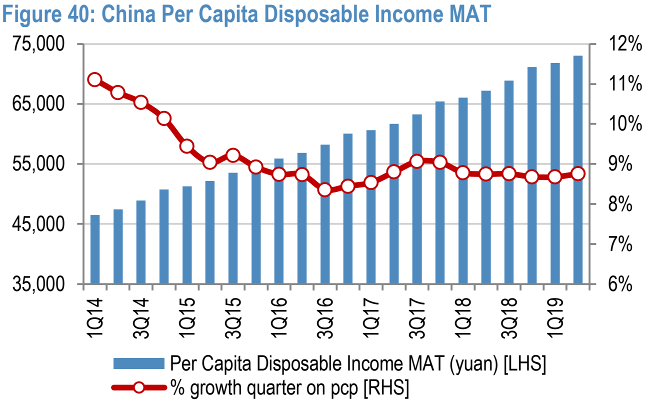
Figure 39: Chinese infant formula market growth, Building blocks



Source: Frost & Sullivan from Feihe Prospectus; Ord Minnett estimates.

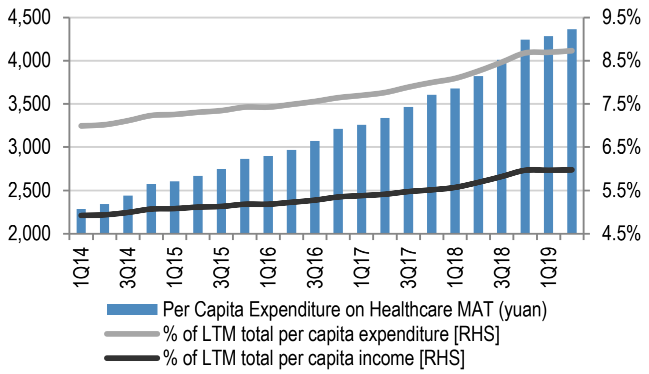
- Yet there are challenges that could moderate the pace of premiumisation growth.
  - Premium products, priced RMB290+, 1.4x above category average, already represent 64% of the category. We believe the Frost & Sullivan definition above fails to take into account the 'Premium' segment of IMF priced at RMB290-350. According to Health & Happiness, Premium product (RMB290+) share has increased from 47% in 2016 to 64% in 2018, driven by the development of Super Premium (RMB350+) and Ultra / Super High Premium with prices of up to RMB550-600. Accounting for Premium products share to increase to 80% by end 2021, it would imply growth rate of the premium segment to decelerate from 30% to a still healthy low double-digit.
  - Down trading or deflation risks exist. (1) The acceleration in premiumisation in 2017-2018 has been concomitant to the surge on premium consumption across many categories (e.g. spirits, cosmetics, apparel) despite no upsurge in disposable income growth. It is unclear how long this consumption boom will continue should the economy slow down. (2) Regulatory measures could also influence consumption and price points with a 2013 investigation by the National Development and Reform Commission resulting in large MNCs voluntarily cutting prices (by an average of 10%).

Figure 40: China Per Capita Disposable Income MAT



Source: National Bureau of Statistics of China. Calendar year quarters.

Figure 41: China Per Capita Expenditure on Healthcare and as % of total per capita expenditure and income



Source: National Bureau of Statistics of China. Calendar year quarters.

Regulation is evolving to improve compliance and encourage domestic production

- The industry is highly regulated, which is understandable given the vulnerability of the end customers, and recent changes have modified the route to market and provided an advantage to larger players (corporate daigou, those able to secure registration).
- International players are negatively impacted by the 60% self-sufficiency plan with the potential for market share losses especially for those outside the premium categories.

BAL implications

- For BAL, these challenges may impact the timing of SAMR approval and require greater investment to regain momentum in China. While the brand & product offering are attractive, the more challenged external environment is more impactful as the business remains in turnaround.

Risk #3: Competition within the China infant formula market could intensify, which would require market share gains to sustain growth rates

Market share gains may be required to sustain elevated rates of growth

- As noted in the risk above, the China infant formula market could see volume growth constrained by demographics while the pace of premiumisation could moderate.
- This could require market share gains to be achieved for participants to sustain historical rates of growth. Heightened competition could materialise in greater costs to access the MBS channel, or product innovation.
- For BAL, heightened competition is unwelcome as it remains in a significant investment phase (China team, marketing) to regain momentum in China.

Competitors have launched organic product with limited success

- BAL has seen several new entrants into the organic infant formula market, including Nestle NAN and Biostime, as well as BUBS more recently announcing its plan to offer a goat organic milk product.

Table 26: BAL – Competitor Offering of Organic Products

Company	Brand
Biostime	Biostime
Bioliving (import into Australia)	Holle organic cow and goat milk
Biostime	Biostime
Bubs	Bubs Organic grass-fed
Nestle	NAN Organic
Nature One Dairy	Nature One Dairy

Source: Media articles, Ord Minnett.

- These are challenges given the distribution reach the companies NAN, Biostime and BUBS (with Chemists Warehouse) have. However, as we have seen in recent store visits as per the figures below, BAL product has been selling well while NAN was being discounted and Biostime was not selling through well.
- This suggests there are challenges with converting existing organic customers to a new brand, and that there is appeal for the BAL product range among customers interested in organic infant formula.

Financials

Profit & Loss

Table 27: BAL – Summary Profit & Loss Statement

$ in millions

	2016	2017	1H18	2H18	2018	1H19	2H19E	2019E	2020E	2021E	2022E
Sales	**234.1**	**240.2**	**174.9**	**153.8**	**328.7**	**129.6**	**157.5**	**287.1**	**331.0**	**398.8**	**433.3**
% growth	85.4%	2.6%	47.9%	26.2%	36.9%	-25.9%	2.4%	-12.7%	15.3%	20.5%	8.7%
Other revenue	0.5	0.2	0.1	0.5	0.6	0.1	0.5	0.5	0.5	0.5	0.5
Group revenue	234.6	240.4	175.0	154.3	329.3	129.7	157.9	287.6	331.5	399.4	433.9
COGS	(132.9)	(148.7)	(111.1)	(88.8)	(199.8)	(73.7)	(89.4)	(163.0)	(187.5)	(223.6)	(240.6)
Gross Profit	101.8	91.8	64.0	65.5	129.5	56.0	68.6	124.6	144.1	175.8	193.2
% gross margin	43.5%	38.2%	36.6%	42.6%	39.4%	43.2%	43.5%	43.4%	43.5%	44.1%	44.6%
CODB (ex D&A)	(47.1)	(49.0)	(29.1)	(29.8)	(58.9)	(30.1)	(37.0)	(67.1)	(71.2)	(85.7)	(91.2)
% of sales	20.1%	20.4%	16.7%	19.4%	17.9%	23.2%	23.5%	23.4%	21.5%	21.5%	21.1%
Underlying EBITDA	**54.6**	**42.8**	**34.9**	**35.7**	**70.5**	**25.9**	**31.5**	**57.5**	**72.8**	**90.1**	**102.0**
% margin	23.3%	17.8%	19.9%	23.2%	21.5%	20.0%	20.0%	20.0%	22.0%	22.6%	23.5%
D&A	(0.3)	(0.8)	(2.1)	(2.2)	(4.3)	(2.8)	(1.7)	(4.4)	(4.3)	(5.3)	(4.9)
Underlying EBIT	**54.3**	**42.0**	**32.7**	**33.5**	**66.2**	**23.2**	**29.9**	**53.0**	**68.5**	**84.8**	**97.1**
% margin	23.2%	17.5%	18.7%	21.8%	20.2%	17.9%	19.0%	18.5%	20.7%	21.3%	22.4%
Net interest	0.6	(1.3)	0.0	0.9	0.9	0.7	0.7	1.4	1.8	2.4	3.0
Tax expense	(16.6)	(12.5)	(10.3)	(9.8)	(20.2)	(7.4)	(9.2)	(16.6)	(21.1)	(26.2)	(30.0)
Underlying NPAT	**38.3**	**28.2**	**22.4**	**24.6**	**47.0**	**16.5**	**21.4**	**37.9**	**49.2**	**61.0**	**70.1**
% growth	282.6%	-26.4%	69.5%	64.0%	66.6%	-26.4%	-13.0%	-19.4%	29.8%	24.1%	14.8%
Statutory NPAT	38.3	(0.8)	22.4	20.4	42.8	8.1	21.4	29.5	49.2	61.0	70.1
Underlying dil. EPS (Acps)	38.6	27.1	19.8	21.1	40.8	13.8	17.9	31.8	41.2	51.2	58.8
% growth	269.1%	-29.6%	49.0%	51.6%	50.4%	-30.0%	-14.8%	-22.2%	29.8%	24.1%	14.8%
DPS (Acps)	11.9	-	-	-	-	-	-	-	-	-	18.0

Source: Company reports and Ord Minnett estimates. June year end.

