

ASX RELEASE
11 January 2017

Business Update

Bellamy's Australia Limited (ASX: BAL) (Bellamy's or the Company) refers to the business update it released to the Australian Securities Exchange (ASX) on 2 December 2016.

Following speculation in the market, Bellamy's requested a trading halt on 12 December and a further voluntary suspension in order to complete a broader analysis of its financial position, pending negotiation with suppliers and to provide the market with a more comprehensive update of the Company's financial outlook. Based on internal management accounts, the Company is now providing guidance for expected revenues, EBIT and EBIT margin for 1H17 and FY17. This is subject to finalisation of the half year accounts as well as external audit review.

The Company's revenue and profitability have been impacted by lower than expected demand for Bellamy's infant milk formula, which has also led to increased inventory levels, excess ingredients and shortfall payments to suppliers.

The Company has responded by amending a key manufacturing contract with Fonterra and implementing measures to reduce production and better manage inventory levels. The Board has also initiated a cost management program to reduce expenses throughout the business.

Personnel changes have also been made at the senior executive level with the Chief Executive Officer, Laura McBain, leaving the Company and Andrew Cohen being appointed as the new acting Chief Executive Officer.

The Company continues to believe in the strength of its brand and products and global sales footprint. Bellamy's is focused on building a sustainable business that can execute on the significant, long term opportunities in Australia, China and other markets, and deliver long term value to its shareholders.

Sales Performance

Since the 2 December 2016 trading update, the Company's sales figures to 31 December 2016 and revenue for 1H17 are expected to be in the range of \$115m to \$120m.

FY17 revenue is expected to be in the range of \$220m to \$240m. This guidance reflects the impacts of higher than anticipated stock levels held by Bellamy's trade customers.

Market Share

As previously announced, in FY16 the Company made a decision to restructure its China route-to-market by selling directly to Chinese resellers rather than indirectly via Australian retailers. The result of this shift was a reduction in Bellamy's share in infant milk formula sales as measured by Australian retail scan data from April to June 2016¹. Since that time, the Company's share of infant milk formula scan sales in Australia has stabilised in terms of volume and value as at November 2016².

In China, external data of estimated sales of Bellamy's infant milk formula on Alibaba, a Chinese e-commerce platform, reflects that Bellamy's online market share has also been stable and has grown slowly since January 2016³. Although this data indicates that underlying sales demand has been stable, 1H17 sales were lower than 2H16 sales due to increased stock levels held by resellers and retailers.

Supply Chain Restructure and Amendment of Key Contract

As a consequence of lower than expected sales and the long lead time in Bellamy's supply chain, inventory levels as at 31 December 2016 are expected to be approximately \$105m to \$110m, with finished goods expected to comprise approximately 75% of this balance.

Given the inventory levels currently being held by Bellamy's and in the market, the Company is focused on reducing production. This will take time to impact inventory levels due to the lead times on ingredient orders and production schedules, resulting in no material change in inventory at the end of FY17. However, inventory levels are being actively managed to limit the need for impairments in FY17, noting that the shelf life for formula products is 2 to 3 years.

A part of Bellamy's strategy is to subcontract manufacturing of its products. Its key manufacturing contracts have minimum volume commitments to secure access to the necessary manufacturing facilities. Under its contractual arrangements with Fonterra and other suppliers/manufacturers, where the Company is not able to fulfil minimum volume commitments, it is required to make shortfall payments.

In support of the Company's and Fonterra's commitment to a long term strategic manufacturing arrangement, the parties have agreed to amend their five-year manufacturing contract, extending the term by a further three years to apportion minimum volume commitments over a longer period. This amendment is conditional on the Company and certain subsidiaries granting Fonterra second-ranking security over their assets, subject to Bellamy's obtaining the consent of its bank.

Under the current manufacturing contract with Fonterra, Fonterra and Bellamy's each have termination rights, including in the event of a change of control. Two additional grounds for termination by Fonterra have been added. The first applies if a person or group of persons acquires 50% or more of Bellamy's voting shares. The second applies if a person or group of persons acquires 30% or more of Bellamy's voting shares and, in Fonterra's opinion, that person or group has effective control of Bellamy's.

¹ Data sourced from IRI MarketEdge based on data definitions provided by Bellamy's.

² Data sourced from IRI MarketEdge based on data definitions provided by Bellamy's.

³ Data sourced from Adways Information Technology (Shanghai) Co. Ltd.

The parties have not specified a minimum notice period for the mutual termination right or 50% termination right. For Fonterra to exercise the 30% termination right, it would be required to give Bellamy's not less than 12 months' notice.

