BESTON GLOBAL FOOD COMPANY

28 February 2017 ASX CODE: BFC

2017 HALF YEAR RESULTS

- FY17 First half results affected by seasonal impacts on milk processing and lower China sales due to a re-positioning of the China business.
- Significant progress made in Australian sales, growth in production capacity and new brands and distribution consistent with our business model and positive for FY17 second half and longer term.
- Improved conditions for milk supply and Australian sales growth give confidence for improved result in six months to June.
- Announced the signing of a significant supply contract with Hondo Food Company for RMB 120m (approx. AUD 22m) which will add to revenues in H2.
- Further purchase orders are expected to be finalised in the next 30 to 45 days with other major customers in Australia, ASEAN and China.
- Investments made in farms and factories in H1 to increase scale and efficiencies in the business.
- First full 6-month interim report (pcp was for period 1 September 2015 to 31 December 2015).

Beston Global Food Company Limited ('BFC', 'Beston' or the 'Company') has issued its 2017 first half report. The company recorded a statutory net profit of -$3.7m for the period to 31 December 2016 and an underlying net profit ('UNPAT') for the same period of -$2.4m. The result was generated on sales revenue of $11.2 million. The previous corresponding period comprised 4 months from the date of the company's listing on 28 August to 31 December 2015.

The results reflect the impact of seasonal conditions on milk processing and lower China sales together with, increased sales in Australia and ongoing growth in the businesses production capacity and distribution agreements

The Chief Executive of BFC, Sean Ebert said: "Our first half results have been affected by poor seasonal conditions which impacted on milk production right across Australia and reduced the returns of most of the key operations in the dairy industry.

This downturn in milk supply coincided with a strategic decision to shift the Company's sales focus in China towards major distributors and customers in the key growth regions of Beijing and Shanghai, which took longer than expected and resulted in less than anticipated sales against budget in China, particularly in Q1".

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"Conditions for milk processing have improved with the change in season, and this, with ground work done to build new sales received for the second half gives us confidence for an improved revenue and earnings results in the period to 30 June 2017," he said.

The Chairman Dr Roger Sexton said "Looking beyond the short term, investments in developing new brands, production optimisation, and building relationships in each region has reinforced the Company's position to deliver on its vision of being the first to market with a business model that provides safe and healthy foods to the growing communities with Australia's best foods through what we believe is a market leading business model. We are continually encouraged by our customers that reaffirm our belief that security of supply and using technology to provide consumers with assurance on what they are eating and buying for their families is safe and traceable will become increasingly more important."

During the period the Company remained focussed on delivering the two core objectives as announced at the Annual General Meeting on the 27 November 2016 of:

1. Growth in Sales
2. Optimising Returns on Assets

Overall, the Company's Group profit result was negatively impacted by the following:

- Lower availability of milk supply for production than budget, resulting in 65% reduction in toll manufacturing revenues and 15% reduction in owned farms revenues.
- Lower than expected sales in China as we move to larger customer base.
- One-off costs in establishing sales offices in new geographic locations.
- One-off increased business development costs relating to securing a range of new customers in each region.
- One-off investment in the development of BFC owned brands, multilingual marketing collateral, setup of social media platforms.

However the result was also driven by the following:

- Strong sales growth of 260% achieved in Australia from dairy related products including the introduction of new products as well as new contract manufacturing (excluding toll manufacturing).
- Sales growth in ASEAN from the launch of a range of own branded cheese products into Thailand and Singapore retail stores.
- The groups operating metrics showed a strong increase across all 4 operating divisions of dairy, seafood, meat and health which also included investee companies.

These decisions were made by management in the interest of building out our platform for growth for the medium to longer term. Investment was made over the period in the areas of:

- Business development and customer acquisition in China, Australia and ASEAN to broaden the customer base and move away from reliance on any one customer. This has resulted in the signing of a series of new customer supply agreements.

- Development of a BFC own branded range of Dairy, Water and Meat products including the global marketing collateral and social media for launch into the retail and food service markets in Australia, followed by China and ASEAN markets.

- The establishment of new sales offices in Beijing, Shanghai, Fuzhou and Vietnam to be closer to our customers, including the start-up of the Joint Venture offices in both Hong Kong and Singapore.

