Simmons
CORPORATE FINANCE

a2 Corporation Limited

Independent Adviser's Report

In Respect of the Allotment of Shares to Freedom Nutritional Products Limited

June 2010

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Section **Page**

1. Introduction

1.1 Overview of a2 Corporation Limited

a2 Corporation Limited (**a2C** or the **Company**) is listed on the alternative market (**NZAX**) operated by NZX Limited (**NZX**) with a market capitalisation of NZ$31.1 million as at 22 June 2010 and unaudited equity of NZ$8.2 million as at 31 December 2009.

a2C is a premium branded fast moving consumer goods (**FMCG**) and ingredients business. It markets a2 Milk™, which is milk that does not contain the protein beta casein A1, through a range of licensed distributors and joint ventures in New Zealand and overseas. The a2 Milk™ brand is supported by a unique suite of intellectual property.

1.2 A2 Dairy Products Australia Pty Limited

A2 Dairy Products Australia Pty Limited (**A2DP**) has the exclusive rights to produce and distribute a2 Milk™ products in Australia and Japan. The products are currently sold through the grocery channel in Australia and explanatory discussions are being held with production and distribution entities in Japan.

A2DP commenced operations in June 2007. Its shareholders are:

- a2C – 2,700,000 fully paid ordinary shares (50%)
- Freedom Nutritional Products Limited (**FNP**) – 2,700,000 fully paid ordinary shares (50%).

1.3 Freedom Nutritional Products Limited

FNP is an Australian company based in New South Wales. It is listed on the Australian Securities Exchange (**ASX**) with a market capitalisation of A$25.6 million as at 22 June 2010, unaudited equity of A$38.1 million as at 31 December 2009 and revenue from wholly owned businesses of A$49.4 million in the 2009 financial year.

FNP is a diversified food company operating in the health and wellness sector. Its portfolio of products are consumer brands with leading or growing market shares in their categories, including Freedom Foods, a2 Milk™ (through A2DP), So Natural, Australia's Own, Paramount, Brunswick and Thorpedo.

FNP's brands and products are primarily positioned in the "free from" market segments comprising food and beverage products manufactured to be free from key allergens such as gluten, wheat, nuts, dairy and in the case of a2 Milk™, A1 protein, while also maintaining a superior nutritional profile.

1.4 Acquisition of 50% of A2DP

a2C has agreed to acquire the 2,700,000 fully paid ordinary shares in A2DP held by FNP (the **Transaction**). This will result in a2C owning 100% of A2DP.

The consideration to be paid by a2C to FNP under the Transaction consists of:

- the issue of 120,376,950 fully paid ordinary shares to FNP (the **FNP Placement**). This will result in FNP holding 25% of the enlarged share capital of a2C
- an option for FNP to acquire further shares that would increase its shareholding in a2C to 27.5% at any time within 12 months from completion of the Transaction (the **FNP Option**)
- an option for FNP to acquire fully paid a2C ordinary shares equal to 25% of any of the 20,000,000 partly paid a2C ordinary shares that become fully paid (the **Top-up Option**)
- the right for FNP to participate in any capital raising within 12 months from completion of the Transaction so as to maintain its shareholding level (the **Capital Raising Right**).

The terms of the Transaction, the FNP Placement, the FNP Option, the Top-up Option and the Capital Raising Right are set out in the Sale and Subscription Implementation Agreement (**SSIA**) between a2C and FNP dated 21 May 2010.

FNP Placement

The key terms of the FNP Placement are:

- the shares will be issued as fully paid up ordinary shares
- the shares cannot be sold or offered for sale for one year after the shares are allotted to FNP (except in certain circumstances involving share buyback offers or takeover offers)
- the allotment is conditional on shareholder approval.

FNP Option

The key terms of the FNP Option are:

- FNP may acquire further a2C ordinary shares up to a maximum shareholding of 27.5%
- FNP must pay an issue price that is the New Zealand dollar equivalent of A$0.11 per share
- the option does not give FNP any right to vote. FNP will acquire voting rights with the ordinary shares it receives on any exercise of the option
- the option is exercisable for the 12 months following completion of the Transaction. FNP may exercise the option once, at any time during this period
- the option will lapse if FNP disposes of any or all of the a2C shares it holds
- all shares issued to FNP upon the exercise of the option will rank equally in all respects with all other a2C shares on issue.

Top-up Option

The key terms of the Top-up Option are:

- the option can be exercised to allow FNP to acquire such number of a2C shares that is equivalent to 25% of the number of partly paid shares that become fully paid at any time
- any shares issued on exercise of the option will be issued for nil consideration
- the option can be exercised to the extent any of the 20,000,000 partly paid shares become fully paid. The partly paid shares were issued to three a2C executives as part of a long term remuneration package at NZ$0.10 per share, partly paid to NZ$0.001 per share
- the last date that the option is exercisable is 24 August 2014 relating to 10,000,000 partly paid shares (with the others expiring not later than 10 September 2011). The option will lapse when none of the partly paid shares are able to be paid up
- the option will lapse if FNP disposes of any or all of the a2C shares it holds.

Capital Raising Right

The key terms of the Capital Raising Right are:

- FNP may participate in any capital raising and thereby acquire such number of further a2C shares as is required to maintain its shareholding percentage
- the shares issued on any exercise of the right will be for the same consideration and on otherwise the same terms and conditions as are offered to all other participants in the capital raising
- the right is only applicable for the 12 months following completion of the Transaction
- the rights is applicable any time a2C undertakes a capital raising.

Conditions

The Transaction is subject to a number of conditions, including:

- a2C shareholder approval of the Transaction
- no a2C prescribed occurrence occurring, which includes changes in capital structure, dividends and capital returns, material changes to the constitution, creation of material encumbrances, material litigation and insolvency events
- no A2DP prescribed occurrence occurring, which includes material litigation, insolvency events and creation of material encumbrances without A2DP board approval
- no a2C and A2DP material adverse change which includes events which could result in a material diminution in a2C or A2DP’s assets or their earnings before interest, tax depreciation and amortisation (**EBITDA**)
- regulatory approvals required to implement the Transaction.

1.5 Regulatory Requirements

Rule 6 of the Code prohibits:

- a person who holds or controls less than 20% of the voting rights in a code company from increasing its control of voting rights (together with its associates) beyond 20%
- a person holding 20% or more of the voting rights in a code company from increasing its control of voting rights

unless the person and that person's associates comply with exceptions to this fundamental rule.

One of the exceptions, set out in Rule 7(d) of the Code, enables a person and its associates to increase their control of voting rights by an allotment of shares if the allotment is approved by an ordinary resolution of the code company.

Because the FNP Placement will result in FNP holding 25% of the shares in the Company and the exercise of the FNP Option and the Top-up Option may result in FNP holding up to 27.5% of the shares in the Company, a2C is required to seek shareholder approval of the FNP Placement, the FNP Option and the Top-up Option.

a2C is holding a special meeting of shareholders on 20 July 2010 where the Company's shareholders will vote on eight resolutions in respect of the Transaction:

- resolution 1 – the FNP Placement
- resolution 2 – the FNP Option
- resolution 3 – the Top-up Option
- resolution 4 – the Capital Raising Right
- resolution 5 – an increase in the maximum number of directors from seven to eight
- resolution 6 – the appointment of Geoffrey Babidge as a director
- resolution 7 – the appointment of Perry Gunner as a director
- resolution 8 – the appointment of Melvyn Miles as a director.

