

Thursday, 28 November 2019

Dear Shareholder

The purpose of this letter is to expand on, and provide some further background information on, the presentation which I made today at the Company's 2019 Annual General Meeting.

When we started out in 2015, at the time of our IPO, our mission was to establish Beston Global Food Company Limited (BFC) as a leading Australian-based supplier of safe, clean, healthy food and beverage products to the world's growing consumer markets. At this time, we had no milk (other than from our own farms), no operational factories, no brands, no market presence and no operational licences (including no export licence). BFC was a start-up business with a sales and profit profile for the first three years which was largely based around the rebuilding and rejuvenation of a group of defunct, non-operating, dairy assets (UDP) at Murray Bridge and Jervois in South Australia, which had been placed in receivership and a single customer in China.

Much has changed over the past four years. The Company has come a long way on its journey to achieve its mission despite encountering a number of headwinds and unexpected setbacks along the way (which in turn has meant that we have taken longer than we expected to convert a group of non-operating dairy assets into a commercial business and achieve our targets).

Where are we today?

As we stand today, BFC is a Company with:

- Annual revenues of around \$85 million (up by 77% on the previous year).
- Cheese production capacity of some 30,000 Metric Tonne per annum.
- A fully refurbished world class Mozzarella plant at Jervois with state-of-the-art Italian made processing equipment.
- Five strategically located dairy farms in south-eastern South Australia which now carry a herd of 3,600 cows (up by 23% on last year).



- Capabilities and capacity in the production of dairy nutraceuticals, especially high value Lactoferrin.
- 114 Australian and International Awards for Quality.
- A wholly owned meat processing business (Provincial Food Group, Shepparton Victoria) which also has capacity and capability in the production of plant-based alternative meats.

Over the past four years, we have achieved average year-on-year growth in revenues of 65% per annum since our IPO in 2015 and built a business which has a key focus on the production and supply of protein to growing consumer markets in Australia and the rest of the world.

The benefits of the achievements we have made in growing our revenues should not be underestimated. We have not simply grown the revenue line for its own sake.

The objective in growing to a \$100 million turnover Company as we will be this year, has been quite deliberate. That is, to give us critical mass on the production side of the business and to give us credibility and clout on the market side of the business.

I have talked previously about our corporate objectives of delivering on the three C's in the first stage of our business plan that is achieving Capacity, Capability, and Credibility.

We have achieved all three of these objectives.

We were very much a new player in the food industry when we started. To be taken seriously, especially by global food service companies, we needed to have the Capacity and Capabilities to deliver on orders and be of sufficient size to have a market presence (that is, with Credibility and Clout as a supplier).

Key Strategic Decisions

Notwithstanding all the important achievements, in meeting our three C objectives, we have not as yet achieved our earnings and dividend objectives.

After working through and completing the first phase of our growth plan and fixing, focussing and building-out our dairy business, the Board resolved that a number of key strategic decisions needed to be taken to re-set the business and increase profitability to achieve our bottom line objectives. These decisions have been based around restructuring the business, leadership changes, consolidating our corporate footprint and repositioning our export market activities.

I will briefly explain each of these very significant decisions which we undertook and implemented during the first half of this 2019-20 Financial Year.

1. Restructuring Changes

The Company announced a number of significant restructuring changes in August 2018 after I took on the executive management role as Executive Chairman for a period, pending the appointment of a new CEO. The changes resulted from a comprehensive review of BFC's operations across all areas of the business: factories, farms, warehouses, customers, systems, people and culture.

Over the period from August to December 2018, net operating costs of in excess of \$1.0 million (on an annualized basis) were taken out of the business, and a number of significant permanent cost savings were locked in as a result of the changes made.

In moving through our journey, from a Phase 1 "start up" to the Phase 2 "consolidation" stage, we have been able to strip out a sizeable amount of operational costs. This has occurred in part, because a number of staff necessary for the "build out" phase (e.g. engineers, project managers, technical specialists etc.) were not required after the infrastructure build-out and plant installation was completed and became operational.

But it has also occurred as we have continually improved our operational performance and extracted efficiencies from the assets which we have employed.