- The expansion of the Australian sales team which included the recruitment of a new National Sales Manager, a National Food Service Manager as well as an Instore Merchandiser to support the roll out of our branded product ranges nationally.

Around half of the new investments for the period related to increased investment in new brands development and securing new customers for sustainable growth. It is anticipated that sales growth will flow in the second half of the financial year in two main areas:

- Sales growth starting from larger and more sustainable longer term customers in China.

- Sales growth in Australia from the expansion of our own branded retail and food service range of products.

1. FINANCIAL RESULTS

The financial performance of the Company over the period was negatively impacted by two main factors out of the items listed above:

1.1 <u>Lower milk availability for processing</u>

The extremely wet winter season in southern parts of Australia reduced the production of milk at our own farms and reduced milk availability across the industry. This resulted in "toll manufacturing" revenues being significantly lower than planned which in turn reduced whey powder production.

The reduction in milk supply in Australia has coincided with a global milk shortage which has seen prices increase for dairy commodities.

1.2 <u>Low China Sales</u>

The sales team in China achieved lower than expected sales revenues for the period. In large part, this was due to repositioning of the China business towards major distributors and customers in the key growth regions of Beijing and Shanghai. The shift in focus was made in order to re-position our business in China and address two issues highlighted in our reports to shareholders in 2015-16, namely:

- The impacts of the Dashang committed sales order of RMB 200 million or approx. AUD 42 million did not eventuate.

- The time it takes to introduce new products into the market and receive customs clearances, health and quarantine (CIQ), and product registration in China.

The China sales team has worked with a number of large new distributors and customers during the Half Year including public Companies and State Owned Enterprises to develop marketing and logistics plans, including undertaking the extensive work required to pass their internal product procurement processes. Recent anti-corruption regulations enforced in China has resulted in government state owned enterprises (SOE's) and large private companies being required to follow specific protocols when dealing with foreign companies. The effort involved and the lead time in getting products to market (including via CIQ health and labelling registration) had a consequential effect on sales for the half year.

The distributors and customers which have been targeted are based on their capacity and scale to purchase product on a more consistent and predictable basis over the long term.

We remain confident that earnings will flow through from these agreements in the second half of the year as evidenced by the announcement on 28 February 2017 of the signing of a Supply Agreement with the Hondo Food Company and an initial purchase order of RMB 120 million (approximately AUD 22 million).

We have established a strong platform for growth in the second half which is now underpinned by a range of major distributors and customers in China as well our key customers across ASEAN and Australia. As a result of these initiatives, together with the launching of a range of our Company owned premium brands in these markets, we believe we are in a solid position for improved revenue and earnings growth in the second half of the year.

No divided was declared for the period.

2. <u>EARNINGS GROWTH STRATEGY:</u>

As explained in our 2016 Annual Report, BFC is a company in growth mode. The Company has been positioned to be a long-term growth business which builds sustainable economic value for shareholders.

BFC has come a long way since listing on the ASX on 28 August 2015, in building out its business across all of the operating divisions and in establishing a platform for the underlying growth in earnings.

In our 2016 Annual Report, we have outlined eight key objectives that underpinned our business strategy in 2015-16. These were:

1. Integrating technology into the whole of our supply chain
2. A holistic approach to whole-of-life healthy foods
3. Exploiting synergies between investee companies
4. Creating new value – added products
5. Developing strategic alliances with other companies to enhance our manufacturing and distribution capabilities
6. Investing in manufacturing capability
7. Improving productivity on our farms
8. Building our own brands

All of these objectives were achieved within the 2015-16 financial year and have established a momentum on which the Company is moving forward.

At our Annual General Meeting on 27 November 2016, we explained that our business strategy for the 2016-17 financial year was principally focussed around two key objectives:

1. Growing sales revenues
2. Optimising the returns on assets employed in the business

Sales revenue growth is being achieved by a shift in emphasis towards more domestic Australian customers (and greater domestic sales volumes) coupled with the re-positioning of the China business so that it is less dependent on smaller customers and distribution channels in China.

