

The a2 Milk Company

Proprietary Channel Checking in China

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OUTPERFORM

We recently visited 34 stores in China, interviewing sales reps & store managers, analysing a2's shelf presence, pricing, and the perception of New Zealand sourced infant formula. We complemented this with a proprietary online survey, with 105 responses from end customers. Travel restrictions meant the channel checks were undertaken by our colleagues in Hong Kong. Our findings provide confidence that The a2 Milk Company (ATM) is performing well in the key offline channel. It also supports our view that the recent daigou-linked downgrade is a temporary issue, particularly as channel mix readjusts. After recent underperformance, ATM is trading at a one year forward PE of ~24x (~21x adjusted for cash and ~19x when also adjusted for US losses) – attractive against any benchmark.

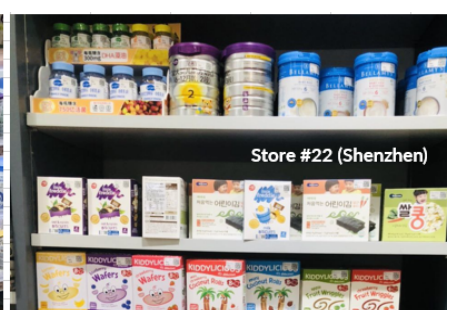
NZX Code	ATM	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$14.35	NPAT* (NZ\$m)	385.8	406.7	498.2	573.1	PE	27.5	26.1	21.3	18.5
Target price	NZ\$23.00	EPS* (NZc)	52.1	54.9	67.3	77.4	EV/EBIT	17.7	16.2	13.1	11.4
Risk rating	High	EPS growth* (%)	34.4	5.4	22.5	15.0	EV/EBITDA	17.5	16.0	12.9	11.2
Issued shares	736.5m	DPS (NZc)	0.0	0.0	0.0	23.2	Price / NTA	9.4	7.0	5.3	4.2
Market cap	NZ\$10,568m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	0.0	1.6
Avg daily turnover	782.4k (NZ\$13,395k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	0.0	2.2

Three key take-aways from our proprietary channel checks

- **Very high recognition that a2 Platinum is New Zealand sourced.** 91% of Mother & Baby Store (MBS) personnel we spoke to indicated that a2 is New Zealand sourced, with the balance citing New Zealand and Australia. This is particularly important given recent escalating geopolitical tension between China and Australia.
- **Strong performance for ATM across our channel checks, with results from our MBS visits surprisingly the strongest.** This includes a2 ranking #1 brand in our MBS interviews, with a2 the most consistently named brand in the “top sellers”. This is encouraging given we view the offline channel as the key avenue of growth for ATM.
- **New Zealand/foreign still ranking well, albeit observable lift in domestic:** New Zealand still tops the list for IF quality perception (by a large margin), however, MBS personnel noted some change in consumer behaviour in favour of domestic brands.

Other notable points of interest

- Signs of discipline from ATM. With well controlled pricing and what appears to be a targeted marketing and investment approach.
- Predominant resistance against buying a2 was price (~18% of total responses in both our offline and online surveys).
- Category showing resilience; 86% of respondents said they would not change their IF brand of choice if their income declined.
- No observable inventory turn issues. With expiry dates fresh and ATM's new lid at all stores visited.



The a2 Milk Company (ATM)

Priced as at 05 Nov 2020 (NZ\$)					14.35											
12-month target price (NZ\$)*					23.00	Spot valuations (NZ\$)										
Expected share price return					60.3%	1. DCF					24.09					
Net dividend yield					0.0%	2. Peer multiple					20.00					
Estimated 12-month return					60.3%	n/a					n/a					
Key WACC assumptions						DCF valuation summary (NZ\$m)										
Risk free rate					1.30%	Total firm value					17,040					
Equity beta					0.90	(Net debt)/cash					854					
WACC					6.4%	Less: Capitalised operating leases					(17)					
Terminal growth					1.5%	Value of equity					17,877					
Profit and Loss Account (NZ\$m)						2019A	2020A	2021E	2022E	2023E	Valuation Ratios	2019A	2020A	2021E	2022E	2023E
Sales revenue						1,300.8	1,731.1	1,853.2	2,274.5	2,616.2	EV/EBITDA (x)	24.0	17.5	16.0	12.9	11.2
Normalised EBITDA						413.6	549.7	579.9	711.5	818.5	EV/EBIT (x)	24.1	17.7	16.2	13.1	11.4
Depreciation and amortisation						(2.2)	(4.4)	(7.3)	(11.6)	(15.5)	PE (x)	37.0	27.5	26.1	21.3	18.5
Normalised EBIT						411.4	545.3	572.6	699.9	803.0	Price/NTA (x)	13.6	9.4	7.0	5.3	4.2
Net interest						4.3	5.7	8.3	11.6	15.6	Free cash flow yield (%)	2.7	4.0	3.2	4.3	5.1
Associate income						0	0	0	0	0	Net dividend yield (%)	0.0	0.0	0.0	0.0	1.6
Tax						(128.0)	(165.2)	(174.2)	(213.4)	(245.5)	Gross dividend yield (%)	0.0	0.0	0.0	0.0	2.2
Minority interests						0	0	0	0	0						
Normalised NPAT						287.7	385.8	406.7	498.2	573.1	Capital Structure	2019A	2020A	2021E	2022E	2023E
Abnormals/other						0	0	0	0	0	Interest cover EBIT (x)	n/a	n/a	n/a	n/a	n/a
Reported NPAT						287.7	385.8	406.7	498.2	573.1	Interest cover EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Normalised EPS (cps)						38.8	52.1	54.9	67.3	77.4	Net debt/ND+E (%)	-143.9	-305.2	-318.1	-393.2	-463.6
DPS (cps)						0	0	0	0	23.2	Net debt/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Growth Rates						2019A	2020A	2021E	2022E	2023E	Key Ratios	2019A	2020A	2021E	2022E	2023E
Revenue (%)						41.0	33.1	7.1	22.7	15.0	Return on assets (%)	40.9	37.5	31.2	29.2	27.2
EBITDA (%)						46.1	32.9	5.5	22.7	15.0	Return on equity (%)	36.5	34.0	26.4	24.4	22.5
EBIT (%)						46.5	32.5	5.0	22.2	14.7	Return on funds employed (%)	106.3	127.2	124.4	126.2	131.1
Normalised NPAT (%)						47.0	34.1	5.4	22.5	15.0	EBITDA margin (%)	31.8	31.8	31.3	31.3	31.3
Normalised EPS (%)						47.4	34.4	5.4	22.5	15.0	EBIT margin (%)	31.6	31.5	30.9	30.8	30.7
Ordinary DPS (%)						n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	0.3	0.4	1.6	2.2	1.9
											Capex to depreciation (%)	155	164	397	431	323
Cash Flow (NZ\$m)						2019A	2020A	2021E	2022E	2023E	Imputation (%)	100	100	100	100	100
EBITDA						413.6	549.7	579.9	711.5	818.5	Pay-out ratio (%)	0	0	0	0	30
Working capital change						(6.5)	33.6	(44.2)	(4.7)	(1.5)						
Interest & tax paid						(129.6)	(192.2)	(165.9)	(201.7)	(229.9)	Operating Performance	2019A	2020A	2021E	2022E	2023E
Other						11.6	35.9	0	0	0	Revenue (breakdown by product)					
Operating cash flow						289.1	427.0	369.8	505.1	587.1	Total Infant Formula	1,064	1,424	1,510	1,873	2,157
Capital expenditure						(3.4)	(7.2)	(29.0)	(50.0)	(50.0)	Total Fresh Milk	171	222	243	281	317
(Acquisitions)/divestments						(162.3)	(21.9)	(21.0)	0	0	Other	66	85	101	120	142
Other						0	(3.6)	(3.5)	(3.7)	(3.8)	Total	1,301	1,731	1,853	2,274	2,616
Funding available/(required)						123.4	394.3	316.3	451.4	533.3						
Dividends paid						0	0	0	0	(68.4)	Revenue (breakdown by country)					
Equity raised/(returned)						2.9	2.4	0	0	0	Australia & NZ	843	965	779	845	874
(Increase)/decrease in net debt						126.3	396.8	316.3	451.4	464.9	China & Other Asia	423	699	1,007	1,328	1,608
											US	35	66	67	101	134
											Other	0	0	0	0	0
Balance Sheet (NZ\$m)						2019A	2020A	2021E	2022E	2023E	Total	1,301	1,731	1,853	2,274	2,616
Working capital						50.6	(7.6)	37.8	46.4	51.2						
Fixed assets						10.3	14.2	37.4	78.2	115.2	EBITDA insights					
Intangibles						13.0	13.6	35.5	35.3	35.1	Gross margin	55	56	57	57	56
Right of use asset						0	16.1	16.3	16.4	16.6	Gross profit	713	969	1,048	1,286	1,472
Other assets						294.5	280.8	280.8	280.8	280.8	Total SG&A expenses	(300)	(419)	(468)	(575)	(654)
Total funds employed						368.4	317.2	407.7	457.1	498.9	incl marketing expenses	(134)	(194)	(208)	(257)	(301)
Net debt/(cash)						(464.8)	(854.2)	(1,172.3)	(1,625.5)	(2,092.3)	Total SG&A as % of revenue	23.0	24.2	25.2	25.3	25.0
Lease liability						0	16.8	17.5	18.1	18.7	Group EBITDA	414	550	580	711	818
Other liabilities						45.4	20.5	21.6	25.6	28.8	US - EBITDA losses	(44)	(51)	(42)	(35)	(28)
Shareholder's funds						787.9	1,134.1	1,540.8	2,038.9	2,543.6	EBITDA excluding US losses	458	600	622	746	846
Minority interests						0	0	0	0	0						
Total funding sources						368.4	317.2	407.7	457.1	498.9						