2. Leadership Changes

On 8 August 2018, we announced that CEO Sean Ebert had stepped aside to take on the short term role of Dairy Division Manager, and on 28 November 2018, the Company announced that Jonathan Hicks had been appointed as the new CEO and would take up the position on 7 January 2019.

Jonathan has come to BFC with a wealth of knowledge and global experience in the Dairy Industry. He is a Cheese Maker by training and spent the early part of this career working for dairy companies and retail supermarket companies in the UK. Over the last 30 years, Jonathan has held senior positions within the Australian Dairy Industry, including with Bega Foods.

As explained to the market at the time, the appointment of Jonathan reflected a strategic decision by the Board of BFC to increase the utilization of the productive capacity at BFC's dairy factories to drive profitability while at the same time shifting more of the Company's sales revenues into higher margin earning segments of the market such as dairy nutraceutical products and pursuing its focus on being a protein business.

3. Consolidation of Corporate Footprint

As we have moved through the process of implementing our business plan over the past few years, we have progressively evaluated our investments, major assets and commercial partnerships against both our corporate and our financial objectives.

In particular, this evaluation has focussed on whether these investments, assets and partnerships continue to support our key strategy, whether they can be scaled up and whether they will enable us to achieve our target returns on capital.

This evaluation process led us, for instance to the decision to divest our interests in B-d Farms Paris Creek in December 2017, to fully impair our investment interests in health and nutrition business, Neptune Bio Innovations (NBI) and to divest our interests in the seafood business of Ferguson Australia. (The details have been provided in various ASX announcements).

The decisions made by the Board on these matters in the first half of FY19 have simplified our core business and reduced our corporate footprint. They have also enabled the management team to be singularly focussed on the core business of dairy and meat and meat alternatives. (Plant-based meat alternatives are one of the most disruptive trends in the global food industry and have been forecast by UBS to grow in consumption at a rate of 35% pa over the period to 2023).

4. Repositioning of Export Market Activities

During the first half of FY19, the Board examined alternative models for achieving our growth objectives in export markets, particularly in China and South East Asia.

The imperative was to achieve those objectives in a more cost-effective manner, while building on the brand presence we have established in these markets in recent years.

A number of strategic sales and distribution arrangements were put in place with parties which are commercially and culturally aligned with BFC to enable the Company to manage and operate export sales opportunities largely out of Adelaide. This enabled BFC to commence the winding down of its two main offices in China and Thailand in the second half.

Consistent, quality business has been growing in a number of key export markets, especially China, Thailand, Malta, Vietnam, Philippines, South Korea, Canada and Japan in recent years and we expect that our market footprint in these countries will continue to expand in FY20.

As a result of implementing these key strategic decisions, the Company generated a number of redundancies and restructuring costs, significant domestic and international inventory disposals and costs and other non-recurring transitional costs, as detailed in the Annual Report.

Putting the changes into perspective

Putting all the strategic decisions into perspective, and by way of summary, we have re-set the focus of BFC over this past financial year to enable us to leverage more effectively on the foundational building blocks which have been systematically put in place over the period since our IPO. The re-set has included:

- bringing our sales team in-house with key appointments in sales and marketing to replace contract third parties;
- reducing operating costs and cost exposures;
- removal of non-core (non value-adding) activities;
- putting more of our milk into our own products and particularly higher value products;
- capitalising on our new product development (NPD) skills and track record with innovative niche products; and
- restructuring and repositioning our now wholly owned Provincial Food Group to capture new contract opportunities;

The re-set of the business has positioned BFC around a number of strategic imperatives which will be key drivers in growing revenues and profits going forward. These imperatives include:

- **Capacity utilisation:** making greater use of the productive capacity which we have built over the past four years in our dairy and meat factories.
- **Sales pipeline:** greater utilisation of the sale pipeline which has now been established, with a broadening and deepening of sales relationships;
- **Product mix:** further increasing the proportion of mozzarella products and other high value milk derivative products in the sales/production mix;
- **Growing milk supply:** from 103ML to 115-130ML in the near term, and;
- **Dairy Nutraceuticals:** increasing the production of high value Lactoferrin and other dairy nutraceutical products.