As highlighted above, while the sales team have been able to implement our re-positioning strategy in China, the time and effort involved came at an unanticipated "cost" i.e., a shortfall in China sales revenues against budget. The BFC China sales team believes that the business has put the foundations in place to improve earnings in the second half (refer below).

Specific initiatives which have been put in place to drive earnings growth in Q3 and Q4 include:

- Expansion of Australian national sales coverage through the appointment of a new Australian Sales Manager and expansion into national IGA, and selected retail and food services accounts.

- China sales teams focussed on the development of long term sales strategies in conjunction with major distributors and customers and deployed into locations where key customers are based.

- Expansion of ASEAN sales revenues through driving existing products into more stores across Thailand and Singapore and the appointment of additional Singapore, Vietnam and Malaysian distributors and resources to build sales revenues.

- Rollout of the Beston Market Place Ecommerce Platform across Australia and into China.

- Further market penetration of BFC owned retail brands for Edwards Crossing and Kyubu Cheese, and the 'ei8ht' water brand including via multi-language marketing collateral, social media platforms and regional promotional campaigns.

- Consolidation of the Beston MindChamps Joint Venture in Singapore and new product development and branding for the supply of the "first 4 kids" nutrition products into 33 MindChamps early learning centres starting in Q4.

- The development of BFC owned range of food service products for release in the second half into the Australian and ASEAN markets.

- The contract manufacture of LeRice product for Lion, for national distribution to Australian retailers.

Specific initiatives which have been put in place to drive the optimisation of returns on assets in Q3 and Q4 include:

- Building on the current farms asset base to ensure efficient operating practices are in place to drive the financial performance of the farms, and that a portfolio approach to capital expenditure is deployed.
- Implementing a number of production optimisation initiatives (such as by accelerating the construction of the Mozzarella Plant, Hard Cheese and Cream Cheese capital projects).
- Driving the performance of the Investee Companies by ensuring their underlying business continues to deliver on their pre-investment financial performance, and BFC to drive their export sales results through our established channels.

Further explanation of these initiatives is contained in the sections below.

3. AUSTRALIAN MARKET EXPANSION

While building our brand presence in China and in other markets in the ASEAN region during this first half, BFC has substantially expanded its sales in Australian, particularly across retail and food service customers.

The Company has opened up a significant number of new customers in the national retail sector and in the ingredients and food service markets. Sales of dairy related products grew by 260% during the six months to 31 December 2016 compared to the previous corresponding period.

We expect sales to customers in this market segment to continue to increase in future periods.

In conjunction with our sales efforts in food service, the Company successfully launched a number of new branded products specifically for distributors and customers operating in this area, such as hotels, restaurants and cafes etc. These products included cheddar cheese slices, cheddar shred and reduced sodium ("LoSal") bulk packs.

While the total sales revenues of the Company over the first half of 2017 were broadly similar to the last half of the FY2016 year, the sales mix was dramatically different as a consequence of the increased focus on the Australian domestic market. Sales in Australia over the period to 31 December 2016 comprised 79% of total revenues compared with only 45% of revenues over the full year period to 30 June 2016.

The sales impetus in Australia was assisted by the winning of silver, gold and "Royal Show Trophy" Awards for Beston Pure Foods cheeses at the Adelaide Royal Show in September 2016. The Awards had the effect of putting our Murray Bridge cheese factory, and our cheesemakers, on the "map" in the minds of food service customers, coming so quickly after BFC took over ownership of the factory from the Receivers, and re-opened the business in September 2015.

4. CHINA MARKET

The China market is complex and requires strong commitment and persistence.

As discovered by a number of Australian food companies in the last six months, China presents a number of "country risks" as a result of changing import regulations, notwithstanding the operation of the China Australian Free Trade Agreement ('ChAFTA') which is in a transition phase and is now in its second year of implementation. The experience of New Zealand food companies selling into China has been that the changes in import regulations during the implementation of the NZ free trade agreement tended to settle down once the transition phase had been completed.

The reduction in tariffs on Australian food and beverage products over four years to 2020 is a transformational dynamic for Australian agri-business – and one which BFC is working hard to capitalise upon, both now and in the long term.