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

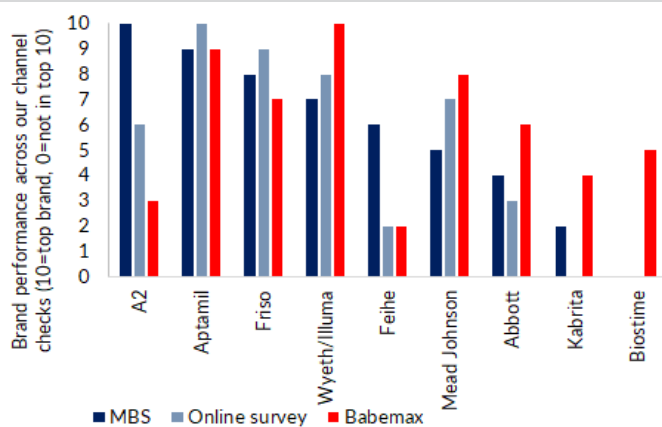
Executive summary

ATM has materially underperformed the NZ market over the past two months, with a clear dent in market confidence and steady share price decline since the first signs of meaningful daigou pressure in late August. While the short-term pain has been worse than anticipated, we continue to believe it is just that — temporary. Our proprietary channel checks show the ATM brand is resonating well and products are in good demand on the ground in China. We are also picking up some early signs of improving daigou confidence.

ATM has (1) an ample runway of growth opportunity remaining and a brand in good health, (2) track record of execution in a dynamic and complex market, (3) a large net cash position, and (4) recently strengthened relationship with its key Chinese partner, SOE China State Farms. Investing in ATM requires a thick skin, however, at current valuation levels we believe it is an attractive entry point, with a favourably skewed risk/reward. **OUTPERFORM.**

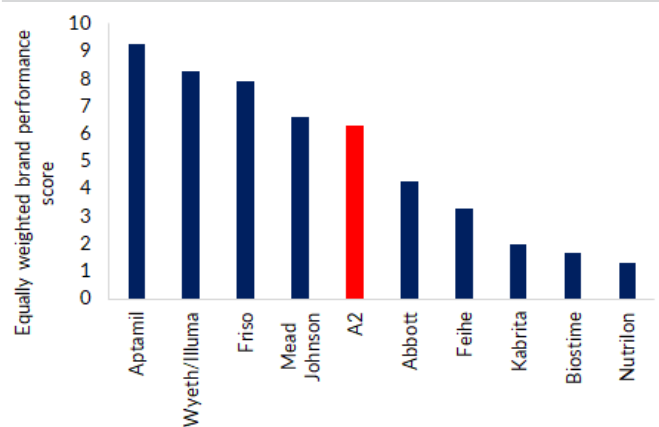
What have we learnt from our proprietary channel checks (in pictures)?

Figure 1. Brand preferences across our three channel checks shows wide dispersion; ATM was a standout in our MBS visits



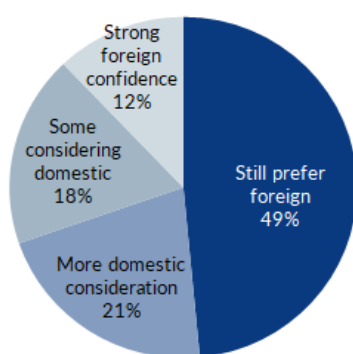
Source: Forsyth Barr analysis. NB 10 = brand rank #1; 0 = not in top 10

Figure 2. Average of brand performance across our three channel checks (equally weighted from Figure 1)



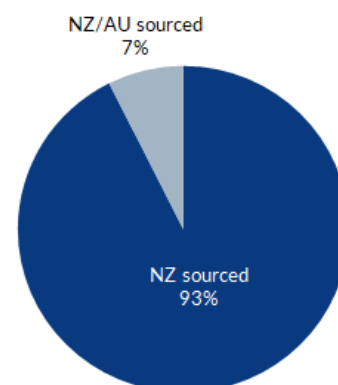
Source: Forsyth Barr analysis, NB 10 would mean the brand ranked #1 in all three surveys

Figure 3. Foreign preferences high; some shift to domestic



Source: Forsyth Barr analysis

Figure 4. Very high recognition that a2 is sourced from NZ



Source: Forsyth Barr analysis

What did we do?

In conjunction with our colleagues in Hong Kong, we have undertaken a series of on-the-ground channel checks in China; including:

- **MBS visits & interviews** — 34 stores in 6 cities. We surveyed in-store personnel and noted observations for a2 and the IF category.
- **Online customer survey** — Totalling 105 responses through WeChat across a broad mix of cities, ages and social demographics.
- **Meeting with large MBS chain store operator, Babemax.**

We recognise the clear limitations of drawing any definitive conclusions from a small sample size in a market as complex and fragmented as China. Nonetheless, we consider our sample relatively random given no pre-screening in the locations and participants chosen. For more detail of methodology, questions and sample breakdown please refer to Appendix 1.

Valuation and earnings

ATM's FY21 guidance (28 September) was a material downgrade vs expectations arising from a substantial decline in the daigou channel. Our on-the-ground research suggest this has been as a result of a combination of issues including lack of tourists & international students, daigou margin contraction from a 3x lift in freight costs, and overall loss of confidence from corporate daigou for order replenishment. Temporary consumer perception concerns (COVID-19 and the Hong Kong ingredients report) may have also contributed. The escalation in daigou pressure for ATM was rapid, but our contacts suggest there is some early signs of recovery.

The limited transparency and complexity of the channels to market in China, external data points, and visibility on specifics factored into ATM's guidance leaves ample room for various interpretation. ATM did indicate it has assumed the September trend in daigou "would continue for at least the calendar year" and is then assuming a daigou improvement as we move into CY21, but not assuming a significant re-stocking from daigou in FY21.

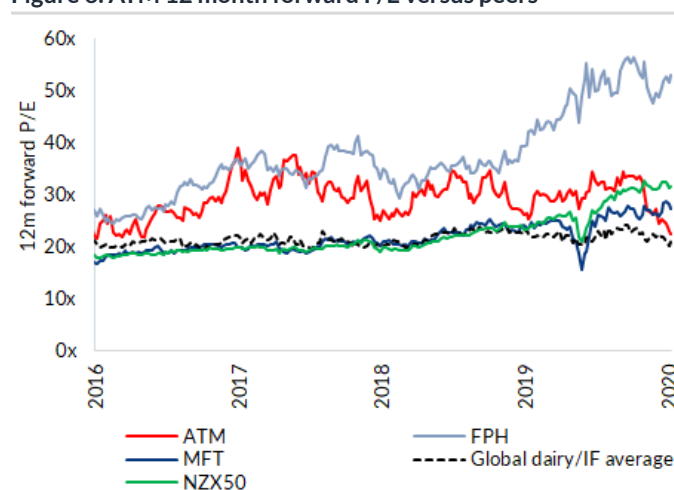
We remain comfortable with our forecasts, albeit based on current anecdotes see potential for 1H/2H mix differences, with upside risk to 1H21 (including vs ATM 1H guidance).