Balance Sheet

Table 28: BAL – Summary Balance Sheet

$ in millions

	2016	2017	1H18	2H18	2018	1H19	2H19E	2019E	2020E	2021E	2022E
Cash & Equivalents	32.3	17.5	85.0	87.6	87.6	94.8	127.4	127.4	171.3	213.2	270.7
Receivables	33.9	37.1	45.2	49.3	49.3	54.3	48.4	48.4	49.4	57.6	60.1
Inventories	67.8	93.5	69.6	90.5	90.5	61.0	80.5	80.5	84.2	99.6	105.8
Other	5.3	2.3	2.8	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Total Current Assets	**139.2**	**150.4**	**202.6**	**230.2**	**230.2**	**212.9**	**259.0**	**259.0**	**307.7**	**373.0**	**439.3**
PP&E	1.1	1.0	3.3	3.8	3.8	4.4	4.9	4.9	10.8	20.0	18.7
Intangibles	1.7	1.7	35.0	40.1	40.1	38.2	37.2	37.2	34.6	33.2	32.9
Other	1.5	3.5	4.3	6.8	6.8	6.7	6.7	6.7	6.7	6.7	6.7
Total Non-Current Assets	**4.3**	**6.3**	**42.6**	**50.7**	**50.7**	**49.2**	**48.8**	**48.8**	**52.1**	**59.9**	**58.2**
TOTAL ASSETS	**143.5**	**156.6**	**245.3**	**280.8**	**280.8**	**262.0**	**307.8**	**307.8**	**359.7**	**432.9**	**497.6**
Payables	48.4	37.7	60.5	69.1	69.1	40.9	65.2	65.2	68.0	80.2	84.9
Borrowings	0.1	25.3	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other	11.6	2.4	0.5	4.2	4.2	3.0	3.0	3.0	3.0	3.0	3.0
Total Current Liabilities	**60.1**	**65.4**	**61.0**	**73.4**	**73.4**	**43.9**	**68.3**	**68.3**	**71.1**	**83.2**	**88.0**
Borrowings	0.0	-	-	-	-	-	-	-	-	-	-
Other	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Total Non-Current Liabilities	**0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
TOTAL LIABILITIES	**60.3**	**65.4**	**61.1**	**73.5**	**73.5**	**44.0**	**68.3**	**68.3**	**71.1**	**83.3**	**88.1**
SHAREHOLDER'S EQUITY	**83.2**	**91.3**	**184.2**	**207.4**	**207.4**	**218.0**	**239.4**	**239.4**	**288.6**	**349.6**	**409.5**
Net Debt	(32.2)	7.8	(85.0)	(87.6)	(87.6)	(94.8)	(127.3)	(127.3)	(171.3)	(213.2)	(270.6)
ND / ND + E	-63%	8%	-86%	-73%	-73%	-77%	-114%	-114%	-146%	-156%	-195%
ND / EBITDA	-0.6x	0.2x	-2.4x	-2.5x	-1.2x	-3.7x	-4.0x	-2.2x	-2.4x	-2.4x	-2.7x
Net Working Capital	53.3	92.8	54.3	70.7	70.7	74.5	63.7	63.7	65.6	77.0	81.0

Source: Company reports and Ord Minnett estimates. June year end.

Cash Flows

Table 29: BAL – Summary Cash Flow Statement

$ in millions

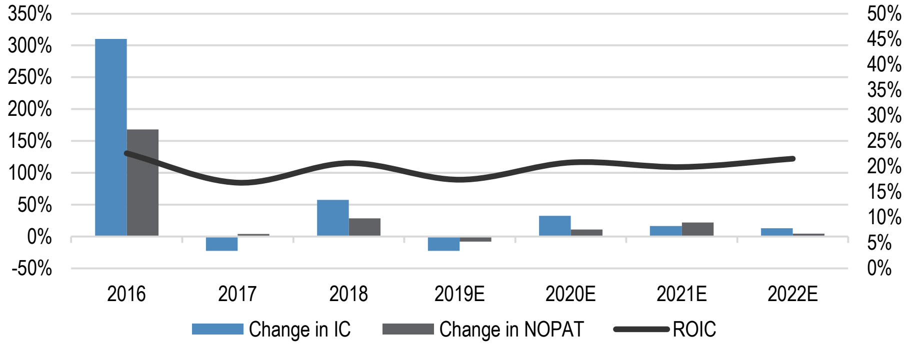
	2016	2017	1H18	2H18	2018	1H19	2H19E	2019E	2020E	2021E	2022E
Cashflow From Operations	**8.9**	**(45.7)**	**59.1**	**9.1**	**68.2**	**8.6**	**33.8**	**42.4**	**51.6**	**54.9**	**70.9**
Capex	(2.4)	(0.3)	(0.8)	(6.7)	(7.5)	(1.4)	(1.3)	(2.6)	(2.6)	(3.1)	(3.3)
Free Cash Flow	**6.5**	**(46.0)**	**58.3**	**2.4**	**60.7**	**7.2**	**32.6**	**39.8**	**48.9**	**51.9**	**67.7**
Investments & Acquisitions	-	(0.5)	(10.5)	-	(10.5)	-	-	-	(5.0)	(10.0)	-
Asset Sales	0.0	0.3	0.0	(0.0)	-	-	-	-	-	-	-
Investing Cashflows	**(2.4)**	**(0.5)**	**(11.2)**	**(6.8)**	**(18.0)**	**(1.4)**	**(1.3)**	**(2.6)**	**(7.6)**	**(13.1)**	**(3.3)**
Borrowings	(0.1)	25.1	(25.2)	0.0	(25.2)	0.0	-	0.0	-	-	-
Equity	0.6	13.2	44.9	0.2	45.1	-	-	-	-	-	-
Distributions	(6.7)	(7.1)	-	-	-	-	-	-	-	-	(10.2)
Financing Cashflows	**(6.2)**	**31.2**	**19.6**	**0.3**	**19.9**	**0.0**	**-**	**0.0**	**-**	**-**	**(10.2)**
FX effect on cash	(0.0)	0.2	-	-	-	-	-	-	-	-	-
Net Change in Cash	0.3	(14.8)	67.5	2.6	70.2	7.2	32.6	39.8	43.9	41.9	57.5
Cash Conversion %	**30.6%**	**-77.6%**	**196.2%**	**45.1%**	**119.7%**	**61.0%**	**134.1%**	**101.1%**	**97.4%**	**87.4%**	**96.0%**

Source: Company reports and Ord Minnett estimates. June year end.

Returns Profile

- Recent operational issues at BAL have resulted in low capital investment (decline in 2017 and 2019) and low returns, despite the capital light operating model having the potential to drive strong ROIC from strong earnings (NOPAT) growth.

Figure 42: A2M – ROIC and Change in Invested Capital and NOPAT



Source: Ord Minnett.

Dividend policy

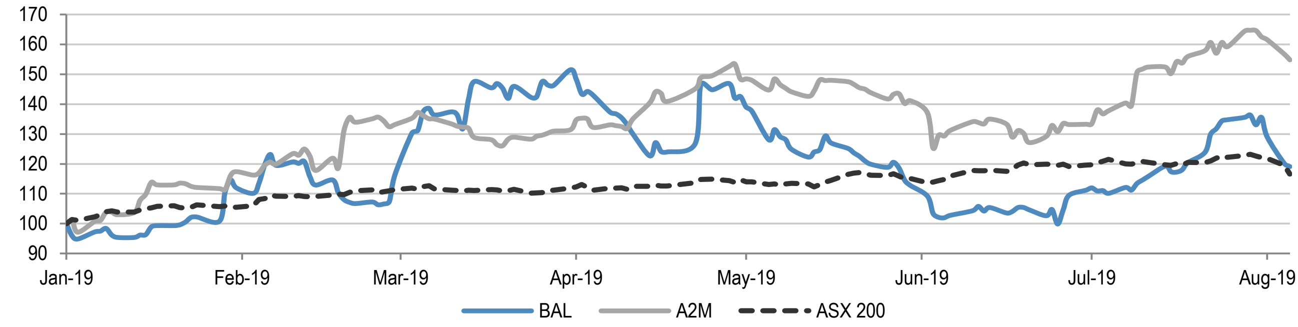
- We have assumed that BAL will not pay a dividend until FY22 with the focus on execution and reinvestment back into the business.

Valuation

Share price performance

- As of market close on 6 August 2019, the BAL share price has risen 19.1% YTD in 2019, slightly outperforming the ASX 200 (up 16.6%).

Figure 43: BAL – Share Price Performance vs A2M and ASX 200 in CY19



Source: Bloomberg. Normalised with price on 2-Jan-19 = 100.

WACC parameters

- We have assumed a 15-year forecast period to 2035.

Table 30: BAL – DCF Valuation Parameters

Parameter	Assumption
Risk free	3.0%
Market risk premium	6.0%
Unlevered beta	1.10
Levered equity beta	1.36
Cost of equity(levered)	11.1%
Cost of debt (pre-tax)	5.0%
Tax rate	30%
Gearing D/(D+E)	25%
WACC	9.2%
Terminal growth rate	3.0%

Source: Ord Minnett estimates.

- The risk free rate and equity market risk premium are consistent across our coverage universe.
- The unlevered beta of 1.10x is for greater deemed risks in the BAL business vs others (such as A2M) especially regarding SAMR approval and execution risk.