China represents a market of some 1.4 billion consumers, a large portion of whom have rising incomes and tastes for clean, green, healthy and safe-to-eat food and beverage products from Australia. As we have stated on numerous occasions, BFC is in the China market for the long-term. The demand for food in China will outstrip supply by 2020 and BFC is building a brand presence in China to capitalise on the resultant opportunities.

Over the next five years, China's private consumption spending is expected to increase to around AUD 18.5 trillion in purchasing power parity terms, making it one of the largest consumer markets in the world. A recent survey by the Boston Consulting Group show that consumption by the new younger generation in China (18 – 30 years) is growing at twice the pace of the last generation (those older than 35 years). More importantly, from the perspective of BFC, the survey also showed that 63% of those in the younger age group were dissatisfied with food quality.

Trend information suggests that middle to high end consumers will constitute over 60% of the buyers of fast moving consumer goods in China, including food, within five years. This is precisely the market segment where the products of BFC are pitched.

We have taken deliberate decisions over the past six months to forgo some short-term sales opportunities, such as through grey channels or the diagou trade in order to build long-term sales channels and relationships with customers and distribution partners that use operating procedures and policies considered standard by western companies.

Short term reporting pressures in the second half of FY2016 led the sales team in China to focus on achieving "quick turn" sales results with a large range of relatively small customers. In the first half of FY2017, we shifted the focus of the China sales team to a sales perspective which is more in line with the company's business model, that is, of keeping customers for the longer term rather than simply pursuing customers that do not necessarily lead to repeat orders

This shift in focus impacted in H1 but is now yielding results which will flow through to revenues in the second half of FY2017.

On 28 February 2017, the Company announced that it has signed a Supply Agreement with the Hondo Food Company, a part of the Hondo Group headquartered in Beijing, with a total supply contract value of RMB 120 million (approximately AUD 22 million) of products.

The initial purchase order will comprise seafood and dairy products manufactured by BFC, either at its wholly owned factories or the factories of its investee companies. Shipments of products in the initial purchase order will start immediately and be completed over the next six to eight months.

Hondo is one of the largest meat producers in China and commenced shipments of beef from Australia in 2015. Hondo is a private company, established in 1992 which has production facilities in Chongqing, South West China and its headquarters in Beijing. Hondo has a well-established distribution network in China for its products, to both wholesale and retail outlets, including supermarkets, restaurants and food service channels.

This arrangement with Hondo, has gone a long way to replacing the "hole" in our forecast revenues resulting from the gap left from the Dashang Group sales commitment.

The Director of Sales for Hondo, Mr Wei Wenxiao, said that the company wished to use its proven distribution network and loyal customer base to expand its product range using premium, healthy food and beverage products from BFC.

"We have been working with Beston for the past twelve months to put this deal together, and greatly value their integrated supply chain which provides us with the opportunity to take high quality, clean green, nutritious and safe products from Australia to our customers on a paddock-to-plate basis", he said.

"We are expecting that the popularity of the Beston products will grow through our traditional customers as well as new customers that we will bring on board, and that our orders will build overtime to around RMB 500 million per annum", he said.

5. PRODUCTION OPTIMISATION INITIATIVES

A number of initiatives were launched during H1 of this FY17 to enhance the returns achieved on the production assets in the business and increase output:

5.1 Farms

A number of productivity improvement programs have been progressed which have been centred around the improvement in production yields and a focus on reducing operating costs. The herd build-out capital program increased the herd from 2650 to approximately 3000 by the end of Q4. The recruitment of new management for two of the larger operating farms in the South East was completed in Q2 in order to enhance the on farm management capabilities and optimise the farms as they grow. In addition to these initiatives, farm management initiated an optimised feed management plan which is anticipated to deliver improved feed costs in the second half of the year.

With the recent milk supply shortage across the Southern parts of Australia, the ownership of our own portfolio of farms demonstrates the essential role that Beston Farms plays by providing security of supply of around 35% of its total milk supply to date to meet the production demand of our Beston Pure Foods dairy facility.

BFC takes the view that having ownership of part of our total milk supply is a key to maintaining competitive advantage and meeting our customers' needs.