Figure 5. ATM market expectations for FY21

FY21E	Forsyth Barr	Consensus	ATM guidance	
			Low	High
Revenue	1,853	1,832	1,800	1,900
% growth	7.1%	5.8%	4.0%	9.8%
EBITDA	579.9	570	558	589
% growth	5.5%	3.7%	1.5%	7.1%
EBITDA margin	31.3%	31.1%	31.0%	31.0%

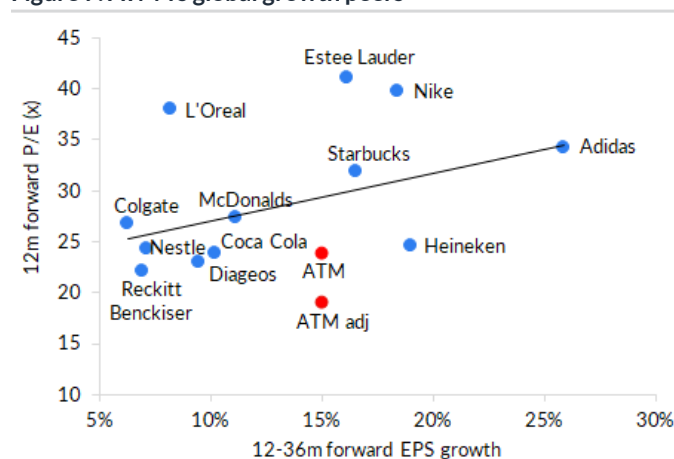
Source: Forsyth Barr analysis

Figure 6. ATM 12 month forward P/E versus peers



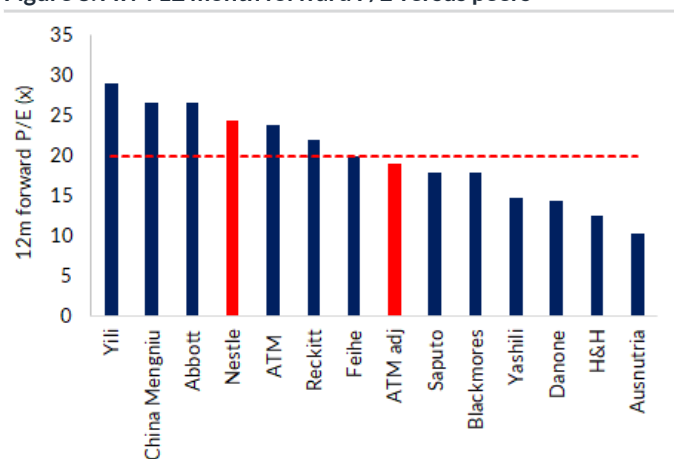
Source: Forsyth Barr analysis

Figure 7. ATM vs global growth peers



Source: Forsyth Barr analysis

Figure 8. ATM 12 month forward P/E versus peers



Source: Forsyth Barr analysis

(1) Proprietary Mother & Baby Store visits and interviews

We recently visited 34 Mother & Baby Stores (MBS), including interviewing in-store personnel, to get updated on-the-ground insights in what is the most important channel for IF sales in China. This is also the key medium-term growth avenue for ATM. Travel restrictions meant the visits were undertaken by our colleagues in Hong Kong. We were pleasantly surprised with the results.

Our key take-aways:

- **a2 is performing well versus other brands**, with the only notable area of resistance being price.
- **91% recognition that a2 is sourced from New Zealand**, with the balance referencing New Zealand and Australia. This follows a regular question we get asked — is ATM recognised as a New Zealand or Australian brand in China?
- **Signs of discipline from ATM**: With well controlled pricing (particularly vs peers) and what appears to be a concentrated/targeted marketing and investment approach. We assume the latter reflects sales outcomes or targets, albeit this couldn't be verified.

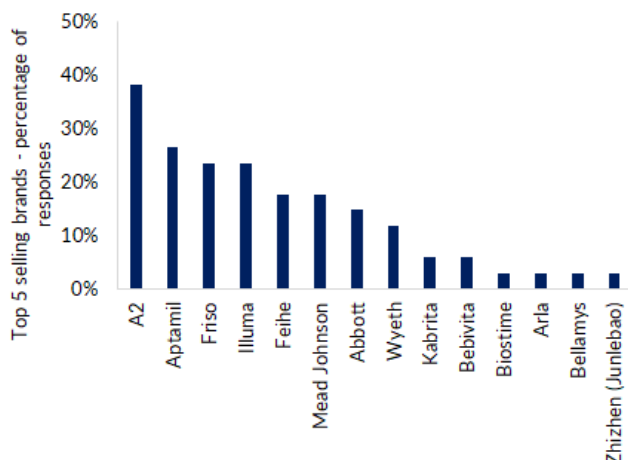
Notable comments

- **a2 performance:**
 - "a2 has witnessed rapid growth and become the top selling brand"
 - "Strong performance to date in 2020"
 - "a2 is a relatively new brand for this store, it is not selling good this year due to the pandemic and given the relative infancy it will take time for consumers to become familiar with the brand"
 - "This store started to sell a2 two years ago. After a2 started promotion activity 12 months ago, it quickly surpassed other brands and became the top selling brand"
 - "a2 has strong performance but due to pandemic and economic slowdown, fewer people choosing a2 due to expensive price"
- **Product source/origin:**
 - "a2 formula is close to breast milk and can help with abdominal distensions, a2 also has the highest DHA levels from Stage 1–3"
 - "If customers care about country of origin, I will recommend a2. The best milk source is NZ and second best is Netherlands"
- **Domestic/foreign choice:**
 - Numerous responses of "no obvious change for foreign brands"
 - "Some customers are beginning to look at Chinese brands"
 - "Affected by pandemic a little, some choosing Chinese product"
 - "Some customers see changes in foreign brand confidence, while some have specific strong confidence in IF from New Zealand following New Zealand's strong controlling of the virus"

Brand preference

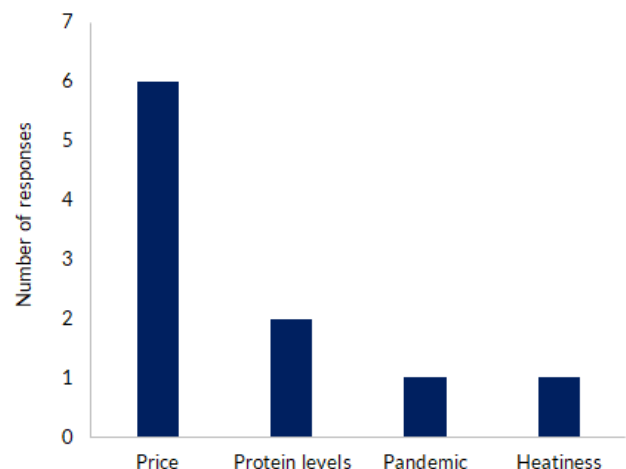
What we observed: Views on the 'top performing/selling' brands varied considerably between stores, even within the same city. ATM was cited most regularly. The most noted reason for resistance to ATM was price.

Figure 9. a2 performing well versus other brands



Source: Forsyth Barr analysis

Figure 10. Reasons for resistance for ATM

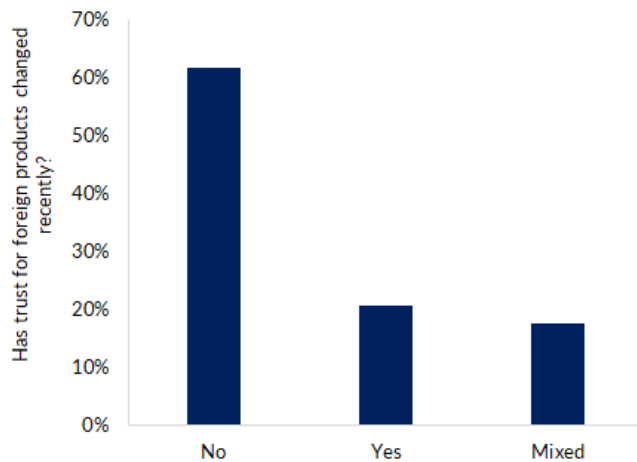


Source: Forsyth Barr analysis

Brand knowledge and perception

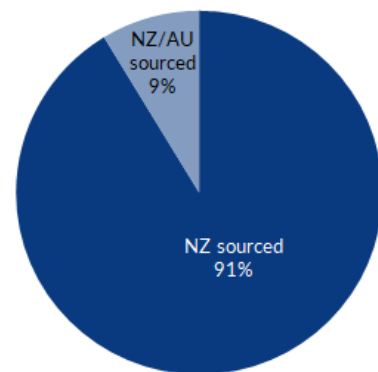
What we observed: Very high recognition for the source of a2 product, this is particularly pleasing given escalating geopolitical tensions between Australia and China. Foreign products continue to be perceived strongly albeit there was some observable shift to domestic.

Figure 11. Has trust in foreign products changed?



Source: Forsyth Barr analysis

Figure 12. What is a2's source of origin?

