June 23, 2016

Australia: Small Companies

Equity Research

Milking ANZ's reputation for quality; Initiate A2M (CL-Buy), BAL (Neutral)

China's IMF market opens up for Australia's leading brands

Penetration into China's US$20 bn infant formula market is driving outsized earnings growth for Australia's leading brands (A2M FY16E EBITDA is up 11x on FY15, BAL is up 4x) and strong share price performance (A2M +180%, BAL +160% yoy). Despite this we believe the potential for A2M at current valuations is still not fully priced in and initiate coverage with CL-Buy for its 25% upside, secure supply arrangements, and defensible margins.

Key drivers of growth: online over offline, foreign over domestic, premium niche over mainstream

Both A2M and BAL are growing in China due to: (1) The shift from offline channels (modern trade and mother & baby stores) to online; (2) The shift from domestic to foreign brands; and (3) A shift from established foreign brands to players like A2M and BAL with differentiated propositions (for A2M, A2-only milk and for BAL, organic ingredients). We forecast the online segment to grow 10% (in value) over FY16E-FY20E vs. market growth of 3% and expect BAL and A2M to increase online share to 6.8% and 7.5% by FY20E, from c. 4% each, driving total revenue CAGR of 20% for both.

Winning formulas: A2M rated Buy (on CL), Bellamy's rated Neutral

We view A2M's valuation on 20x/17x FY17E/FY18E P/E as attractive on 2 yr EPS CAGR of 49%. Our 12 month PT (on 50/50 DCF and EV/GCI) implies a 25% total return. Our investment thesis on A2M is based on: (1) A strongly growing infant formula brand in China; (2) Secure access to supply with Synlait; and (3) A solidly growing dairy business in ANZ.

We view the risk/reward for BAL as balanced and initiate with Neutral given valuation, 20x/16x FY17E/FY18E P/E on 2 yr EPS CAGR of 33%. Our 12 month price target (50/50 DCF and EV/GCI) implies a 12% total return. We expect: (1) good, but slower growth vs. A2, in China given a more mature brand; (2) Solid growth in Australia from a broader product range. We believe supply risks are slightly higher than for A2M given the economics of securing organic milk, but expect BAL to have sufficient supply as per our forecasts given that it consumes <1% of the world's organic milk. Recent farmgate price falls should also keep costs manageable.

Key risks: Adverse regulatory outcomes for cross-border trade in China i.e. labelling changes or customs tightening up on 'daigou's', more intense competition from other brands; supply constraints, IP risks for A2M.

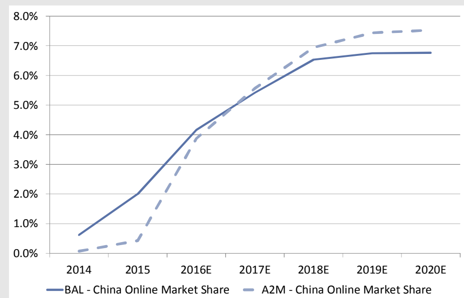
Summary of stocks in our SMID coverage group leveraged to the Chinese consumer

Ticker	Rating	Last Price	Price Target	Div Yield	Total Return
ATM.NZ	Buy	1.77	2.20	1.1%	25%
A2M.AX	Buy	1.70	2.10	1.2%	25%
BKL.AX	Neutral	135.77	160.00	3.7%	22%
BAL.AX	Neutral	10.76	12.00	1.0%	12%

*ATM.NZ and A2M.AX are on the ANZ Conviction List

Source: Goldman Sachs Global Investment Research. Prices as of market close of 20 June, 2016.

We forecast BAL and A2M to increase online IMF share to 6.8% and 7.5% by FY20E, from c.4% each



Source: Euromonitor, Goldman Sachs Global Investment Research.

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Prices in this report are based on the market close of June 20, 2016

Executive Summary: Milking ANZ's reputation for quality

We initiate coverage on two leading ANZ infant milk formula (IMF) brands that are carving a niche in China's premium IMF market. Both are set to grow earnings on the back of rapid sales growth as the value of China's fragmented IMF market continues to expand with growing urbanization and wealth, and sustainable premium pricing power for 'trusted' foreign brands amid still-reverberating health concerns around local IMF supply.

- **A2M: Buy (Conviction List)** – unique seller of 'A2' milk formula - which (its own) research suggests is easier to digest and may have health benefits.
- **Bellamy's: Neutral** – the only organic milk formula from Australia.

A2M is our key pick amongst the China exposed names in our coverage (A2M, BAL and BKL). We make the following comparisons against Blackmores (BKL.AX):

1. **Clearer regulatory path with the Chinese FDA:** The risks around product registration/filing for vitamins and health supplements beyond the government's May 2017 deadline does not apply to infant formula. Infant formula brands have until January 2018 to register with the CFDA. Based on details released so far, we believe both A2M and BAL should have sufficient time to obtain FDA registration by January 2018 for the bonded warehouse channel.
2. **Lower market shares but in a more concentrated, lower growth market:** We estimate A2M and BAL's share of the online market (FY16E) to be c. 4% each, equating to c. 1% each of the overall infant formula market. In contrast, for BKL, we estimate its share online to be c. 11% and c. 1.6% of the overall market. Online penetration in vitamins and health supplements is lower – c. 15% of the total market for vitamins/health supplements vs. 30% for infant formula. Accordingly, we forecast stronger growth for the online channel for vitamins and health supplements (c. 18% p.a. vs. infant formula online at c. 12%).
3. **But valuation more attractive:** At current share prices, A2M is trading on an FY17E / FY18E P/E of 20x/17x vs. BKL on 20x/19x for 2 year EPS CAGR of 49%/11%.

Underpinnings of our high-growth thesis

The Chinese infant formula market is transitioning rapidly and we believe both A2M and BAL are well-placed to benefit.

Growth in the overall market is driven chiefly by growing wealth, relatively low rates of breastfeeding and by premiumisation, a function of health scandals around Melamine-tainted formula. At the same time, consumers are moving increasingly online, particularly in higher-tier cities, as this gives them access to the more-trusted foreign brands, which facilitates A2M and Bellamy's market share gains – predominantly from local brands as well as larger multinational brands.

A2M and Bellamy's both have capital-light business models and have diverse sales channels – chiefly through Chinese traders and online retailers via direct mail or bonded warehouses.

Main risks

Supply is an important risk - although we believe both firms have secured sufficient supply to meet our volume growth forecasts for the next few years. In our view, Bellamy's risk is slightly more elevated given the economics of organic milk farming i.e. fewer certified 'organic' dairy farms, high costs for organic milk vs. regular milk and a 3 year conversion process to organic. 'A2' milk has fewer supply risks, as about 30% of the overall herd dairy in farms across Australia and New Zealand are 'A2' cows.

Competition from other brands is also increasing with many new brands entering the market and existing multi-national players increasing investments in online. Branding is critical and we expect further investments by BAL and A2M to support its growth.

Regulation is also a risk – given evolving regulatory and governmental considerations around the quality and formulations of formula; licensing of foreign manufacturers; Chinese labelling for products sold through cross-border e-commerce; and additional tax/compliance requirements for cross-border sales (although not just for IMF).

Recent news sources (AFR 10 May 2016, 26 May 2016, Weibo) suggest the government is **tightening its enforcement of taxes/compliance through the direct mail channel** (including at airports, express parcels). We think this may create some short-term disruption for both BAL/A2M given that a number of B2C businesses were likely avoiding taxes previously. Our view based on official customs statements and other channel checks suggest that the direct mail channel will continue to remain open but be subject to higher taxes and potentially greater regulatory oversight. Given the non-discretionary nature of infant formula, and strong demand for these brands, we believe that the medium-term investment thesis remains intact.

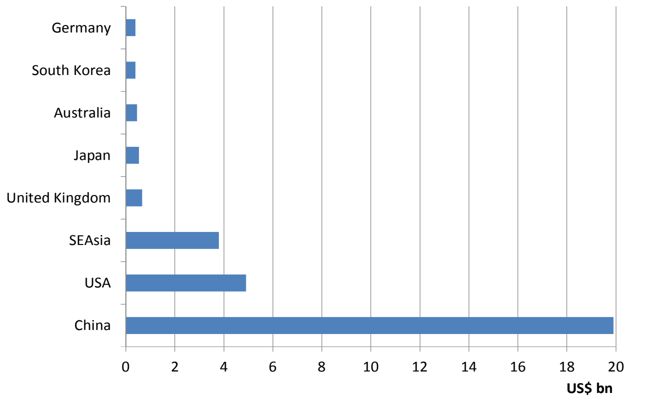
Other risks: (1) Quality, safety and reputational risks; (3) Intellectual property risks for A2M

Financials and valuation

We forecast high earnings growth of 36% EPS 3yr CAGR over FY16E-19E for A2M and 25% for Bellamy's – driven by their China expansion. Our 12-month target prices are based on an equal blend of DCF (to capture the longer-term growth) and EV/GCI-CROCI (for nearer term growth). They offer potential upsides to current prices of 25% for A2M and 12% for Bellamy's. We prefer A2M over Bellamy's for its more attractive valuation given its higher growth prospects.

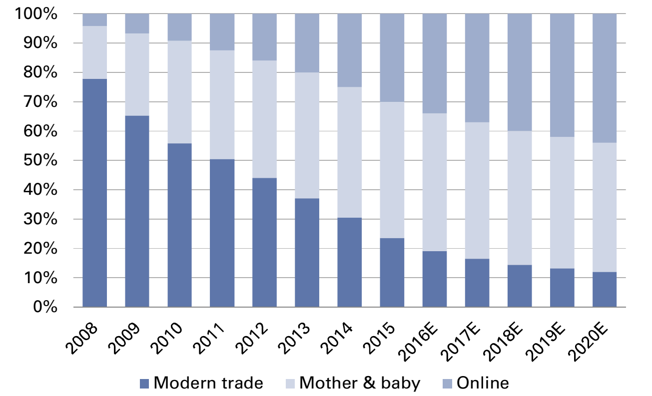
Our thesis in six charts

Exhibit 1: China is a US$20bn market
Market for infant formula (2015)



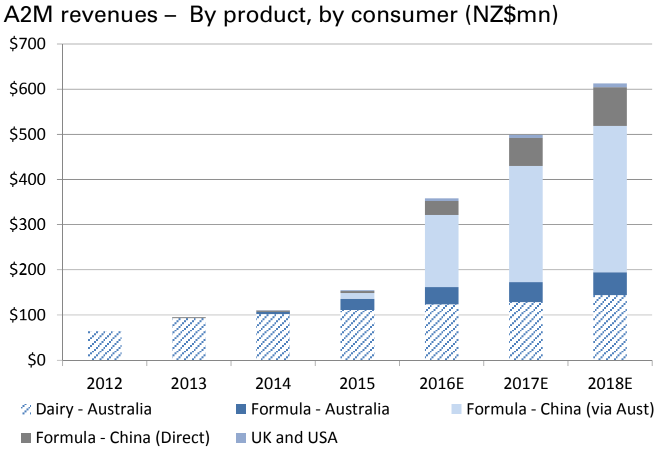
Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 2: Online is disrupting traditional channels
China market – By selling channel



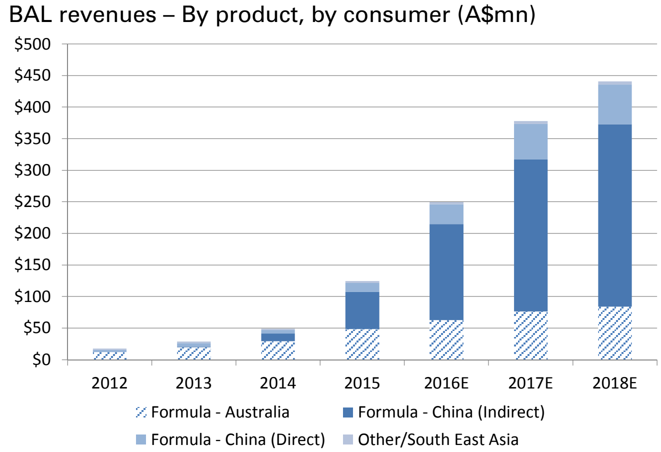
Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 3: For A2M, Chinese consumer sales c. 50% in FY16
A2M revenues – By product, by consumer (NZ$mn)



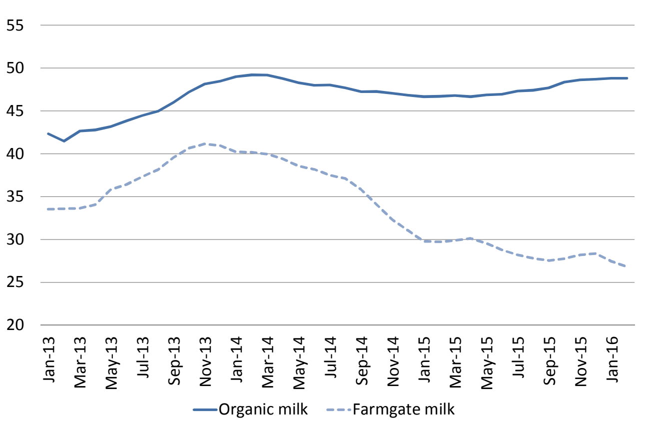
Source: Company data, Goldman Sachs Global Investment Research.

Exhibit 4: For BAL, Chinese consumer sales c. 70% in FY16
BAL revenues – By product, by consumer (A$mn)



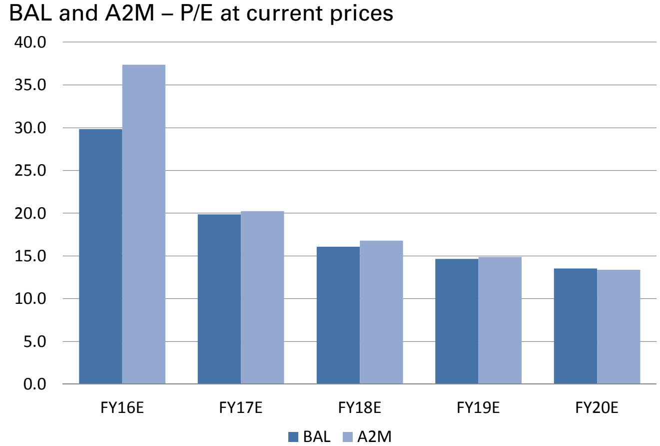
Source: Company data, Goldman Sachs Global Investment Research.

Exhibit 5: Supply risks slightly more elevated for BAL
Organic milk vs. Conventional milk prices - Germany



Source: BMELV

Exhibit 6: On our forecasts, A2M's P/E premium narrows by FY20E
BAL and A2M – P/E at current prices



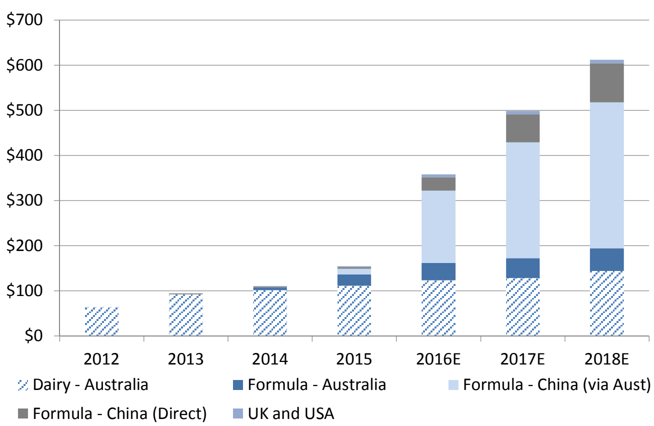
Source: Goldman Sachs Global Investment Research.

The cream of Australia's infant formula brands

Leveraged to China

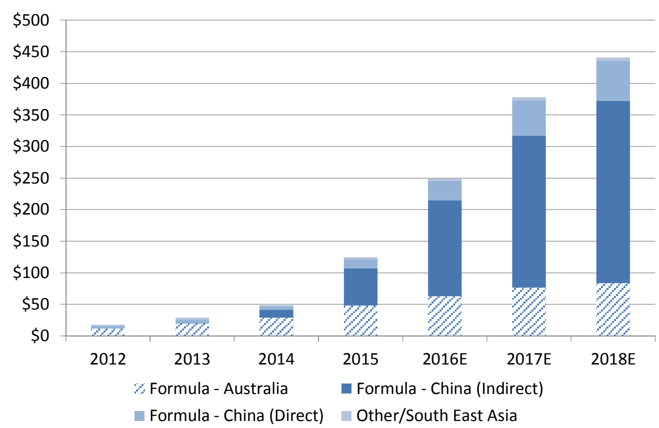
A2M and BAL are two of Australia's leading infant formula brands. Since 2014, both have seen strong revenue growth mainly from Chinese consumers who purchase products sold in Australia (C2C or "daigou" trade). Both companies are also increasingly selling direct into China (B2C, offline and online).

Exhibit 7: For A2M, sales to Chinese consumers account for >50% of FY16E revenues
Group revenues – NZ$mn



Source: Company data, Goldman Sachs Global Investment Research.

Exhibit 8: For BAL, sales to Chinese consumers account for c. 70% of FY16E revenues
Group revenues – A$mn



Source: Company data, Goldman Sachs Global Investment Research.

A2Milk (A2M.AX, dual-listed) – 65% infant formula / 35% dairy (FY16E revenues)
A2M sells infant formula under the a2 Platinum brand and branded dairy under the a2Milk brand in Australia, China, US and UK.

Exhibit 9: Launched infant formula in 2013, prior to this A2M was a liquid milk business
Company history

Year	Event
2000	a2 Milk Company founded in New Zealand
2012	Listed on NZX Main Board
	Commissioned milk processing facility in Sydney
	Agreement with Synlait for supply of infant formula targeted at Asian markets
	Launched a2Milk in the UK through a JV with Robert Wiseman Dairies (RWD)
	Agreement with China State Farm for offline distribution in China
2013	a2 platinum infant formula launched in China, Australia, New Zealand
	Assumes full ownership of the UK JV from RWD
2015	Listed on the ASX
	Receives takeover offer from Freedom Foods and Dean Foods. Freedom Foods subsequently sells its stake
	Launched a2Milk in the Californian fresh milk market
	Launches Tmall Global flagship store

Source: Company data.