The Transaction is conditional on all eight resolutions being approved. Accordingly, each resolution is conditional on all of the other resolutions being approved. If any resolution is not approved, then no resolutions will be approved and therefore the Transaction cannot proceed.

Rule 18 of the Code requires the directors of a code company to obtain an Independent Adviser's Report on the merits of an allotment under Rule 7(d).

This Independent Adviser's Report is to be included in the notice of meeting pursuant to Rule 16(h).

1.6 Purpose of the Report

The directors of a2C have engaged Simmons Corporate Finance Limited (**Simmons Corporate Finance**) to prepare an Independent Adviser's Report on the merits of the allotment of shares under the FNP Placement and the potential allotment of shares under the FNP Option and the Top-up Option in accordance with Rule 18 of the Code.

An Independent Adviser's Report is not required in respect of the merits of the Transaction overall. However, issues associated with the acquisition of the 50% interest in A2DP are considered in this report.

An Independent Adviser's Report is not required in respect of the merits of the Capital Raising Right as the exercise of the Capital Raising Right by FNP will simply maintain its level of voting rights rather than increase the level.

Simmons Corporate Finance was approved by the Takeovers Panel on 21 May 2010 to prepare the Independent Adviser's Report.

Simmons Corporate Finance issues this Independent Adviser's Report to a2C's directors to assist the Company's shareholders in forming their own opinion on whether to vote for or against the resolutions in respect of the FNP Placement (resolution 1), the FNP Option (resolution 2) and the Top-up Option (resolution 3).

We note that each shareholder's circumstances and objectives are unique. Accordingly, it is not possible to report on the merits of the FNP Placement, the FNP Option and the Top-up Option in relation to each shareholder. This report on the merits of the FNP Placement, the FNP Option and the Top-up Option is therefore necessarily general in nature.

This Independent Adviser's Report is not to be used for any other purpose without our prior written consent.

2. Evaluation of the Merits of the Allotment of Shares to FNP

2.1 Basis of Evaluation

Rule 18 of the Code requires an evaluation of the merits of the FNP Placement, the FNP Option and the Top-up Option, having regard to the interests of the shareholders not associated with FNP.

There is no legal definition of the term *merits* in New Zealand in either the Code or in any statute dealing with securities or commercial law.

In the absence of an explicit definition of *merits*, guidance can be taken from:

- the Takeovers Panel guidance note on the role of independent advisers dated August 2007
- definitions designed to address similar issues within New Zealand regulations which are relevant to the proposed transaction
- overseas precedents
- the ordinary meaning of the term *merits*.

We are of the view that an assessment of the merits of the FNP Placement, the FNP Option and the Top-up Option should focus on:

- the rationale for the FNP Placement, the FNP Option and the Top-up Option
- the terms of the FNP Placement, the FNP Option and the Top-up Option
- the impact of the FNP Placement, the FNP Option and the Top-up Option on a2C's financial results
- the impact of the FNP Placement, the FNP Option and the Top-up Option on the control of the Company
- the impact of the FNP Placement, the FNP Option and the Top-up Option on a2C's share price
- other issues associated with the FNP Placement, the FNP Option and the Top-up Option
- the implications if the resolutions in respect of the FNP Placement, the FNP Option and the Top-up Option are not approved.

Our opinion should be considered as a whole. Selecting portions of the evaluation without considering all the factors and analyses together could create a misleading view of the process underlying the opinion.

2.2 Summary of the Evaluation of the Merits of the Allotment of Shares to FNP

Our evaluation of the merits of the FNP Placement, the FNP Option and the Top-up Option is set out in detail in sections 2.3 to 2.13.

In our opinion, after having regard to all relevant factors, the FNP Placement, the FNP Option and the Top-up Option have considerable merit from the perspective of the Company's shareholders:

- the rationale for the FNP Placement, the FNP Option and the Top-up Option is sound
- the assessed value of the 50% shareholding in A2DP exceeds the assessed value of the consideration being paid to FNP
- the terms of the FNP Option are reasonable. The exercise price of A$0.11 per share is at a significant premium to the current market price for a2C's shares
- the terms of the Top-up Option are reasonable
- the Transaction (including the FNP Placement, the FNP Option and the Top-up Option) will have a significant impact on the Company's financial results. As a wholly owned subsidiary, a2C will have access to A2DP's cash flows and A2DP's financial performance and financial position will be consolidated into a2C's financial results. A2DP is budgeting revenue of A$31.2 million and net profit after tax (**NPAT**) of A$2.2 million for the 2011 financial year
- the FNP Placement, the FNP Option and the Top-up Option will have a significant impact on FNP's ability to exert control over the Company in that FNP will hold up to 27.5% of the shares in the Company and will have two appointees on the Company's board of directors
- the FNP Placement, the FNP Option and the Top-up Option are unlikely to have any material impact on the liquidity of a2C's ordinary shares or the Company's share price
- the FNP Placement, the FNP Option and the Top-up Option may reduce the attraction of a2C as a takeover target to a small degree
- the dilutionary impact of the FNP Placement, the FNP Option and the Top-up Option on the shareholders' proportionate shareholdings in the Company will be significant in the range of 25.0% to 27.5%
- the implications of the FNP Placement, the FNP Option and the Top-up Option not being approved by the shareholders are that the Transaction will not proceed. The directors of a2C may or may not seek to renegotiate some or all aspects of the Transaction. There is no certainty that the Transaction would be renegotiated. However, if the Transaction were to be renegotiated, then, depending upon the requirements of the NZAX Listing Rules, the Code and the Companies Act 1993, a2C may seek shareholder approval of the alternate transaction. In the meantime, A2DP will remain a 50:50 joint venture with FNP.

2.3 Rationale for the FNP Placement, the FNP Option and the Top-up Option

The FNP Placement, the FNP Option and the Top-up Option form part of the consideration payable to FNP under the Transaction, in conjunction with the Capital Raising Right.

a2C's directors have explained the rationale for the Transaction as allowing the Company to:

- increase its exposure to A2DP's successful and growing business
- control the direction, scope and speed of A2DP's development
- further strengthen its financial position through issuing shares to fund the acquisition of A2DP
- more efficiently fund A2DP's expansion
- aligning the Korean and Japanese markets which may be significant development opportunities for a2C
- directly access A2DP's cash flows, which will result in a2C becoming cash flow positive considerably earlier than would otherwise have been possible
- consolidate A2DP's earnings, thereby significantly reducing the time until a2C becomes profitable
- increase a2C's market capitalisation and profile as a listed company, which should make it easier for a2C to access capital to fund its growth
- more effectively demonstrate the potential of a2 Milk™ products to other possible partners.

We consider the rationale for the Transaction to be sound. The acquisition of the remaining 50% of A2DP will enable a2C to fully control A2DP. While a joint venture structure may have been appropriate when A2DP commenced operations (utilising a2C's intellectual property and FNP's Australian consumer foods business capabilities), the business has grown to a size whereby it is now a significant operation. Having a single owner will better allow A2DP to execute its business strategy to expand its product range and geographical coverage of Australia. Furthermore, a2C will be able to consolidate A2DP in its financial results, thereby significantly transforming its financial performance. Its income statement will include 100% of A2DP's revenue and expenditure.