5.2 Australian Provincial Cheese

The Company acquired the assets and brands of Australian Provincial Cheese early in the first half of the 2017 financial year with the production line successfully relocated from Victoria to the Beston Pure Foods Murray Bridge Facility in South Australia. This included the installation of a state of the art new Thermoformer machine to improve packaging efficiency, and a further capital program to improve the production yields which is planned for completion in Q4 FY17.

In April 2016, the Company was successful in securing a South Australian Regional Development Grant which was primarily based on regional employment growth in the Beston Pure Foods facilities. The company completed its first project milestone and received part payment in Q2 FY2017 which related to the relocation of the Australian Provincial Cheese assets.

The first order fulfilment of Mable's cheese to Costco Japan was produced and exported in Q2 FY17 from the new facility, with repeat orders from both Costco Australia and Japan received for Q3 FY17 period. This has delivered growth in production by 30% to 130 tonnes per annum in the first quarter of production. A focus on growth in Australian retail sales is planned for the second half the financial year as part of the Company's focus on the expanding its own branded products into the Australian market.

5.3 European Hard Cheese Production Assets

The opportunity was identified in the previous financial year to utilise Beston Pure Foods asset base in higher margin products such as Hard Cheese products. When the UDP assets were acquired by BFC in 2015, it was identified that the Murray Bridge facility previously produced a range of 5 to 6 European high grade hard cheeses of which a large part of the plant and production expertise still remained in place.

The Hard Cheese project was initiated in Q1 FY17 which involved the refurbishment of the existing plant and equipment to bring it up to international export standards. The planned capacity of the plant is anticipated to be around 200 tonnes per annum will produce a range of high value European products such as Gruyere Swiss style cheese, Tilsit German style cheese, Raclette French style cheese, Pecorino a traditional Italian style cheese and Parmesan (hard). Parmesan is one of the most commonly known traditional Italian cheeses.

The project forms part of the secured Regional Development Grant fund milestones and will bring further employment growth to the region with first production anticipated for late Q4 FY17.

Product will be sold through existing distribution arrangements across Australia.

5.4 Mozzarella Cheese Production Assets

The UDP plant formerly produced premium quality Mozzarella at the Jervois site of which the brand and plant was sold during the company's receivership and prior to BFC acquiring the assets.

Based on the global demand for Mozzarella the Company has initiated a major capital project to re-instate the Mozzarella plant using the state of the art technology from a leading European manufacturer to provide production capacity of around 14,500 tonnes per annum which in turn also increases the volume of whey for conversion into whey powder.

In the first half of this year, a project team including external specialist consultants initiated an accelerated program of works to bring forward anticipated first production of Mozzarella to Q2 FY18. The order placement of long lead time items was completed in Q2 FY17, and the manufacturing and refurbishing of the site to bring it up to international export standards is scheduled for the second half of the year.

The Mozzarella project forms part of the secured Regional Development Grant Funding as it provides increased employment into the region.

5.5 BMTG AquaEssence Production Assets

In May 2016, BFC acquired a 51% interest in AquaEssence a naturally alkaline high pH water bottling company based in Mt Gambier South Australia. In the first half of 2017 through an extensive product and brand redevelopment process, developed a premium global water brand called 'ei8ht' which followed extensive consumer testing in China, ASEAN and Australian market.

In the first half of 2017, BMTG AquaEssence initiated a capital program to increase bottling production capacity from 24,000 per day to 120,000 per day with anticipated production to start in Q1 FY18. This was to provide capacity to meet future anticipated export growth for the new 'ei8ht' brand, and to provide new product formats in glass and sparkling product categories.

6. NEW PRODUCT DEVELOPMENT

BFC invested significant resources into new product development during the first half. Much of this development centred around the "Beston MindChamps Kids Nutrition" joint venture.

BFC recognises the importance of healthy eating to the growth and development of young children and is committed to supporting healthy food and drink choices at this critical stage of life. The joint venture signed between MindChamps and BFC in August 2016 recognises that there are very few food companies which focus specifically on producing foods which meet children's nutritional requirements and which contain less fat, less salt and less sugar.