Bellamy's (BAL.AX) – 95% Infant formula / 5% Infant food (FY16E revenues)
BAL sells infant formula under the Bellamy's Organic brand in Australia, China and Southeast Asia.

Exhibit 10: Launched infant formula product in 2005
Company history

Year	Event
2004	Bellamy's Organic is formed in Launceston, Tasmania
2005	Produces Australia's first organic baby formula
2007	Tatura Milk, now part of Bega Cheese, supplies Bellamy's with infant formula
2007	Acquired by Tasmanian Pure Foods (private)
2012	Bellamy's opens an office in Shanghai
2013	Bellamy's launches its range in Chemist Warehouse (via Sigma Pharmaceuticals)
	Shanghai Industrial Investment Co (SIIC) becomes distribution partner in China
2014	Public listing on the ASX
	Launches in Costco Australia
2015	Opens Bellamy's flagship tmall.hk store
	Signs five-year contract with Fonterra to produce Bellamy's infant formula

Source: Company data.

The product: Australia/New Zealand credentials provide an edge

Both brands benefit from their Australian/New Zealand credentials — i.e. home-grown Australian/New Zealand brands made locally. They also have unique customer propositions which enable premium pricing vs. competitors.

A2M – the 'a2 only' edge

A2 branded milk is naturally occurring cow's milk. Regular cows' milk contains two main types of beta-casein protein, the A2 protein and A1 protein. A2 milk is different from regular cows' milk because it is free of the A1 protein, but in other respects it is comparable. Research cited by A2M show that during digestion, a fragment produced from the A1 but not the A2 protein has the potential to impact digestion, causing discomfort (for detail see (https://www.thea2milkcompany.com/human-digestion-trial-shows-a-difference-2-2/). The company acknowledges that further clinical trials are needed to confirm these findings. A2 milk is licensed and marketed by A2M and protected by patents and trademarks, the majority of which expire in 2023.

BAL – the 'organic' edge

Bellamy's infant formula is sourced from 100% organic produce — that is, farmed and produced without the use of pesticides, hormones, antibiotics or genetic modification. It is the only infant formula company that has been certified by the Australian organic certification authorities (NASAA).

Supply chain: 100% outsourced supply chain

Unlike their larger global competitors, BAL and A2M operate a 100% outsourced supply chain. Both have struggled to keep up with the surge in demand for its products, with BAL having additional strain given the scarcity of organic ingredients with lead times for ingredient orders extending out 6-9 months.

A2M – close ties with Synlait

Processing: A2M contracts with NZ-based processor Synlait for its infant formula production. Synlait is licensed and accredited by the Chinese regulatory authority, CNCA, for supply into the Chinese market. Consistent with industry practice, A2M pays Synlait a processing margin and sets its raw ingredient pricing every 3 months. Synlait also contracts with Mead Johnson (bulk product) and New Hope Dairy (based in China, fully finished product).

Milk supply: Synlait, with A2M's assistance, sources a2 milk from segregated A2 only herds. Most commercial farms worldwide will have c. 30% of cows that are naturally A2 only. Farmers receive a c. 5%-10% premium above the farmgate milk price to supply A2 only milk.

BAL – close ties with Fonterra and Bega

Processing: BAL contracts with Bega (BGA.AX, Not Covered) and Fonterra (FSF.NZ, Coverage Suspended) for supply of finished product. Like Synlait, both are licensed and accredited by the Chinese regulatory authorities, CNCA. Consistent with industry practice, BAL pays Bega and Fonterra a processing margin and sets its raw material costs out 3-6 months in advance. Bega also makes product for Mead Johnson, Blackmores and others; Fonterra for Danone, Beingmate and others.

Milk supply: Fonterra and Bega, with BAL's assistance, source organic inputs from Australia, New Zealand, Germany and Austria. Given higher farming costs and lower yields, the premium paid for organic milk inputs is typically 30% more than standard milk inputs, although given strong demand and recent falls in the farm gate price for standard milk this premium is on the rise.

Exhibit 11: BAL and A2M outsource their supply, unlike many more vertically integrated competitors

Supply chain of major players vs. BAL and A2M

Milk collection & processing	Manufacturing - processing, blending, packing	Selling & marketing	
Fonterra Bega	Fonterra Bega	Bellamy's	ANZ brands
Synlait	Synlait	A2	
Bega	Bega	Blackmores	
Various	Heinz		
Various	Nestle		Multi-nationals
Various	Mead Johnson		
Various	Danone		
Various	Abbott		
Various	Beingmate		Chinese brands
Various	Biostime		
Various	Yashili		

Source: Company Data, Goldman Sachs Global Investment Research.

Infant formula in China: A market in rapid transition

Sizing the market

We value the Chinese infant formula market at RMB120bn (US$19.7bn, A$27.1bn), c. 60x larger than the Australian market and c. 4x larger than the US market, although we note that BAL's and A2M's nearer term addressable market is limited to higher tiered cities given its high pricing. In volume terms, c. 740,000 tonnes of infant formula was consumed in China in 2015.

We forecast the overall market to grow at a CAGR of 3%, on volume growth of 4% and price growth of -1%. We set out the four key drivers of this growth below.

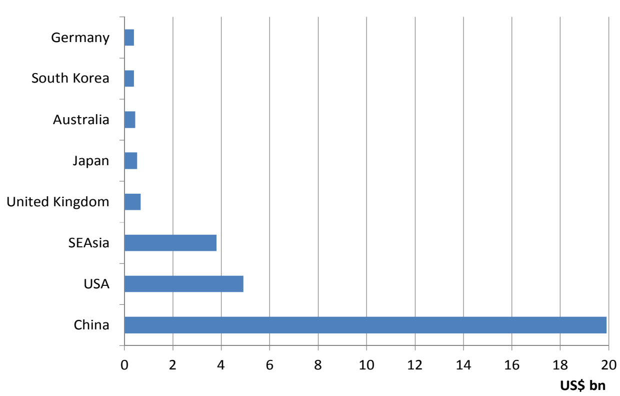
Exhibit 12: We estimate that there are approximately 14mn babies born to the urban working population in China
Key metrics – market sizing – China vs. Australia

	China	Australia
Market size - local currency (2015)	**$ 122,082**	**$ 380**
Market size - US$mn (2015)	**$ 19,669**	**$ 317**
No. of babies born (2015)	16mn	300,000
No. of babies aged 0-3 years old (to include demand for follow-up formula (2015))	45mn	
No. of babies aged 0-3 years old born to "urban middle" and "urban mass"[1]	**14mn**	
Breastfeeding rate by the end of 6 months[2]	**15%**	**40%**
Average price per can of infant formula - local currency (foreign brands for China[3])	**225**	**22**
Average price per can of infant formula - US$	38	17
Average spend per month (assuming 4 cans per month) - local currency (foreign brands for China)	900	88

[1] Working population earning above US$5,500 per capita
[2] 16% of urban Chinese women exclusively breastfed through the age of 6 months
[3] Average price per can for foreign brands in China

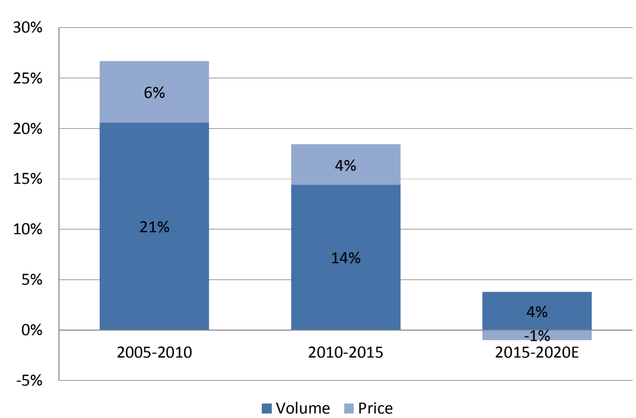
Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 13: The Chinese infant formula market is valued at US$20bn
Market size by country



Source: Euromonitor, Goldman Sachs Global Investment Research. SEAsia is Indonesia, Thailand, Singapore, Malaysia.

Exhibit 14: We forecast the Chinese infant formula market to grow volumes at 4% p.a. for the next 5 years
Volume and price growth for Chinese infant formula



Source: Euromonitor, Goldman Sachs Global Investment Research.

Four key drivers of market growth

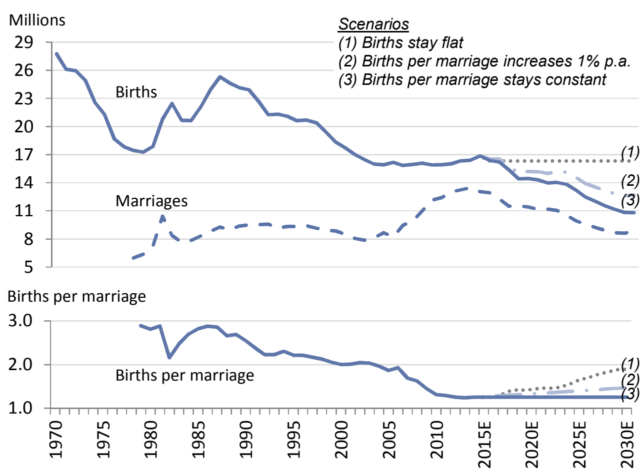
(1) Volume growth: Urbanisation and higher income levels to drive higher consumption per capita (not relaxation of the one child policy)
We expect increasing consumption per capita growth to be underpinned by rising income levels, increasing urbanization and more women entering the workforce.

We expect overall consumption per capita to grow even against the backdrop of falling birth numbers in China. The end of the one child policy is in our view unlikely to generate a country-wide baby boom given that there are now fewer mothers; to keep births flat, births per marriage would have to increase by c. 50% to closer to two births per marriage.

Key points

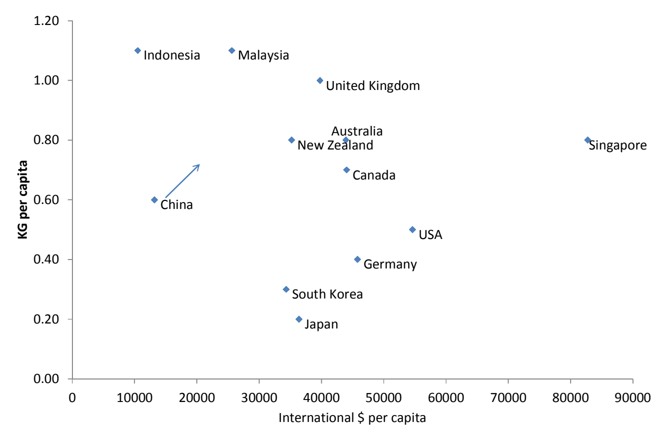
- **Births in top-tier cities to rise with urbanization:** Births and school enrolment in Beijing and Shanghai have been growing above national trends as migrants put down roots. Millennials are a big driver of this migration; only 23% were born in urban areas but 59% live there.
- **Babies are born to parents with higher incomes**: Urbanisation and rising income levels mean that babies are increasingly born to older and wealthier working parents willing to spend more.
- **Low and declining breastfeeding rates in urban areas:** Social and cultural factors such as the lack of maternity leave policies in workplaces, low community support for breastfeeding and aggressive marketing by IMF brands translate to low breastfeeding rates. In 2014, c. 16% of urban Chinese women exclusively breastfed their child to 6 months. Breastfeeding rates are higher in rural China at c. 30%, but in both cases they continue to decline (Source: National Health and Family Planning Commission).

Exhibit 15: We expect the number of births in China to fall even with relaxation of the one child policy
No. of births and births per marriage in China



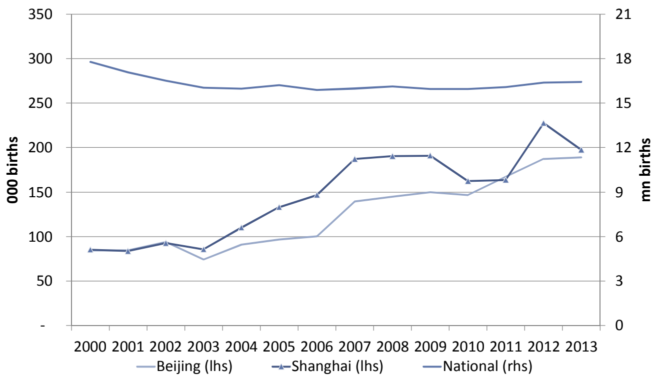
Source: NBS, CEIC, Goldman Sachs Global Investment Research.

Exhibit 16: But market volume should be supported by increasing consumption per capita, even though the numbers of infants may decline….



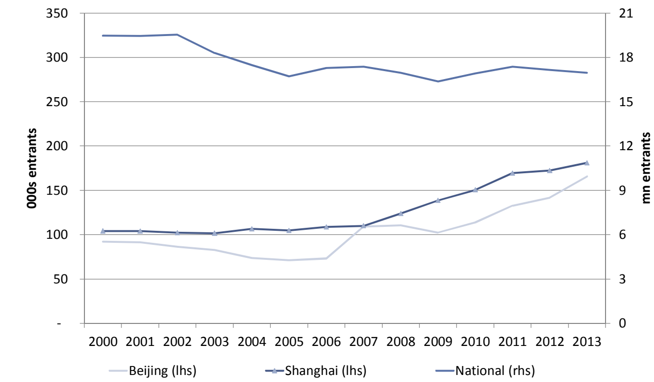
Source: Bloomberg, Euromonitor, Goldman Sachs Global Investment Research

Exhibit 17: While overall birth rates are flat, there are more babies being born in urban areas
Number of live births – Beijing, Shanghai, China.



Source: CEIC, China NBS.

Exhibit 18: More children entering school in key cities
Number of primary school entrants – Beijing, Shanghai, China.



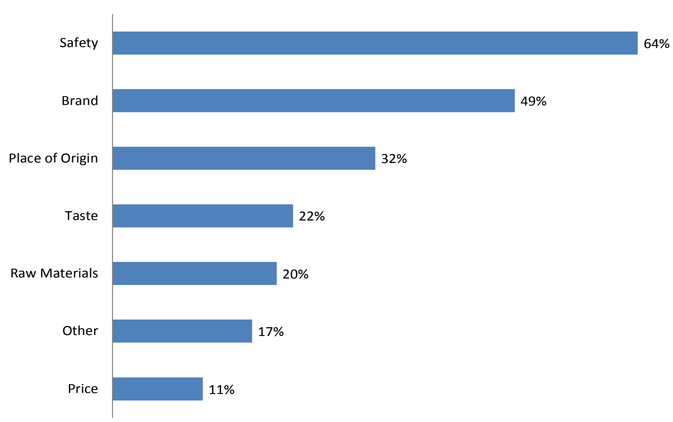
Source: CEIC, China NBS.

(2) Pricing growth: Online-led deflation and competition offset by premiumisation
Pricing growth has been positive in the last five years as consumers traded up. We expect this premiumisation trend to continue and to more than offset by the deflationary forces from competition and the shift to online.

Key points

- **Premiumisation/uptrading to continue:** As income levels rise, we expect Chinese mothers to continue to trade up to premium Western brands, which are widely perceived to have greater nutritional benefits/safety profiles.

Exhibit 19: Safety and brand are paramount for Chinese consumers given contamination scares in recent years
Key decision-making factors for Chinese infant formula consumers

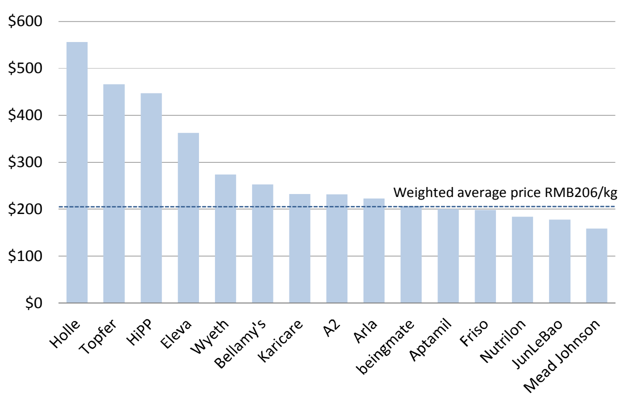


Source: Shanghai International Baby Maternity Industry Expo (CBME China), September 2014.

(3) Shift to online an enabler of premiumisation but also encourages competition: This premiumisation trend has been enabled by the rise of e-commerce (i.e. WeChat, Taobao, Tmall, JD and other online platforms) which has opened the market up to new Western brands and allowed consumers to trade up to imported finished product. E-commerce prices are generally comparable to prices in offline channels excluding tariffs and VAT, suggesting healthy margins for channel participants. Over time, however, we would expect this margin to erode as more brands enter the channel. *We discuss this in greater detail in the following sections.*

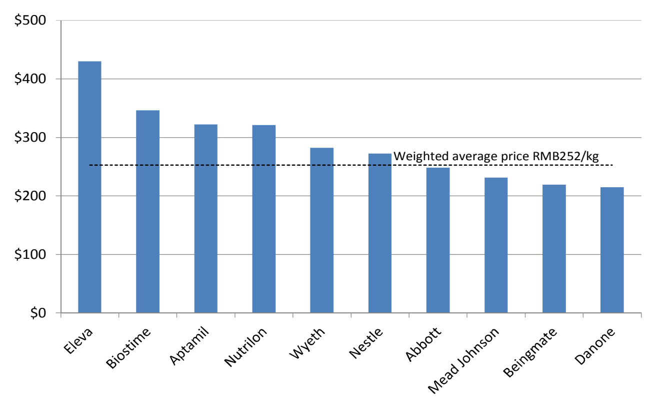
(4) Recent regulatory changes to narrow the price differential to offline: On the 8th of April, the government introduced an 11.9% tax for infant formula purchases through the cross-border e-commerce channel which will narrow the price differential to offline. However, we expect other factors including greater choice, assurances of authenticity etc to mean that the online channel will continue to exceed growth in offline. *We discuss this in greater detail in the following sections.*

Exhibit 20: Online driving price compression, c. 10-20% cheaper than Mother & Baby channel
Average prices for top IMF brands on Tmall (Rmb) – January 2016 survey, excludes 11.9% tax increase



Source: Tmall.com, Goldman Sachs Global Investment Research.