Capital Management Initiatives

The Company announced on 11 January 2019 that it was giving consideration to capital management initiatives to assist the Company in improving its profitability in the near term. The Board of BFC believes that there are compelling opportunities to allocate capital to projects which can accelerate the profitability of the Company.

As part of the process of implementing the restructuring changes outlined above, the Company identified a number of areas in the factories and farms where investment in new technology and plant and equipment could result in cost savings and increases in profits from the existing revenue base.

The investment areas relate to in-house packaging, expansion of our dairy protein operations, storage and logistics, production line upgrades, ESG cost saving measures and dairy cow herd expansion.

The areas identified are all “low hanging fruit” in terms of providing relatively short pay-back periods (i.e. less than four years) and have now been developed into detailed costed “priority projects”.

As explained in our 2019 Annual Report, we have pushed ahead with implementing a number of these projects from internally generated cash flow and through the selective use of plant and equipment finance.

These projects have primarily been:

- The addition of 1,500 new dairy cows at the BFC owned dairy farms at Mount Gambier (for both replacements and additions).
- The expansion of the Company’s dairy nutraceutical capabilities with the installation of freeze drying and milling equipment at the Jervois factory.
- The installation of new plant and equipment at the PFG Shepparton Factory to increase both the capacity and efficiency of production and introduce the capability for production of plant-based alternative meat products.

The Company has three capital management initiatives under consideration by which to accelerate the implementation of a number of the other high value adding projects, all of which would enable us to extract greater returns from the existing asset base and reduce operating costs to achieve our profitability and dividend objectives. These initiatives are:

- A Share Purchase Plan
- A Purchase and Leaseback of the BFC Dairy Farms
- A Rights Issue and Placement

Share Purchase Plan

The Board of BFC has resolved to offer the opportunity for shareholders to participate in a Share Purchase Plan.

The SPP will provide Eligible Shareholders with an opportunity to apply for up to \$30,000 of BFC fully paid ordinary shares. Participation is optional and there are no brokerage or transaction costs for participating.

The Company is targeting to raise up to \$3.0 million under the SPP for the following purposes:

- Facilitate early investment in the next phase of expansion of our lactoferrin plant; and
- To provide an opportunity for our shareholders, particularly small shareholders to take advantage of the current BFC market share price, which in the opinion of Directors, does not fairly reflect the underlying value of BFC shares.

Details of the SPP and timing of the Offer, will be announced soon.

Farms Sale and Leaseback

As explained in the Company's 2017-18 Annual Report, the Board of BFC has contemplated the creation of a Dairy Farm Real Estate Investment Trust (REIT) to acquire additional farms and increase own-farm milk supply to our factories.

The objectives around this concept were to:

- Free up capital to provide funds for additional contract milk purchases;
- Redeploy the capital currently tied up in our dairy farms to higher revenue and profit generating assets; and
- Secure access to an additional 35-40 million litres of milk to add to the capacity of our dairy factories.

A number of structures were tested in the marketplace to ascertain investment interest in a Dairy Farm REIT. A number of option agreements were also entered into at the same time for the potential acquisition of a number of suitable, pre-qualified dairy farms.

The Board of BFC examined two specific models of purchase and leaseback (to Beston Pure Farms) on secured sizable portfolios. In each case the models called for BFC to underwrite the volatility of the earnings at levels which were unacceptable. Simultaneously the value of dairy farms in the South East of South Australia has risen and demand from buyers (particularly from overseas) has increased.

For these reasons, the Board resolved to move to a longer term, (reduced risk) model based on directly leasing individual dairy land from partner farmers, with options to purchase at future market value. The Board has taken the view that this approach better aligns progressive accumulation of milk volume to production demand and avoids the malalignment of dairy farm values to dairy farm net incomes.

During August 2019, BFC finalised a commercial lease for the first farm under this model, a 100-hectare property located at Allendale East in close proximity to its three core farms. The lease contains a call option to acquire the farm after five years, on market terms, a flexibility that suits the new Lessor.