Currently, Fonterra only manufactures one of Bellamy's three infant milk formula products and under the manufacturing contract the Company is not restricted from manufacturing its own products.

Shortfall payments are reflected in the revised reported EBIT forecasts for FY17 and will be expensed in the year they are incurred. Shortfall payments in respect of FY17 volumes are not payable until FY18. Under its contractual arrangements with key suppliers/manufacturers, Bellamy's projects over the next 2 years that shortfall payments would range between \$11m and \$13m each year depending on the Company's underlying sales growth and production requirements.

Profitability and Operating Margins

The Company's expected gross profit margin for 1H17 is the range of 39% to 40%. It is expected to reduce to a range of 32% to 34% in 2H17. Overall for FY17, gross profit margin is expected to be in the range of 35% to 38%.

The Company's expected EBIT for 1H17 is \$12m to \$14m, representing an EBIT margin of 10% to 12%. The Company's expected EBIT for FY17 is \$22m to \$26m.

The Company's expected gross profit margin and EBIT reflects the impact of:

- Lower than expected sales volumes and changes in the Company's customer mix;
- Manufacturing shortfall payments;
- Increased cost of organic ingredients in order to secure supply; and
- Previously announced additional investment in marketing, people and promotions.

The Company's EBIT has also been impacted by a number of provisions relating to inventory write downs, foreign exchange losses and other one off items associated with the supply chain restructure. Removing the impact of those one-off charges, EBIT margin for 1H17 would have been between 14% and 16%.

The Company's profit after tax in 1H17 is expected to be between 6% and 9% of revenue, reducing to 4% to 6% in 2H17, reflecting the impact of the factors outlined above plus interest expense on borrowings.

The Company's cash (net of debt) position at 31 December 2016 is approximately \$1.0m. The Company utilises a banking facility to manage its working capital requirements.

Management is working on a range of initiatives to reduce the Company's cost base and improve its supply chain. In the short term, these initiatives will focus on customer mix, promotions and indirect costs. Over the medium term the focus will turn to reducing ingredient costs which will allow greater investment in marketing and Bellamy's products.

Departure of CEO and Review of Executive Team

Laura McBain is leaving the Company. She will cease to be Chief Executive Officer of Bellamy's effective today, but will remain employed by the Company until 31 March 2017 to assist with outstanding matters. Andrew Cohen will assume her responsibilities as acting Chief Executive Officer while the Board undertakes a search for a permanent replacement.

Chairman, Rob Woolley said: "Laura has overseen the growth of the Company over the past decade since she joined Bellamy's as General Manager in 2006, including the expansion of Bellamy's markets and its brand. I would like to thank Laura for her contributions to Bellamy's over the last 10 years."

Andrew Cohen joined Bellamy's in July 2016 as Chief Operating Officer. Andrew has 15 years' retail, fast moving consumer goods and private equity experience in management and consulting roles. He was most recently a Partner with Bain & Company, where he held a leadership role in its Consumer Products and Retail practice, and was involved in many high profile corporate turnaround engagements.

The Board is more broadly assessing the skills and experience required in the Executive Team to respond to market conditions and current needs and to lead Bellamy's through its next phase. This includes a review of all existing positions in the Executive Team.

Nigel Underwood has been appointed as acting Chief Financial Officer. Nigel is an experienced Chief Financial Officer, having recently held this position at Keolis Downer. The Company's former Chief Financial Officer, Shona Ollington, will continue with Bellamy's as part of the Finance Team and will report to Nigel.

Further, Dimitri Kiriacoulacos has been appointed as Chief Corporate Development and Legal Officer to assist the Company for a transitional period as it responds to market conditions. Dimitri has also been appointed as an additional company secretary.

Banking Facilities

Bellamy's has a facility in place with its bank. Bellamy's is in compliance with its obligations under that facility. Based on current expectations for FY17, Bellamy's expects to remain in compliance with those obligations.

Outlook

The Board and management are focused on rebuilding confidence with key stakeholders – customers, suppliers and investors.

The Company is actively working to realign its supply chain and key customer channels to target more sustainable and visible growth across its home market and South East Asia and the important China market. Key aspects of this are pricing strategy, route-to-market, ongoing marketing programs and improving customer relationships.

The Company notes the recent media references to possible class actions against the Company. No class actions have been served on the Company. The Company will inform the market if a class action claim is served on the Company.

- Ends -

Investor and analyst conference call

The Company will be holding an investor and analyst conference call at 2.15PM AEDT today.

Participants can dial + 61 2 8038 5221 or 1800 123 296 (toll free) to join the call. When prompted, please provide CONFERENCE ID: 51976393

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