Consideration for the acquisition is to be in the form of an issue of equity through the FNP Placement and the FNP Option. We consider this to be beneficial to both a2C and FNP:

- the issue of equity preserves a2C's cash resources (which amounted to NZ$6.0 million as at 31 December 2009) for deployment into ongoing operations and other strategic initiatives
- a2C will not need to undertake a capital raising from its shareholders for the Transaction. The size of any capital raising to fund the acquisition would be significant. There would be no guarantee that the capital raising would be successful and the associated costs would be significant – especially if the capital raising were to be underwritten
- by accepting scrip, FNP will continue to share in the risks and rewards of the A2DP business via its shareholding in a2C.

The rationale for the Top-up Option and the Capital Raising Right is to mitigate against any dilution of FNP's shareholding as a result of any partly paid shares becoming fully paid and any non pro rata capital raisings in the year after the completion of the Transaction.

We consider this to be a reasonable requirement for a new cornerstone shareholder in a company who is taking a shareholding of between 25.0% and 27.5%. It is understandable that such a shareholder would not wish to be diluted to below 25.0% soon after it acquired its cornerstone shareholding.

2.4 Value of 50% of A2DP

We assess the fair market value of 50% of the equity in A2DP to be in the vicinity of NZ$12.5 million to NZ$14.6 million.

Our valuation assessment is set out in section 6.

2.5 Value of Consideration Paid

a2C will issue 120,376,950 fully paid ordinary shares to FNP and grant it the FNP Option, the Top-up Option and the Capital Raising Right as consideration for FNP's 50% shareholding in A2DP.

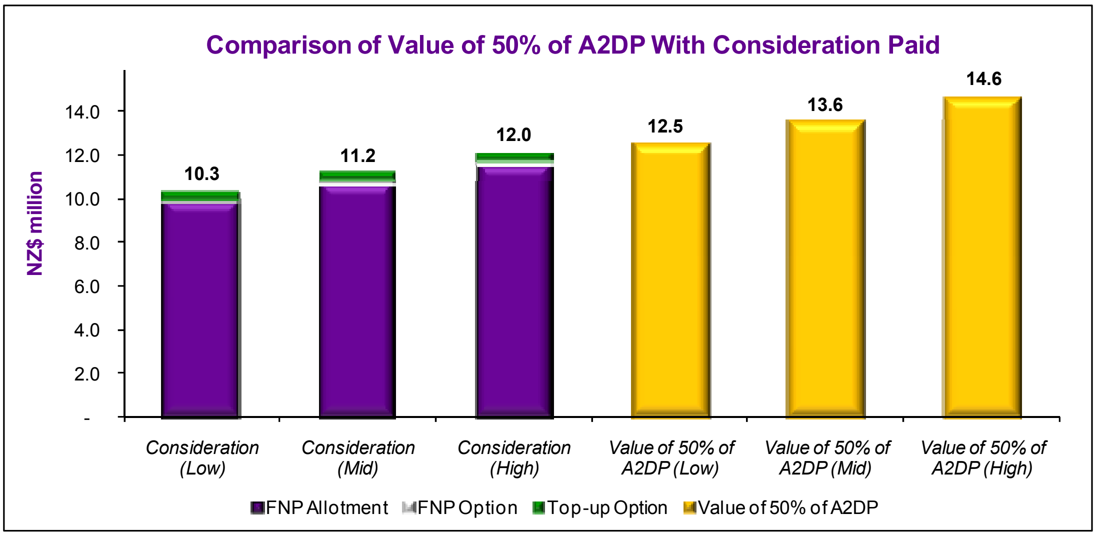
Our evaluation of the FNP Placement is set out in section 7. We assess the value of the FNP Placement to be in the range of NZ$9.9 million to NZ$11.6 million.

Our assessment of the value of the FNP Option is set out in section 8. We assess the value of the FNP Option to be in the vicinity of NZ$0.1 million.

Our assessment of the value of the Top-up Option is set out in section 9. We assess the value of the Top-up Option to be in the vicinity of NZ$0.3 million.

We consider the Capital Raising Right to have negligible value as FNP will be required to subscribe for shares under any capital raising at the same consideration and on the same terms and conditions as any other participants in the capital raising. While this will ensure that FNP maintains its shareholding percentage in a2C, there is no way of determining at this point in time whether any potential capital raising during the life of the option will be on financially advantageous terms to the participants in the capital raising.

FNP is paying no consideration for the FNP Option, the Top-up Option and the Capital Raising Right. Accordingly, the total consideration that a2C is paying for the 50% shareholding in A2DP is in the range of NZ$10.3 million to NZ$12.0 million.



The value of the total consideration paid to FNP is below the assessed valuation range of the 50% shareholding in A2DP. Based on the midpoints of the assessments, a2C is paying NZ$11.2 million for a NZ$13.6 million asset.

In addition to the above, a2C may incur an after tax cost in the vicinity of NZ$0.4 million in respect of the possible disestablishment of its chief executive officer role as a consequence of the Transaction. This is discussed further in section 2.10 under *Operations*.

2.6 Terms of the FNP Placement

In our view, the terms of the FNP Placement are reasonable.

The shares are effectively being issued at a premium to their current market value. The implied issue price of the 120,376,950 shares is in the range of NZ$0.101 to NZ$0.118 (based on the assessed valuation range of NZ$12.5 million to NZ$14.6 million for 50% of the shares in A2DP).

This represents a premium of between 3% and 44% over the Company's volume weighted average share price (**VWAP**) measured over the past one month, three months, six months and one year period (NZ$0.082 to NZ$0.096).

The shares cannot be sold or offered for sale for one year after the shares are allotted to FNP. This will ensure that a large parcel of shares will not be placed for sale on the market in the short term, which otherwise could have a negative impact on the Company's share price.

2.7 Terms of the FNP Option

The FNP Option enables FNP to subscribe for additional a2C ordinary shares which will result in FNP holding up to 27.5% of the ordinary shares in the Company.

The exercise price for the FNP Option is A$0.11 per share (NZ$0.138 based on NZ$1 = A$0.80). This represents a significant premium of 44% to 68% over a2C's one month, three months, six months and one year VWAP (NZ$0.082 to NZ$0.096).

In the event that the FNP Option is exercised because the option is in the money (ie a2C's share price is at least NZ$0.138), then all of a2C's shareholders would have benefited from the substantial uplift in the value of their investment in the Company.

2.8 Terms of the Top-up Option

The Top-up Option will allow FNP to acquire fully paid a2C ordinary shares equal to 25% of any of the 20,000,000 partly paid a2C ordinary shares that become fully paid. The objective of the Top-up Option is to maintain FNP's shareholding level in the event that the partly paid shares are paid up.

The implications of the Top-up Option are that FNP may be issued up to 5,000,000 fully paid ordinary shares at nil consideration, depending on whether the partly paid shares are paid up.

We assess the value of the Top-up Option to be in the vicinity of NZ$0.3 million.