DCF valuation

- Our DCF is detailed in the table below.

Table 31: BAL – DCF Valuation
$ in millions

PV of Cashflows	$640
Terminal Value	$307
Enterprise Value	**$947**
Net debt	($129)
Minorities	($0)
Valuation	**$1,077**
Per Share ($)	**$9.03**

Source: Ord Minnett.

Comparable peer metrics

Table 32: BAL – Compco Multiples (P/E, EV/EBITDA, EV/Sales) and Growth Forecasts (EPS, EBITDA, Sales)

		MCap	P/E			EV/EBITDA			EV/Sales		
Company name	**Ticker**	**$m**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**
a2 Milk Co	**A2M AU**	**11,835**	**41.7x**	**33.5x**	**27.2x**	**28.2x**	**22.8x**	**18.6x**	**9.1x**	**7.3x**	**6.1x**
Bellamy's Australia	**BAL AU**	**1,025**	**30.1x**	**23.7x**	**19.5x**	**17.4x**	**13.3x**	**11.2x**	**3.3x**	**2.7x**	**2.4x**
ANZ Infant Formula											
Blackmores	BKL AU	1,437	23.8x	21.1x	18.3x	15.2x	13.3x	11.6x	2.2x	2.0x	1.9x
Fonterra Co-operative Group	FSF AU	5,822	26.0x	13.1x	10.1x	10.8x	9.0x	8.1x	0.7x	0.6x	0.6x
Synlait Milk	SML NZ	1,611	19.0x	15.6x	12.7x	12.2x	9.4x	8.0x	1.9x	1.5x	1.4x
Median			**23.8x**	**15.6x**	**12.7x**	**12.2x**	**9.4x**	**8.1x**	**1.9x**	**1.5x**	**1.4x**
ANZ Other F&B											
Bega Cheese	BGA AU	846	20.6x	17.3x	13.6x	11.2x	10.0x	8.7x	0.8x	0.8x	0.7x
Coca-Cola Amatil	CCL AU	7,291	19.6x	18.7x	18.0x	10.1x	9.7x	9.4x	1.8x	1.8x	1.7x
Huon Aquaculture Group	HUO AU	387	19.7x	11.2x	9.3x	9.9x	6.3x	5.6x	1.8x	1.5x	1.3x
Freedom Foods Group	FNP AU	1,165	51.4x	25.9x	15.5x	24.1x	13.8x	9.1x	2.7x	2.0x	1.6x
Inghams Group	ING AU	1,442	13.8x	12.8x	12.2x	7.9x	7.5x	7.2x	0.7x	0.7x	0.6x
Select Harvests	SHV AU	678	17.6x	18.6x	16.6x	10.2x	10.4x	9.5x	3.1x	2.9x	2.8x
Tassal Group	TGR AU	876	15.2x	13.5x	11.8x	8.4x	7.4x	6.5x	1.7x	1.5x	1.4x
Treasury Wine Estates	TWE AU	11,779	26.7x	22.3x	18.9x	16.6x	14.1x	12.3x	4.4x	4.0x	3.6x
Median			**19.7x**	**18.0x**	**14.5x**	**10.1x**	**9.9x**	**8.9x**	**1.8x**	**1.7x**	**1.5x**
China Infant Formula & Dairy											
Ausnutria Dairy Corp	1717 HK	3,852	20.0x	15.6x	12.1x	14.3x	10.5x	8.3x	2.5x	1.9x	1.6x
China Mengniu Dairy Co	2319 HK	21,881	22.3x	22.2x	18.8x	16.0x	13.9x	12.2x	1.4x	1.3x	1.1x
Health & Happiness International	1112 HK	5,189	17.5x	14.2x	12.2x	10.7x	9.3x	8.5x	2.5x	2.2x	1.9x
Inner Mongolia Yili Industrial	600887 CH	35,889	24.3x	20.9x	17.8x	16.7x	14.3x	12.3x	1.8x	1.6x	1.4x
Yashili International Holdings	1230 HK	821	30.6x	29.5x	18.8x	9.6x	8.8x	5.0x	0.5x	0.4x	0.4x
Median			**22.3x**	**20.9x**	**17.8x**	**14.3x**	**10.5x**	**8.5x**	**1.8x**	**1.6x**	**1.4x**
Global Infant Formula											
Abbott Laboratories	ABT US	216,493	25.6x	23.0x	20.5x	19.7x	17.3x	15.9x	5.1x	4.8x	4.5x
Danone	BN FP	86,728	20.0x	18.1x	16.9x	14.0x	13.0x	12.3x	2.6x	2.5x	2.4x
Nestle	NESN SW	466,200	23.4x	21.6x	20.2x	17.1x	16.3x	15.5x	3.7x	3.6x	3.5x
Reckitt Benckiser Group	RB/ LN	76,241	17.3x	16.6x	15.9x	13.8x	13.5x	13.0x	4.0x	3.9x	3.8x
Median			**21.7x**	**19.9x**	**18.6x**	**15.6x**	**14.9x**	**14.2x**	**3.9x**	**3.7x**	**3.6x**

		MCap	EPS Growth			EBITDA Growth			Sales Growth		
Company name	**Ticker**	**$m**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**
a2 Milk Co	**A2M AU**	**11,835**	**na**	**24.8%**	**22.8%**	**50.3%**	**23.7%**	**22.2%**	**42.2%**	**25.3%**	**19.6%**
Bellamy's Australia	**BAL AU**	**1,025**	**-23.5%**	**27.0%**	**21.5%**	**-17.2%**	**30.9%**	**18.6%**	**-13.3%**	**19.2%**	**16.3%**
ANZ Infant Formula											
Blackmores	BKL AU	1,437	-14.6%	12.5%	15.5%	-10.7%	13.5%	15.0%	16.3%	7.4%	6.6%
Fonterra Co-operative Group	FSF AU	5,822	na	97.9%	30.0%	58.1%	20.4%	10.3%	-0.3%	4.8%	4.1%
Synlait Milk	SML NZ	1,611	15.9%	21.6%	23.5%	16.3%	29.4%	17.4%	15.6%	24.5%	14.0%
Median			**0.7%**	**21.6%**	**23.5%**	**16.3%**	**20.4%**	**15.0%**	**15.6%**	**7.4%**	**6.6%**
ANZ Other F&B											
Bega Cheese	BGA AU	846	-22.6%	19.3%	27.5%	32.0%	11.3%	15.0%	11.8%	7.2%	5.2%
Coca-Cola Amatil	CCL AU	7,291	-3.2%	4.9%	4.3%	0.9%	4.3%	3.4%	4.4%	2.9%	3.2%
Huon Aquaculture Group	HUO AU	387	-26.2%	75.6%	20.3%	-10.3%	57.1%	12.9%	-8.9%	23.0%	10.2%
Freedom Foods Group	FNP AU	1,165	14.7%	98.8%	66.7%	82.0%	75.0%	50.8%	37.0%	35.8%	27.8%
Inghams Group	ING AU	1,442	3.4%	7.5%	5.3%	0.5%	5.2%	4.2%	3.4%	3.1%	2.6%
Select Harvests	SHV AU	678	74.1%	-5.7%	12.1%	46.7%	-2.0%	9.0%	17.6%	7.6%	3.5%
Tassal Group	TGR AU	876	-2.8%	12.7%	14.3%	5.5%	14.3%	13.3%	17.5%	10.3%	8.2%
Treasury Wine Estates	TWE AU	11,779	31.2%	19.7%	18.0%	27.1%	17.3%	15.4%	15.3%	10.4%	11.0%
Median			**0.3%**	**16.0%**	**16.2%**	**16.3%**	**12.8%**	**13.1%**	**13.5%**	**8.9%**	**6.7%**
China Infant Formula & Dairy											
Ausnutria Dairy Corp	1717 HK	3,852	21.4%	28.1%	29.3%	28.5%	35.9%	26.9%	29.4%	31.4%	24.8%
China Mengniu Dairy Co	2319 HK	21,881	50.7%	0.4%	18.2%	16.2%	15.2%	14.4%	11.5%	8.5%	10.9%
Health & Happiness International	1112 HK	5,189	60.2%	22.8%	16.5%	11.8%	14.7%	10.2%	16.7%	14.1%	12.4%
Inner Mongolia Yili Industrial	600887 CH	35,889	8.0%	16.3%	17.1%	7.2%	16.5%	16.5%	14.5%	11.9%	11.0%
Yashili International Holdings	1230 HK	821	135%	3.7%	57.1%	283%	8.6%	77.0%	16.8%	11.5%	8.7%
Median			**50.7%**	**16.3%**	**18.2%**	**16.2%**	**15.2%**	**16.5%**	**16.7%**	**11.9%**	**11.0%**
Global Infant Formula											
Abbott Laboratories	ABT US	216,493	79.3%	11.5%	11.9%	19.6%	13.5%	9.4%	4.5%	7.2%	7.1%
Danone	BN FP	86,728	-20.3%	10.6%	6.9%	9.7%	8.4%	5.5%	2.9%	3.8%	4.2%
Nestle	NESN SW	466,200	22.7%	8.2%	6.9%	14.9%	4.8%	5.3%	2.9%	2.2%	3.5%
Reckitt Benckiser Group	RB/ LN	76,241	4.8%	3.8%	4.9%	13.4%	2.3%	3.6%	4.0%	4.1%	3.5%
Median			**13.8%**	**9.4%**	**6.9%**	**14.1%**	**6.6%**	**5.4%**	**3.5%**	**3.9%**	**3.8%**

Source: Bloomberg consensus estimates. As of 6-Aug-19.