Exhibit 21: VAT and channel margins mean Mother & Baby shops losing ground to online
Average prices for top brands in the mother & baby channel – January 2016 survey, includes VAT

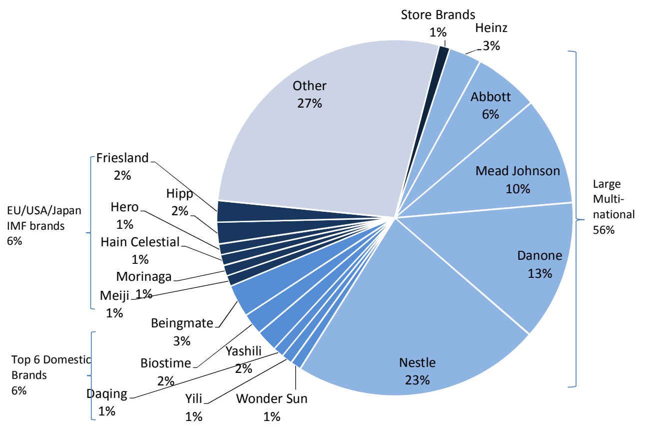


Source: Nielsen, Goldman Sachs Global Investment Research.

Market players: A crowded market

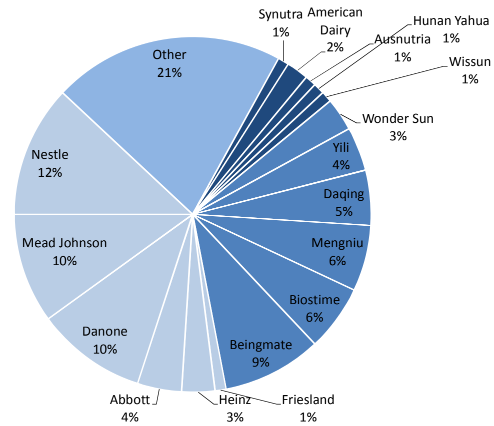
BAL and A2M face a competitive market in China. Infant formula is one of the most consolidated food products globally - dominated by the Top 5 multinational companies (Nestle, Danone, Mead Johnson, Abbott & Heinz), but the Chinese market in contrast, is highly fragmented with thousands of brands and many players. This market structure is supported by a regulatory framework that favours local players (in the form of tax breaks, funding for capex investments etc) although consumer preference is strongly skewed to foreign brands.

Exhibit 22: The global infant formula market is highly concentrated…
Global market shares (2015)



Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 23: … but so not in China
China market shares (2015)

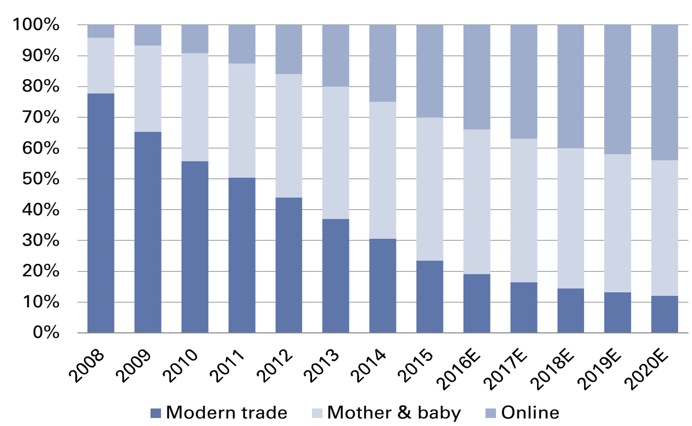


Source: Euromonitor, Goldman Sachs Global Investment Research.

Selling channels: Online gaining over traditional trade

The mix of sales channels is changing rapidly in China away from traditional trade and mother & baby stores and towards online channel. This has disrupted the traditional share base of incumbent players and helped support the growth of foreign brands like BAL and A2M. The mother & baby store is still the dominant selling channel in China, particularly beyond Tier 1 cities, given its high service model and influence over customer purchasing decisions. However, pricing through this channel has eroded as online has grown. Given the relative lack of service and high selling prices, the modern trade channel (i.e. supermarkets) is being disrupted the most by online. *We discuss this in greater detail in the following sections.*

Exhibit 24: Channel shift from trade to online
Chinese infant formula market – by channel



Source: Euromonitor, Goldman Sachs Global Investment Research.

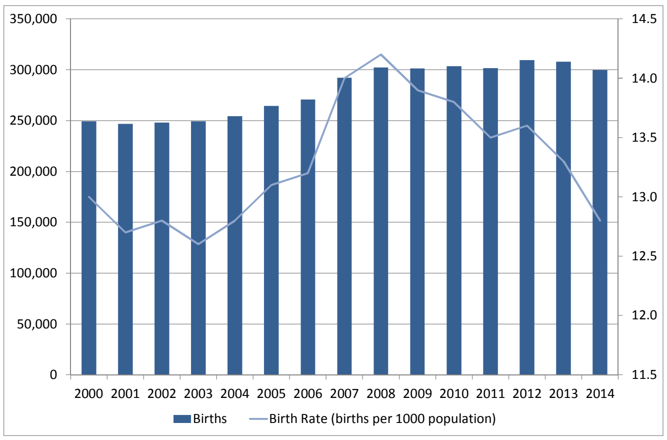
Infant formula in Australia: Mature growth

In Australia, underlying demand is mature given stable birth numbers and breastfeeding rates. We forecast category growth of 5%, with vol 2% and price 3%.

How do A2M/BAL sell in Australia?

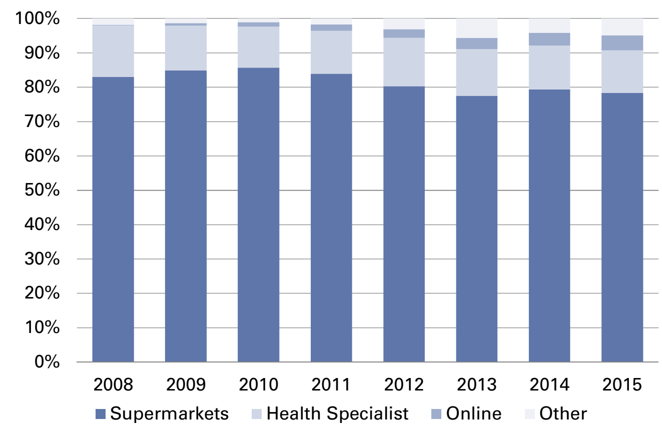
In Australia, infant formula is sold mainly through grocery outlets and pharmacies. 80% is sold through the supermarket channel (of which Coles and Woolworths have a c. 70% share). Leading discount pharmacy chain Chemist Warehouse has also grown in importance for both BAL and A2M given its prominence as a destination for Chinese consumers/traders.

Exhibit 25: Stable birth numbers in Australia
Australia – Number of Births and Birth Rate



Source: ABS.

Exhibit 26: Supermarkets dominant but losing some ground to health specialists and online
Australian market by selling channel

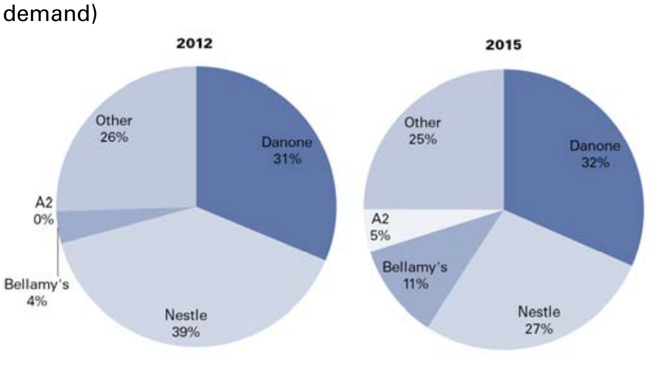


Source: Euromonitor.

Niche brands have been gaining share

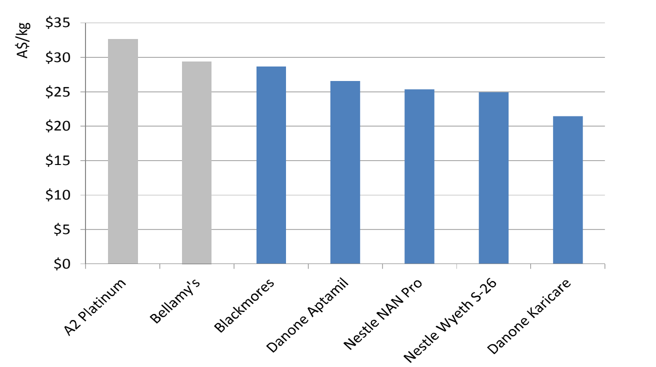
The Australian market, like most other markets ex-China, is dominated by large global players. In recent years, however, niche brands with differentiated selling points like BAL and A2M have been gaining share, even after adjusting for Chinese grey market demand.

Exhibit 27: Niche brands like BAL with differentiated selling points have been gaining share
Market shares – Australian consumers (adjusted for Chinese demand)



Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 28: BAL and A2M command premium pricing in Australia
Pricing by brand



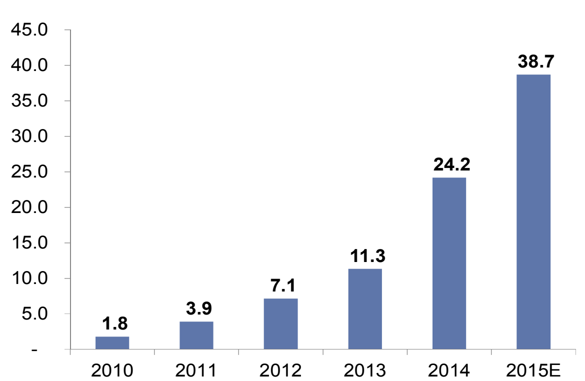
Source: Goldman Sachs Global Investment Research.

BAL/A2M growing in popularity in China

Why are Bellamy's and a2 Platinum popular? Can this continue?

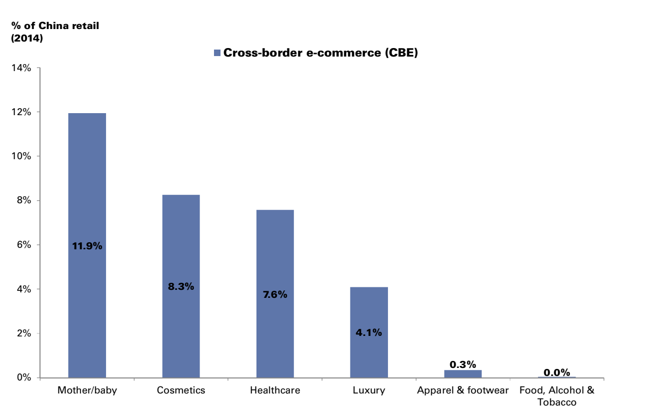
- **A crisis of consumer confidence:** Serious contamination scares (from 2008 and as recently as 2012), corruption scandals and price fixing allegations created a high level of distrust towards the safety and quality of local product among Chinese consumers. Wealthier consumers turned to foreign markets to satisfy their requirements; buying fully finished formula from other countries. They source product via a multitude of ways: through friends and relatives, small traders, directly from foreign websites or more recently through cross-border e-commerce (via Chinese online retailers/marketplaces). The Chinese government has overhauled the domestic industry and is encouraging consolidation and better supply chain transparency, but we expect it will take many years before the Chinese industry wins back the trust of its consumers.
- **"Brand ANZ":** Australia and New Zealand have a strong reputation in China for producing quality food produce. Germany and the Netherlands are also popular. The growing numbers of Chinese students (c. 170,000 in total vs. 300,000 in the US), tourists (now annualizing c. 1mn a year) and residents in Australia and New Zealand also contribute towards "Brand ANZ's" popularity. We note that ANZ was the fourth-best selling source for products sold on Tmall during Single's Day 2015 (after the US, Korea and Japan).
- **Premium leading brands:** Chinese consumers tend to gravitate towards premium local brands that are perceived to be popular in their home country. We believe A2M's success can be partly explained by its high pricing in the Australian market, which is associated with quality and prestige. Consumption of organic produce is also on the rise in China which supports BAL's brand.
- **The rise of "cross-border e-commerce":** The Chinese government introduced a pilot program for cross-border e-commerce platforms in 2014 which saw the creation of preferential tax and regulation zones for the importation of foreign goods. These goods are imported through government-owned bonded warehouses and sold to consumers via China's major online retailers (Tmall/Taobao, JD etc). Our estimates suggest that this bonded warehouse model now accounts for c. RMB40bn of trade, comprising c. 20% of overall cross-border trade (including direct mail/parcel trades).

Exhibit 29: Cross-border e-commerce (CBEC) has been growing fast in China
China's CBEC market (US$bn)



Source: CECRC.

Exhibit 30: CBEC already accounts for c.10% for mother/baby and cosmetics products' sales in China
CBEC by product category (%)



Source: CECRC, Euromonitor, Goldman Sachs Global Investment Research.

Sales channel shifts favour more nimble Western brands

Selling channels for infant formula are evolving rapidly in China influencing channel and brand profitability. We expect the online channel to continue to take share away from traditional trade given lower 'cost to serve' for suppliers, assurances of authenticity and better convenience for customers. We would also expect the trader route-to-market to remain significant (particularly if labelling changes are required) although direct sales will grow in importance given higher selling margins.

Three main routes into China

1. **Indirectly via Australian retailers via direct mail or bonded warehouse, the main route to market (c. 70%-80% of sales to Chinese consumers):** Product purchased from Australian retailers (pharmacy chains and supermarkets) by Chinese traders and sold online via WeChat, Taobao/Tmall, JD and other online platforms. We expect this indirect trade from Australia will remain an important way of accessing product for the Chinese consumer given lingering concerns over authenticity of product sold in onshore channels. Based on Tmall/Taobao data, we estimate that c. 20%-50% is sold through the bonded warehouse, the remainder being sold through direct mail, although the lack of clear data makes estimating this challenging.

   Recent news sources (AFR 10 May 2016, 26 May 2016, Weibo) suggest the government is tightening its enforcement of taxes/compliance through the direct mail channel (including at airports, express parcels). We think this may create some short-term disruption for both BAL/A2M given that a number of B2C businesses were likely avoiding taxes previously. Our view, which is based on official customs statements, is that the direct mail channel will continue to remain open but will be subject to greater regulatory oversight. Given the non-discretionary nature of infant formula, and strong demand for these brands, we believe that the medium-term investment thesis remains intact.

2. **Directly in China via e-commerce, growing in importance:** A key focus for BAL/A2M going forward, subject to meeting the appropriate regulatory requirements, and involves product sold via own online stores. BAL earns high selling margins from this channel (43% China EBIT margin in 1H16) and can exert greater control over its pricing architecture, advertising and brand. Based on our channel checks, A2M sells through distribution partners, and we therefore believe it realises a lower GM than BAL in this channel.

3. **Directly via Chinese offline retailers, and likely to remain small:** Issues over authenticity as well as higher prices due to taxes (VAT + tariffs) and middlemen margins mean that this channel is likely to remain small in the absence of more direct investment to improve its on-the-ground presence in the country.

The importance of traders in moving product

The retail price differential in China vs. Australia and strong demand has seen a lucrative informal trade mushroom between the two countries. These traders serve as a marketing tool helping to promote, market and educate consumers and are influential in determining which brands flourish and which do not.

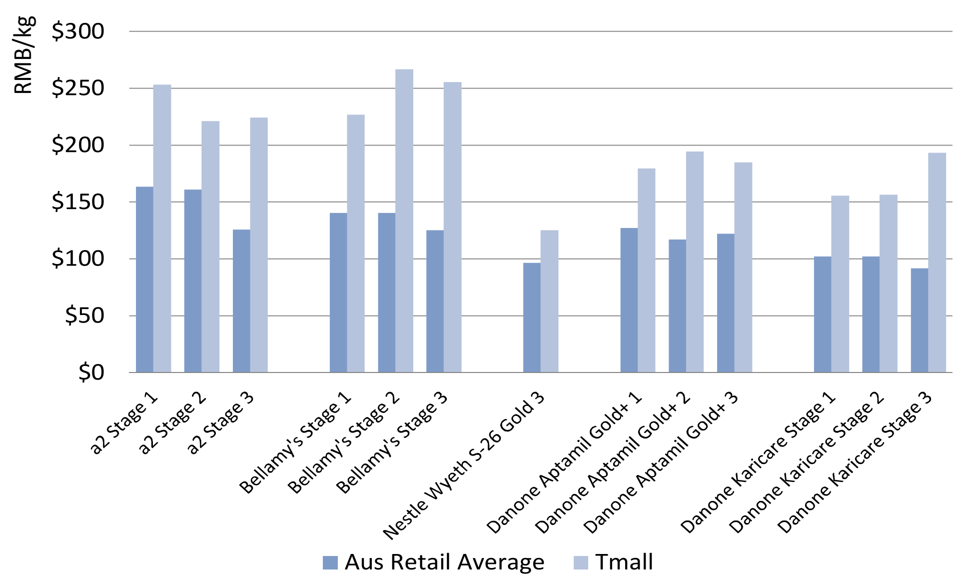
Understanding the motivations and profitability of the vast web of traders/resellers (from students using third party courier services to larger businesses with in-house logistics and warehousing) are key in understanding BAL and A2M's future prospects. We see profit margins as well as availability/regularity of supply as being two critical motivators.

Our **profitability analysis** suggests lucrative profits for channel participants:

- Larger traders with better access to supply and who pay closer to wholesale prices earn the highest margin, although margins are still solid even for smaller traders who pay closer to retail prices margins.
- We expect the trader route to remain significant but expect more growth from direct sales into the Free Trade Zone/bonded warehouse given BAL/A2M would earn higher margins.