2.9 Impact of the FNP Placement and the FNP Option on a2C's Financial Results

A summary of a2C's recent financial performance and financial position is set out in sections 3.4 and 3.5.

a2C currently records its 50% shareholding in A2DP as an investment in an associate. The carrying value of the investment was NZ$2.2 million as at 31 December 2009. a2C records its share of A2DP's after tax profits in its income statement. This amounted to NZ$0.4 million for the six months ended 31 December 2009 and NZ$0.6 million for the 15 months ended 30 June 2009.

The Transaction will result in A2DP being wholly owned by a2C, enabling it to access A2DP's cash flows and to fully consolidate A2DP's financial results. This will result in 100% of A2DP's revenue and expenditure being disclosed in a2C's income statement and 100% of A2DP's assets and liabilities being disclosed in a2C's balance sheet.

A summary of A2DP's recent financial performance and projected financial performance is set out in section 4.4. A2DP is budgeting revenue of A$31.2 million, EBITDA of A$3.4 million and NPAT of A$2.2 million for the 2011 financial year.

A summary of A2DP's recent financial position is set out in section 4.5. A2DP had total assets of A$8.3 million as at 30 April 2010 and total liabilities of A$4.1 million.

2.10 Impact on Control

Share Capital and Shareholders

a2C currently has 381,130,850 shares on issue:

- 361,130,850 fully paid ordinary shares held by 1,115 shareholders
- 20,000,000 partly paid ordinary shares held by three shareholders.

The names, number of shares and percentage holding of the ten largest holders of fully paid shares as at 11 June 2010 are set out in section 3.7.

Mountain Road Investments Limited (**Mountain Road**) is a2C's largest shareholder, holding 41.14% of the Company's fully paid shares.

FNP Shareholding Level

The FNP Placement will result in FNP holding 25.0% of the Company's fully paid ordinary shares. The FNP Option will enable FNP to increase its shareholding to up to 27.5% of the Company's shares. The Top-up Option and the Capital Raising Right will enable FNP to maintain its shareholding level. Therefore, following the Transaction, FNP will hold at least 25.0% of the voting rights in the Company and could hold up to 27.5% of the voting rights.

The FNP Placement will dilute Mountain Road's shareholding down to 30.8%. If FNP exercises the FNP Option so as to increase its shareholding to 27.5% and there are no other changes to a2C's capital structure, Mountain Road's shareholding will dilute down to 29.8%.

Potential Shareholding Levels

	Current		Post FNP Placement		Post FNP Option[1]	
	No. of Shares[2]	%	No. of Shares[2]	%	No. of Shares[2]	%
Mountain Road	148,558,701	41.1%	148,558,701	30.8%	148,558,701	29.8%
Other current shareholders	212,572,149	58.9%	212,572,149	44.2%	212,572,149	42.7%
	361,130,850	100.0%	361,130,850	75.0%	361,130,850	72.5%
FNP	-	-	120,376,950	25.0%	136,980,667	27.5%
	361,130,850	100.0%	481,507,800	100.0%	498,111,517	100.0%

1 Assumed to be exercised to the maximum extent possible (ie up to a 27.5% shareholding level)
2 Fully paid ordinary shares only

Shareholder Voting

Mountain Road's current shareholding of 41.1% enables it to singlehandedly block special resolutions (which require the approval of 75% of the votes cast by shareholders) and to significantly influence the outcome of ordinary resolutions (which require the approval of more than 50% of the votes cast by shareholders).

Under the Companies Act 1993, a special resolution is required to:

- adopt, alter or revoke a company's constitution
- approve a major transaction
- approve an amalgamation of a company
- place a company in liquidation.

While a 41.1% interest is technically not sufficient to pass an ordinary resolution, in reality, it potentially could in a listed company with more than 1,100 shareholders (as a2C currently has). This is because a number of shareholders in listed companies tend not to vote on resolutions and hence the relative weight of the 41.1% interest increases.

Accordingly, Mountain Road currently has significant shareholding voting control over a2C.

With FNP holding a 25.0% shareholding (following the FNP Placement) then possibly increasing this to 27.5% (following the exercise of the FNP Option to the maximum extent possible), it will also be able to single-handedly block special resolutions.

Therefore the effect of the FNP Placement and the FNP Option on shareholding voting is that a2C will have two shareholders who hold the ability to block special resolutions – Mountain Road with 29.8% and FNP with 27.5%. Neither shareholder will be able to singlehandedly control the outcome of ordinary resolutions but they will be able to do so if they voted in the same manner.

The ability for any shareholder to influence the Company's ordinary resolutions or special resolutions may be reduced by external factors such as the Company's constitution, the NZAX Listing Rules and the Companies Act.

We are of the view that the FNP Placement, the FNP Option and the Top-up Option will have significant impact on FNP's ability to exert shareholder control over a2C. However, the shareholders in a2C already face this situation as Mountain Road currently has significant shareholder control over the Company.

Board of Directors

The current directors of a2C are:

- Cliff Cook, chairman, associated with Mountain Road
- Dr Jock Allison, independent director
- Gregory Hinton, executive director, associated with Mountain Road
- Richard Le Grice, independent director
- David Mair, executive director.

Upon completion of the Transaction, a2C will appoint Geoffrey Babidge, Perry Gunner and Melvyn Miles to the Company's board of directors. Mr Gunner will be appointed deputy chairman.

Mr Babidge is the managing director and chief executive officer of FNP and executive chairman of A2DP. He will join a2C as its managing director and from that time his interests will be aligned with those of the Company's shareholders.

Mr Gunner is the independent chairman of FNP and Mr Miles is an independent non-executive director of FNP. They will represent FNP on a2C's board.

Resolution 5 will see the maximum number of directors increase from seven to eight. FNP will have two appointees on a board of eight directors (25%).

In our view, FNP will have considerable influence at board level, but it will be proportionate to its shareholding level. Mountain Road will also have two representatives on the board, which will be broadly proportionate to its diluted shareholding level.

Operations

The FNP Placement, the FNP Option and the Top-up Option per se will have no discernible impact on the operations of the Company. However, the Transaction will significantly impact on a2C's operations. The majority of the Company's earnings and operating assets will be domiciled in Australia.

Mr Babidge will be appointed the managing director of a2C. He has significant public company experience in the food industry. He has been a director of FNP since 2002. He was formerly the chief executive officer of Bunge Defiance (a major milling and baking group) and managing director of the dairy interests of National Foods Limited.

As a consequence of Mr Babidge's appointment as a2C managing director, it is possible that the role of the Company's chief executive officer held by Scott Pannell will be disestablished. Under the terms of Mr Pannell's employment agreement, Mr Pannell may become entitled to a termination payment in the vicinity of NZ$0.6 million, which would equate to an after tax cost to a2C in the vicinity of NZ$0.4 million.

Under the SSIA, FNP is required to continue to provide the same services (at the same service levels) as has been provided by FNP to a2C in the ordinary course over the past year. The services are to be provided for 12 months at the current fee level.

2.11 Impact on Share Price and Liquidity

A summary of a2C's daily closing share price and daily volumes of shares traded since 3 January 2008 is set out in section 3.8, along with an analysis of VWAP, traded volumes and liquidity (measured as traded volumes as a percentage of total shares outstanding and the free float).