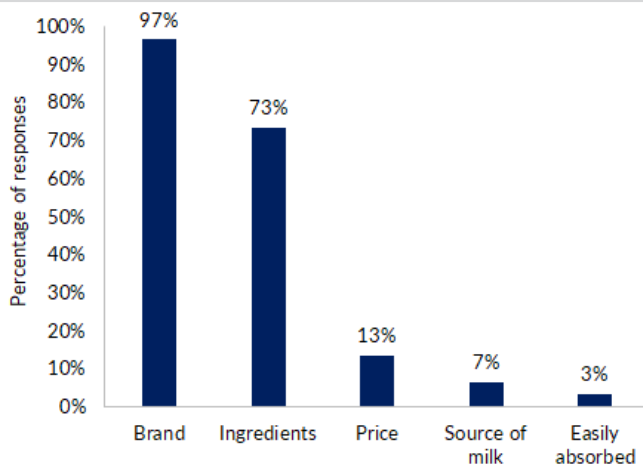


Source: Forsyth Barr analysis

Purchase decision drivers

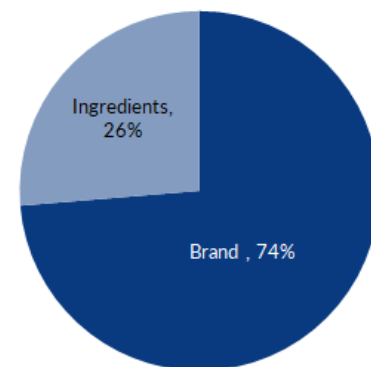
What we observed: The dominant drivers of IF purchase are brand and ingredients — consistent for both ATM and the IF category.

Figure 13. The key drivers of IF purchasing decisions



Source: Forsyth Barr analysis

Figure 14. Why consumers are purchasing a2

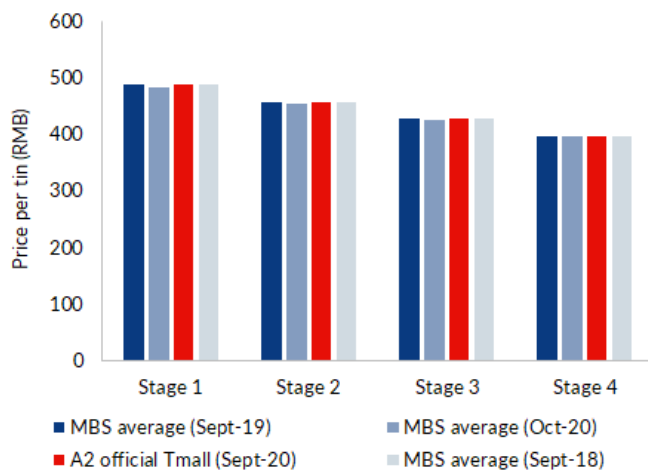


Source: Forsyth Barr analysis

Observations – availability, price and advertising

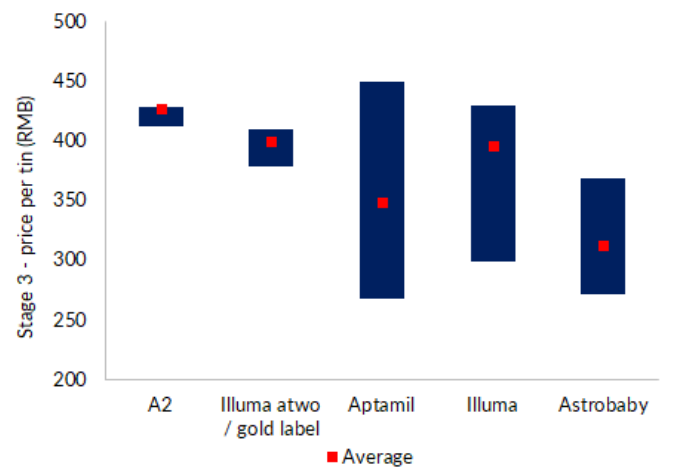
- **Availability:** Shelf space and availability varied materially across stores. a2 IF (Stage 1–3) was available in the majority of our sample, while later stage products, particularly Smart Nutrition, penetration was notably lower.
- **Price:** Little pricing deviation for a2 between stores, particularly relative to peers. Price has also been stable through time.
- **Marketing:** Mixed across stores and cities for ATM and its competitors. ATM appears to have a concentrated approach to marketing. Only five stores in our sample had an a2 specific sales rep ('push girl').
- **a2 protein competition limited:** With a2 and Illuma atwo/gold dominating the channel. At only one store was an alternative competing a2 product observed (Zhizhen Junlebao).

Figure 15. a2 Platinum price stable through time



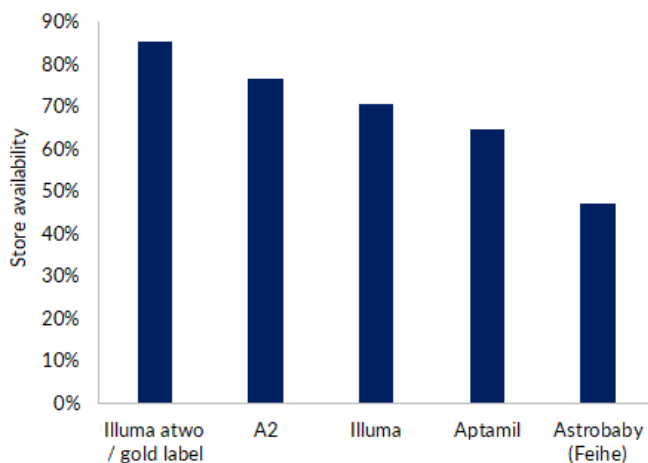
Source: Forsyth Barr analysis

Figure 16. a2 pricing consistent across our sample



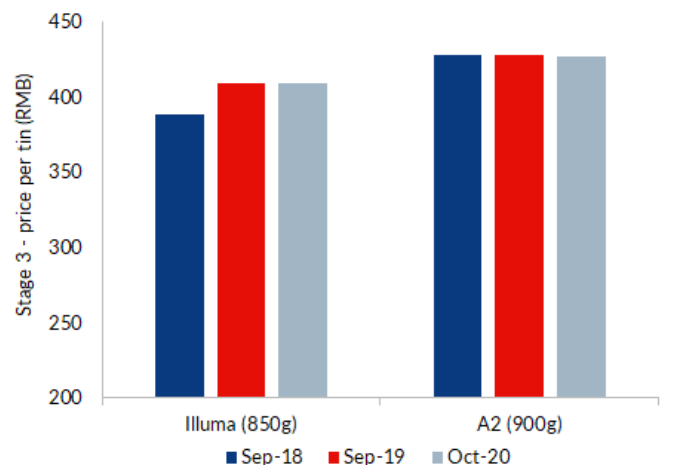
Source: Forsyth Barr analysis

Figure 17. Prevalence across some key brands



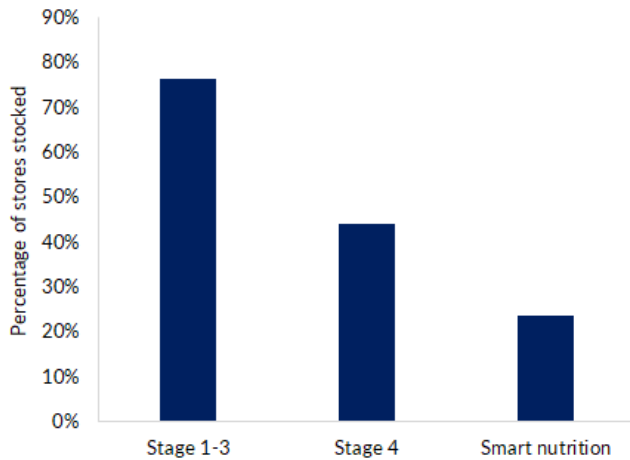
Source: Forsyth Barr analysis

Figure 18. Illuma atwo/gold vs a2 pricing through time



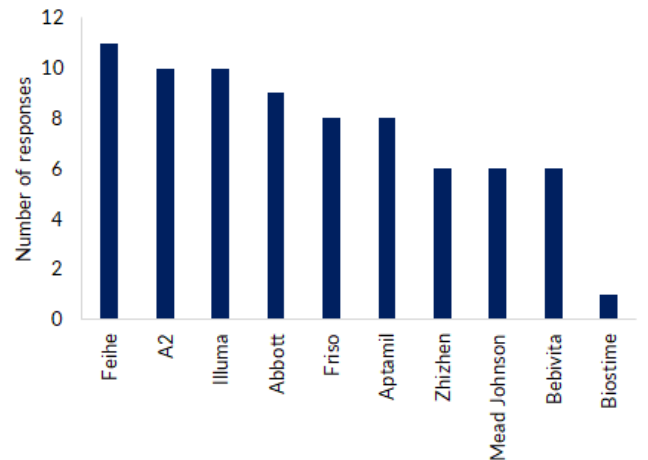
Source: Forsyth Barr analysis, NB we have not adjusted prices for size differences

Figure 19. ATM product availability across stores



Source: Forsyth Barr analysis

Figure 20. Notable marketing/advertising by brand



Source: Forsyth Barr analysis

Other interesting snippets

- **Long timeframe to expiry:** To get a gauge of product turnover within each store we investigated product expiry dates. Average months to expiration was ~15 compared to ~16 during our last visit (September 2019). Pleasingly, 90% of product has an expiry date past December 2021.
- **New lid evident across all stores:** 100% of all stores with A2 Platinum had stock with the new tamper evident lid which was recently launched for Stages 1-3 (in late CY19/early CY20). Only three stores also had product with the old lid.
- **Reasonable degree of discounting:** 43% of stores that sell a2 product currently have a discount/promotion, the most common of which was a "buy 6 get 1 free" promotion. This is common across other brands and in our visit 12 months ago.