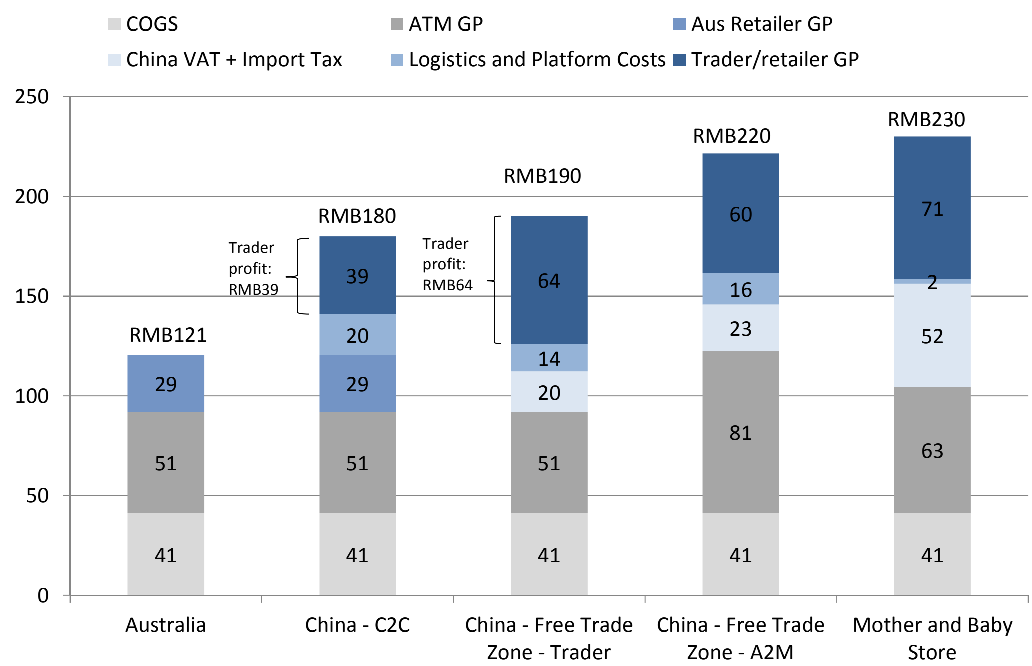
Exhibit 31: Price in China (based on Tmall) are c. 75% higher (value-weighted) than retail prices in Australia

Tmall vs. Aus retail ave (Coles, Woolworths, Chemist Warehouse) price – January 2016 survey – pre 11.9% tax increase



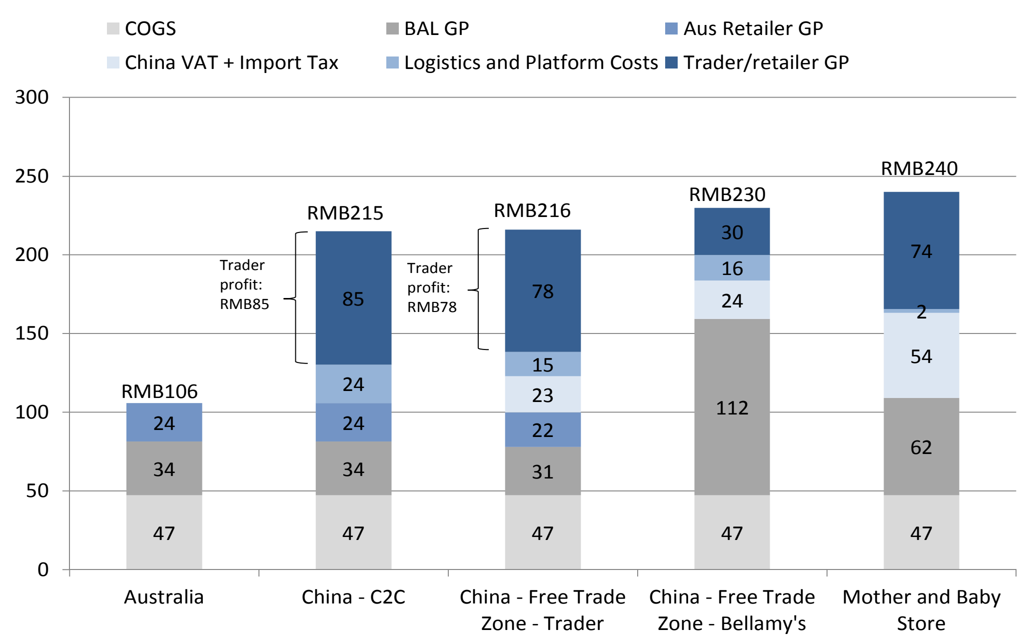
Source: Tmall, Goldman Sachs Global Investment Research. A$ prices translated at 4.6 AUD/CNY.

Exhibit 32: A2M – Sizable profit margins for the trader
A2M – profitability by distribution channel (CNY) – for Level 3 formula



Source: Tmall.com, Goldman Sachs Global Investment Research.

Exhibit 33: BAL - Sizable profit margins for the trader, BAL makes highest margin from direct selling
BAL – profitability by distribution channel (CNY) – For Level 3 formula

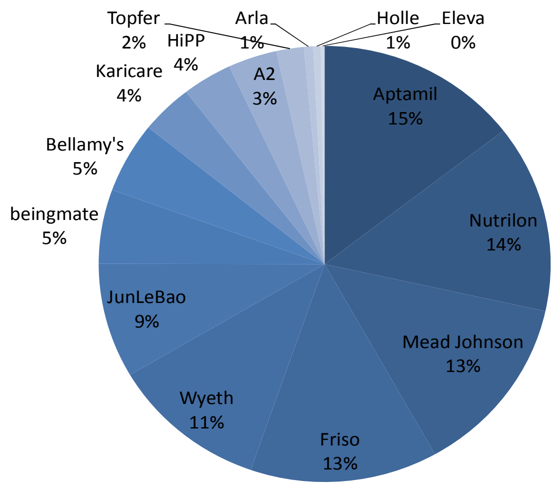


Source: Tmall.com, Goldman Sachs Global Investment Research.

Channel dynamics favour online Western brands

E-commerce has lowered the entry costs (i.e. marketing costs, retailer/distributor margins, logistics, taxes) and evened the playing field for many Western brands. We believe these dynamics will continue to favour brands with effective e-commerce strategies over existing brands (domestic or Western) with offline businesses to protect, subject to obtaining the appropriate regulatory compliance.

Exhibit 34: Snapshot of brands available on Tmall
Market shares by brand – Tmall survey January 2016

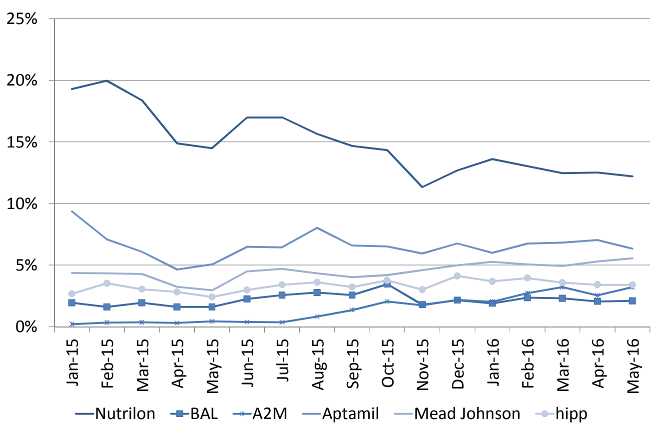


Source: Tmall.com, Goldman Sachs Global Investment Research

Niche brands winning at the expense of more mainstream brands

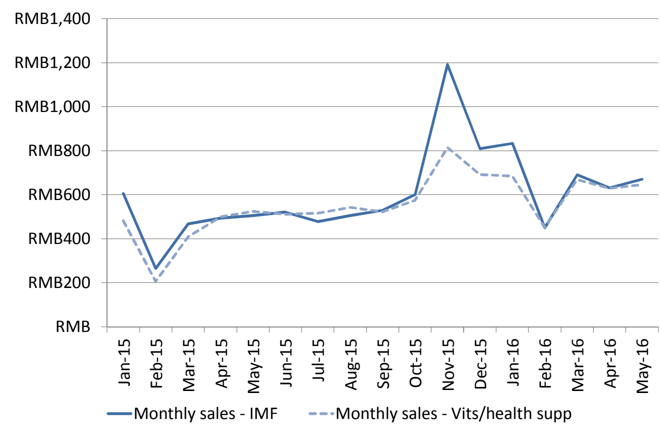
Tmall/Taobao sales data suggest that niche, premium/super premium brands are also winning share at the expense of more mainstream brands. For context, we note that Tmall/Taobao account for c. 20%-30% of A2M/BAL sales to Chinese consumers, so while providing a helpful guide it does not tell the full story.

Exhibit 35: Tmall/Taobao data suggest that niche brands are taking share away from more mainstream brands
Market share - % of category



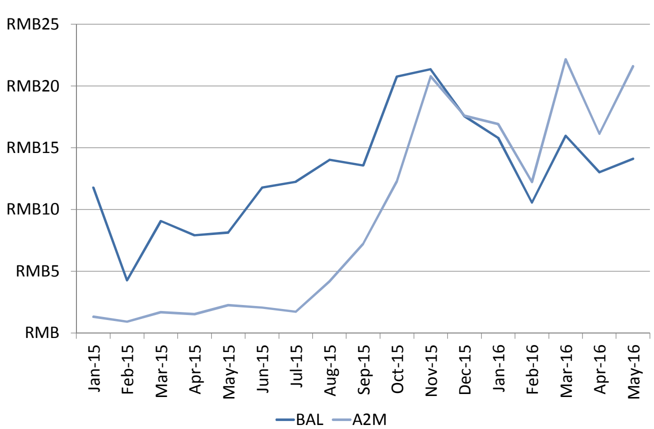
Source: Tmall.com, Taobao.com.

Exhibit 36: Positive category growth for both infant formula and vitamins/health supplements
Turnover – RMB mn



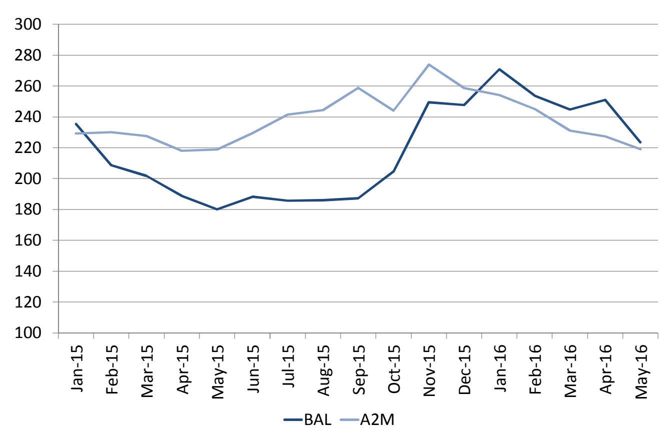
Source: Tmall.com, Taobao.com

Exhibit 37: A2M has seen strong growth…
Monthly turnover – A2M and BAL



Source: Tmall.com, Taobao.com

Exhibit 38: … partially price driven
Average price – A2M and BAL



Source: Tmall.com, Taobao.com

Securing supply the key to sustaining growth

The ability to supply the market is key to growth. Both BAL and A2M have experienced product shortages in the Australian market mainly due to the unexpected surge in demand and long lead times for ingredient sourcing and production (typically 3-6 months). For BAL, there is also the additional cost and constraint from the sourcing of organic raw ingredients.

BAL's organic supply chain is fragmented

The organic milk market is highly fragmented so forecasting the amount of milk available to BAL is challenging. BAL has not provided this information to the market but the company has noted that it will be increasing its investment to encourage more farmers to convert to organic farming.

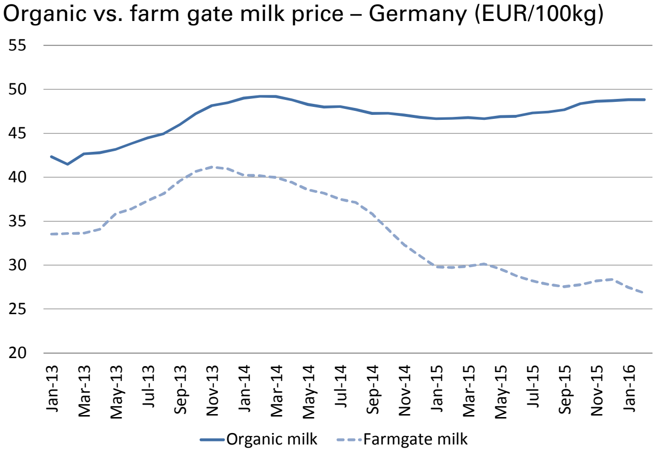
Conversion to organic farming takes three years: Conversion to organic farming from conventional farming takes c. 3 years and is considered a risky proposition for many farmers in the interim. During the first year of conversion, produce is sold at conventional prices and many incur losses given lower yields. In years two and three, "in conversion" produce can be sold at a small premium. Farm yields can rise to pre-conversion levels over time, delivering financial returns which exceed conventional farming given the premiums paid for organic produce.

In the past, this premium has been c. 30% although this has now increased to c. 80%-100% (see German organic pricing below) as global demand for organic has continued to rise and as regular milk prices have fallen. If these trends continue, which we think they will, they will likely encourage greater conversion rates and greater organic supply from FY18 onwards.

In an environment of tight supply, we expect that BAL should be able to pay a competitive price to secure supply vs. other organic dairy companies given its higher margins. We would also expect recent falls in the farmgate price helps keep organic costs manageable for BAL.

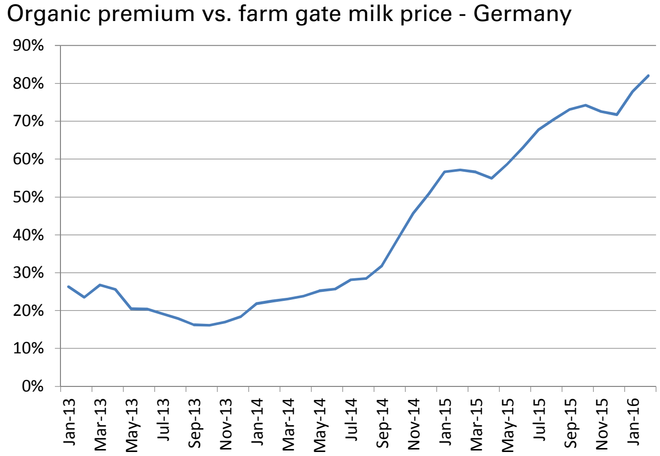
Europe the main source: The organic milk supply in Australia is insufficient to meet BAL's requirements (40mn in Australia vs. 4.5bn litres globally) and hence BAL source organic milk mainly from Europe.

Exhibit 39: The organic milk price is more stable than farmgate…
Organic vs. farm gate milk price – Germany (EUR/100kg)



Source: BMELV.

Exhibit 40: … Organic premium is expanding, now 80% premium to farm gate milk price
Organic premium vs. farm gate milk price - Germany



Source: BMELV.

A2M's raw ingredient supply more easily secured

A2 only cows are present in c. 30% of all herds globally. A2M pays a premium (has in the past been 5%-10%) to the farmer for the costs of breeding and segregation of the herd. A2M notes that Synlait intends to double its raw milk supply of A2 milk to reach 200mn litres by the middle of 2017, which on our forecasts provides ample raw ingredients. If 50% of the additional milk (i.e. 100mn litres) were used in infant formula, we forecast this equates to c. A$250-300mn p.a. in additional infant formula revenues for A2M.

Sensitivity to fluctuations in raw input pricing

A2M and BAL wear all the fluctuations in raw input pricing and generally set their raw input prices with their manufacturers every quarter. Raw dairy costs generally make up 20%-30% of total COGS. As such, every 10 % fluctuation in milk prices, impacts BAL/A2M COGS by 2%-3% and impacts BAL/A2M GM by c. 100-150 bp. There is limited supply or cost pressures on other non-dairy ingredients.

BAL increased its shelf prices by c. 30% in November 2015 to be closer to its premium price peers, which should more than offset the increase in its raw input costs such that the majority of this price increase drops to the bottom line.

Processing capacity at partners sufficient for both BAL and A2M

BAL: On our estimates, BAL make up 10,000-12,000 tonnes Bega's capacity (annualizing 2H16) which makes it Bega's second largest customer after Mead Johnson. Of Bega's total capacity of c. 35,000 tonnes, Mead Johnson have rights to c. 15,000 tonnes. Mead Johnson's agreement with Bega extends to 2018. Bega also processes for its Blackmores JV and a number of smaller brands. BAL's agreement with Bega extends to 2021.

To meet its growing needs, BAL recently struck a new agreement with Fonterra which will deliver product from FY17 onwards (to 2020) providing an additional boost of supply (see previous section). Fonterra's Darnum plant has capacity of 50,000 tonnes of which 50% is underwritten by Fonterra's JV partner Beingmate.

BAL operate a toll manufacturing contract with Fonterra i.e. BAL supply the raw ingredients, while Bega provides a more full service solution i.e. Bega purchases the raw ingredients according the BAL requirements.

Both contracts (out to 2020/2021) involve commitments for minimum annual supply levels as well as future growth and capacity commitments.

A2M: Synlait has capacity for c. 30,000 tonnes of infant formula with its canning and mixing facilities the main bottleneck. Synlait have drying capacity of c. 80,000 tonnes. In 1H16, Synlait produced 7,500 tonnes of infant formula, of which we estimate A2M comprised c. 55% making it Synlait's biggest infant formula customer. Synlait also makes fully finished infant formula for a number of small US/Chinese brands and makes bulk formula for a number of brands. A2M's agreement with Synlait extends to 2021.