Table 33: BAL – Compco Returns (ROE) and Margin (EBITDA, Gross) Profile

		MCap	ROE			EBITDA Margin			Gross Margin		
Company name	**Ticker**	**$m**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**
a2 Milk Co	**A2M AU**	**11,835**	**41.4%**	**35.6%**	**32.1%**	**32.5%**	**32.1%**	**32.8%**	**53.9%**	**53.4%**	**53.0%**
Bellamy's Australia	**BAL AU**	**1,025**	**15.8%**	**17.4%**	**17.8%**	**18.8%**	**20.6%**	**21.0%**	**43.2%**	**43.7%**	**44.2%**
ANZ Infant Formula											
Blackmores	BKL AU	1,437	30.3%	31.3%	32.7%	14.2%	15.0%	16.2%	56.8%	56.2%	64.7%
Fonterra Co-operative Group	FSF AU	5,822	3.6%	6.8%	8.5%	6.2%	7.1%	7.5%	15.1%	15.0%	15.8%
Synlait Milk	SML NZ	1,611	18.4%	18.6%	19.0%	15.8%	16.4%	16.9%	na	na	na
Median			**18.4%**	**18.6%**	**19.0%**	**14.2%**	**15.0%**	**16.2%**	**36.0%**	**35.6%**	**40.2%**
ANZ Other F&B											
Bega Cheese	BGA AU	846	5.5%	6.0%	7.4%	7.3%	7.6%	8.3%	18.9%	18.9%	18.9%
Coca-Cola Amatil	CCL AU	7,291	23.4%	23.6%	23.8%	18.0%	18.2%	18.2%	58.9%	73.3%	69.1%
Huon Aquaculture Group	HUO AU	387	7.7%	8.8%	10.1%	18.1%	23.1%	23.6%	na	na	na
Freedom Foods Group	FNP AU	1,165	3.4%	6.2%	9.8%	11.4%	14.7%	17.4%	25.7%	27.0%	27.8%
Inghams Group	ING AU	1,442	51.1%	69.2%	64.4%	8.7%	8.8%	9.0%	19.9%	20.1%	20.0%
Select Harvests	SHV AU	678	9.3%	8.7%	9.3%	30.7%	27.9%	29.4%	25.4%	15.6%	17.8%
Tassal Group	TGR AU	876	9.3%	9.7%	10.4%	20.3%	21.0%	22.0%	40.4%	40.8%	40.7%
Treasury Wine Estates	TWE AU	11,779	12.3%	14.1%	16.1%	26.7%	28.3%	29.4%	45.0%	46.1%	46.6%
Median			**9.3%**	**9.2%**	**10.3%**	**18.0%**	**19.6%**	**20.1%**	**25.7%**	**27.0%**	**27.8%**
China Infant Formula & Dairy											
Ausnutria Dairy Corp	1717 HK	3,852	22.7%	26.8%	28.3%	17.8%	18.4%	18.7%	51.3%	52.0%	52.5%
China Mengniu Dairy Co	2319 HK	21,881	16.3%	14.9%	15.6%	8.5%	9.1%	9.3%	37.9%	38.3%	38.4%
Health & Happiness International	1112 HK	5,189	25.7%	25.7%	25.4%	23.0%	23.1%	22.7%	66.2%	66.0%	65.9%
Inner Mongolia Yili Industrial	600887 CH	35,889	23.4%	24.6%	25.4%	10.6%	11.1%	11.6%	38.0%	38.3%	38.6%
Yashili International Holdings	1230 HK	821	2.3%	2.4%	3.6%	4.9%	4.8%	7.7%	41.5%	43.1%	45.0%
Median			**22.7%**	**24.6%**	**25.4%**	**10.6%**	**11.1%**	**11.6%**	**41.5%**	**43.1%**	**45.0%**
Global Infant Formula											
Abbott Laboratories	ABT US	216,493	18.0%	18.5%	19.4%	26.1%	27.6%	28.2%	59.3%	59.7%	60.0%
Danone	BN FP	86,728	14.6%	15.1%	15.0%	18.8%	19.6%	19.9%	42.2%	43.1%	39.0%
Nestle	NESN SW	466,200	23.8%	25.0%	25.8%	21.5%	22.1%	22.5%	50.3%	50.7%	51.0%
Reckitt Benckiser Group	RB/ LN	76,241	16.0%	15.4%	15.0%	29.4%	28.9%	28.9%	60.5%	60.4%	60.4%
Median			**17.0%**	**17.0%**	**17.2%**	**23.8%**	**24.8%**	**25.3%**	**54.8%**	**55.2%**	**55.5%**

Source: Bloomberg consensus estimates. As of 6-Aug-19.

Table 34: BAL – Compco Multiples Summary

Valuation Metrics	P/E			EV/EBITDA			EV/Sales		
	FY19E	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**
ANZ Infant Formula	23.8x	15.6x	12.7x	12.2x	9.4x	8.1x	1.9x	1.5x	1.4x
ANZ other Food & Beverages	19.2x	16.6x	13.5x	10.0x	9.1x	8.0x	1.7x	1.5x	1.4x
China Infant Formula & Dairy	22.3x	20.9x	17.8x	14.3x	10.5x	8.5x	1.8x	1.6x	1.4x
Global/MNC Infant Formula	21.7x	19.9x	18.6x	15.6x	14.9x	14.2x	3.9x	3.7x	3.6x
a2 Milk Co Ltd	**41.7x**	**33.5x**	**27.2x**	**28.2x**	**22.8x**	**18.6x**	**9.1x**	**7.3x**	**6.1x**
Bellamy's Australia Ltd	**30.1x**	**23.7x**	**19.5x**	**17.4x**	**13.3x**	**11.2x**	**3.3x**	**2.7x**	**2.4x**
Growth	**EPS Growth**			**EBITDA Growth**			**Sales Growth**		
	FY19E	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**	**FY19E**	**FY20E**	**FY21E**
ANZ Infant Formula	0.7%	21.6%	23.5%	16.3%	20.4%	15.0%	15.6%	7.4%	6.6%
ANZ other Food & Beverages	0.3%	15.4%	18.5%	11.4%	14.0%	13.9%	12.5%	7.4%	6.7%
China Infant Formula & Dairy	50.7%	16.3%	18.2%	16.2%	15.2%	16.5%	16.7%	11.9%	11.0%
Global/MNC Infant Formula	13.8%	9.4%	6.9%	14.1%	6.6%	5.4%	3.5%	3.9%	3.8%
a2 Milk Co Ltd	**na**	**24.8%**	**22.8%**	**50.3%**	**23.7%**	**22.2%**	**42.2%**	**25.3%**	**19.6%**
Bellamy's Australia Ltd	**-23.5%**	**27.0%**	**21.5%**	**-17.2%**	**30.9%**	**18.6%**	**-13.3%**	**19.2%**	**16.3%**

Source: Bloomberg consensus estimates. As of 6-Aug-19.

Estimates vs consensus

- Our forecasts compared to consensus are detailed in the table below. We note that consensus forecasts vary significantly hence median consensus preferred but even then clarity on consensus is not high.

Table 35: BAL – Earnings estimates vs Bloomberg median consensus

		Median Consensus			JPMf			OML variance (%)		
		2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Total Sales	($m)	289.0	347.0	395.0	287.1	338.8	412.3	-0.7%	-2.4%	4.4%
% growth		-12.1%	20.1%	13.8%	-12.7%	18.0%	21.7%			
EBITDA	($m)	54.7	74.8	85.7	55.9	72.4	84.7	2.2%	-3.1%	-1.2%
% growth		-22.5%	36.7%	14.6%	-20.7%	29.6%	16.9%			
EBITDA margin	(%)	18.9%	21.6%	21.7%	19.5%	21.4%	20.5%	0.55ppt	-0.17ppt	-1.16ppt
EBIT	($m)	46.4	54.3	64.9	51.4	68.1	79.4	10.7%	25.5%	22.4%
% growth		-30.0%	17.0%	19.5%	-22.5%	32.7%	16.6%			
EBIT margin	(%)	16.1%	15.6%	16.4%	17.9%	20.1%	19.3%	1.83ppt	4.47ppt	2.83ppt
NPAT (pre sig items)	($m)	35.5	50.2	55.6	36.7	48.9	57.2	3.4%	-2.5%	2.9%
% growth		-24.4%	41.4%	10.8%	-21.9%	33.3%	17.0%			
NPAT margin	(%)	12.3%	14.5%	14.1%	12.8%	14.4%	13.9%	0.50ppt	-0.02ppt	-0.20ppt
Diluted EPS (pre sig items)	(Acps)	29.1	38.4	45.7	30.8	41.0	48.0	5.8%	6.8%	5.0%
% growth		-28.7%	32.0%	19.0%	-24.6%	33.3%	17.0%			
DPS	(Acps)	0.0	2.5	3.5	0.0	0.0	0.0	Na	-100.0%	-100.0%

Source: Bloomberg, Ord Minnett. As of 5-Aug-19. June year end.