(2) Proprietary online consumer survey

To better understand consumer preferences and purchase habits we also conducted a proprietary survey via WeChat. 105 responses were received with a relatively broad mix of cities, ages (mum and bub) and social demographics.

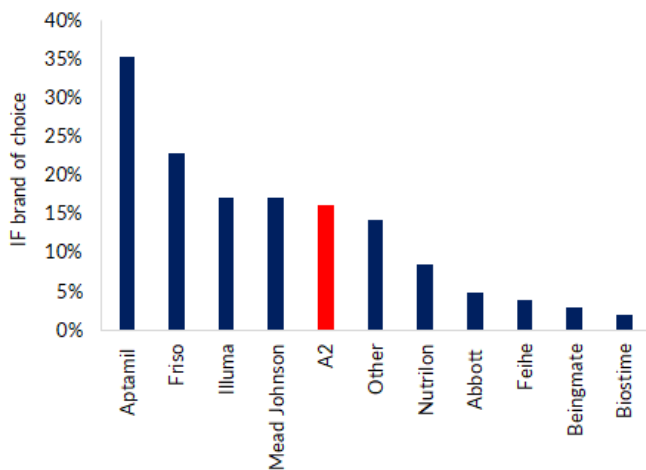
Key take-aways:

- **Little change to the perception of a2, foreign or New Zealand products.** ATM ranked 5th in our survey, with responses supportive of favourable perception and brand attributes.
- **Purchase drivers and behaviours were largely as expected, and seemingly stable/resilient in CY20.** IF purchases are primarily influenced by recommendations; with brand, reputation and formula the key attributes prioritised.
- **Category showing resilience, 86% of respondents said they would not change their IF brand of choice if income declined**

How does a2 rank?

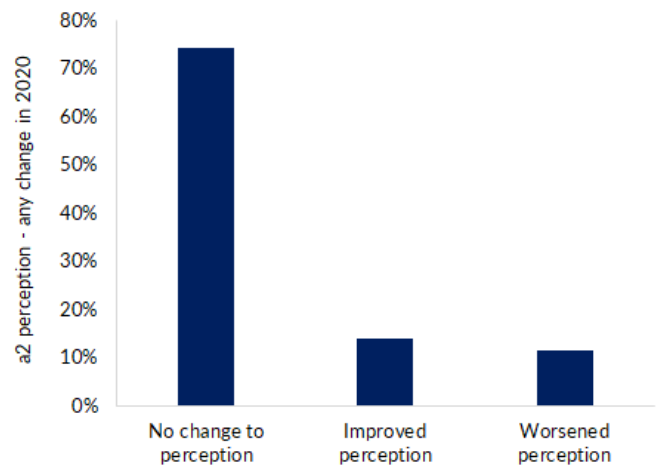
a2 ranked 5th in our survey on brand choice, albeit only marginally behind Illuma (3rd) and Mead Johnson (4th). There was no material change in perception of a2 across our survey respondents.

Figure 21. IF brand of choice



Source: Forsyth Barr analysis

Figure 22. No material recent change evident in a2 perception

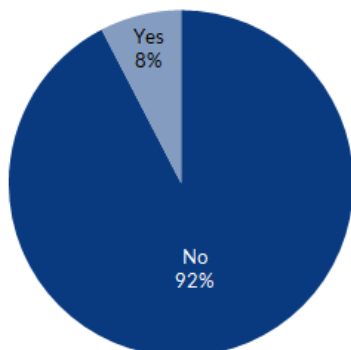


Source: Forsyth Barr analysis

Perception and source of origin

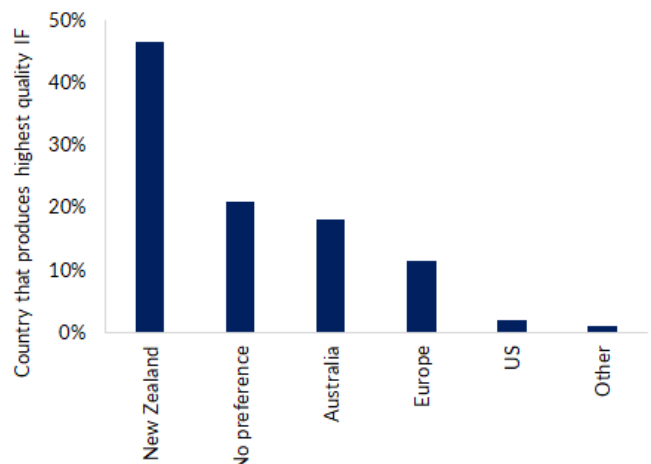
There is no material shift in confidence or perception of foreign IF in our survey, with NZ still top of the list (by a large margin) for quality perception. Of respondents noting a change in confidence for foreign IF, 63% attributed COVID-19 (5% of total respondents).

Figure 23. No material change in confidence for foreign IF



Source: Forsyth Barr analysis

Figure 24. NZ still tops the list on IF quality perception

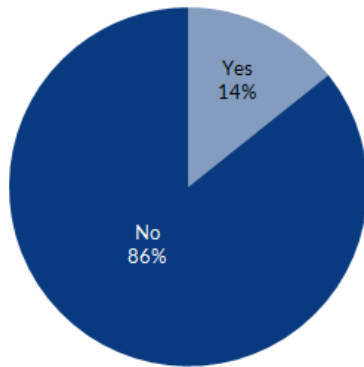


Source: Forsyth Barr analysis

Understanding behaviour

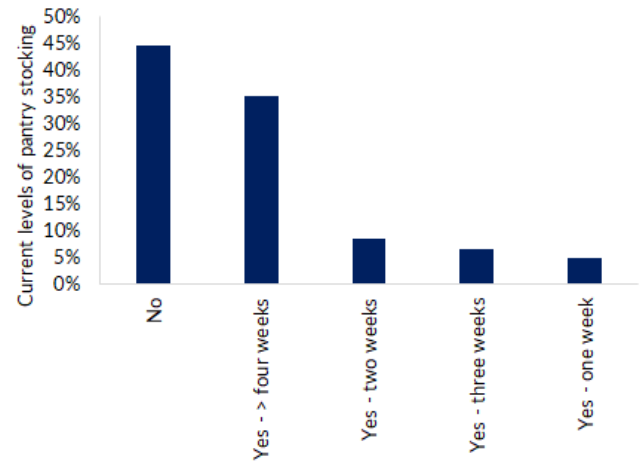
Our scenario test – would you change IF brand if your income declined (COVID-19 or otherwise) – demonstrated the resilience of the category, potentially helped by the "one baby, six adults" effect in China. Pantry stock levels were mixed, although take-aways are difficult for this question without history or a baseline for comparison.

Figure 25. Will you change your IF brand if income declined?



Source: Forsyth Barr analysis

Figure 26. Do you currently hold extra IF cans in your pantry?



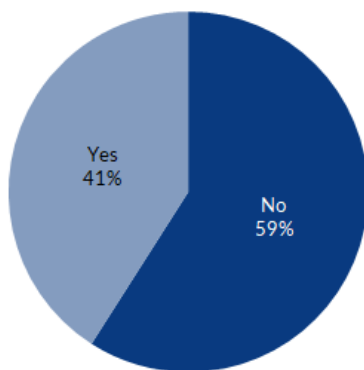
Source: Forsyth Barr analysis

Awareness of a2

China is a very large market – the largest IF market in the world by some magnitude. Hence, somewhat unsurprisingly, there is a material untapped market for ATM. Brand awareness did outpace recent advertising awareness for a2.

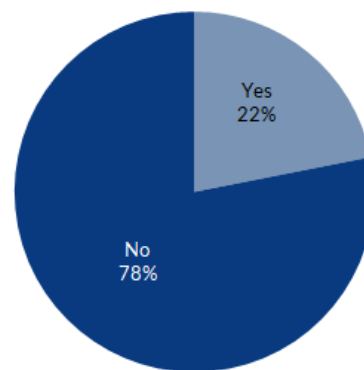
The key reasons noted for not buying ATM was having not heard of the brand and/or high price.