BFC has therefore developed a range of food products which meet these criteria, under the brand name "Champion Foods". The products are sub-labelled as "Best For Kids". An example is reduced fat, reduced salt cheddar cheese slices.

These "Champion Food" products are gradually being introduced to the 33 childcare centres operated by MindChamps Pte Ltd in Singapore. By April 2017, the products will be supplied to over 2500 children daily in Singapore.

Over time, it is intended to roll out the products to childcare centres in other parts of Asia, China and the Middle East. A General Manager has been appointed to the Beston MindChamps joint venture, for this purpose, and is based in Singapore.

Other product development was also undertaken during first half at the Murray Bridge dairy factory of Beston Pure Foods, and in conjunction with our investee company, Neptune Bio-Innovations Pty Ltd. This work is continuing under the guidance of our in-house dietetics and food technology professionals with the aim of adding value to the core products which we produce (as we did for example in creating our Kyubu" Japanese style cheese snacks) and building our own brands around products where we can "own the space" in the market we are targeting (such as "Kids nutrition").

7. INVESTEE COMPANIES

1. Ferguson Australia

Ferguson Australia successfully completed the consolidation and integration of the Mori and 5 Star acquisition. The business experienced a delay in the start of the season in the Northern Zone due to regulatory requirements. However the anticipated lobster catch over the full financial year is expected to increase by 13% to 450T combined across the three businesses compared with 400T in the previous financial year.

The product, brand positioning and launch of the first range of Ferguson Australia branded retail products into the Australian market was undertaken in the first half year.

BFC holds a 32% equity interest in Ferguson Australia.

2. Scorpio Foods

Scorpio Foods fulfilled its first order for the full range of Yarra Valley (9 SKU's) into Spinney's, a major retailer in the Middle East in Q1 FY2017, with repeat orders placed in Q2 FY2017. The final product approvals for Aldi were completed in the first half of the year with launch of the first SKU into ALDI stores under the ALDI "Farmwood" homebrand anticipated for distribution early in the second half of the year into stores across South Australia and Victoria.

The construction of a new production facility in the Shepparton facility was completed in late Q2 FY2017 providing an increase in Yarra Valley production capability in Colac and Shepparton from 2500T to 9000T. This consolidates production into one facility for products manufactured for a major customer located near the Shepparton facility.

BFC has a 45% beneficial interest in Scorpio Foods under a convertible note instrument (which earns an interest rate of 9.5%).

3. NBI

Neptune Bio Innovations completed an extensive product development and distributor listing of a range of NBI own branded pharmacy retail products targeted specifically at people with hypertension, diabetes and requiring rapid recovery from dehydration.

The release of the full range of NBI products into retail pharmacies across Australia commenced in January 2017.

The new product development of the first 'low fat low salt cheese' using the NBI ingredients for the Beston MindChamps Joint Venture was completed in the first half year and will be ready for delivery in Q4 FY2017.

BFC holds a 20% equity interest in NBI.

4. Bd Farm Paris Creek

Bd Farm Paris Creek completed the first phase of their new Extended Shelf Life (ESL) capital project in Q4, following delays due to wet weather. The first phase involved the construction of the new building extension required to house the installation of the ESL production line.

The installation of the new plant is currently underway with production anticipated in early FY2018.

The Bd Farm Paris Creek Organic Lo-Fat Yoghurt will be served to over 2000 children in 33 MindChamps leading early learning centres across Singapore through the Beston MindChamps Joint Venture in Singapore with a planned start in Q4 FY2017.

Australian Sales remain strong based on the consumer recognition for premium quality organic dairy products. Further growth will maintain the demand for additional organic certified farms to supply organic milk.

BFC has a 26.5% beneficial interest in Bd Farm Paris Creek under a convertible note instrument (which earns an interest rate of 9.5%).

8. <u>OUTLOOK</u>

The company is expecting improved trading results for the period to 30 June 2017 as seasonal market conditions support improved margins in milk processing and revenues increase as a result of the new sales agreements and purchase orders put in place in both the domestic Australian and international markets (China and ASEAN).

The Company is in the final stages of negotiations on a number of additional sales agreements and purchase orders in Australian and overseas which we expect to announce over the next 30 to 45 days as they become finalised.