FY19 Result Preview

- BAL will report its FY19 result on 28 August 2019. The current guidance is for FY19 revenue of $275-300m and 18-22% EBITDA margins.

Appendix

What is infant formula?

- Infant formula is broadly described as a nutritive powder for infants, made from a mixture of dairy and other ingredients, and designed to mimic human breast milk as closely as possible. Infant formula is segmented into stages based on age range of consumers primarily to avoid regulation and restrictions on advertising.

Table 36: A2M – Five Stage Segmentation of Infant Nutrition Products

	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Pregnant mothers
Common names	Infant formula	Infant formula	Children's nutrition			Pregnancy formula
		Follow on formula	Toddler formula			
		Follow up formula	Growing up milk			
Regulatory environment	- Highly regulated	- Less regulated as it is not the only source of food (baby is eating solids)				- Regulated as dairy
	- Advertising banned (by law or voluntarily)	- Advertising allowed				- Advertising allowed
	- Manufacturers focus on selling through doctors & nurses	- Traditional FMCG sales & marketing				
		- "Take advantage of brand loyalty developed in Stages 1 & 2 to retain customers as they grow older"				
Defined target age range	Birth to 6mths	6mths to 1yr	1yr to 3yrs	3yrs to 6yrs	6yrs+	Pregnant & lactating women

Source: Coriolis reports, Ord Minnett.

What is a2 milk?

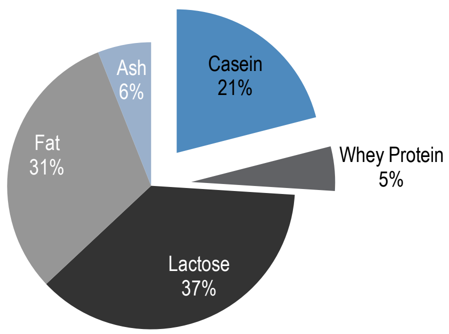
Attributes

- A2M's unique selling proposition is its A1 protein-free milk, or A2 milk, which it claims provides improved digestive comfort and reduces symptoms associated with milk protein sensitivities in individuals who have adverse experiences following the consumption of regular dairy products (which contain A1 proteins). A recent article from the Journal of Pediatric Gastroenterology and Nutrition indicated improved digestion and cognitive performance from A2 milk in Chinese preschool children.

Product characteristics

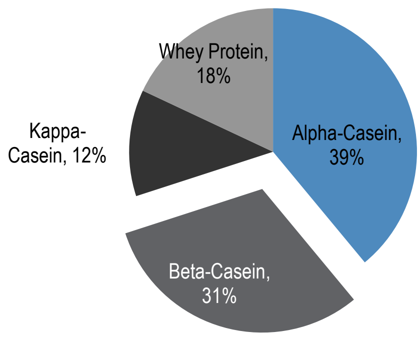
- Regular cows' milk contains about 26% protein, which comprises casein, whey proteins and some enzymes, with beta-casein making up ~30% of the total protein content of milk. Regular cows' milk contains 2 main types of beta-casein protein, A2 protein and A1 protein.

Figure 44: A2M – Average Composition of Solids in Regular Cow Milk



Source: Company reports.

Figure 45: A2M – Average Composition of Regular Cow Milk Protein



Source: Company reports.

-

- As per A2M, scientific research has demonstrated that A1 and A2 proteins are structurally different with A1 proteins releasing beta casomorphin-7 (BCM-7) during the process of digestion, which may affect aspects of digestive function if not broken down further. A2 proteins release no or very little BCM-7 during digestion. Further human clinical trials are needed to confirm the differential health effects of A2 protein vs A1, but recent advances support A2M's proposition of allowing dairy nutrition access to consumers who otherwise would limit their dairy intake.

Sourcing

- A2M branded milk is sourced from herds producing milk containing only A2 protein. This is done by identifying and segregating cows that naturally produce A1 protein-free milk, with no genetic engineering or technological processes involved.

Figure 46: A2M – Genetic Variation Resulted in Mixed A1 and A2 Cow Herds

Source: Company reports.

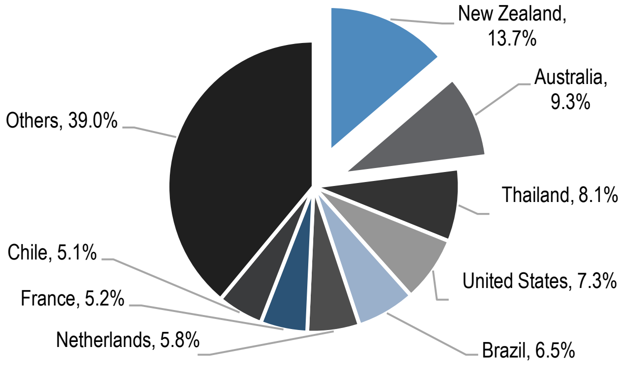
- Originally all cows produced milk containing only A2 proteins, until a genetic mutation occurred thousands of years ago in some European cattle. A2 milk remains high in herds in much of Asia, Africa, and parts of Southern Europe, while A1 milk is commonly found in the United States, New Zealand, Australia, and Europe. Currently, a third of the herd in Australia, New Zealand and the United States are A1 free hence there is supply.

ANZ food including infant formula well perceived in China with rising middle class a positive

ANZ products have a strong brand identity in China

- Australia and New Zealand's dairy industries have a strong brand identity in China, as the long history of dairy production coupled with the clean and healthy image of ANZ products resonate well with Chinese consumers. A recent Bain survey found cross-border shoppers in China are 1.6 times more likely to associate Australia with health and nutrition than the US, Germany, Japan and South Korea.

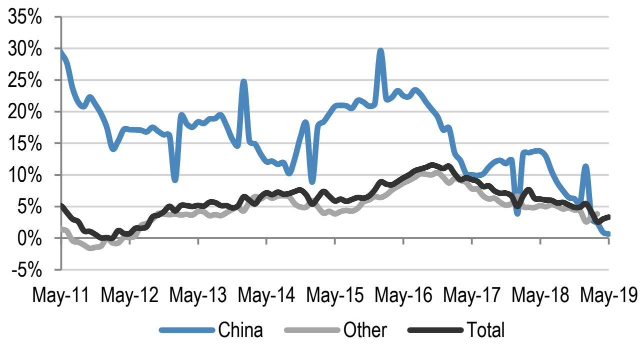
Figure 47: China's major suppliers of agricultural consumer-oriented food (2018)



Source: ATO Guangzhou, GTA, USDA GAIN Report on China Food Retail Sector (Jun-2019).

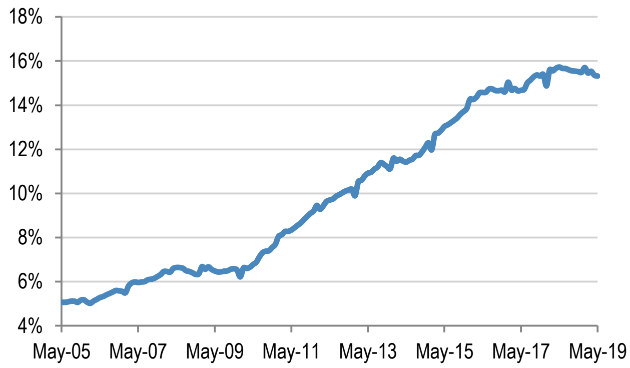
- For an ANZ brand to succeed in China, we suggest it is important that the brand must achieve consumer credibility within Australia, as Chinese consumers want to consume the quality products that Australian locals do. The increase in the number of Chinese tourists to Australia allows for more word-of-mouth marketing as well as sales via the daigou channel.

Figure 48: Australia visitor arrivals growth – by country of residence



Source: ABS, Ord Minnett. Rolling 12 month visitor growth vs pcp.

Figure 49: % Chinese among total visitor arrivals – LTM

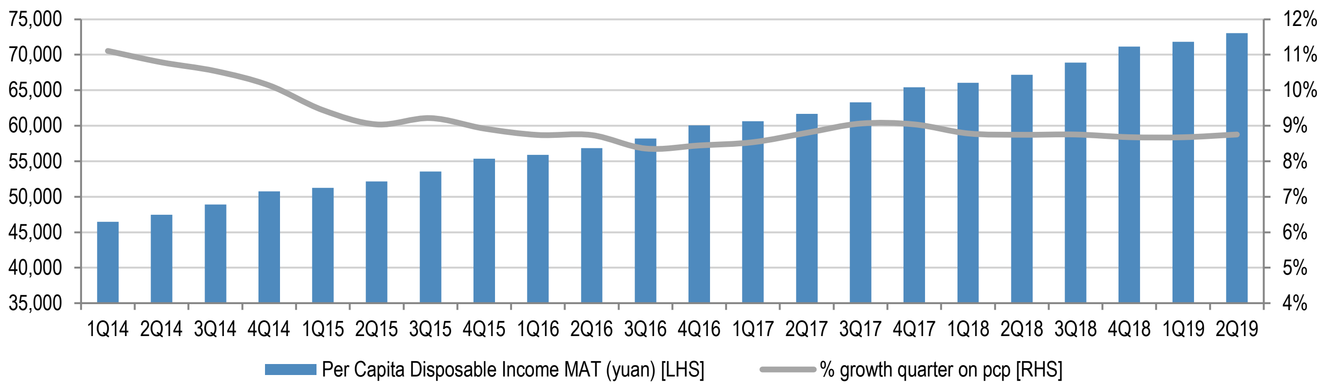


Source: ABS, Ord Minnett. Rolling 12 month visitors.