Figure 27. Awareness of a2



Source: Forsyth Barr analysis

Figure 28. Heard/seen advertising from a2 in past three months

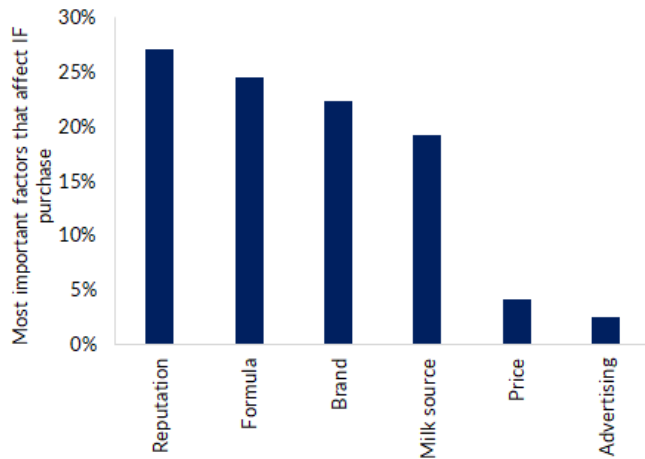


Source: Forsyth Barr analysis

Purchase decision drivers

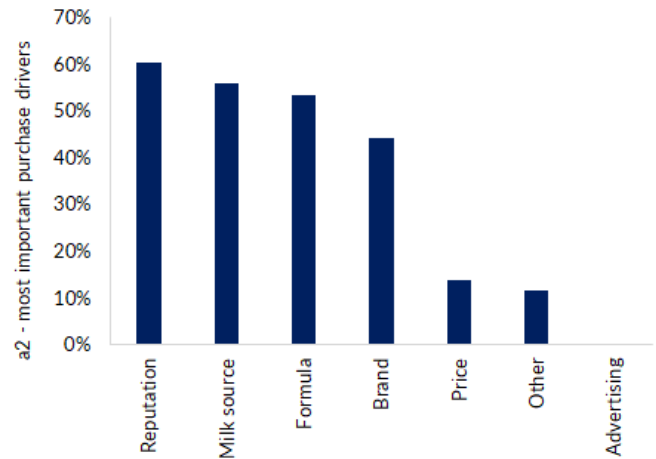
The main drivers of IF purchasing decisions are led by reputation, milk source, formula and brand. Advertising was the clear cut leader for the least important driver of IF purchasing. Unsurprisingly, recommendations from friends, family and professionals is a consistently high source of information across the majority of respondents.

Figure 29. Most important purchasing drivers for IF



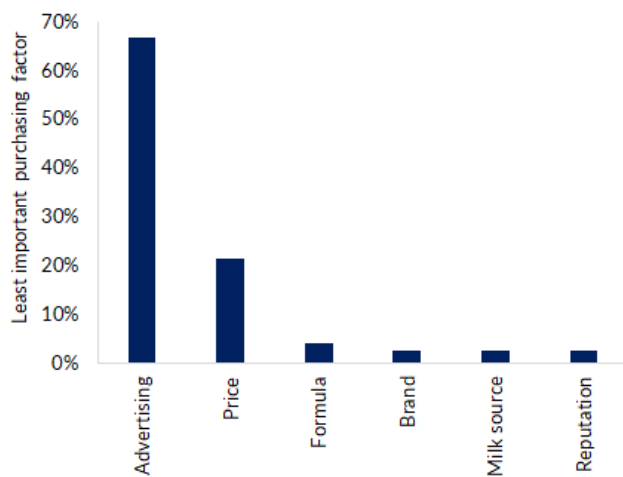
Source: Forsyth Barr analysis; NB respondents could choose more than one option

Figure 30. a2 purchasing decision drivers



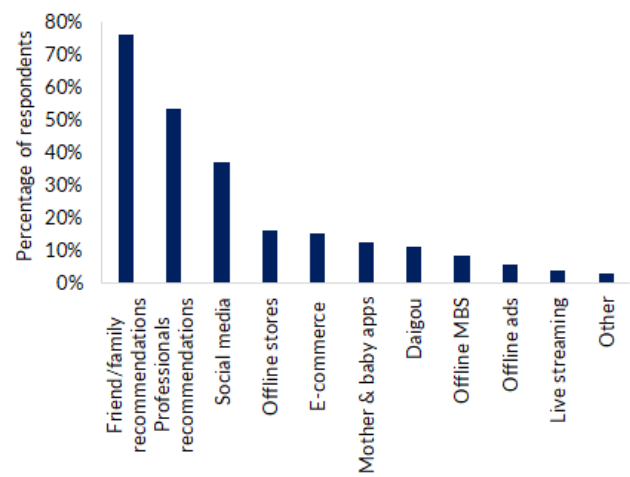
Source: Forsyth Barr analysis; NB respondents could choose more than one option

Figure 31. Least important purchasing decision drivers for IF



Source: Forsyth Barr analysis; NB respondents could choose more than one option

Figure 32. Recommendations are the key source of information



Source: Forsyth Barr analysis; NB respondents could choose more than one option

(3) Meeting with MBS chain store operator, Babemax

The offline channel, particularly the large highly fragmented network of Mother & Baby Stores (MBS), is the largest sales channel of IF in China. Sources vary on materiality, typically ranging between 50–55% of the overall market. It is a very difficult channel to get a definitive view on overall trends, growth rates and preferences. Babemax is the operator of a chain of MBS stores which we have met/talked to for the last three years.

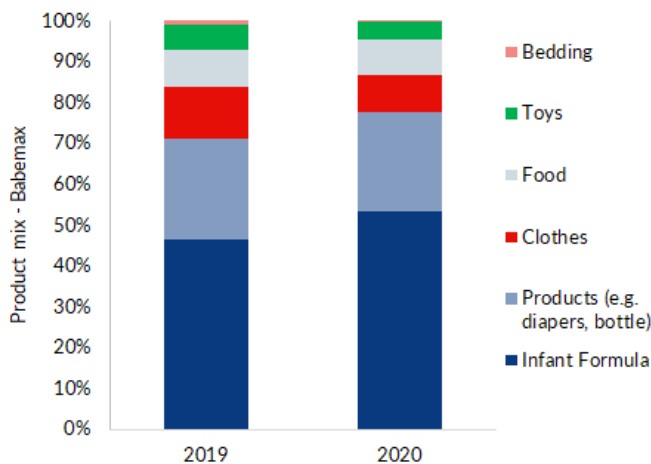
Key take-aways of note from the latest meeting:

- ATM outperforming category growth (+20% vs -3%) in Babemax, albeit remains ranked at brand #8.
- No change to previous feedback a2 offers an above-average margin to the channel – important for ensuring incentives are aligned.
- Multi-nationals are underperforming, while Feihe is experiencing strong growth (albeit is still a relatively new brand for Babemax).

Who is Babemax?

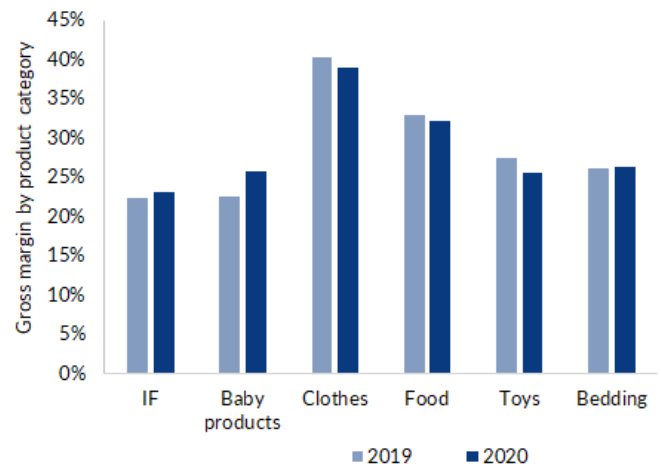
Aiyingshi, or Babemax, is one of China's leading chain retailers in the Maternity, Baby & Child sector, founded in 1997. Babemax currently operates 282 MBS with a strong presence in the affluent Eastern provinces of Shanghai, Zhejiang, Fujian and Jiangsu. Babemax has steadily expanded its network, from ~160 stores c. five years ago, and expects to continue to grow its network (30 new stores are targeted for 2021). The company also has a membership club with >1m active users.