Exhibit 41: Australian and New Zealand manufacturers and their current and announced capacity expansions, and a large number of disclosed brands – a number are planning large capacity expansions
Australian/New Zealand manufacturers of infant formula

Australia

Manufacturer	Brands	Current capacity (kt)	Announced capacity expansions (kt)
Camperdown Powder	Duribaby, Camperdown	9	
VIPlus Dairy	VIPlus	5	10
Farmland Dairy	Farmdaisy Formula	5	
Australian Dairy Park	Oz Farm Infant Formula, O'Milk Premium Gold	20	
Burra Foods	Burra Foods	10	
Tatura Milk Industries	Mead Johnson, Bellamy's, Blackmores, Snow	35	
Murray Goulburn Co-op	Natrastart, Mead Johnson, Kalbe	18	90
Blend and Pack	Bellamy's	5	
	Capacity - Australia	**107**	

New Zealand

Manufacturer	Brands	Current capacity (kt)
Nutricia	Karicare	40
Canpac (Fonterra)	Anmum	60
Synlait	A2 Platinum, Danone Nutricia, New Hope Nutritionals, Nouriz	30
Blue River	Blue River Sheep Milk Powder	5
Sutton Group (Danone)	Danone Brands	20
New Image International	Babysteps, Symbiotics, Bioactive	Small
Dairy Goat Co-operative	Karihome	Small
New Zealand New Milk		Small
	Capacity - NZ	**155**

Source: Company data, Goldman Sachs Global Investment Research.

Our volume growth forecasts and assumptions

Bringing this together, we outline our volume growth forecast for the market and for BAL and A2M. We forecast market share driven volume growth from:

- The shift from offline to online as e-commerce penetration grows;
- The shift from local to foreign brands as cross-border trade expands;
- The shift from mainstream foreign to niche foreign brands as Chinese consumers search for premium niche alternatives.

China is a 740,000 tonne market by volume. Of this, the online channel (c. 25% of total volumes) is growing rapidly while the traditional trade channel is shrinking. We estimate the online channel to grow by c. 20,000 – 35,000 tonnes per year.

For BAL and A2M, we estimate they will each grow volumes by 1,000 – 6,600 tonnes respectively each year. In FY16E, this makes up 30% of overall volume growth in the online channel. We acknowledge that at first glance this appears to be outsized growth vs. their market share in the channel (combined c. 6.5% share of volumes online in FY16). However, as we have noted above a number of mainstream brands are shrinking rapidly as their branding and channel strategies have not been as successful. By FY20E, we expect growth to reach a more steady state such that their contribution to growth (11% combined) more closely matches their combined market shares (11%).

We forecast market share gains for both, but forecast slower growth for BAL given tighter constraints on organic raw materials.

Exhibit 42: The Chinese market is rapidly evolving. We forecast market share driven volume growth for BAL and A2M
Volume growth projections

Volume analysis (tonnes)	FY15E	FY16E	FY17E	FY18E	FY19E	FY20E
China overall volumes	739,725	773,013	803,933	832,071	857,033	882,744
Volume growth (%)	0	4%	4%	3%	3%	3%
Online volumes	192,991	227,051	256,568	288,057	309,805	330,145
Additional volumes		34,060	29,518	31,489	21,748	20,340
Online as a % of total volumes	*26%*	*29%*	*32%*	*35%*	*36%*	*37%*
Online growth (%)		*18%*	*13%*	*12%*	*8%*	*7%*
BAL volumes in China	2,665	6,736	10,892	13,113	14,444	15,560
Additional volumes		4,071	4,156	2,221	1,330	1,117
% growth		*153%*	*62%*	*20%*	*10%*	*8%*
Additional vols as % of online growth		*12%*	*14%*	*7%*	*6%*	*5%*
Market share - of total	*0.4%*	*0.9%*	*1.4%*	*1.6%*	*1.7%*	*1.8%*
Market share - of online	*1.4%*	*3.0%*	*4.2%*	*4.6%*	*4.7%*	*4.7%*
A2M volumes in China	631	7,234	12,466	15,323	17,490	19,139
Additional volumes		6,604	5,232	2,857	2,167	1,649
% growth		*1047%*	*72%*	*23%*	*14%*	*9%*
Additional vols as % of online growth		*19%*	*18%*	*9%*	*10%*	*8%*
Market share - of total	*0.1%*	*0.9%*	*1.6%*	*1.8%*	*2.0%*	*2.2%*
Market share - of online	*0.3%*	*3.2%*	*4.9%*	*5.3%*	*5.6%*	*5.8%*

Source: Company data, Goldman Sachs Global Investment Research.

A complex regulatory environment

Regulation of infant formula

In response to serious contamination issues and price-fixing cases, the government launched a large scale regulatory review culminating in a landmark document in 2013 (Working Opinion on How to Improve the Quality and Safety of China's IMF Industry), which outlines its broad-based goals for the industry. However, we note that the policy details and fine print continue to evolve. These goals include:

1. **Consolidation of domestic manufacturers** to ensure adequate supply to meet demand and restore public confidence. The government's target is for the top 10 players to comprise 80% of the market, to reduce the number of players from 80 to 50 and to nurture a group of 3-5 domestic players with annual sales of RMB 5bn by 2018; and

   From a BAL/A2M perspective, despite these significant changes, market share data suggests that demand has not yet returned to domestic brands. We believe it may take a number (if not many) years before consumer confidence in domestic manufacturers is restored. However, government support for domestic companies in the form of tax breaks, funding for capex investments etc, plus forced consolidation, will likely mean that a more crowded market structure will continue to prevail.

2. **Safety & quality:** Increase regulatory oversight of the production process to ensure supply chain integrity from cow to can (including introducing strict licensing requirements for all IMF manufacturers that export to China) and stream-lining domestic supply chains (including banning OEM production). Every foreign manufacturer needs to be compliant according to strict standards set by the CNCA and audits are conducted regularly. BAL and A2M's manufacturers have CNCA approval.

3. **Three brands per manufacturer:** To promote supply chain transparency, the government is also requiring each domestic and foreign manufacturer to reduce the number of brands produced to only 3 product lines and 9 formulas. All brands have until October 2016 to comply with these rules.

   We expect this to have a limited impact on BAL and A2M given their importance to their respective manufacturers. The elimination of the long tail of brands will be overall positive for the industry. A2M's position with Synlait is secure given that it is Synlait's biggest customer, although having only 1 supplier raises the risks of potential safety/contamination issues. BAL is also a substantial customer for Bega - on our estimates, Bega's second largest customer. BAL is also an important customer for Fonterra. Fonterra will begin supplying BAL from FY17 onwards from its Australian Darnum plant which is 50% owned by China's Beingmate.

Regulation of the cross-border e-commerce channel

New regulation has also been introduced for the cross-border e-commerce/bonded warehouse channel in recent months. We believe the key issues for A2M/BAL are:

1. **Formula registration by 2018:** By 2018, infant formula brands sold through the bonded warehouse will be required to register their formulas with the CFDA. Before then, all infant formula with registration from the CNCA (includes both BAL and A2M product) will still be allowed through the cross-border e-commerce channel.

2. **Chinese labelling by 2018**: Chinese labelling for all cross-border e-commerce infant formula will be required by 2018 and could have significant impacts on consumer perceptions. BAL and A2M both have a Chinese labelled product available for sale in the offline channel, however, sales remain small. If Chinese consumers perceive the Chinese label product as inferior to an English label product, we expect sales to divert

away from the bonded warehouse channel to direct mail which is less scalable. BAL and A2M will need to rely more on its direct relationships with distributors/traders to sell a Chinese label product through the bonded warehouse.

3. **Higher taxes, but still lower than offline:** From April 8 2016, an 11.9% effective tax (calculated as 70% of the 17% offline VAT) increase from all infant formula sales will apply through the bonded warehouses. This narrows the price differential between the online and offline channels but we believe that this is unlikely to impact demand through online materially given: (1) prices are still 10%-20% more expensive offline (given import tariffs and selling margins); (2) consumers are willing to pay a premium for foreign made imported product vs. in-store product; and (3) greater range available online.
4. **Tightening of the direct mail channel**: Recent news sources (source: AFR (*10-May 2016, 26 May 2016*), Weibo) suggest the government is tightening its enforcement of taxes/compliance through the direct mail channel (including at airports, express parcels). We think this may create some short-term disruption for both BAL/A2M given that a number of B2C businesses were likely avoiding taxes previously. Our view, based on official customs statements and other channel checks, is that the direct mail channel will continue to remain open but be subject to higher taxes and greater regulatory oversight. **There is not yet a requirement for compliance with CFDA registration in the direct mail channel, although this cannot be ruled out.**

Other risks: Competition, safety; breastfeeding; IP

Competition from other brands

The growth in the online channel has encouraged many new brands to enter the Chinese market and competition is increasing. The Australian market has also seen a number of new entrants (Devondale, Blackmores, Faulding, Nature's Way) looking to capitalize on strong Chinese demand. Branding is critical and we expect further investments by BAL and A2M to support its growth. The increased regulatory oversight by the Chinese regulatory authorities through the cross-border channel (i.e. product formulation registration, 3 brands per manufacturer) will, however, raise the barriers to entry, insulating more established/larger players to a degree.

Quality, safety and reputational risks

Product quality, safety and brand reputation is critical. Any threats to this will be extremely damaging for any infant formula brand.

Higher breast feeding rates in China

The Chinese government is making a bigger effort to promote breast-feeding rates in China. Over time, we would expect awareness of the benefits of breast feeding to grow with better education which will limit overall market growth, although BAL and A2M's small market share in China still means positive growth opportunities, in our view.

Intellectual property risks for A2M

A number of A2M's competitors have launched competing "containing A2 protein" milks, although with limited success. We note that A2M's ability to source, market and sell A2 only milk is protected by trademarks and patents. The first of A2M's supply chain patents expired in late 2015, although the majority of patents expire by the end of 2023. A2M also has trademark registrations or applications covering 57 territories and has secondary trademarks associated with key beneficial messaging.

Valuation: High-growth prospects not priced in

We use a 50/50 blend of DCF (upside, base, downside) and EV/GCI for our price target methodology. We cross-check this valuation to P/E, PEG and EV/EBITDA vs. BAL and A2M's other high growth, dairy and China-exposed peers.

Exhibit 43: BAL 12-month target price of A$12.00 is based on a 50/50 of: (1) weighted average DCF of our base/upside/downside case and (2) EV/GCI.
Summary of our valuation methodology (A$) – 3 year EPS CAGR (FY16E-FY19E)

BAL		
Methodology	**Metric**	**Comment**
Primary methodology		
(1) Weighted average DCF (WACC 10.2%, Beta 1.2, Rf rate 5%, MRP 5%, TGR 3%)		
Base case (50%)	$11.76	
Upside case (25%)	$15.44	
Downside case (25%)	$8.17	
DCF valuation	$11.78	
(2) EV/GCI		
EV/GCI (x)	11.3	Versus high CROCI consumer, retail, healthcare peers
3 year average GCI (A$mn)	101	
Implied EV (A$mn)	1,139	
Adjusted for FY17E net debt (A$mn)	-24	
Implied equity value (A$mn)	1,164	
Valuation per share	$12.15	
Blend of (1) and (2) = Target Price	**$12.00**	Rounded

Source: Goldman Sachs Global Investment Research.

Exhibit 44: A2M/ATM 12-month target prices of A$2.10/NZ$2.20 are based on a 50/50 of: (1) weighted average DCF of our base/upside/downside case and (2) EV/GCI.
Summary of our valuation methodology (A$) – FY16E-FY19E EPS CAGR

A2M		
Methodology	**Metric**	**Comment**
Primary methodology		
(1) Weighted average DCF (WACC 10.2%, Beta 1.15, Rf rate 5%, MRP 5%, TGR 3%)		
Base case (50%)	$2.07	
Upside case (25%)	$2.87	
Downside case (25%)	$1.55	
DCF valuation	$2.14	
(2) EV/GCI		
EV/GCI (x)	7.5	Vs high CROCI consumer, retail, healthcare peers
3 year average GCI (A$mn)	168	
Implied EV (A$mn)	1,260	
Adjusted for FY17E net debt (A$mn)	-69	
Implied equity value (A$mn)	1,329	
Valuation per share	$1.97	
Blend of (1) and (2) = Target Price	**$2.10**	Rounded

Source: Goldman Sachs Global Investment Research.

DCF valuation scenarios

We construct three scenarios based on market share outcomes and margins. Our upside case assumes 1% point of additional market share above our base case, while our downside case assumes growth in-line with the overall online channel. Our upside case assumes margin growth from operating leverage on strong revenues, while our downside case assumes flat margins.

Exhibit 45: BAL – our base/downside/upside cases assume 6.8%/5.0%/7.8% online market share respectively by 2020E
Summary of Base Case, Downside Case and Upside Case (A$mn)

Base Case	2015	2016E	2017E	2018E	2019E	2020E	FY16E - FY18E CAGR (%)	FY16E - FY20E CAGR (%)
BAL market share of Chinese Online IMF market (by value) (%)	2.0%	4.2%	5.4%	6.5%	6.8%	6.8%	25%	13%
BAL market share of Chinese Total IMF market (by value) (%)	0.6%	1.4%	2.0%	2.6%	2.8%	3.0%	36%	20%
BAL Revenues (A$mn)	131.9	258.1	380.0	443.2	486.6	525.6	31%	19%
BAL EBIT (A$mn)	12.9	50.7	76.9	91.6	100.1	108.4	34%	21%
BAL EBIT margin(%)	9.8%	19.7%	20.2%	20.7%	20.6%	20.6%		
Downside Case	**2015**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**FY16E - FY18E CAGR (%)**	**FY16E - FY20E CAGR (%)**
BAL market share of Chinese Online IMF market (by value) (%)	2.0%	4.2%	5.0%	5.0%	5.0%	5.0%	10%	5%
BAL market share of Chinese Total IMF market (by value) (%)	0.6%	1.4%	1.9%	2.0%	2.1%	2.2%	19%	12%
BAL Revenues (A$mn)	131.9	258.1	357.0	360.5	385.9	415.8	18%	13%
BAL EBIT (A$mn)	12.9	50.7	64.3	64.9	69.5	74.9	13%	10%
BAL EBIT margin(%)	9.8%	19.7%	18.0%	18.0%	18.0%	18.0%		
Upside Case	**2015**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**FY16E - FY18E CAGR (%)**	**FY16E - FY20E CAGR (%)**
BAL market share of Chinese Online IMF market (by value) (%)	2.0%	4.2%	6.4%	7.5%	7.8%	7.8%	35%	17%
BAL market share of Chinese Total IMF market (by value) (%)	0.6%	1.4%	2.4%	3.0%	3.3%	3.4%	46%	25%
BAL Revenues (A$mn)	131.9	258.1	434.9	497.1	544.1	587.8	39%	23%
BAL EBIT (A$mn)	12.9	53.3	92.3	112.7	122.9	133.0	45%	26%
BAL EBIT margin(%)	9.8%	20.7%	21.2%	22.7%	22.6%	22.6%		

Source: Company data, Goldman Sachs Global Investment Research.

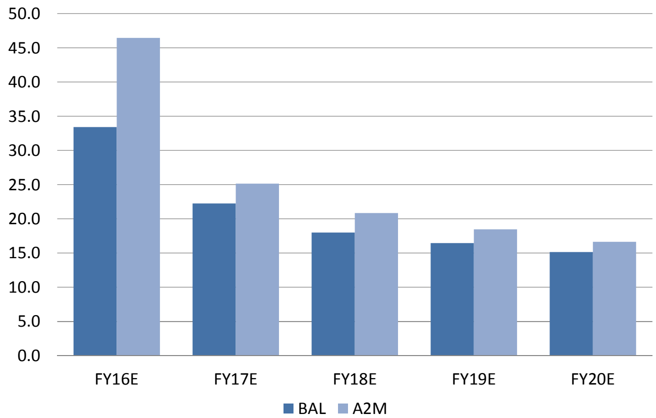
Exhibit 46: A2M – our base/downside/upside cases assume 7.5%/5.6%/8.5% online market share respectively by 2020E
Summary of Base Case, Downside Case and Upside Case (NZ$mn)

Base Case	2015	2016E	2017E	2018E	2019E	2020E	FY16E - FY18E CAGR (%)	FY16E - FY20E CAGR (%)
A2M market share of Chinese Online IMF market (by value) (%)	0.4%	3.9%	5.6%	6.9%	7.4%	7.5%	34%	18%
A2M market share of Chinese Total IMF market (by value) (%)	0.1%	1.3%	2.1%	2.8%	3.1%	3.3%	45%	26%
A2M Revenues (NZ$mn)	154.8	358.5	499.5	613.1	688.8	748.5	31%	20%
A2M EBIT (NZ$mn)	2.9	50.7	92.0	108.8	121.1	132.6	46%	27%
A2M EBIT margin(%)	1.8%	14.1%	18.4%	17.8%	17.6%	17.7%		
Downside Case	**2015**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**FY16E - FY18E CAGR (%)**	**FY16E - FY20E CAGR (%)**
A2M market share of Chinese Online IMF market (by value) (%)	0.4%	3.9%	5.6%	5.6%	5.6%	5.6%	20%	10%
A2M market share of Chinese Total IMF market (by value) (%)	0.1%	1.3%	2.1%	2.2%	2.4%	2.5%	30%	17%
A2M Revenues (NZ$mn)	154.8	358.5	499.5	534.3	573.3	617.1	22%	15%
A2M EBIT (NZ$mn)	2.9	50.7	79.9	85.5	91.8	98.8	30%	18%
A2M EBIT margin(%)	1.8%	14.1%	16.0%	16.0%	16.0%	16.0%		
Upside Case	**2015**	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**FY16E - FY18E CAGR (%)**	**FY16E - FY20E CAGR (%)**
A2M market share of Chinese Online IMF market (by value) (%)	0.4%	3.9%	6.6%	7.9%	8.4%	8.5%	43%	22%
A2M market share of Chinese Total IMF market (by value) (%)	0.1%	1.3%	2.4%	3.2%	3.5%	3.7%	55%	30%
A2M Revenues (NZ$mn)	154.8	358.5	556.7	672.4	752.5	817.6	37%	23%
A2M EBIT (NZ$mn)	2.9	50.7	113.7	139.5	162.4	177.5	66%	37%
A2M EBIT margin(%)	1.8%	14.1%	20.4%	20.8%	21.6%	21.7%		

Source: Company data, Goldman Sachs Global Investment Research.