The arrangement will provide an additional estimated 2.5 million litres of milk (on an annualised basis) to BFC at limited additional variable operating cost.

We are now looking to replicate this model with our own farms by entering into 10 year sale and lease-back agreements on the farms by which BFC will continue to operate the farms, take the milk produced on the farms into our own factories and have rights to buy back the farms at market value in future periods. Discussions have been initiated with a number of large Australian and International Pension Funds, Institutional and Family Office investors which have long-term return objectives closely aligned with the returns being generated on-farm.

The overriding objective in any sale and lease-back arrangements which might be put in place, will be to retain long-term control over the dairy farms and guarantee the future supply of milk to BFC factories.

For BFC, the implementation of this initiative will facilitate a re-allocation of capital to projects which can generate much higher returns, and at a much faster rate, than having a large proportion of our capital tied up in farms.

Following completion of the sale and lease-back of our dairy farms, the gearing level of the Company would reduce from 49%, as at 30 June 2019, to around 15%. The sale and lease-back would unlock over \$30 million of low return capital, re-set our balance sheet and provide ample working capital for the day-to-day operations of the Company, including the funding of additional contracted milk to achieve our capacity utilisation targets. Importantly, also, it will enable BFC to achieve a more efficient use of capital, by redeploying some of the capital tied up in our farms (where it earns comparatively low returns) to our factories (where we can, by building milk supply, achieve greater utilisation of our plant and thereby significantly higher returns on capital employed).

Rights Issue and Placement

As previously outlined, in our announcement on 11 January 2019, BFC has identified two significant project opportunities which would achieve a step-lift in earnings and profitability and provide a relatively short period of pay-back (i.e. within four years or less).

These projects are centred around a significant expansion of our existing lactoferrin plant and the internalisation of our cheese processing requirements (cut, shred, wrap and pack).

The lactoferrin plant at Jervois which we refurbished and commissioned late in 2018 is producing lactoferrin of very high grade from the whey by-product of our Mozzarella production.

Demand exceeds our capacity to produce and is expected to remain substantially so well into the future with major customers in both Australia and overseas. An increased investment into our dairy nutraceutical facilities at Jervois can be expected to generate incremental margins from revenues on these products of between 60% and 80%. We propose to invest approximately \$10 million to triple the size of our lactoferrin plant at Jervois. The completion of this project will add around \$6 million of EBITDA pa with a pay-back of less than 24 months.

The Company's cheese processing requirements (cut, shred, wrap and pack) are currently being met by interstate third party contract providers. The arrangement involves double-handling (both in transport and factory processes) and limits the control held by BFC over the quality and presentation of the end product delivered to consumers. The arrangement also inhibits the ability of BFC to add further value to our premium quality, award winning cheeses after the products leave the cheese vats.

The acquisition of cut and pack facilities by BFC would save the Company around \$3 million per annum in payments (in gross terms) to interstate third party contractors and enable full

oversight over the quality assurance processes and the quality of the end products shipped to customers.

As part of these projects, consideration is also being given to the installation of solar energy equipment to reduce our power costs, which have risen substantially in recent years (and are expected to increase further as we increase cheese production at our two plants in SA and our meat plant in Victoria).

A substantial amount of work has been undertaken on the evaluation of these projects during the year. This evaluation work is continuing with a view to enabling the Board to come to a decision about proceeding, or otherwise, with either or both of these investment projects.

If a decision is made to proceed, it is the Board's intention to fund the projects by way of a rights issue and placement. The size and terms of the issue/placement will be determined at the time.

Conclusion

On behalf of the Board, and as a fellow shareholder, I would like to thank you for your patience as we have moved through the process of building the Company, dealing with all the headwinds and adversities which we have encountered on our journey, and then in this last twelve months, re-setting the focus of the business via a number of important strategic decisions. We are proud of what we have achieved in building the business of BFC, in a relatively short period of time.

I can assure you that the obligations to our Shareholders have remained top of mind for the Board as we have both scaled up and simplified the business through these strategic decisions over the past twelve months.