During the period, a2C's shares have traded between NZ$0.05 and NZ$0.23 at a VWAP of NZ$0.09. The one month, three month, six month and one year VWAP has ranged from NZ$0.082 to NZ$0.096.

Trading in the Company's shares is extremely thin, reflecting that approximately 41% of the shares are held by cornerstone shareholder Mountain Road.

In our view, given that the FNP Placement includes restrictive terms on FNP's ability to transact the shares it is issued and given that the size of the free float will not change, the FNP Placement is unlikely to have a positive or negative effect on the liquidity of a2C's shares.

As the FNP Placement shares are effectively being issued at a premium to the current market value of a2C's shares, the FNP Placement is unlikely to have any material adverse impact on the Company's share price. Instead, it may have a positive impact on the Company's shares. However, this will be influenced by the level of supply and demand for the Company's shares after the completion of the Transaction.

2.12 Other Issues

May Reduce the Likelihood of a Takeover Offer from Mountain Road

As long as Mountain Road holds more than 20% and not more than 50% of the voting rights in the Company, it cannot increase the level of its shareholding unless it complies with the provisions of the Code. It will only be able to acquire more shares in the Company if:

- it makes a full or partial takeover offer or
- the acquisition is approved by way of an ordinary resolution of non-associated shareholders or
- the Company makes an allotment of shares which is approved by way of an ordinary resolution of non-associated shareholders.

We are not aware of any past or current intention on Mountain Road's part to make a takeover offer for a2C. We note however that with FNP becoming a cornerstone shareholder in a2C, Mountain Road may be less inclined to make a takeover offer for the Company if it had any such intentions.

Likelihood of Other Takeover Offers may Reduce

At present, any bidder looking to fully take over the Company would need to ensure that Mountain Road would accept its offer.

Following the completion of the Transaction, any bidder looking to fully take over the Company would need to ensure that both Mountain Road and FNP would accept its offer. While dealing with two cornerstone shareholders potentially increases the complexity of negotiating a takeover, this in itself is unlikely to deter parties who are seriously contemplating a takeover of the Company.

Having said that, FNP's shareholding in a2C arising from the FNP Placement, the FNP Option and the Top-up Option may have some negative impact on the attraction of a2C as a takeover target to other parties.

Overall, we do not consider this to be a significant issue.

Dilutionary Impact is Significant

The FNP Placement will result in a2C's current shareholders' proportionate shareholdings in the Company being diluted by 25.0%. The combined effect of the FNP Placement and the FNP Option will result in a2C's current shareholders' proportionate shareholdings in the Company being diluted by 27.5%.

However, given that the FNP Placement shares are effectively being issued at a premium to the current share price, the value of the current shareholders' investment in a2C is unlikely to be diluted. In other words, there is no value transfer from the current shareholders to FNP. Ultimately, the question of any value transfer is likely to be of greater importance to the holders of small minority parcels than the dilution in their proportionate voting interest.

Shareholder Approval is Required

Pursuant to Rule 7(d) of the Code, the Company's shareholders must approve by ordinary resolution the FNP Placement, the FNP Option and the Top-up Option.

The FNP Placement, the FNP Option and the Top-up Option will not proceed unless the shareholders approve all eight resolutions in respect of the Transaction.

2.13 Implications of the Resolutions not Being Approved

In the event that any of the eight resolutions is not approved, then the Transaction cannot proceed.

If the Transaction does not proceed, then A2DP will remain a 50:50 joint venture with FNP. The directors of a2C may or may not seek to renegotiate some or all aspects of the Transaction. There is no certainty that the Transaction would be renegotiated. In the event that the Transaction is renegotiated, then, depending upon the requirements of the NZAX Listing Rules, the Code and the Companies Act, a2C may seek shareholder approval of the alternate transaction.

In the meantime however, a2C will not be in a position to capture the benefits of the Transaction discussed in section 2.3.

2.14 Voting For or Against the Resolutions

Voting for or against the resolutions in respect of the FNP Placement, the FNP Option and the Top-up Option is a matter for individual shareholders based on their own views as to value and future market conditions, risk profile and other factors. Shareholders will need to consider these consequences and consult their own professional adviser if appropriate.

3. Profile of a2C

3.1 Background

a2C was founded by Howard Paterson and Dr Corran McLachlan. It was incorporated on 17 February 2000 and issued approximately 20.4 million A class shares and 115.7 million B class shares.

The Company's shares were initially traded on the unlisted securities market. It listed on the NZAX on 21 April 2004. Prior to listing on the NZAX, the Company's share capital was restructured into one class.

3.2 Nature of Operations

The Company's business was initially based around the research of Dr McLachlan in respect of beta casein A1, a protein found in milk, which has been linked to heart disease.

The Company owns and licenses a suite of intellectual property that enables the identification of cattle for the production and subsequent marketing of milk that does not contain A1, which it calls a2 Milk™. a2C has strong protection of its intellectual property with registered patents and trademarks in all existing and potential markets for a2 Milk™ products.

a2C currently operates with two main business models - licensing and joint venture models. The licensing model has been utilised in New Zealand and Korea, whilst the Company has formed joint ventures in Australia and America to drive the growth of a2 Milk™.

New Zealand

a2 Milk™ has been sold in New Zealand since 2003. Two licensees produce a2 Milk™ in New Zealand branded as *Fresha Valley A2 Milk* and *Ridge A2*.

Australia

A2 Australia Pty Limited (**A2 Aust**) was the licensed processor and marketer of a2 Milk™ in Australia. A2 Aust operated as a wholly owned subsidiary of a2C until May 2007.

On 1 June 2007, a new joint venture business – A2DP – commenced trading by taking over the business and assets of A2 Aust.

A profile of A2DP is set out in section 4.

USA

a2 Milk™ was launched in a test market in the Mid-West of the USA in April 2007 through the joint venture business a2 Milk Company LLC (**a2MCo**). The joint venture is owned 50:50 by a2C and ISI Brand Inc.

The USA dairy market is intensely competitive and continues to be a major challenge.

Korea

After Purmil (formerly called Lotte) made the decision to withdraw a2 Milk^{TM} from the Korean market in January 2009, a2C terminated the Purmil licence in December 2009 and is now pursuing its rights under that agreement.

a2C is also taking actions against Namyang Dairy Products Co. Limited to protect its brand and patent rights in Korea.

Business Strategy

The Company has recently reviewed its strategic plan to focus on increasing the global availability of a2 Milk^{TM}. a2C's objective is to ensure the availability of a2 Milk^{TM} for consumers all around the world. Its vision is to provide the health benefits of a2 Milk^{TM} to all global consumers of dairy products.

This process of geographic growth is structured around a strategic plan that envisages multiple business model options to suit the individual requirements of any one country or region. The expansion plan of the business is based around steady, profitable growth on a region by region basis, ensuring the growth of the business is sustainable. a2C aims to improve human health via the consumption of a2 Milk^{TM} whilst ensuring the business delivers a strong return on investment to its shareholders.

3.3 Key Issues Affecting a2C

The main industry and specific business factors and risks that a2C faces include:

- its ability to raise sufficient capital to fund ongoing costs of developing and operating its business
- changes in economic conditions, particularly in the key markets that it focuses on
- changes in the regulatory environment in respect of the production and sale of milk and milk products
- the success or otherwise of its licensees and joint ventures in generating sales of a2 Milk^{TM} and related products in their respective territories
- the protection of its intellectual property
- the outcome of further scientific investigations in respect of beta-casein A1 and A2.