Exhibit 47: Our 12-month target prices imply 22x/25x for BAL/A2M on FY17E P/E

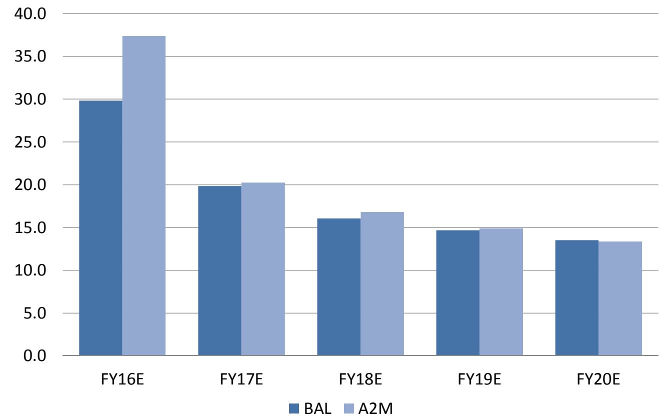
A2M/BAL implied P/Es at our 12M-PT



Source: Goldman Sachs Global Investment Research.

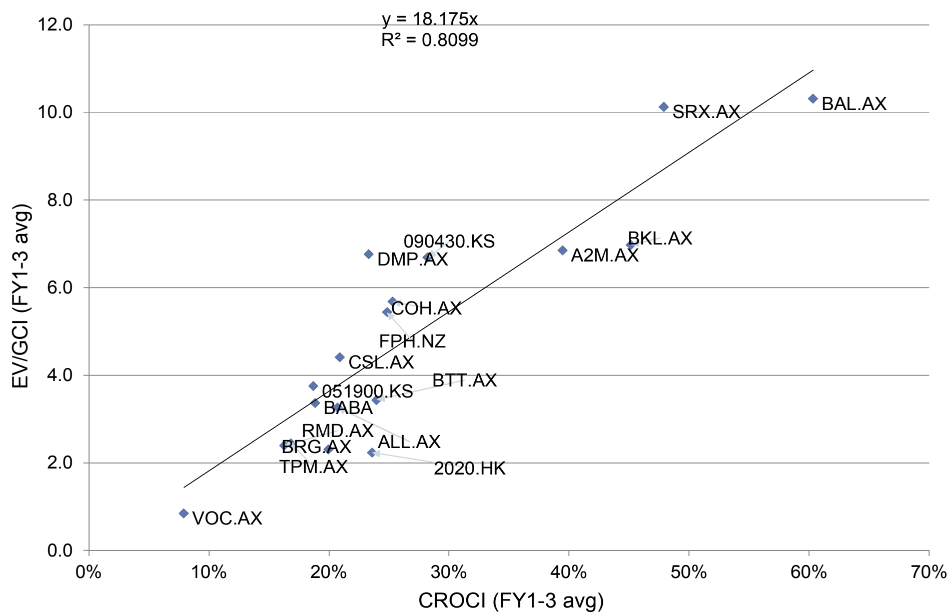
Exhibit 48: At current prices, BAL/A2M is trading on 20x/20x FY17E

A2M/BAL P/Es at current prices



Source: Goldman Sachs Global Investment Research.

Exhibit 49: EV/GCI vs CROCI – High CROCI consumer, retail and healthcare peers



Source: Goldman Sachs Global Investment Research.

Exhibit 50: We believe valuations for BAL and A2M's growth prospects/risk profile are attractive versus its peers
Benchmarking to peers

Company Name	Ticker	Local currency	Mkt Cap. (LC$mn)	% growth - FY15-FY18E CAGR Rev	EBITDA	EPS	EBITDA margin FY2	P/E FY16E	P/E FY17E	PEG FY16E	PEG FY17E	EV/EBITDA FY16E	EV/EBITDA FY17E	ROE (%) FY1
Bellamy's Organic	BAL.AX	AUD	995.7	52.3%	94.1%	89.4%	20%	30.0x	20.0x	0.3x	0.2x	16.9x	16.8x	56%
A2 Milk *	A2M.AX	NZD	1,093	58.2%	187.5%	49.2%	15%	37.7x	20.4x	0.8x	0.4x	47.6x	17.3x	34%
GLOBAL AND DAIRY PEERS														
Global IMF players														
Danone	DANO.PA	EUR	37,228	3.7%	3.4%	4.6%	18%	20.9x	20.4x	4.5x	4.4x	11.6x	11.4x	14%
Mead Johnson	MJN	USD	16,310	0.7%	4.3%	7.9%	27%	25.6x	23.6x	3.2x	3.0x	17.3x	16.0x	
Nestle S.A.	NESN.S	SFr	227,383	3.1%	1.9%	4.7%	19%	22.0x	20.9x	4.7x	4.4x	13.9x	14.1x	16%
Kraft Heinz Company (The)	KHC	USD	104,738	0.6%	10.8%	18.2%	29%	26.4x	22.8x	1.5x	1.3x	16.7x	16.0x	7%
MEDIAN				**1.9%**	**3.9%**	**6.3%**	**23%**	**23.8x**	**21.8x**	**3.9x**	**3.7x**	**15.3x**	**15.1x**	**14%**
China IMF players														
Biostime International Holdings Ltd	1112.HK	HKD	16,388	20.4%	83.5%	58.6%	24%	39.7x	18.3x	0.7x	0.3x	38.7x	11.9x	16%
Beingmate Baby & Child Food Co Ltd	001250.SZ	CNY	13,221	n.a.	n.a.	n.a.	8%	111.9x	54.0x	n.m.	n.m.	53.3x	32.4x	4%
Yashili International Holdings Ltd	1230.HK	HKD	7,925	26.9%	105.0%	42.4%	9%	41.9x	27.1x	1.0x	0.6x	34.5x	10.2x	4%
MEDIAN				**23.7%**	**94.2%**	**50.5%**	**9%**	**41.9x**	**27.1x**	**0.8x**	**0.5x**	**38.7x**	**11.9x**	**4%**
Dairy producers														
Fonterra Co-operative Group Ltd	FSF.NZ	NZD	8,799	7.0%	15.7%	23.8%	11%	11.1x	10.8x	0.5x	0.5x	8.7x	8.2x	13%
Synlait Milk Ltd	SYN.NZ	NZD	461	18.5%	33.2%	n.m	15%	17.2x	12.9x	n.m.	n.m.	10.2x	8.4x	16%
Bega Cheese Ltd	BGA.AX	AUD	894	6.2%	28.3%	24.8%	6%	30.5x	24.6x	1.2x	1.0x	14.4x	12.3x	9%
Saputo Inc	SAP.TO	CAD	15,014	3.0%	7.9%	10.6%	11%	23.6x	21.0x	2.2x	2.0x	14.0x	12.8x	16%
MG Unit Trust	MGC.AX	AUD	247	3.8%	26.9%	n.m	5%	16.3x	12.4x	n.m.	n.m.	6.5x	5.2x	4%
MEDIAN				**6.2%**	**26.9%**	**23.8%**	**11%**	**17.2x**	**12.9x**	**1.2x**	**1.0x**	**10.2x**	**8.4x**	**13%**
China dairy														
China Mengniu Dairy Co Ltd	2319.HK	HKD	50,794	6.2%	9.0%	8.7%	9%	17.8x	16.7x	2.0x	1.9x	10.6x	9.8x	10%
Inner Mongolia Yili Industrial Group Co Ltd	600887.SS	CNY	99,402	9.3%	14.9%	14.1%	12%	20.8x	17.8x	1.5x	1.3x	13.4x	11.6x	24%
China Huishan Dairy Holdings Co Ltd	6863.HK	HKD	42,586	17.2%	12.0%	13.6%	32%	n.m.	n.m. .	n.m.	n.m.	29.8x	27.0x	8%
China Modern Dairy Holdings Ltd	1117.HK	HKD	6,631	7.5%	5.6%	(2.4%)	25%	7.7x	8.4x	-3.2x	-3.5x	8.4x	8.2x	7%
China Shengmu Organic Milk Ltd	1432.HK	HKD	10,358	12.2%	18.1%	10.6%	41%	10.9x	8.7x	1.0x	0.8x	7.5x	5.8x	17%
MEDIAN				**9.3%**	**12.0%**	**10.6%**	**25%**	**14.4x**	**12.7x**	**1.3x**	**1.0x**	**10.6x**	**9.8x**	**10%**
DOMESTIC PEERS														
Australian China export peers														
Blackmores Ltd	BKL.AX	AUD	2,323	22.3%	34.0%	38.6%	22%	23.2x	19.8x	0.6x	0.5x	14.9x	12.9x	72%
Vitaco Holdings Ltd	VIT.AX	AUD	218	15.3%	18.0%	n.m	11%	16.0x	14.0x	n.m.	n.m.	15.9x	10.6x	5%
Freedom Foods Group Ltd	FNP.AX	AUD	734	43.7%	55.5%	39.5%	15%	53.3x	36.2x	1.3x	0.9x	21.3x	18.2x	28%
MEDIAN			**734**	**22.3%**	**34.0%**	**38.6%**	**14.6%**	**23.2x**	**19.8x**	**0.6x**	**0.5x**	**15.9x**	**12.9x**	**27.7%**
Australian high growth peers														
Sirtex Medical	SRX.AX	AUD	1,534	22.9%	33.1%	28.0%	31%	29.3x	22.1x	1.0x	0.8x	19.4x	14.5x	32%
Domino's Pizza Enterprises Ltd	DMP.AX	AUD	5,923	23.4%	29.0%	31.6%	20%	63.9x	49.2x	2.0x	1.6x	33.4x	25.4x	29%
BT investment Management Ltd	BTT.AX	AUD	2,952	11.3%	14.5%	13.2%	40%	18.9x	17.7x	1.4x	1.3x	13.8x	13.1x	20%
Corporate Travel Management Ltd	CTD.AX	AUD	1,428	24.2%	28.2%	32.3%	26%	33.5x	26.1x	1.0x	0.8x	20.3x	15.8x	17%
IRESS Ltd	IRE.AX	AUD	1,940	10.5%	12.0%	14.1%	31%	27.8x	24.4x	2.0x	1.7x	18.3x	16.3x	21%
Carsales.com Ltd	CAR.AX	AUD	2,985	8.8%	9.5%	7.6%	50%	27.3x	24.4x	3.6x	3.2x	18.4x	16.8x	46%
OzForex Group Ltd	OFX.AX	AUD	536	15.2%	19.5%	10.4%	32%	21.4x	20.2x	2.1x	1.9x	10.7x	11.6x	51%
Cochlear Ltd	COH.AX	AUD	6,875	12.4%	15.8%	23.8%	29%	35.7x	30.4x	1.5x	1.3x	21.1x	18.4x	49%
iSentia Group Ltd	ISD.AX	AUD	719	15.4%	16.0%	15.1%	33%	22.2x	19.6x	1.5x	1.3x	14.9x	13.0x	24%
TPG Telecom Ltd	TPM.AX	AUD	9,885	29.3%	27.3%	24.3%	33%	27.6x	23.0x	1.1x	0.9x	14.1x	12.5x	25%
MEDIAN			**2,446**	**15.3%**	**17.8%**	**19.4%**	**32%**	**27.7x**	**23.7x**	**1.5x**	**1.3x**	**18.3x**	**15.1x**	**27%**
DOMESTIC MEDIAN			**1,940**	**15.4%**	**19.5%**	**23.8%**	**31%**	**27.6x**	**23.0x**	**1.5x**	**1.3x**	**18.3x**	**14.5x**	**28%**
Small Industrials						9.2%		15.9x	14.8x	1.7x	1.6x	9.9x	9.2x	
ASX 200 Industrials						3.8%		20.2x	18.1x	5.3x	4.7x	10.6x	9.8x	

* A2 Milk FY16E - FY18E EPS CAGR

Source: Goldman Sachs Global Investment Research (for Bellamy's, A2Milk, Danone, Mead Johnson, Nestle, Kraft, Blackmores, Sirtex, Domino's, BT, Cochlear and TPG Telecom), Bloomberg for all others.

A2Milk (A2M.AX/ATM.NZ): Initiate with CL-Buy

Source of opportunity

We initiate on A2M with a Buy rating and add it to our ANZ Conviction List. Our 12-month price targets of A$2.10/NZ$2.20 suggest potential upside of 25%, including dividend. A2M has been gaining share in the branded milk category in Australia, and more recently has seen outsized growth in infant formula revenues from Chinese consumers.

We forecast continued market share gains in China and believe the market has yet to recognize the multi-year growth opportunity that China represents for A2M.

Catalyst

We expect A2M to deliver revenue and earnings growth above market expectations as it expands its reach in China, mainly through online channels (largely indirect via Australia, but increasingly direct to China) as cross-border e-commerce penetration grows and Chinese consumers increasingly look for premium niche alternatives. Its manufacturing partner Synlait has, in our view, sufficient processing capacity and raw ingredient supply to meet our FY16-18E forecasts.

Valuation

Our 12-month price target of A$2.10 is based on a 50/50 blend of DCF and FY17 EV/GCI vs. CROCI. We forecast 36% EPS CAGR over the next 3 years (FY16E to FY19E), implying a PEG of 0.55x on FY17E/FY18E P/E of 20x/17x. For ATM.NZ, we also have a CL-Buy and translate the A$ target price to NZ$ at spot rates. This gives a 12-month target price of NZ$2.20.

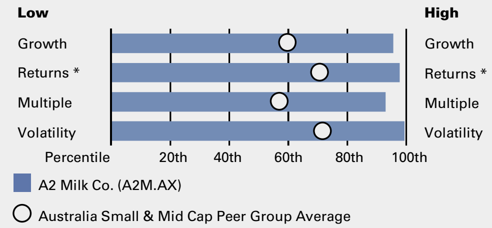
Key risks

Key risks: (-) Safety and quality risks given A2M contracts exclusively with Synlait for manufacture; intense competition from other foreign brands; adverse regulatory outcomes in China.

INVESTMENT LIST MEMBERSHIP
Australia & New Zealand Buy list
Australia & New Zealand Conviction Buy list

Coverage View: Neutral

Investment Profile

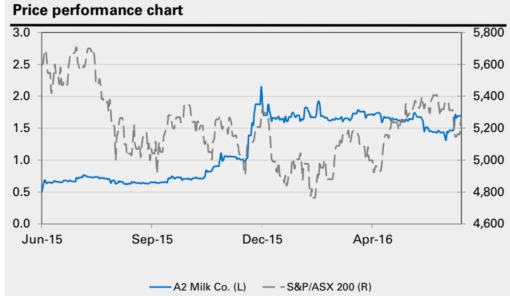


* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (A$)	1.70
12 month price target (A$)	2.10
Market cap (A$ mn)	1,093.2

	6/15	6/16E	6/17E	6/18E
NPAT preNRIs (NZ$ mn)	(0.9)	32.8	63.3	76.2
EPS adj (NZ¢)	(0.1)	4.7	8.7	10.5
EPS growth (%)	(9,059.5)	3,558.6	84.7	20.5
PER (X)	NM	37.5	20.3	16.9
DPS (NZ¢)	0.0	0.0	4.5	6.3
Dividend yield (%)	0.0	0.0	2.5	3.6
Frank/Imput (%)	100.0	100.0	100.0	100.0
P/FCFPS (X)	(39.5)	168.3	40.4	31.2
EV/EBITDA (X)	73.2	21.9	12.6	10.6
P/BV (X)	6.3	9.7	7.8	6.6
Avg shares (fd) (mn)	643.1	691.7	723.3	723.3
Debt/equity (%)	--	--	--	--

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	(1.7)	22.7	233.3
Rel. to S&P/ASX 200	(3.1)	19.2	254.9

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 6/20/2016 close.