Figure 33. Babemax product mix breakdown



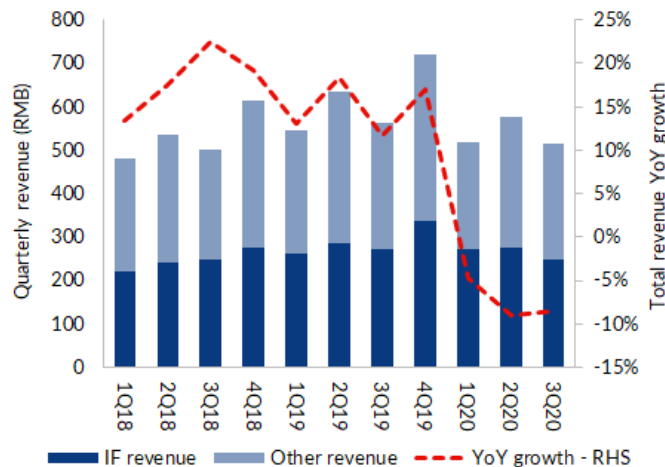
Source: Forsyth Barr analysis, Company disclosure

Figure 34. Gross margin by product category for Babemax



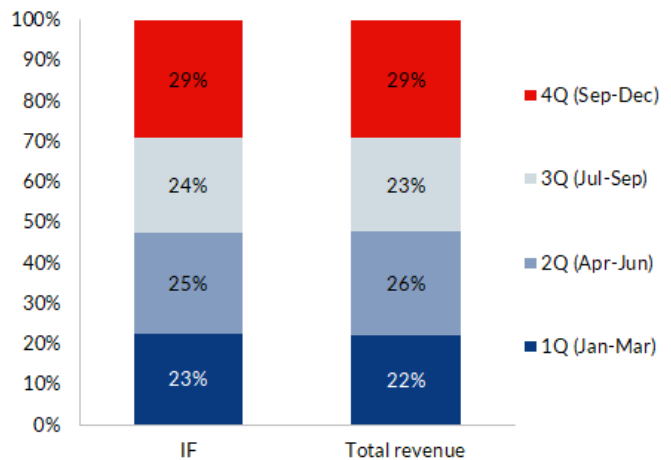
Source: Forsyth Barr analysis, Company disclosure

Figure 35. Revenue performance through time



Source: Forsyth Barr analysis, Company disclosure

Figure 36. Seasonality of revenue



Source: Forsyth Barr analysis, Company disclosure

IF brands and ranking

ATM is ranked #8 in Babemax, unchanged on October 2019, with sales growth tracking at c. +20% in 2020 (cycling a very strong comparative). ATM is outperforming the category, which recorded a decline of -2.8% for 9M20. Feihe is experiencing strong growth (albeit this is still a fairly new brand for Babemax) and the large multi-national brands are losing share.

Figure 37. Top 10 IF brands according to Babemax

Rank	2020 Brand Ranking	Performance in 2020, where provided	Ranking change in 2020	2019 Brand Ranking
1	Wyeth	Sales decline -20%	no change	Wyeth
2	Danone / Aptamil	Slight decrease	no change	Danone / Aptamil
3	Mead Johnson	Slight decrease	-2	Abbott
4	Friso		+1	Mead Johnson
5	Abbott		-2	Friso
6	Biostime		+1	Kabrita
7	Kabrita		-1	Biostime
8	a2	Sales +20% (2019 sales growth +130%)	no change	a2
9	Feihe	High growth off low base (new to Babemax in 2019)	new	Healthy Times
10	Nestle		no change	Nestle

Source: Forsyth Barr analysis

Investment by brands – a2 is (still) offering an above average gross margin

Investment and support for the channel is key in China, ensuring incentives are aligned. Shelf space and brand success is driven by a combination of popularity, gross margin paid to the channel and brand co-operation with terms of discounts/rebates/marketing.

Specific comments of note:

- **ATM offers a gross margin of 30–40% to Babemax, higher than average (~23%).** We observed a step-change in ATM's support for the channel between 2018 ("don't invest enough") and 2019 (good support; "pay high gross margin"), with 2020 unchanged.
- **Top brands like Wyeth and Abbott offer a low gross margin.**
- **Feihe offers a 'mid-level' gross margin** and has invested heavily leading into the current 11/11 Shopping Festival.

Industry snippets

- **Gradually recovering post COVID-19 disruption:** Average store revenue is gradually recovering, but still saw a year-on-year decline in Q3. Average spend per customer was relatively stable, down single digits. It appears Babemax has been harder hit/is underperforming versus the broader MBS channel.
- **IF is the key category and foot traffic driver,** making up 53% of revenue, which is up on last year. It will remain the most important category, albeit Babemax is developing other 'non-essential' categories which are more defensive to declining birth rates.
- **Differing trends by IF product stage:** With outperformance in Stage 2 and Stage 4. The latter is likely helped by a lower base.
 - Performance in order: Stage 4 (sales growth >+20%); Stage 2 (single-digit growth); Stage 3 and Stage 1 (both seeing a double-digit decline).
- **Customer stockpiling:** There was material stockpiling of IF in February and March. Babemax commented that Q3 (ended 30 September) was still affected by the stocking.
- **Q3 is seasonally weak:** Given stocking during the 618 Shopping Festival and ahead of the upcoming 11/11 Shopping Festival.

What has changed in 12 months?

- **Notable changes since our last meeting in September 2019: An acceleration in Stage 4 and COVID-19.**
 - Stage 4: In 2019 comments were this is not a key category or priority, "consumers go to liquid milk instead". Meanwhile in 2020 Stage 4 is outperforming other IF product categories (as highlighted above).
 - COVID-19: Babemax still appears to be recovering from restrictions earlier in the year.
- **Consistent areas: Growth for Feihe, positive disposition to a2.**
 - Feihe growing strongly, albeit helped by a low base as a fairly new entrant to Babemax (in 2019).
 - Daigou channel shrinking in importance.
 - Positive on a2 given "brand is quite popular and pay a high gross margin" to Babemax, above that of other multi-national brands ("as it should given lower volumes").

Appendix 1. Methodology and sample analysis

(1) Proprietary Mother & Baby Store visits and interviews

Our colleague at Forsyth Barr Asia visited 34 Mother & Baby Stores in China in October – focussing on observations and armed with a proprietary survey of questions which were asked of the in-store personnel. We also compared the results to that from our visit c. 12 months ago in September 2019 for any notable change. We plan to continue this exercise in future.

Key focus areas included:

- Observations in-store, particularly focussed on the IF category and a2.
- Questions to the in-store personnel, with focus areas including:
 - Brand preference, any recent change and key purchase drivers
 - Foreign vs domestic preferences/sentiment
 - a2 specific questions focussed on performance, knowledge of country of origin, reasons for/against buying

Breakdown of store locations

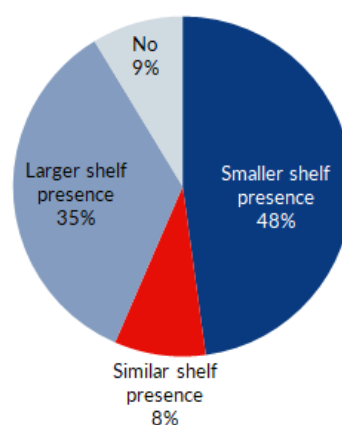
Stores visited were mainly within the Guangdong province, across five different cities, with the balance in Shanghai. There was no pre-screening to exclude stores which didn't stock a2.

Figure 38. Surveyed cities breakdown

City	Tier	Stores surveyed	Population (m)	a2 availability
Shanghai	1	4	25	100%
Guangzhou	1	7	15	100%
Shenzhen	1	6	12.5	67%
Dongguan	1*	6	8	67%
Foshan	2	5	7.2	100%
Huizhou	2	6	4.6	50%
Total		34		

Source: Forsyth Barr analysis *A new Tier 1 city

Figure 39. a2 availability/shelf presence vs other brands



Source: Forsyth Barr analysis

(2) Proprietary online consumer survey

We have initiated a proprietary consumer survey which was distributed on WeChat in late October 2020. A total of 105 responses were collected across current and prospective parents. We plan to repeat this survey in future, particularly to monitor any notable change through time.

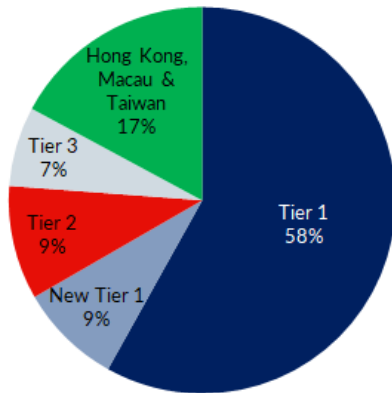
Key question focus areas included:

- Purchase drivers and influences
- Current purchase habits including channel, brand and pantry stock levels
- Foreign vs domestic sentiment
- Behaviour changes due to COVID-19 or under an economic slowdown/income reduction
- a2 specific questions focussed on penetration, advertising and reasons for/against buying

Survey sample analysis of the 105 responses

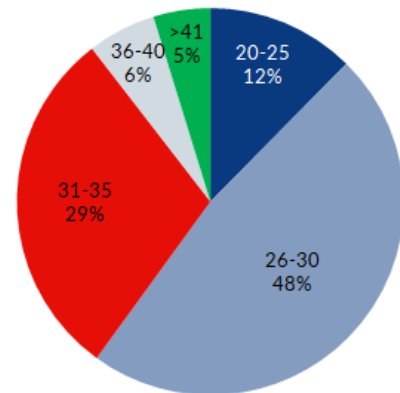
We had no influence on survey respondents, however, distribution through WeChat and Forsyth Barr Asia's network saw an over representation of Tier 1 and Hong Kong, Macau & Taiwan vs the Chinese population. The majority of respondents were female (79%), while other variables saw a broad mix including income levels and baby's age (Figures 40 to 43).