3.4 Financial Performance

Summary of a2C Financial Performance	Year to 31 Mar 07 (Audited) NZ$000	Year to 31 Mar 08 (Audited) NZ$000	15 Mths to 30 Jun 09 (Audited) NZ$000	6 Mths to 31 Dec 09 (Unaudited) NZ$000
Total revenue	7,590	2,797	1,575	249
Total expenses	(12,715)	(9,095)	(5,103)	(966)
Profit / (loss) before tax	(5,125)	(6,298)	(3,528)	(717)
Taxation	0	0	0	0
Profit / (loss) for the year	(5,125)	(6,298)	(3,528)	(717)

Source: a2C audited financial statements and 31 December 2009 half year report

a2C has recorded operating losses since it listed on the NZAX.

The Company's operating revenue consists mainly of licence fees, milk royalties and interest received. Revenue in the 2007 financial year included milk sales in Australia from a2C's wholly owned subsidiary A2 Aust which ceased operations in May 2007.

Operating expenses consist mainly of costs associated with milk sales (up to May 2007), along with employee costs and financing costs.

The results for the 2008 financial year included the trading results of A2 Aust up to 31 May 2007 (a loss of NZ$0.9 million) and equity accounted results of A2DP and a2MCo (losses totalling NZ$2.5 million).

Operating revenue in the 2008 financial year included NZ$1.4 million from the sale of a perpetual licence agreement to A2DP.

Revenue in the 2009 financial period included NZ$0.5 million of foreign exchange gains and NZ$0.5 million of interest income.

Expenses in the 2009 financial period included NZ$0.3 million of impairment losses in respect of the investment in a2MCo and NZ$1.1 million in respect of the settlement of a profit share entitlement with the Child Health Research Foundation.

3.5 Financial Position

Summary of a2C Financial Position	As at 31 Mar 07 (Audited) NZ$000	As at 31 Mar 08 (Audited) NZ$000	As at 30 Jun 09 (Audited) NZ$000	As at 31 Dec 09 (Unaudited) NZ$000
Current assets	2,846	347	7,379	6,317
Non-current assets	819	461	1,845	2,159
Total assets	3,665	808	9,224	8,476
Current liabilities	(5,020)	(8,431)	(419)	(325)
Total equity	(1,355)	(7,623)	8,805	8,151

Source: a2C audited financial statements and 31 December 2009 half year report

a2C's main current assets as at 31 December 2009 were cash and short term deposits of NZ$6.0 million and accounts receivables of NZ$0.2 million.

Its non-current assets consisted mainly of the investment in A2DP.

Current liabilities consisted mainly of accounts payable and employee entitlements.

3.6 Cash Flows

Summary of a2C Cash Flows

	Year to 31 Mar 07 (Audited) NZ$000	Year to 31 Mar 08 (Audited) NZ$000	15 Mths to 30 Jun 09 (Audited) NZ$000	6 Mths to 31 Dec 09 (Unaudited) NZ$000
Net cash flow from / (used in) operating activities	(5,202)	(4,202)	(2,799)	(990)
Net cash from / (used in) investing activities	(745)	(916)	(1,272)	0
Net cash from / (used in) financing activities	0	0	18,611	20
Net increase / (decrease) in cash held	(5,947)	(5,118)	14,540	(970)
Opening cash balance	3,197	(2,709)	(7,811)	7,165
Effect of exchange rate fluctuations	41	16	436	(156)
Closing cash balance	(2,709)	(7,811)	7,165	6,039

Source: a2C audited financial statements and 31 December 2009 half year report

a2C's negative operating cash flows reflect its operating losses each period.

The Company raised NZ$18.6 million (net) from the issue of 196,315,757 shares in the 2009 financial period.

3.7 Capital Structure and Shareholders

a2C currently has 381,130,850 shares on issue:

- 361,130,850 fully paid ordinary shares held by 1,115 shareholders
- 20,000,000 partly paid ordinary shares held by three shareholders.

The Company's shares were listed on the NZAX on 21 April 2004. a2C completed a one for two renounceable rights issue on 26 April 2004, undertook a five to one share consolidation on 3 May 2005, completed a two for one renounceable rights issue on 19 September 2005 and a three for four renounceable rights issue on 26 August 2008. It issued 13,915,962 shares to the Child Health Research Foundation on 29 August 2008 and issued 83,000,000 shares to institutional investors at NZ$0.10 per share in September 2008.

The names, number of shares and percentage holding of the ten largest holders of fully paid shares as at 11 June 2010 are set out below.

a2C's Ten Largest Shareholders – Fully Paid Shares		
Shareholder	**No. of Shares Held**	**%**
Mountain Road	148,558,701	41.14%
New Zealand Central Securities Depository Limited	116,117,607	32.15%
Child Health Research Foundation	13,915,962	3.85%
Ulrike McLachlan	7,178,563	1.99%
DDD Investments Limited	6,000,000	1.66%
TP Trustee Brendemeer Limited	5,000,000	1.38%
Peter Hinton	3,293,064	0.91%
Forsyth Barr Custodians Limited	3,000,000	0.83%
Michael Hare	2,400,000	0.66%
Custodial Services Limited	1,840,750	0.51%
Subtotal	307,304,647	85.10%
Others (1,105 shareholders)	53,826,203	14.90%
Total	361,130,850	100.00%

Source: NZX Data

Mountain Road is a2C's largest shareholder, holding 41.14% of the fully paid ordinary shares. It acquired its shares in September 2005 via underwriting the rights issue in that year, through the transfer of a2C shares previously held by its associate Machin Investments Limited and via underwriting a rights issue in 2008.

Mountain Road's shareholders are:

- Private Health Care (NZ) Limited (**Private Health Care**) (90%)
- Gregory Hinton (10%).

Private Health Care is owned by interests associated with Cliff Cook, the chairman of a2C. Mr Hinton is a director of a2C.

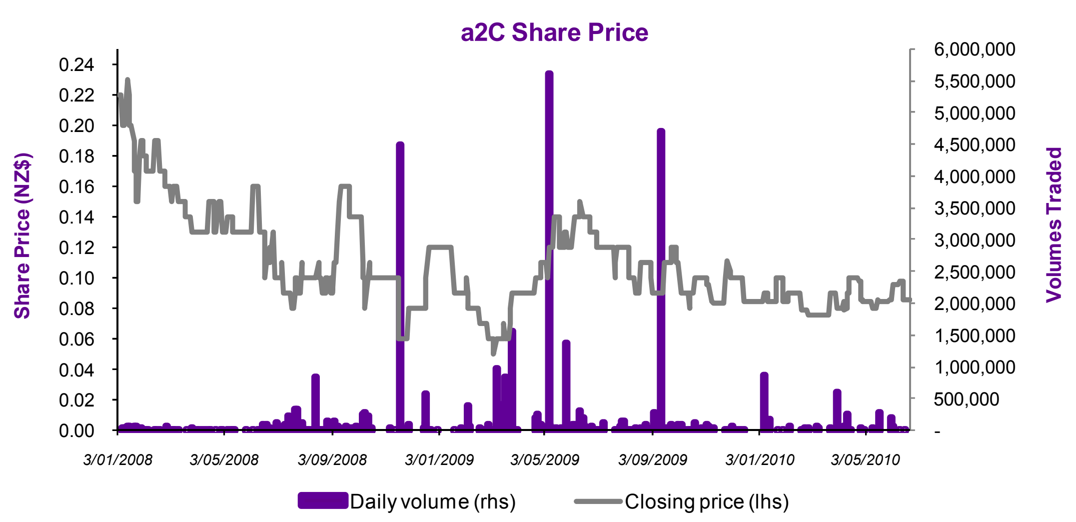
The holders of the partly paid shares are set out below.