A2 Milk Co.: Summary financials

Profit model (NZ$ mn)	6/15	6/16E	6/17E	6/18E
Total revenue	**154.8**	**358.5**	**499.5**	**613.1**
Cost of goods sold	(100.4)	(200.8)	(274.7)	(337.2)
SG&A	(49.9)	(104.5)	(128.4)	(161.7)
R&D	--	--	--	--
Other operating profit/(expense)	0.3	0.3	0.1	0.2
EBITDA	**4.8**	**53.6**	**96.5**	**114.4**
Depreciation & amortization	(1.9)	(2.9)	(4.5)	(5.5)
EBIT	**2.9**	**50.7**	**92.0**	**108.8**
Interest income	0.2	0.2	1.4	1.8
Interest expense	(0.0)	0.0	0.0	0.0
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Pretax profits	**3.0**	**50.9**	**93.4**	**110.7**
Income tax	(3.8)	(18.1)	(30.1)	(34.4)
Minorities	0.0	0.0	0.0	0.0
Net income pre-preferred dividends	**(0.9)**	**32.8**	**63.3**	**76.2**
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**(0.9)**	**32.8**	**63.3**	**76.2**
Post-tax exceptionals	(1.2)	0.0	0.0	0.0
Net income	**(2.1)**	**32.8**	**63.3**	**76.2**
EPS (basic, pre-except) (NZ¢)	(0.1)	4.7	8.7	10.5
EPS (basic, post-except) (NZ¢)	(0.3)	4.7	8.7	10.5
EPS (diluted, post-except) (NZ¢)	(0.3)	4.7	8.7	10.5
DPS (NZ¢)	0.0	0.0	4.5	6.3
Dividend payout ratio (%)	0.0	0.0	51.3	60.0
Free cash flow yield (%)	(3.3)	0.6	2.5	3.2

Balance sheet (NZ$ mn)	6/15	6/16E	6/17E	6/18E
Cash & equivalents	6.1	55.0	72.6	75.0
Accounts receivable	39.9	93.2	129.9	159.4
Inventory	4.8	14.3	35.0	61.3
Other current assets	9.7	9.7	9.7	9.7
Total current assets	**60.5**	**172.2**	**247.1**	**305.4**
Net PP&E	9.3	9.3	9.3	9.3
Net intangibles	17.2	17.2	17.2	17.2
Total investments	0.0	0.0	0.0	0.0
Other long-term assets	1.8	1.8	1.8	1.8
Total assets	**88.9**	**200.6**	**275.4**	**333.7**
Accounts payable	28.4	65.7	91.5	112.3
Short-term debt	0.0	0.0	0.0	0.0
Other current liabilities	0.6	0.6	18.0	25.0
Total current liabilities	**29.0**	**66.3**	**109.5**	**137.3**
Long-term debt	0.0	0.0	0.0	0.0
Other long-term liabilities	1.3	1.3	1.3	1.3
Total long-term liabilities	1.3	1.3	1.3	1.3
Total liabilities	**30.2**	**67.6**	**110.8**	**138.6**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**58.6**	**133.0**	**164.6**	**195.1**
Minority interest	0.0	0.0	0.0	0.0
Total liabilities & equity	**88.9**	**200.6**	**275.4**	**333.7**
BVPS (NZ¢)	**8.9**	**18.4**	**22.8**	**27.0**

Growth & margins (%)	6/15	6/16E	6/17E	6/18E
Sales growth	39.9	131.6	39.3	22.7
EBITDA growth	34.9	1,014.1	80.1	18.5
EBIT growth	71.7	NM	81.4	18.3
Net income growth	NM	NM	93.2	20.5
EPS growth	(21,511.7)	1,547.2	84.7	20.5
Gross margin	35.2	44.0	45.0	45.0
EBITDA margin	3.1	14.9	19.3	18.7
EBIT margin	1.8	14.1	18.4	17.8

Ratios	6/15	6/16E	6/17E	6/18E
CROCI (%)	3.7	34.9	42.1	41.4
ROE (%)	(3.6)	34.2	42.5	42.4
ROA (%)	(2.5)	22.6	26.6	25.0
ROACE (%)	(2.0)	50.0	73.3	70.7
Inventory days	19.0	17.4	32.8	52.1
Receivables days	79.3	67.8	81.5	86.1
Payable days	84.0	85.5	104.4	110.3
Net debt/equity (%)	(10.4)	(41.4)	(44.1)	(38.4)
Interest cover - EBIT (X)	NM	NM	NM	NM

Cash flow statement (NZ$ mn)	6/15	6/16E	6/17E	6/18E
Net income pre-preferred dividends	(0.9)	32.8	63.3	76.2
D&A add-back	1.9	2.9	4.5	5.5
Minorities interests add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	(10.4)	(25.5)	(31.4)	(35.1)
Other operating cash flow	1.3	0.0	0.0	0.0
Cash flow from operations	**(8.1)**	**10.2**	**36.3**	**46.7**
Capital expenditures	(3.6)	(2.9)	(4.5)	(5.5)
Acquisitions	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Cash flow from investments	**(3.6)**	**(2.9)**	**(4.5)**	**(5.5)**
Dividends paid (common & pref)	0.0	0.0	(14.2)	(38.8)
Inc/(dec) in debt	0.0	0.0	0.0	0.0
Common stock issuance (repurchase)	0.0	41.6	0.0	0.0
Other financing cash flows	0.0	0.0	0.0	0.0
Cash flow from financing	**0.0**	**41.6**	**(14.2)**	**(38.8)**
Total cash flow	**(9.9)**	**48.9**	**17.6**	**2.4**

Valuation	6/15	6/16E	6/17E	6/18E
P/E (analyst) (X)	NM	37.5	20.3	16.9
P/B (X)	6.3	9.7	7.8	6.6
EV/EBITDA (X)	73.2	21.9	12.6	10.6
EV/GCI (X)	5.6	8.4	6.9	5.7
Dividend yield (%)	0.0	0.0	2.5	3.6

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

Bellamy's Australia Limited (BAL.AX): Initiate with Neutral

Source of opportunity

We initiate on BAL.AX with a Neutral rating. Our 12-month price target of A$12.00 suggests 12% potential return, including dividend. BAL is a pure play infant formula/baby food company. Its Australia-made and organic credentials are popular among Chinese consumers, delivering outsized revenue growth in the last two years. We forecast continued market share gains in China but see this as already captured in the market's estimates.

Growth drivers

We expect BAL to deliver strong revenue and earnings growth as it expands its reach in China, mainly through online channels (largely indirect via Australia, but increasingly direct to China) as cross-border e-commerce penetration grows and Chinese consumers increasingly look for premium niche alternatives. Compared to A2M, however, we believe its organic milk supply requirements could pose a greater constraint to growth, both in volumes and in gross margin. Our FY17E-18E forecasts also sit -13%/-22% below consensus (Bloomberg) but we note that recent share price underperformance (-30% from the peak in December 2015) means that this downside risk is already partly captured in market expectations.

Valuation

Our 12-month price target of A$12.00 is based on a 50/50 blend of DCF and FY17 EV/GCI vs. CROCI. We forecast 25% EPS CAGR over the next 3 years, implying a PEG of 0.74x on FY17E/FY18E P/E of 19x/16x.

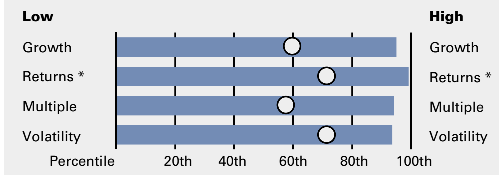
Key risks

Key risks: (-) Raw ingredient shortfalls vs. market expectations; higher raw ingredient costs; competition from other organic/foreign brands; adverse regulatory outcomes in China. (+) Strong demand from Chinese consumers.

INVESTMENT LIST MEMBERSHIP
Neutral

Coverage View: Neutral

Investment Profile

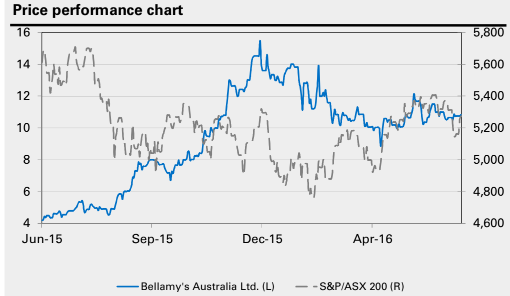


* Returns = Return on Capital For a complete description of the investment profile measures please refer to the disclosure section of this document.

Key data	Current
Price (A$)	10.84
12 month price target (A$)	12.00
Market cap (A$ mn)	1,003.1

	6/15	6/16E	6/17E	6/18E
NPAT preNRIs (A$ mn)	9.1	35.9	54.3	64.5
EPS adj (A¢)	9.8	37.5	56.2	66.7
EPS growth (%)	404.5	282.2	50.0	18.6
PER (X)	22.7	28.9	19.3	16.2
DPS (A¢)	2.9	10.5	28.2	40.0
Dividend yield (%)	1.3	1.0	2.6	3.7
Frank/Imput (%)	0.0	100.0	100.0	100.0
P/FCFPS (X)	46.0	71.0	152.0	26.0
EV/EBITDA (X)	13.7	19.4	13.0	10.9
P/BV (X)	4.3	14.1	10.3	8.2
Avg shares (fd) (mn)	92.5	95.8	96.6	96.6
Debt/equity (%)	(65.0)	(52.5)	(27.1)	(27.8)

Price performance chart



Share price performance (%)	3 month	6 month	12 month
Absolute	1.5	(21.0)	161.2
Rel. to S&P/ASX 200	(0.6)	(23.5)	177.2

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 6/21/2016 close.

Bellamy's Australia Ltd.: Summary financials

Profit model (A$ mn)	6/15	6/16E	6/17E	6/18E
Total revenue	**125.3**	**258.1**	**380.0**	**443.2**
Cost of goods sold	(84.1)	(149.8)	(224.4)	(266.1)
SG&A	(28.9)	(57.6)	(78.9)	(85.6)
R&D	--	--	--	--
Other operating profit/(expense)	0.0	0.2	0.2	0.2
EBITDA	**12.7**	**51.7**	**78.2**	**93.2**
Depreciation & amortization	(0.4)	(0.9)	(1.4)	(1.6)
EBIT	**12.3**	**50.7**	**76.9**	**91.6**
Interest income	0.7	0.8	1.0	0.7
Interest expense	(0.1)	(0.2)	(0.2)	(0.2)
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Pretax profits	**13.0**	**51.3**	**77.6**	**92.1**
Income tax	(3.9)	(15.4)	(23.3)	(27.6)
Minorities	0.0	0.0	0.0	0.0
Net income pre-preferred dividends	**9.1**	**35.9**	**54.3**	**64.5**
Preferred dividends	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	**9.1**	**35.9**	**54.3**	**64.5**
Post-tax exceptionals	0.0	0.0	0.0	0.0
Net income	**9.1**	**35.9**	**54.3**	**64.5**
EPS (basic, pre-except) (A¢)	9.8	37.5	56.2	66.7
EPS (basic, post-except) (A¢)	9.8	37.5	56.2	66.7
EPS (diluted, post-except) (A¢)	9.8	37.5	56.2	66.7
DPS (A¢)	2.9	10.5	28.2	40.0
Dividend payout ratio (%)	29.2	28.0	50.2	60.0
Free cash flow yield (%)	2.1	1.4	0.7	3.8

Balance sheet (A$ mn)	6/15	6/16E	6/17E	6/18E
Cash & equivalents	32.0	39.1	27.7	35.5
Accounts receivable	20.9	42.9	71.7	92.9
Inventory	17.1	35.2	67.7	79.0
Other current assets	0.6	0.6	0.6	0.6
Total current assets	**70.7**	**117.9**	**167.7**	**208.0**
Net PP&E	0.6	0.8	0.8	0.8
Net intangibles	0.1	0.1	0.1	0.1
Total investments	0.0	0.0	0.0	0.0
Other long-term assets	1.0	1.0	1.0	1.0
Total assets	**72.4**	**119.8**	**169.7**	**210.0**
Accounts payable	19.1	37.9	51.8	55.8
Short-term debt	0.1	0.1	0.1	0.1
Other current liabilities	3.8	7.3	16.1	26.6
Total current liabilities	**23.1**	**45.3**	**68.0**	**82.5**
Long-term debt	0.1	0.1	0.1	0.1
Other long-term liabilities	0.3	0.3	0.3	0.3
Total long-term liabilities	0.4	0.4	0.4	0.4
Total liabilities	**23.5**	**45.8**	**68.4**	**82.9**
Preferred shares	**0.0**	**0.0**	**0.0**	**0.0**
Total common equity	**48.9**	**74.0**	**101.2**	**127.0**
Minority interest	0.0	0.0	0.0	0.0
Total liabilities & equity	**72.4**	**119.8**	**169.7**	**210.0**
BVPS (A¢)	**51.5**	**76.6**	**104.7**	**131.4**

Growth & margins (%)	6/15	6/16E	6/17E	6/18E
Sales growth	156.3	105.9	47.3	16.6
EBITDA growth	447.0	305.7	51.5	19.1
EBIT growth	497.0	312.9	51.5	19.2
Net income growth	616.7	295.8	51.3	18.6
EPS growth	404.5	282.2	50.0	18.6
Gross margin	32.9	41.9	41.0	40.0
EBITDA margin	10.2	20.0	20.6	21.0
EBIT margin	9.8	19.7	20.2	20.7

Ratios	6/15	6/16E	6/17E	6/18E
CROCI (%)	40.5	59.7	62.6	60.2
ROE (%)	28.1	58.4	62.0	56.5
ROA (%)	19.1	37.4	37.5	34.0
ROACE (%)	59.9	135.9	98.8	77.5
Inventory days	54.0	63.8	83.7	100.6
Receivables days	39.8	45.1	55.0	67.8
Payable days	55.6	69.4	73.0	73.8
Net debt/equity (%)	(65.0)	(52.5)	(27.1)	(27.8)
Interest cover - EBIT (X)	NM	NM	NM	NM

Cash flow statement (A$ mn)	6/15	6/16E	6/17E	6/18E
Net income pre-preferred dividends	9.1	35.9	54.3	64.5
D&A add-back	0.4	0.9	1.4	1.6
Minorities interests add-back	0.0	0.0	0.0	0.0
Net (inc)/dec working capital	(8.5)	(21.3)	(47.4)	(28.5)
Other operating cash flow	3.7	0.0	0.0	4.3
Cash flow from operations	**4.7**	**15.5**	**8.2**	**41.9**
Capital expenditures	(0.4)	(1.1)	(1.4)	(1.6)
Acquisitions	0.0	0.0	0.0	0.0
Divestitures	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
Cash flow from investments	**(0.4)**	**(1.1)**	**(1.4)**	**(1.6)**
Dividends paid (common & pref)	0.0	(7.3)	(18.4)	(32.5)
Inc/(dec) in debt	(0.2)	0.0	0.0	0.0
Common stock issuance (repurchase)	23.4	0.0	0.0	0.0
Other financing cash flows	0.0	0.0	0.0	0.0
Cash flow from financing	**23.2**	**(7.3)**	**(18.4)**	**(32.5)**
Total cash flow	**27.6**	**7.1**	**(11.5)**	**7.8**

Valuation	6/15	6/16E	6/17E	6/18E
P/E (analyst) (X)	22.7	28.9	19.3	16.2
P/B (X)	4.3	14.1	10.3	8.2
EV/EBITDA (X)	13.7	19.4	13.0	10.9
EV/GCI (X)	3.6	13.3	9.9	7.7
Dividend yield (%)	1.3	1.0	2.6	3.7

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

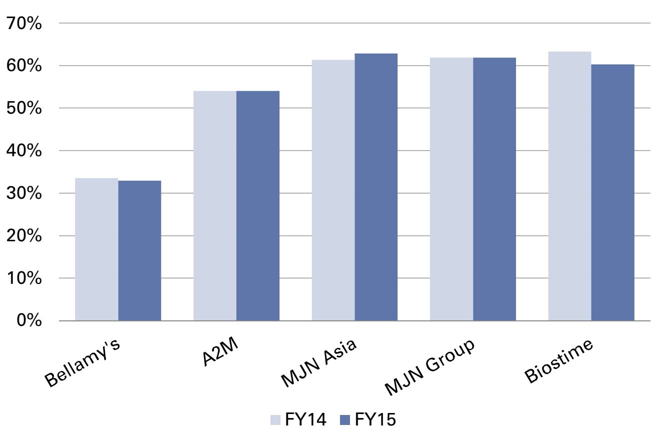
Financials: Asset light businesses generate high returns

Asset/capital returns are high for both given both operate a fully outsourced, cash generative and low-debt business model. We note the following:

1. **Net cash:** Both have net cash positions. BAL of A$32mn at end of FY15, A2M of A$6mn at end of FY15.
2. **Limited PP&E and intangible assets:** BAL/ A2M carry minimal PP&E on balance sheet given fully outsourced model. Its intangible assets largely relate to IP and trademarks.
3. **Limited provisions on balance sheet**
4. BAL/A2M should deliver good **cashflow conversion** given minimal provisions or capitalized expenses. We note the following:
   - **Working capital drag from inventory build and less attractive debtor terms:** We expect BAL's/A2M's working capital requirements, more specifically the need to improve its supply and inventory position, to be a drag on cashflow. As it grows, we also expect their mix of customers to skew larger (i.e. to those that enjoy more generous payment terms). We also expect BAL may have to shorten payment terms to creditors to secure supply
   - **Limited capex requirements**
   - **Dividend payout ratio** of 30% in FY16E, increasing to 70% in FY19E for BAL. Whilst ATM has historically not paid a dividend, given its strong cash flow generation ability, we think that it could sustain a dividend payout ratio of 50%-70%, based on its low capex requirements.

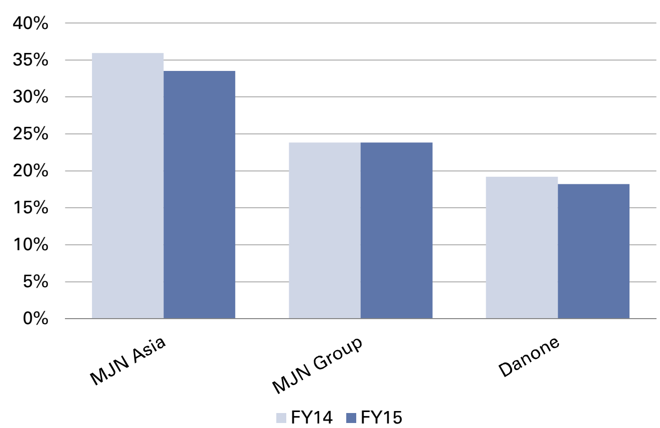
Benchmarking margins to peers

Exhibit 51: Most vertically integrated infant formula companies have gross margins of c.60%
Gross margins – infant formula (%)



Source: Company data, Goldman Sachs Global Investment Research.

Exhibit 52: The larger, more vertically integrated players have operating margins of 15-35%
Operating margins – infant formula (%)



Source: Company data, Goldman Sachs Global Investment Research.

Exhibit 53: China to drive near term sales and EBIT growth – Bellamy's financials
Sales and EBIT breakdown by country

Fiscal Year to 30 June (AUD mn)	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Gross Sales - reported							
Australia	11.7	20.8	41.4	107.0	221.8	317.4	372.8
-Consumed in Australia	11.7	19.7	29.0	48.2	62.6	76.4	83.7
-Consumed in China	0.0	1.0	12.4	58.9	159.1	240.9	289.1
China/Hong Kong	3.8	5.1	5.4	14.1	31.1	56.3	63.1
South East Asia	2.1	2.7	2.1	4.1	5.2	6.4	7.2
Group	**17.6**	**28.6**	**48.9**	**125.3**	**258.1**	**380.0**	**443.2**
Total sales to Chinese consumers	**3.8**	**6.2**	**17.8**	**73.0**	**190.2**	**297.2**	**352.2**
% of Total Sales	22%	22%	36%	58%	74%	78%	79%
Sales Growth							
Australia		78%	99%	159%	107%	43%	17%
China/Hong Kong		34%	6%	160%	120%	81%	12%
South East Asia		31%	-23%	97%	26%	23%	13%
Group		**63%**	**71%**	**156%**	**106%**	**47%**	**17%**
EBIT							
Australia			3.8	13.0	35.7	54.1	67.3
China/Hong Kong			0.2	0.4	14.9	22.5	24.0
South East Asia			0.2	0.7	0.2	0.3	0.4
Corporate			-2.1	-1.8	0.0	0.0	0.0
Group	1.9	4.5	2.1	12.3	50.7	76.9	91.6
EBIT Margin (EBIT less Other Income/Gross Sales)							
Australia			9%	12%	16%	17%	18%
China/Hong Kong			3%	3%	48%	40%	38%
South East Asia			7%	17%	3%	4%	5%
Group	**11%**	**16%**	**4%**	**10%**	**20%**	**20%**	**21%**

Source: Company data, Goldman Sachs Global Investment Research.