Rising middle class

- Chinese per capita disposable income has been growing strongly, with at least 8% yoy growth observed every quarter for the last 5 years.

Figure 50: China Per Capita Disposable Income MAT



Source: National Bureau of Statistics of China. Calendar year quarters.

- Chinese consumers now prefer to pay more but buy less, focusing more on product quality, unique design, good service, and wellness rather than low prices.
- The spending behavior change, as detailed by Ord Minnett China Consumer analyst Kevin Yin here, can be attributed to: (1) rising disposable income; (2) changes in demographics and preference (millennials seem to care more about design and quality than price); and (3) increasing hygiene and health awareness.

Board and Management Profiles – A2M and BAL

Table 37: A2M – Board Profile

Name	Title	Experience
David Hearn	Chair and Executive Director	Director since 2014
		Previous Senior Executive roles (including CEO or MD) for: Goodman Fielder Limited, UB Snack Foods Europe/Asia, Del Monte UK, Smith's Crisps, Cordiant Communications Group
		Director Lovat Partners Limited, Robin Partington & Partners Limited, Committed Capital Limited
Julia Hoare	Deputy Chair, Independent Non-Executive Director	Director since 2013
		Previous Partner, PwC New Zealand (20 years)
		Member – New Zealand External Reporting Advisory Panel, New Zealand Institute of Directors National Council
		Deputy Chair, Watercare Services Limited
		Director – New Zealand Post Limited, Port of Tauranga Limited, AWF Madison Group Limited, Auckland International Airport Limited
Jayne Hrdlicka	CEO and MD	CEO, Jetstar Group (subsidiary Qantas)
		Previous Non-Executive Director Woolworths (2010-2016)
		Previous Partner, Bain & Company
Peter Hinton	Independent, Non-Executive Director	Director since 2016
		Previous Partner, Simpson Grierson
Warwick Every-Burns	Independent, Non-Executive Director	Director since 2016
		Previous Senior Vice President, Vice President APAC, The Clorox Company
		Previous Managing Director, NationalPak Limited
		Non-Executive Director, Treasury Wine Estates
Jesse Wu	Independent, Non-Executive Director	Director since 2017
		Previous Group Chair, Johnson & Johnson Consumer Group
		Previous Vice President APAC, Johnson & Johnson Consumer Group
Geoffrey Babidge	Former MD and CEO	Director since 2010
		Previous Senior Executive roles: Freedom Foods Group, Bunge Defiance, National Foods

Source: Company reports.

Table 38: A2M – Management Profile

Name	Title	Experience
Jayne Hrdlicka	CEO and MD	CEO, Jetstar Group (subsidiary Qantas)
		Previous Non-Executive Director Woolworths (2010-2016)
		Previous Partner, Bain & Company
Craig Louttit	CFO	General Manager Finance, Transport, Technology Systems, UGL Limited (2007-2014)
		Senior Finance Roles EMI Group PLC (1999-2007)
Peter Nathan	Chief Executive, Asia-Pacific	Chief Executive ANZ, A2M (2010-2017)
		General Manager Freedom Foods Group Limited
		Senior marketing and sales roles, Gillette and Colgate Plamolive
Li Xiao	Chief Executive, Greater China	Experience with Mars, Nike, Burger King, and the Kids Entertainment Division at Wanda Group
Blake Waltrip	Chief Executive, USA	CEO of Quinoa Corporation
		VP and CMO, beverage division, Hain Celestial Group
		Managing Partner, Growth Ventures
Jaron McVicar	General Counsel & Company Secretary	15 years of legal experience as a corporate and commercial lawyer
Shareef Khan	COO	Senior management experience in supply chain management in the FMCG sector
Susan Massaso	Chief Marketing Officer	Senior executive positions, Campbell Arnott's
Phil Rybinksi	Chief Technical Officer	Senior QA and R&D leadership roles at Dairy Farmers, Fonterra, Parmalat and Lactalis
Lisa Burquest	Chief People Officer	Human resources roles with BHP Billiton, Origin Energy, Jetstar, Qantas Airlines
Melanie Kansil	Chief Commercial Officer	Strategy & Investments at Nine Entertainment Company, and McKinsey and Company

Source: Company reports.

Table 39: BAL – Board Profile

Name	Title	Experience
John Ho	Non-Executive Chair	Founder and CIO of Janchor Partners
		Deputy Chairman HK Exchange Listing Committee
		Director Vocus Communications
John Murphy	Independent, Deputy Chair	Previous MD Coca-Cola Amatil
		Previous CEO Visy Packaging
		Previous Managing Director Fosters Australia
Rodd Peters	Non-Executive Director	Solicitor Supreme Court of NSW and High Court of Australia
Wai-Chan Chan	Independent, Non-Executive Director	Partner and Global Leader of Consumer Goods Practice, Oliver Wyman
		Regional North Asia Director, Dairy Farm
		Partner, McKinsey & Company
Shirley Liew	Independent, Non-Executive Director	Senior Commercial Finance Roles and Partnership roles in Grant Thornton and Ernst & Young
		Chair, Outset Group
		Director – Lantern Hotels Group, Amber Group Australia, Hunter United Employees Credit Union, Bridge Housing Limited

Source: Company reports.

Table 40: BAL – Management Profile

Name	Title	Experience
Andrew Cohen	CEO	COO and Chief Strategy Officer (2016-2017)
		Partner, Bain & Company
Nigel Underwood	CFO	CFO, Keolis Downer
Melinda Harrison	General Counsel, Company Secretary	General Counsel, Carter Holt Harvey
Peter Fridell	Director of Operations	Strategy Director and Supply Finance General Manager, Carlton & United Brewers
David Jednyak	Director of Sales & Marketing	Principal, Bain & Company

Source: Company reports.

a2 Milk Company (ASX)

a2 Milk Company (A2M)

Year-end Jun (NZ$)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (NZ$ mn)	549	922	1,311	1,663	1,980
Gross margin	48.0%	50.3%	54.0%	53.1%	53.6%
EBITDA margin	25.7%	30.7%	32.0%	31.5%	32.8%
Adj. net income (NZ$ mn)	91	196	293	367	457
Adj. EPS (NZ$)	0.12	0.26	0.40	0.50	0.62
BBG EPS (NZ$)	-	-	-	-	-
Reported EPS (NZ$)	0.12	0.26	0.40	0.50	0.62
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.9%
Adj. P/E	133.1	62.2	41.4	32.8	26.3
EV/EBITDA	85.9	42.1	28.2	21.9	17.0

Source: Company data, Bloomberg, Ord Minnett estimates.

Investment Thesis, Valuation and Risks

a2 Milk Company *(Accumulate; Price Target: $17.23)*

Investment Thesis

- **A2M has several key drivers.** Product (A1 free), brand (aspirational, health & wellness), ANZ provenance, ANZ usage and a deep engagement with core consumers. A2M has a nimble route to market which is able to adjust to changing points of purchase, while its understanding of daigou channel economics is a competitive advantage. Looking forward, further growth in China is forecast as A2M can continue to expand its addressable market, geographically and by channel especially MBS where it is somewhat under-represented.

- **A2M is exposed to some industry risks but we are confident further market share gains will be achieved.** The outlook for the China infant formula market is less robust as demographics constrain volume growth and questions exist on the pace of ongoing premiumisation. This could see greater level of competition for access to MBS, especially given the desire from China for domestic production to grow to 60%. For A2M, it is able to expand its addressable market (geographically, greater MBS presence) and it has performed well when competitors have entered the A2 category.

- **A2M is evolving with significant organisational change.** Such management changes are not unexpected yet A2M must not allow these to upset the culture that has driven the significant growth of the business.

- **Valuation support exists despite strong share price performance.** A2M has outperformed the ASX 100 by 37.9% since 1 January 2019 and is trading at high earnings multiples. Yet there is valuation support (DCF NZ$17.40) while we suggest the premium multiple is justified given the strong forecast revenue, EBITDA and EPS growth over the next 3-6yrs.

Valuation

Table 41: A2M – DCF Valuation

NZ$ & $ in millions

	NZ$	$
PV of Cashflows	$7,121	$6,765
Terminal Value	$4,919	$4,673
Value of Associates	$291	$276
Enterprise Value ($m)	**$12,331**	**$11,714**
Net debt	($460)	($437)
Valuation ($m)	**$12,790**	**$12,151**
Per Share ($)	**$17.40**	**$16.53**

Source: Ord Minnett.