a2C Shareholders – Partly Paid Shares				
Shareholder	**Position**	**Issue Date**	**Amount Paid Up NZ$**	**No. of Shares Held**
Scott Pannell	Chief executive officer	22 May 2009	0.001	10,000,000
David Mair	Executive director	10 Sep 2009	0.001	5,000,000
Gregory Hinton	Executive director	24 Nov 2009	0.001	5,000,000
				20,000,000

The 20,000,000 partly paid shares were issued at NZ$0.10 per share, partly paid to NZ$0.001 per share at the issue date.

3.8 Share Price History

Set out below is a summary of a2C's daily closing share price and daily volumes of shares traded from 3 January 2008 to 22 June 2010.



During the period, a2C's shares have traded between NZ$0.05 (on 6 March 2009) and NZ$0.23 (on 14 January 2008) at a VWAP of NZ$0.09.

Trading in the Company's shares is extremely thin, reflecting that approximately 41% of the shares are held by cornerstone shareholder Mountain Road.

An analysis of VWAP, traded volumes and liquidity (measured as traded volumes as a percentage of total shares outstanding and the free float) is set out below.

a2C Share Trading

Period	Low [1] NZ$	High [1] NZ$	VWAP [1] NZ$	Volume Traded [1] (000)	Liquidity Total [1]	Liquidity Free Float [1]
1 month	0.085	0.098	0.088	337	0.1%	0.2%
3 months	0.079	0.100	0.082	1,773	0.5%	0.8%
6 months	0.076	0.100	0.084	3,127	0.9%	1.5%
12 months	0.076	0.140	0.096	10,290	2.8%	4.8%

1 To 22 June 2010

4. Profile of A2DP

4.1 Company Background

A2DP was registered for trading on 10 May 2007. It commenced trading in June 2007 after acquiring the business and assets of A2 Aust.

4.2 Nature of Operations

Overview

A2DP has the exclusive rights to produce and distribute a2 Milk^{TM} products in Australia and Japan.

The rights relate to a series of patents and brand registrations that restrict other organisations in sourcing, distributing and marketing a2 Milk^{TM}.

Organisational Structure

A2DP currently employs 17 people and also receives support in the form of administration and management services from FNP under a management services agreement.

The executive chairman of A2DP is Geoffrey Babidge, who is also the managing director and chief executive officer of FNP. The executive general manager of A2DP is Peter Nathan and the general manager operations is Simon Hennessy.

Products

A2DP sells a range of fresh milk and long life (UHT) milk products in Australia with yoghurt products in this market sold under licence.

A2DP Products

Milk	Yoghurt
a2 Full Cream Milk – 1 litre, 2 litres	a2 Jalna Natural Low Fat Creamy Yoghurt – 1kg
a2 Light Milk – 1 litre, 2 litres	a2 Jalna Creamy Vanilla Yoghurt – 1kg
a2 Long Life Full Cream Milk – 1 litre	a2 Jalna Low Fat Berryfruit Yoghurt – 200g
a2 Long Life Light Milk – 1 litre	a2 Jalna Low Fat Passionfruit Yoghurt – 200g
a2 No Fat Milk – 2 litres	

Source: A2DP

Milk

A2DP outsources the supply, production and packaging of its milk products to three companies:

- Southern Processing Pty Limited (**Southern Processing**)
- Norco Co-operative Limited (**Norco**)
- Challenge Dairy Co-operative Limited (**Challenge**).

A2DP Milk Suppliers and Production

Company	Location	States Supplied	Operations
Southern Processing	Victoria	Victoria South Australia Tasmania	Milk supply and packaging managed by Southern Processing
Norco	New South Wales	New South Wales Queensland	Milk supply sourced and managed by A2DP. Packaging managed by Norco
Challenge	Western Australia	Western Australia	Milk supply and packaging managed by Challenge

Source: A2DP

Yoghurt

A2DP recently entered into a licence and supply arrangement with Jalna Dairy Foods Pty Limited (**Jalna**) for the manufacture and sale of a2 branded yoghurts in Australia.

The licence agreement enables Jalna to develop, manufacture, market and distribute dairy yoghurts co-branded as a2 utilising A2DP's intellectual property on an exclusive basis for the Australian market. Licence fees are paid by Jalna during the term of the agreement.

The supply agreement provides for A2DP to supply a2 certified milk and dairy product ingredients for use in the manufacture Jalna's a2 yoghurt range.

An initial range of a2 Jalna yoghurts was launched in retail supermarkets during the first half of 2010.

Sales Channels

A2DP primarily sells its products through the grocery channel to the two major supermarket chains in Australia – Coles and Woolworths. Approximately 85% of A2DP's products are supplied to the supermarkets' distribution centres, with the remaining products delivered by distributors direct to stores.

4.3 Business Strategy

The key elements of A2DP's strategy are:

- build brand value by developing the unique a2 proposition by powerful communication platforms and the roll-out of high quality products
- build scale to further build brand awareness and develop organisational capability
- build manufacturing capability and security through key strategic alliances
- continue to develop milk supply arrangements to secure adequate supply.

The company's core initial focus is in the fresh milk, UHT milk, yoghurt and infant formula categories.