Figure 40. Geographic mix of respondents



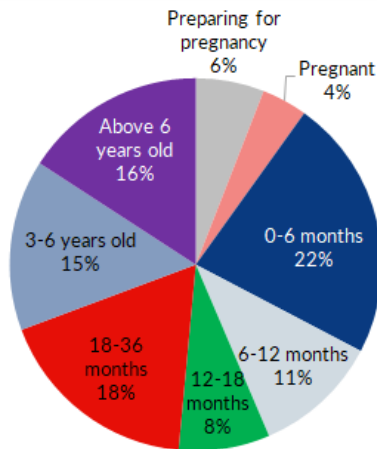
Source: Forsyth Barr analysis

Figure 41. Age of respondents



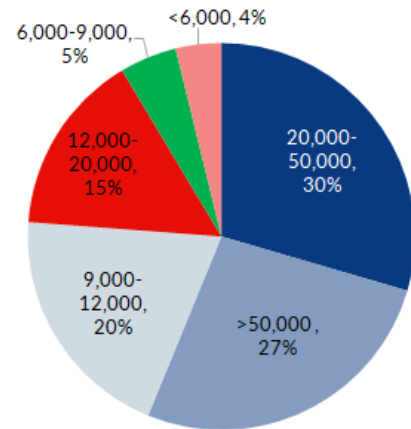
Source: Forsyth Barr analysis

Figure 42. Age of respondents' baby



Source: Forsyth Barr analysis

Figure 43. Monthly income of respondents (RMB)

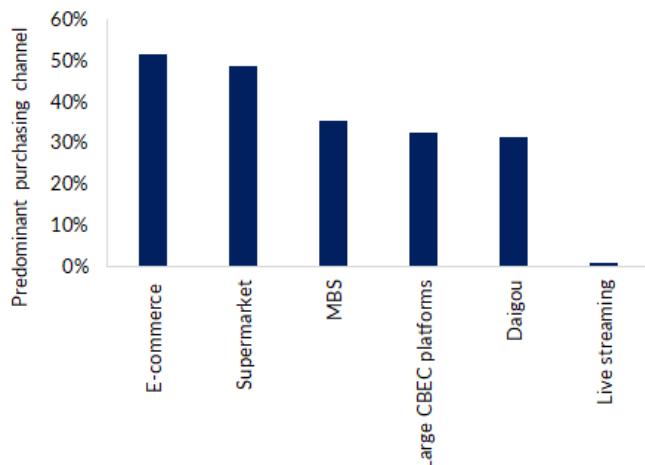


Source: Forsyth Barr analysis

Key channels used to purchase IF

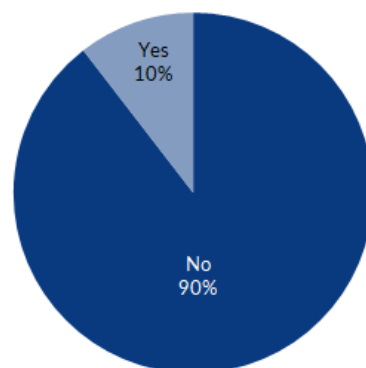
The main channels used by our survey respondents are offline and ecommerce – broadly consistent with the sales mix for the IF category. It also shows the wide range of channels to market. Channels were surprisingly stable over the past 12 months, with only 10% noting a change in purchase channel.

Figure 44. Predominant purchasing channel

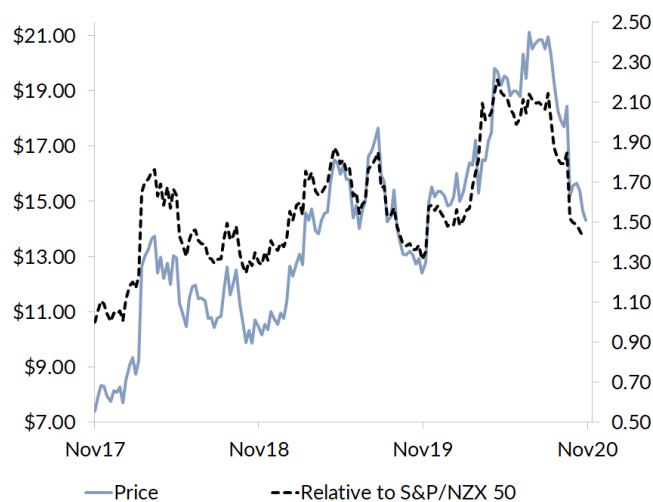


Source: Forsyth Barr analysis; NB respondents could choose more than one option

Figure 45. Any change in channel used over past 12 months?



Source: Forsyth Barr analysis

Figure 46. Price performance


Source: Forsyth Barr analysis

Figure 47. Substantial shareholders

Shareholder	Latest Holding
The Vanguard Group	7.0%
Mitsubishi UFJ Financial Group	6.4%
Commonwealth Bank of Australia	6.3%
BlackRock Investment Management	5.2%
Pendal Group Limited	5.2%

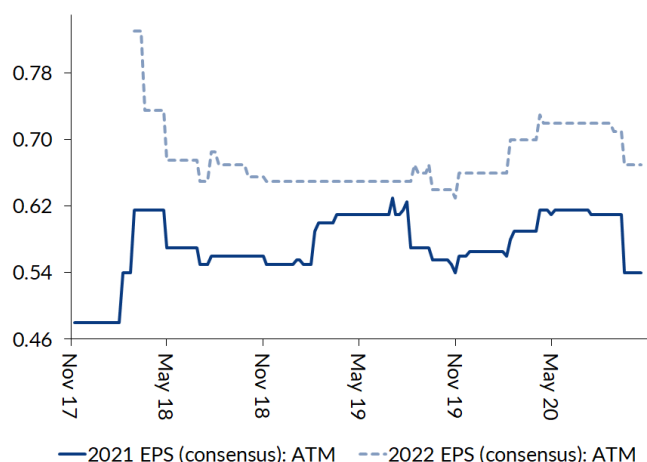
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 48. International valuation comparisons

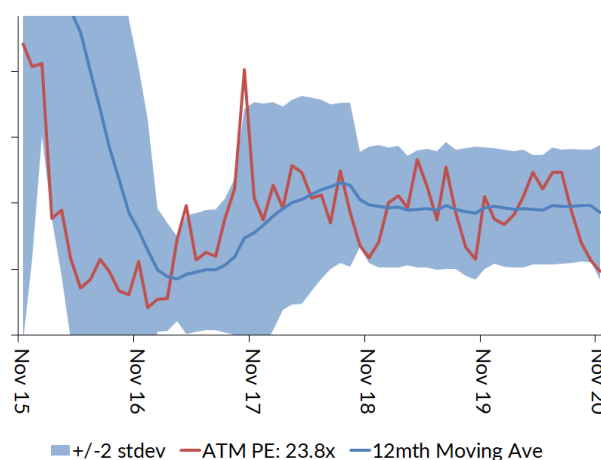
Company	Code	Price	Mkt Cap (m)	PE 2021E 2022E	EV/EBITDA 2021E 2022E	EV/EBIT 2021E 2022E	Cash Yld 2022E
(metrics re-weighted to reflect ATM's balance date - June)							
The a2 Milk Company	ATM NZ	NZ\$14.35	NZ\$10,568	26.1x 21.3x	16.8x 13.7x	17.0x 13.9x	0.0%
CHINA FEIHE	6186 HK	CNY17.78	CNY158,835	25.0x 19.9x	16.7x 13.3x	17.6x 13.9x	1.8%
SYNLAIT MILK *	SML NZ	NZ\$5.20	NZ\$933	12.0x 10.0x	7.7x 6.9x	10.4x 9.3x	0.0%
BLACKMORES	BKL AT	A\$71.80	A\$1,389	41.3x 28.5x	20.4x 16.1x	29.0x 20.2x	2.4%
HEALTH AND HAPPINESS H&H INT	1112 HK	CNY31.00	CNY19,973	15.7x 13.3x	9.3x 8.3x	10.4x 9.2x	3.9%
RECKITT BENCKISER GROUP PLC	RB/ LN	£69.20	£49,247	21.5x 20.7x	15.9x 15.5x	18.1x 17.6x	2.5%
AUSNUTRIA DAIRY CORP	1717 HK	CNY10.86	CNY18,629	13.5x 10.8x	9.6x 7.8x	10.4x 8.3x	3.4%
INNER MONGOLIA YILI INDUS-A	600887 CH	CNY39.11	CNY237,914	30.5x 26.1x	19.9x 17.1x	24.8x 21.4x	2.5%
DANONE	BN FP	€49.47	€33,968	14.6x 13.7x	10.4x 9.9x	13.6x 12.9x	4.4%
CHINA MENGNIU DAIRY CO	2319 HK	CNY37.95	CNY149,766	36.2x 26.9x	22.0x 17.2x	33.7x 23.7x	0.9%
Compco Average:				23.4x 18.9x	14.7x 12.5x	18.7x 15.2x	2.4%
ATM Relative:				12% 13%	14% 10%	-9% -9%	-100%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (ATM) companies fiscal year end

Figure 49. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 50. One year forward PE (x)


Source: Forsyth Barr analysis

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