Exhibit 54: Like BAL, we expect China to drive near term sales and EBIT growth for A2M
Sales and EBIT breakdown by country

Fiscal Year to 30 June (NZD mn)	FY12	FY13	FY14	FY15	FY16E	FY17E	FY18E
Total Sales - reported							
Australia	64.0	92.7	106.9	149.1	321.9	429.4	518.0
-Consumed in Australia	64.0	92.7	106.9	136.5	161.6	172.2	194.5
-Consumed in China	0.0	0.0	0.0	12.6	160.3	257.2	323.5
China - Direct	0.0	2.0	2.7	4.0	31.2	63.3	87.3
UK and USA	0.0	0.0	1.1	1.9	5.8	6.9	8.0
Group	**64.0**	**94.7**	**110.7**	**155.1**	**358.9**	**499.6**	**613.3**
Sales Growth							
Australia		45%	15%	40%	116%	33%	21%
China - Direct		n.m.	39%	47%	671%	103%	38%
UK and USA		n.m.	n.m.	74%	200%	20%	15%
Group		**48%**	**17%**	**40%**	**131%**	**39%**	**23%**
Total sales to Chinese consumers	**0.0**	**2.0**	**2.7**	**16.7**	**191.4**	**320.5**	**410.8**
% of Total Sales	0%	2%	2%	11%	53%	64%	67%
Other Income	1.6	0.4	0.2	0.3	0.3	0.1	0.2
Gross Sales	**62.5**	**94.3**	**110.5**	**154.8**	**358.5**	**499.5**	**613.1**
EBITDA							
Australia	5.2	10.4	18.7	30.0	78.6	118.3	131.5
China - Direct	0.0	-0.1	-3.3	-3.1	5.6	13.3	19.2
UK and USA	0.0	-0.2	-4.3	-12.1	-11.6	-10.4	-8.0
Corporate	0.1	-0.2	-7.5	-10.0	-19.0	-24.7	-28.4
Group	5.3	9.8	3.6	4.8	53.6	96.5	114.4
EBITDA Margin							
Australia	8%	11%	17%	20%	24%	28%	25%
China - Direct	n.m.	-7%	-120%	-77%	18%	21%	22%
UK and USA	n.m.	n.m.	-388%	-627%	-200%	-150%	-100%
Group	**8%**	**10%**	**3%**	**3%**	**15%**	**19%**	**19%**

Source: Company data, Goldman Sachs Global Investment Research.

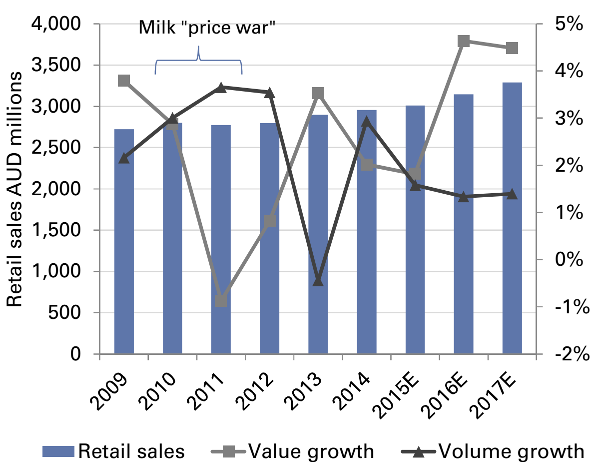
Appendix 1: A2M's dairy businesses in Australia, the US and UK

Australia: Strong share gains in competitive market

Since entering the market in 2007 (initially via JV with Freedom Foods) A2M has reached c. 9% market (by value drinking milk).

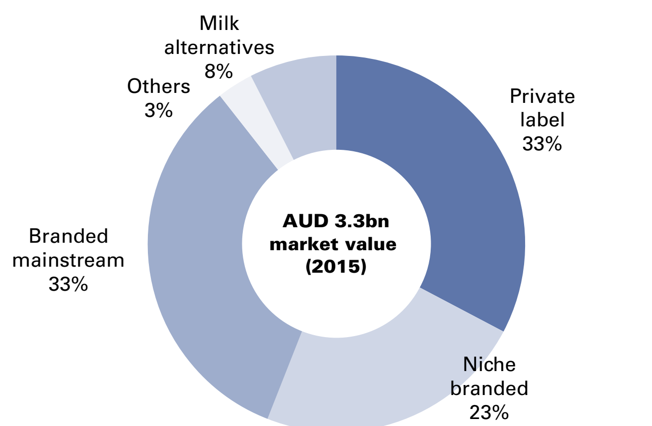
The Australian drinking milk market is valued at A$3.3bn (Euromonitor estimate, 2015). From 2009 to 2014 the drinking milk market grew at a 2.1% CAGR. This modest growth was partly due to intense competition between Australia's two dominant supermarket chains, Coles and Woolworths, cutting the price of white drinking milk to A$1 / litre, which materially impacted value growth.

Exhibit 55: A2M has grown share in a soft market
Australian drinking milk market growth (incl. alternatives)



Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 56: Branded products dominate the Australian market
Milk market value share by category (2015)



Source: Euromonitor, Goldman Sachs Global Investment Research.

A2M has been able to win market share due to:

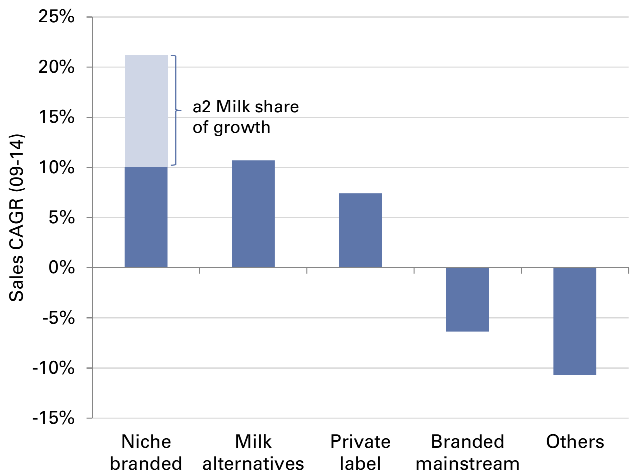
1. Rapid breadth and depth of store penetration

A2M achieved national distribution with Coles and Woolworths (c. 70% combined share of the Australian food retail market) within 2-3 years. Once it achieved store penetration, ATM was able to increase the rate of sale and in-store shelf space rapidly. ATM's premium price point provides retailers a healthy gross margin per sqm in a commoditised product category which helps drive larger shelf space.

2. Combined with brand development through consumer education and advertising

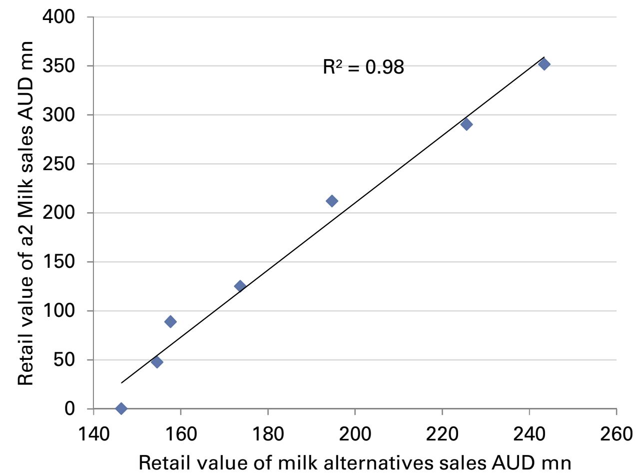
A2M developed a differentiated brand through consumer education and TV advertising (Thank you A2 campaign), spending 5% of sales on marketing, which justifies its premium pricing.

Exhibit 57: Niche branded and milk alternatives have led in growth …
Retail CAGR (2009-2015) by milk category



Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 58: … and ATM sales demonstrate a strong relationship to milk alternatives
a2 Milk retail sales vs. milk alternative sales



Source: Euromonitor, Goldman Sachs Global Investment Research.

UK – Private label dominance means challenging markets

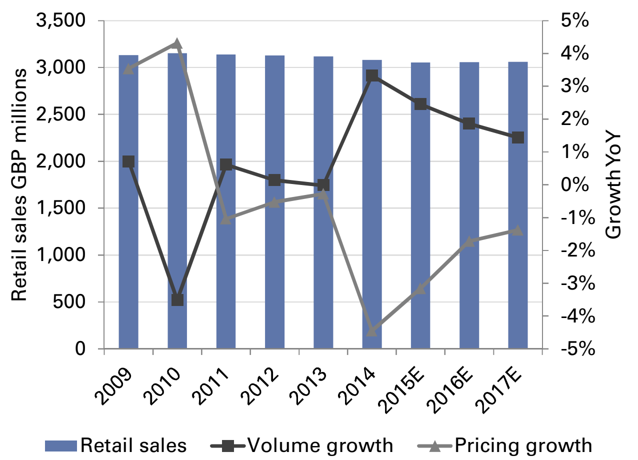
A2M entered the UK market in November 2011 through a 50/50 joint venture with Robert Wiseman Dairies (RWD). In January 2014, following the acquisition of RWD by the Muller Group in early 2012, A2M acquired RWD's interest in the JV.

Since assuming full ownership ATM has established an end-to-end supply chain in the UK and is growing its retail distribution (products sold in Tesco, Waitrose, Morrisons, Ocado, J Sainsbury and Wholefoods). A2M is also repositioning the brand from mainstream to the premium specialty segment.

The UK drinking milk market is worth GBP3.1bn in retail sales (2014, Euromonitor). From 2009-14 the market grew at a -0.1% CAGR, reflecting underlying volume growth of -0.4% and pricing growth of 0.3%. Private label dominates the UK milk market with c.70% market share (2014). This level of market share has been broadly consistent over the last five years.

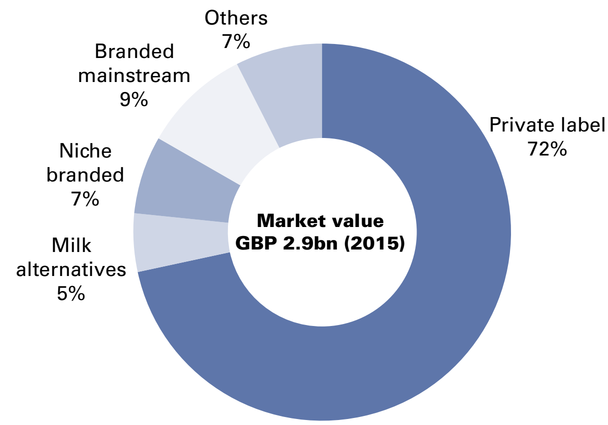
The UK market is less attractive in Australia given: (1) The milk alternatives market in the UK has seen slower growth rates that Australia, although it is still the best performing category in the market; (2) Gross margins are lower in the UK given lower retail prices.

Exhibit 59: The UK is a challenging milk market…
UK liquid milk market growth



Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 60: …Given private label dominates
UK liquid milk market share by value



Source: Euromonitor, Goldman Sachs Global Investment Research.

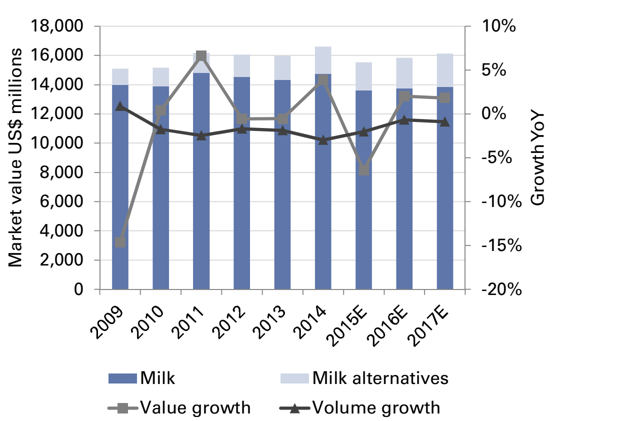
US – Small, niche opportunities, also dominated by private label

A2M started selling A2 Milk in California in H2 FY15. A2M's US business plan assumes an initial investment of c.US$20m over three years to fund market entry and working capital requirements.

Euromonitor estimates that the US drinking milk market is worth US$15.5bn in 2014. From 2009-14 the market grew at a 2.0% CAGR, reflecting underlying volume growth of -2.1% and pricing growth of 4.2%. However, taking share from branded competitors will be difficult given branded milk represents only 13% market share, of which 5% is branded mainstream.

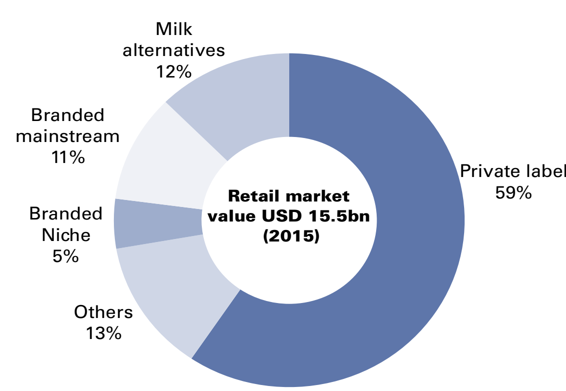
The US market is also fragmented with the three largest players representing c.8% of the market. The remaining branded players have less than 1% market share. This fragmentation points to the challenges of building scale, even at the state level, and suggests only small niche opportunities for A2M.

Exhibit 61: Small niche opportunities available…
USA liquid milk market growth



Source: Euromonitor, Goldman Sachs Global Investment Research.

Exhibit 62: … But private label dominance
USA liquid milk market share by category (by value; 2015)



Source: Euromonitor, Goldman Sachs Global Investment Research.

Appendix 2: Governance considerations

Exhibit 63: Below, we consider BAL's key Environmental, Social and Governance factors

ESG Consideration	Our View
Board	Four of BAL's five board members are independent non-executive directors. The company is chaired by independent non-executive director Rob Woolley.
Board Skills	Three of the five board members have a a high level of experience in accounting and professional services (including CEO), one has experience in retail, marketing and financial services, and one is experienced in corporate advisory and in the legal field, with specific experience in China.
Remuneration	BAL's remuneration committee is comprised of three independent, non-executive directors, and chaired by independent non-executive director Michael Wadley. The CEO's remuneration is comprised of a fixed base salary (A$300k excluding superannuation in FY15), and a variable component made up of an STI cash component of up to 50% of the fixed component and a LTI component payable in the form of share options. STI remuneration is measured against financial KPIs - business unit performance and group performance, and non-financial KPIs - market development, people and culture, brand management, and board and shareholder returns. LTI remuneration for FY15 was split into 3 tranches. Tranche 1 (16% weighting) was based on achieving an absolute EPS target of 4.74 cents/share for FY15, Tranche 2 (33% weighting) will be fully paid out on achieving a EPS Growth CAGR of at least 15% between FY15 and FY17 and lastly, Tranche 3 (50% weighting) will be fully paid on achieving compound annual Share Price Growth (SPG) of at least 15% between FY15 and FY17 (from a starting share price of A$1.30). At the end of FY15, CEO, Laura McBain held 1.57m ordinary shares.

Source: Company data, Goldman Sachs Global Investment Research.

Exhibit 64: Below, we consider ATM's key Governance factors

ESG Consideration	Our View
Board	Three of ATM's six board members are independent non-executive directors. The company is chaired by executive director David Hearn (not an independent director).
Board Skills	Two of the six board members have a experience in accounting and professional services (including CEO), three have experience across a number of roles within FMCG, and one with experience as a director and shareholder of a number of private companies.
Remuneration	ATM's remuneration committee is comprised of two non-executive directors and one executive director, and chaired by non executive director Julia Hoare. The CEO's remuneration is comprised of a fixed base salary (A$525.3k in FY15), and a variable component made up of an STI cash component of up to 30% of the fixed component and a LTI component payable in the form of share options or performance rights. At the end of FY15, CEO, Geoffrey Babidge held 11m partly paid shares.
Internal Audit	In the Company's annual report, it is noted that due to the Company's current size and business circumstances, the Company does not have an internal audit function. Under the Audit and Risk Management Committee Charter, the Audit and Risk Management Committee is responsible for providing an independent and objective assessment to the Board regarding the adequacy, effectiveness and efficiency of the Company's risk management and internal control processes.

Source: Company data, Goldman Sachs Global Investment Research.

Disclosure Appendix

Reg AC

We, Andrea Chong, CFA and Aaron Yeoh, hereby certify that all of the views expressed in this report accurately reflect our personal views about the subject company or companies and its or their securities. We also certify that no part of our compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

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The precise calculation of each metric may vary depending on the fiscal year, industry and region but the standard approach is as follows:

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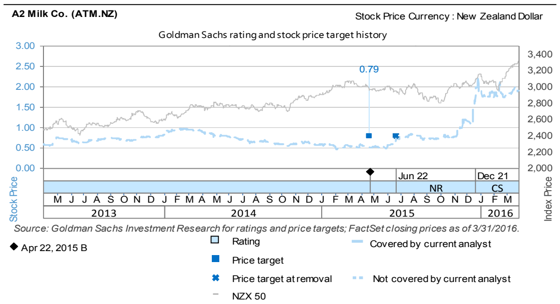

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