- We initiate with a 30 June 2020 price target of $17.23 per share on A2M AU. It is derived from our theoretical share price target, which is based on our DCF valuation, rolled forward at the cost of equity (9.7%), less forecast dividends, with a modest discount due to expected volatility in the share price of companies exposed to the China consumer. Our price target implies that A2M will trade at a ~36x FY20E P/E multiple.

Risks to Rating and Price Target

- Changes in the rate of growth in the infant formula industry in China, including volume (birth rates, kilo per capita), the rate premiumisation, competitive dynamics (including any change in terms to access the growing Mother & Baby Store, MBS, channel).
- Changes in regulation of the infant formula industry in China, especially relating to cross-border e-commerce, the daigou channel and efforts to increase domestic production.
- Competitive dynamics within the A1 free dairy category, including new scientific studies and the impact of new entrants.
- Changes in the relative appeal of A2M product to the daigou channel and changes in how inventory levels are managed.
- Any disruption of the infant formula supply chain, especially from Synlait and in the future Fonterra, including product safety.
- Changes in the timing of break even in the United States (FY21) and the quantum of losses in the United Kingdom.
- The effectiveness of how the significant level of organisational change is being managed.

a2 Milk Company

NZ$ in millions, year end Jun

Profit And Loss	FY17	FY18	FY19E	FY20E	FY21E
Revenue	**549**	**922**	**1,311**	**1,663**	**1,980**
Revenue growth	*55.8%*	*67.9%*	*42.1%*	*26.8%*	*19.1%*
COGS	(286)	(458)	(603)	(781)	(918)
Operating Expenses	(123)	(182)	(291)	(362)	(415)
EBITDA	**141**	**283**	**419**	**523**	**650**
EBITDA growth	*158.6%*	*100.5%*	*48.1%*	*24.9%*	*24.2%*
EBITDA margin	*25.7%*	*30.7%*	*32.0%*	*31.5%*	*32.8%*
Amortisation	(1)	(1)	(1)	(1)	(1)
Depreciation	(1)	(1)	(2)	(3)	(3)
EBIT	**138**	**281**	**416**	**520**	**646**
Other Income	-	-	-	-	-
Other Expenses	-	-	-	-	-
Net Interest	1	2	3	4	7
Pre-Tax Profit	**139**	**283**	**419**	**524**	**654**
Tax	(49)	(88)	(126)	(157)	(196)
Tax Rate	*35.0%*	*30.9%*	*30.2%*	*30.0%*	*30.0%*
Minorities	0	0	0	0	0
Abnormals (post tax)	0	0	0	0	0
Reported NPAT	**91**	**196**	**293**	**367**	**457**
Normalised NPAT	**91**	**196**	**293**	**367**	**457**
Growth	*197.8%*	*115.9%*	*49.7%*	*25.3%*	*24.7%*
End of Period Shares	718	730	735	735	735
EFPOWA	738	744	741	735	735
Reported EPS	0.13	0.27	0.40	0.50	0.62
Normalised EPS	**0.12**	**0.26**	**0.40**	**0.50**	**0.62**
Growth	*185.2%*	*114.0%*	*50.2%*	*26.3%*	*24.7%*
DPS	0.00	0.00	0.00	0.00	0.15
Growth	-	-	-	-	-
DPS/EPS payout	0.0%	0.0%	0.0%	0.0%	24.1%

Cash Flow Statement	FY17	FY18	FY19E	FY20E	FY21E
Net Profit for Cashflow	91	196	293	367	457
Depreciation & Amortisation	3	2	3	3	4
Non Cash Items	-	-	-	-	-
Working Capital Changes	(31)	(96)	(43)	(2)	1
Other Operating Cashflows	38	129	(4)	0	0
Cashflow from Operating Activities	**100**	**231**	**249**	**368**	**463**
Capex	-	-	-	-	-
Net Acquisitions	-	-	-	-	-
Other Investing cashflows	0	0	0	0	0
Investing Cash Flow	**(51)**	**(21)**	**(168)**	**(6)**	**(7)**
Inc/(Dec) in Borrowings	0	0	0	0	0
Equity Issued	4	7	2	0	0
Dividends Paid	-	-	-	-	-
Other Financing Cashflows	0	0	0	0	(51)
Financing Cash Flow	**4**	**7**	**2**	**0**	**(51)**
Net Cash Flow	**52**	**219**	**81**	**362**	**404**

Valuation Summary	$m	$ps
Current mkt capitalisation	11,606.91	15.79
Price Target		17.23
Capital growth to price target		9.1%

Trading Multiples	FY17	FY18	FY19E	FY20E	FY21E
PE Pre-abnormals	133.1	62.2	41.4	32.8	26.3
PE Reported	133.1	62.2	41.4	32.8	26.3
EV/EBITDA	85.9	42.1	28.2	21.9	17.0
EV/EBIT	87.6	42.4	28.4	22.0	17.1

Key Ratios	FY17	FY18	FY19E	FY20E	FY21E
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.9%
Franking	-	-	-	-	-
Return on Assets (%)	32.7%	36.9%	35.0%	31.4%	28.8%
Return on Equity (%)	48.4%	49.1%	43.5%	37.1%	32.9%
ROIC (%)	35.1%	40.6%	46.5%	51.3%	60.1%

Leverage	FY17	FY18	FY19E	FY20E	FY21E
Gearing (Net Debt / Equity)	NM	NM	NM	NM	NM
Gearing (ND / (ND + E))	(100.5%)	(158.2%)	(114.4%)	(195.2%)	(294.7%)
Net Debt / EBITDA	NM	NM	NM	NM	NM
EBIT Interest Cover (x)	(156.1)	(118.6)	(136.5)	(126.8)	(90.0)

Balance Sheet	FY17	FY18	FY19E	FY20E	FY21E
Cash	121	340	422	784	1,188
Receivables	73	59	89	101	109
Investments	-	-	-	-	-
Inventories	28	64	81	96	108
Other Current Assets	36	36	48	48	48
Total Current Assets	**258**	**500**	**640**	**1,029**	**1,453**
Net PPE	8	10	11	14	16
Total Intangibles	13	15	15	16	17
Other Non Current Assets	64	192	291	319	319
Total Non Current Assets	**86**	**217**	**318**	**349**	**352**
Total Assets	**344**	**716**	**957**	**1,377**	**1,804**
Creditors	71	109	124	149	170
Current Borrowings	0	0	0	0	0
Current Tax Provisions	31	51	31	31	31
Other Current Provisions	0	0	0	0	0
Other Current Liabilities	0	1	12	12	12
Total Current Liabilities	**102**	**160**	**167**	**192**	**213**
Non Current Creditors	0	0	0	0	0
Non Current Borrowings	0	0	0	0	0
Deferred Tax Liabilities	0	0	0	0	0
Other Non Current Provisions	-	-	-	-	-
Other Non Current Liabilities	0	0	0	0	0
Total Non Current Liabilities	**0**	**0**	**0**	**0**	**0**
Total Liabilities	**102**	**161**	**167**	**192**	**213**
Equity	134	142	143	143	143
Other Equity	0	0	0	0	0
Reserves	12	123	63	92	92
Retained Profits	95	291	584	951	1,357
Outside Equity Interests	-	-	-	-	-
Total Shareholders Equity	**241**	**556**	**790**	**1,186**	**1,592**
Net Debt	(121)	(340)	(422)	(784)	(1,188)

Source: Company reports and Ord Minnett estimates.

Bellamy's Australia

Bellamy's Australia (BAL)

Year-end Jun ($)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue ($ mn)	240	329	288	339	413
Gross margin	38.1%	39.1%	43.1%	43.3%	43.4%
EBITDA margin	0.6%	19.6%	15.3%	21.4%	20.5%
Adj. net income ($ mn)	16	45	33	49	57
Adj. EPS ($)	0.15	0.39	0.28	0.41	0.48
BBG EPS ($)	0.26	0.39	0.30	0.38	0.46
Reported EPS ($)	(0.01)	0.37	0.24	0.41	0.48
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%
Adj. P/E	60.0	23.2	32.9	22.2	19.0
EV/EBITDA	5.6	NM	NM	NM	NM

Source: Company data, Bloomberg, Ord Minnett estimates.

Investment Thesis, Valuation and Risks

Bellamy's Australia *(Hold; Price Target: $9.50)*

Investment Thesis

- **BAL has several key drivers.** It is well positioned to leverage the fast growing organic food and infant formula market. It has expertise in sourcing organic product, which is difficult; it has a predominantly organic product range; and it enjoys a known & trusted brand with organic credentials. The company has set a $500m revenue ambition predicated on new branding & product formulation, new product development (including China-label, subject to SAMR approval) with these initiatives supported by investments in marketing and its China team. Finally, its baby food product helps drives brand awareness for the core consumer, introducing and extending the time with the brand.