At core, BFC is a dairy products manufacturing business. The dairy business represents the bulk of our assets at this point, and the bulk of the contribution to earnings (90% of group sales currently).

Unfortunately, there are not many things that still get made in Australia. Dairy products are some of the things that we do still manufacture in our country and we are proud to be part of the industry.

Clearly, the dairy industry has had to face a mix of complex issues in this last year including drought, increase feed costs, increased global competition, soaring energy prices and ageing farmers leaving the industry.

The number of dairy farms in Australia today (less than 6,000) is only around a third of the numbers in operation in the early eighties. And yet, with the increasing world-wide demand for food, and protein in particular, the need for our dairy farmers, and the products produced by BFC, is rising.

It is pleasing, as our CEO, Jonathan Hicks has pointed out at the AGM, that while a number of our competitors have experienced significant setbacks in this past financial year, the revenues and sales pipeline of BFC has continued to build.

The forward focus of BFC in FY20 is around the Volume, Value and Velocity strategy which our CEO has been implementing in the business following on from the comprehensive commercial review which commenced in H1 and continued through H2. Put another way, it is about continuing the sales drive, getting costs out, increasing margins and conserving cash.

We are pleased with the achievements we have made in these areas during FY19 and particularly with the initiatives taken to broaden our revenue base and drive cost reductions as we have progressed from a Phase One “start-up” Company to a Phase Two “consolidation” stage business.

In simple terms, BFC has transformed and consolidated over the past twelve months into a protein business; dairy protein, meat protein, and plant-based protein products.

There are 10 key messages that I would like you to take away from reading this Shareholder Letter and as we embark on our forward journey:

1. We are gradually and methodically increasing the milk supply to our factories to achieve our 200 million litres plus short-term target.
2. We are putting more of our milk into our own products and particularly higher value products.
3. We are making our milk go further (i.e. “stretching” our milk with new products) and have expanded our product offerings around Mozzarella to provide a range of different qualities and price points (e.g. high fat/low moisture; low fat/high moisture etc.) using the technology we acquired as part of our state-of-the-art Italian made Mozzarella Plant.
4. We are expanding our production capacity in dairy nutraceuticals, especially Lactoferrin, where we can earn high margins on the by-products from our Mozzarella production line.
5. We have developed, and are developing further capacity, in the contract manufacture of plant-based foods (a rapidly growing global food segment).
6. We are re-deploying capital within the business to achieve greater returns on capital employed (ROCE).
7. We are maturing our sales pipelines and bringing on new customers with well-established markets who are more concerned with quality and consistency of quality than price.
8. We are continuing to develop Beston Technologies to reduce its cost to other users and increasing its affordability relative to other emerging competitors and alternative solutions in the market place (as explained in the 2019 Annual Report).

9. We are exploring the best way to achieve our cut, pack and shred requirements with a view to reducing this cost and provide greater quality control over the final product.
10. We have adopted a “be ready” position for strategic vertically integrating expansion opportunities and are formulating capital management options around this position.

At Board level, our core purpose and our passion remains unchanged. That is to ensure that we continue to build the business to achieve our earnings and dividend objectives so as to create wealth for our shareholders. The difficulties we have experienced in the business over the past few years have only made us stronger in our determination to achieve our objectives and meet the expectations of all of our stakeholders.

Having achieved our revenue objectives and taken the Company to a turnover of \$100 million in this current financial year, we are now heavily focussed on the bottom-line results. We believe that we are in a strong position, with all the hard work that has been done, to continue to build on the Company’s foundations to extract increased earnings from incremental sales revenues in FY20 and beyond. And, that is very much the focus of the management and the Board.

While we will continue to face some short-term challenges in the business environment in which we operate, especially around the flow-on effects of the drought, we have made some solid, scalable investments and some sound strategic decisions to secure profitable growth into the future. We are now moving into our next stage of our growth (consolidation around a core profit focus) with a clear strategy in place and a clear set of drivers to achieve the strategy.

On behalf of the Board of BFC, I thank you for your continued support.

Yours sincerely



Roger Sexton AM
Chairman
Beston Global Food Company Ltd