- **BAL is exposed to some industry risks which we suggest may moderate the rate of market share gains in China.** The outlook for the China infant formula market is less robust as demographics constrain volume growth and questions exist on the pace of ongoing premiumisation. This could see greater level of competition for access to MBS, especially given the desire from China for domestic production to grow to 60%. For BAL, these challenges may impact the timing of SAMR approval and require greater investment to regain momentum in China. While the brand & product offering are attractive, the more challenged external environment is more impactful as the business remains in turnaround.

- **BAL faces several company specific risks and uncertainties.** There has been a delay with SAMR approval (for China-label product) and it has not yet been received. The economics of BAL organic formula are less attractive than peers, with higher price points (and volumes) required to offset the higher COGS associated with organic product. Further, there is significant change occurring at BAL, and while there has been sound performance in its new branding & product reformulation, execution risk remains.

- **Valuation support mixed.** BAL has outperformed the ASX 100 by 2.2% since 1 January 2019. There is modest valuation support (DCF $9.03) and the prospect for P/E multiple expansion if earnings growth can be achieved. Yet we are cautious about the pace of multiple expansion given execution risk and the less established position which makes BAL more vulnerable to industry risks.

Valuation

Table 42: BAL – DCF Valuation

$ in millions

PV of Cashflows	$640
Terminal Value	$307
Enterprise Value	**$947**
Net debt	($129)
Minorities	($0)
Valuation	**$1,077**
Per Share ($)	**$9.03**

Source: Ord Minnett.

- We initiate with a 30 June 2020 share price target of $9.50 per share on BAL. It is derived from our theoretical share price target, which is based on our DCF valuation, rolled forward at the cost of equity (11.1%), less forecast dividends, with a modest discount due to expected volatility in the share price of companies exposed to the China consumer. Our price target implies that BAL will trade at a ~23x FY20E P/E multiple.

Risks to Rating and Price Target

- Changes in the rate of growth in the infant formula industry in China, including volume (birth rates, kilo per capita), the rate premiumisation, competitive dynamics (including any change in terms to access the growing Mother & Baby Store, MBS, channel).
- Changes in regulation of the infant formula industry in China, especially relating to cross-border e-commerce, the daigou channel and efforts to increase domestic production.
- Competitive dynamics within the organic infant formula and baby food categories, including the pace that new supply is added and the impact of new entrants.
- Changes in the relative appeal of BAL product to the daigou channel and changes in how inventory levels are managed.
- The receipt, or further delay, of SAMR approval for China-label product.
- The effectiveness of increased investment (marketing, China team) and new product development.

Bellamy's Australia

$ in millions, year end Jun

Profit And Loss	FY17	FY18	FY19E	FY20E	FY21E
Revenue	**240**	**329**	**288**	**339**	**413**
Revenue growth	*2.5%*	*37.0%*	*(12.7%)*	*18.0%*	*21.7%*
COGS	(149)	(200)	(163)	(192)	(233)
Operating Expenses	(49)	(59)	(69)	(75)	(95)
EBITDA	**1**	**65**	**44**	**72**	**85**
EBITDA growth	*(97.5%)*	*4578.7%*	*(31.9%)*	*64.9%*	*16.9%*
EBITDA margin	*0.6%*	*19.6%*	*15.3%*	*21.4%*	*20.5%*
Amortisation	(1)	(4)	(4)	(3)	(2)
Depreciation	(0)	(1)	(1)	(1)	(3)
EBIT	**1**	**60**	**39**	**68**	**79**
Other Income	-	-	-	-	-
Other Expenses	-	-	-	-	-
Net Interest	(1)	1	1	2	2
Pre-Tax Profit	**(1)**	**61**	**41**	**70**	**82**
Tax	(13)	(20)	(16)	(21)	(25)
Tax Rate	*(1851.0%)*	*33.0%*	*39.4%*	*30.0%*	*30.0%*
Minorities	0	0	0	0	0
Abnormals (post tax)	(29)	(4)	(8)	0	0
Reported NPAT	**(1)**	**43**	**28**	**49**	**57**
Normalised NPAT	**28**	**47**	**37**	**49**	**57**
Growth	*(26.4%)*	*66.6%*	*(21.9%)*	*33.3%*	*17.0%*
End of Period Shares	104	115	119	119	119
EFPOWA	104	115	119	119	119
Reported EPS	(0.01)	0.39	0.25	0.43	0.50
Normalised EPS	**0.27**	**0.41**	**0.31**	**0.41**	**0.48**
Growth	*(29.6%)*	*50.4%*	*(24.6%)*	*33.3%*	*17.0%*
DPS	0.00	0.00	0.00	0.00	0.00
Growth	*(100.0%)*	-	-	-	-
DPS/EPS payout	0.0%	0.0%	0.0%	0.0%	0.0%

Cash Flow Statement	FY17	FY18	FY19E	FY20E	FY21E
Net Profit for Cashflow	(1)	43	28	49	57
Depreciation & Amortisation	1	4	5	4	5
Non Cash Items	-	-	-	-	-
Working Capital Changes	(37)	18	8	(5)	(13)
Other Operating Cashflows	(9)	3	(0)	0	0
Cashflow from Operating Activities	**(46)**	**68**	**41**	**48**	**50**
Capex	-	-	-	-	-
Net Acquisitions	-	-	-	-	-
Other Investing cashflows	0	0	0	0	0
Investing Cash Flow	**(0)**	**(18)**	**(3)**	**(8)**	**(13)**
Inc/(Dec) in Borrowings	25	(25)	0	0	0
Equity Issued	13	45	0	0	0
Dividends Paid	(7)	0	0	0	0
Other Financing Cashflows	0	0	0	0	0
Financing Cash Flow	31	20	0	0	0
Net Cash Flow	**(15)**	**70**	**39**	**41**	**37**

Valuation Summary	$m	$ps
Current mkt capitalisation	1,034.49	9.13
Price Target		9.50
Capital growth to price target		4.1%

Trading Multiples	FY17	FY18	FY19E	FY20E	FY21E
PE Pre-abnormals	60.0	23.2	32.9	22.2	19.0
PE Reported	NM	24.5	38.4	22.2	19.0
EV/EBITDA	5.6	NM	NM	NM	NM
EV/EBIT	13.1	NM	NM	NM	NM

Key Ratios	FY17	FY18	FY19E	FY20E	FY21E
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%
Franking	-	-	-	-	-
Return on Assets (%)	10.5%	20.7%	11.3%	14.6%	14.4%
Return on Equity (%)	18.1%	30.3%	14.9%	18.6%	18.1%
ROIC (%)	16.8%	20.6%	17.4%	20.8%	19.9%

Leverage	FY17	FY18	FY19E	FY20E	FY21E
Gearing (Net Debt / Equity)	0.1	NM	NM	NM	NM
Gearing (ND / (ND + E))	7.9%	(73.1%)	(112.7%)	(138.6%)	(144.5%)
Net Debt / EBITDA	5.6	NM	NM	NM	NM
EBIT Interest Cover (x)	0.5	(65.0)	(28.0)	(38.9)	(34.1)

Balance Sheet	FY17	FY18	FY19E	FY20E	FY21E
Cash	17	88	126	167	204
Receivables	37	49	48	52	61
Investments	-	-	-	-	-
Inventories	93	90	81	88	106
Other Current Assets	2	3	3	3	3
Total Current Assets	**150**	**230**	**258**	**309**	**373**
Net PPE	1	4	5	11	20
Total Intangibles	2	40	37	35	33
Other Non Current Assets	4	7	7	7	7
Total Non Current Assets	**6**	**51**	**49**	**52**	**60**
Total Assets	**157**	**281**	**307**	**361**	**433**
Creditors	38	69	65	71	85
Current Borrowings	25	0	0	0	0
Current Tax Provisions	0	2	0	0	0
Other Current Provisions	2	2	3	3	3
Other Current Liabilities	0	0	0	0	0
Total Current Liabilities	**65**	**73**	**68**	**74**	**88**
Non Current Creditors	-	-	-	-	-
Non Current Borrowings	0	0	0	0	0
Deferred Tax Liabilities	0	0	0	0	0
Other Non Current Provisions	-	-	-	-	-
Other Non Current Liabilities	0	0	0	0	0
Total Non Current Liabilities	**0**	**0**	**0**	**0**	**0**
Total Liabilities	**65**	**73**	**68**	**74**	**88**
Equity	54	121	121	121	121
Other Equity	0	(0)	(0)	(0)	(0)
Reserves	6	12	14	14	14
Retained Profits	32	75	103	152	209
Outside Equity Interests	-	-	-	-	-
Total Shareholders Equity	**91**	**207**	**238**	**287**	**344**
Net Debt	8	(88)	(126)	(167)	(204)

Source: Company reports and Ord Minnett estimates.

Ord Minnett Private Client Research

Please contact your Ord Minnett Adviser for further information on our document.

Guide to Ord Minnett Recommendations

Our recommendations are based on the total return of a stock – nominal dividend yield plus capital appreciation – and have a 12-month time horizon.

SPECULATIVE BUY	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
ACCUMULATE	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
HOLD	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
LIGHTEN	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
SELL	We expect the total return to lose 15% or more.
RISK ASSESSMENT	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historical volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

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