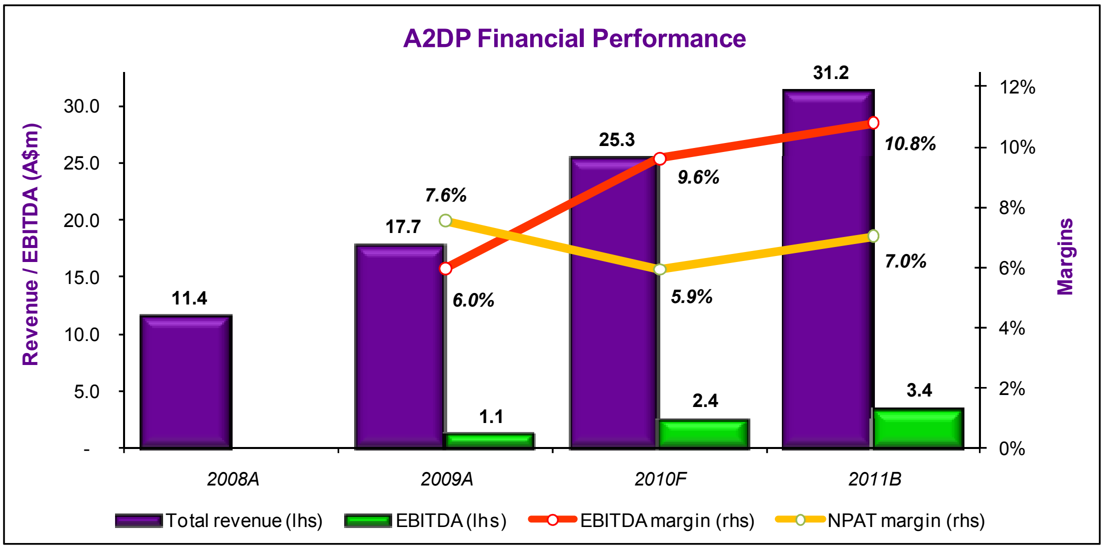
4.4 Financial Performance

Summary of A2DP Financial Performance

	14 Mths to 30 Jun 08 (Unaudited) A$000	Year to 30 Jun 09 (Audited) A$000	Year to 30 Jun 10 (Forecast) A$000	Year to 30 Jun 11 (Budget) A$000
Volume (000 litres)	6,600	10,862	15,752	19,457
Revenue	11,444	17,659	25,283	31,170
EBITDA	(3,545)	1,055	2,433	3,365
EBIT	(3,559)	1,033	2,404	3,328
NPAT	(3,825)	1,334	1,502	2,192
Volume (growth p.a.)		65%	45%	24%
Revenue growth p.a.		54%	43%	23%
EBITDA margin	(31%)	6%	10%	11%
EBIT margin	(31%)	6%	10%	11%
NPAT margin	(33%)	8%	6%	7%

EBIT: Earnings before interest and tax

Source: A2DP 2009 annual report, 2010 forecast and 2011 budget



A2DP commenced trading commenced in June 2007. Following a loss in its first financial period, the company has recorded positive earnings as volumes of sales have increased.

Revenue growth has been driven by volume increases with the average price per litre of milk remaining relatively steady.

The increases in milk volumes have been driven by:

- expanding the base of fresh milk sales in New South Wales, Queensland and Victoria through the supermarket channel
- launching a2 Milk™ into Western Australia and Tasmania
- introducing new products
- increased marketing spend
- support from the grocery trade in improving shelf presence and availability
- an increasing awareness of the benefits of a2 Milk™.

Sales in New South Wales currently account for approximately one third of volumes sold, with Victoria representing approximately one quarter and Queensland one fifth of volumes sold.

A2DP pays a2C a royalty of A$0.01 per litre on milk sales up to 25 million litres and A$0.02 per litre on any additional milk sales.

The 2010 forecast is based on ten months actual results to 30 April 2010.

The key assumptions adopted in the 2011 budget are:

- an increase in volumes to 19.5 million litres
- constant product mix and relatively constant revenue per litre
- relatively constant gross margin
- slight reductions in variable distribution costs and marketing spend as a percentage of revenue due to higher revenue levels.

4.5 Financial Position

Summary of A2DP Financial Position

	As at 30 Jun 08 (Unaudited) A$000	As at 30 Jun 09 (Audited) A$000	As at 30 Apr 10 (Unaudited) A$000
Current assets	4,200	4,986	6,694
Non-current assets	1,306	2,078	1,592
Total assets	5,506	7,064	8,286
Current liabilities	(9,331)	(5,055)	(2,415)
Non-current liabilities	0	0	(1,665)
Total liabilities	(9,331)	(5,055)	(4,080)
Total equity	(3,825)	2,009	4,206

Source: A2DP 2009 annual report and 30 April 2010 balance sheet

A2DP's main current assets as at 30 April 2010 were trade debtors of A$6.1 million. It holds negligible inventory.

Its non-current assets consisted of fixed assets of A$0.1 million, intangible assets of A$1.3 million (a2 intellectual property acquired from a2C at the commencement of operations) and a deferred tax asset of A$0.2 million.

Current liabilities consisted of trade creditors of A$1.4 million and provisions and accruals of A$1.0 million.

Non-current liabilities consisted of a A$1.7 million draw down of A2DP's A$3.0 million debtor financing facility provided by National Australia Bank. A2DP has no bank overdraft or other loans.

a2C and FNP have converted A$4.5 million of convertible notes and A$0.9 million of shareholders' advances into equity between May 2009 and July 2009.

4.6 Cash Flows

Summary of A2DP Cash Flows

	14 Mths to 30 Jun 08 (Unaudited) A$000	Year to 30 Jun 09 (Audited) A$000
Net cash used in operating activities	(5,090)	(956)
Net cash used in investing activities	(1,320)	(4)
Net cash provided by financing activities	6,500	1,079
Net increase in cash held	90	119
Opening cash balance	-	90
Closing cash balance	90	209

Source: A2DP 2009 annual report

The improved earnings in the 2009 financial year resulted in a significant reduction in net cash outflows from operating activities.

Investing activities cash outflow in the 2008 financial period related mainly to A$1.3 million in respect of the acquisition of a2 intellectual property.

Net cash provided by financing activities in the 2008 financial period consisted of A$4.7 million from the issue of convertible notes to a2C and FNP and A$1.8 million drawn down from the debtor financing facility.

Net cash provided by financing activities in the 2009 financial year consisted of A$0.4 million of loans from a2C and FNP, A$0.3 million from the issue of convertible notes and A$0.4 million from the debtor financing facility.

The convertible notes and shareholder loans have now all been converted into ordinary shares in A2DP.

4.7 Directors

The A2DP board presently has five board members:

- Geoffrey Babidge (FNP representative), executive chairman
- Ronald Perich (FNP representative)
- Gregory Hinton (a2C representative)
- Rory Macleod (FNP representative)
- David Mair (a2C representative).

4.8 Capital Structure and Shareholders

A2DP currently has 5,400,000 fully paid ordinary shares on issue, currently held by:

- a2C – 2,700,000 shares (50%)
- FNP – 2,700,000 shares (50%).

5. Overview of the Australian Dairy Sector

5.1 Industry Overview

The dairy industry is one of Australia's major rural industries. Based on a farm-gate value of production of approximately A$4.0 billion in 2008/09, it ranks third behind the beef and wheat industries. It is estimated that approximately 40,000 people are directly employed on dairy farms and manufacturing plants[1].

Australia accounts for approximately 10% of the Asia-Pacific dairy market's value. Milk sales are a significant proportion of the market, generating total revenue of A$1.7 billion in 2008[2]. Milk production in 2010 was 8.9 billion litres, down from 9.4 billion litres in 2009. The forecast for 2011 is for a slight increase to 9.0 billion litres[3].

Dairying is a well-established industry across temperate and some subtropical areas of Australia. While the bulk of milk production occurs in the south-east corner of the country – some 80% in the three states of Victoria, South Australia and Tasmania – all states have dairy industries that supply fresh drinking milk to nearby cities and towns. Milk production remains strongly seasonal in the three main states, reflecting the pasture-based nature of the industry, with production peaking in October and tapering off in the cooler months from April onwards.

International markets and prices are the major factor determining the price received by farmers for their milk. The average milk price was approximately US$35 per 100kg of milk in 2008[4], a comparatively lower price compared with many major producing countries. In the last decade around half of Australia's milk production has been exported.

While farm numbers have steadily decreased over the past three decades, milk output has generally increased, due to increasing cow numbers and improved yields up until the major drought of 2002/03. The following few years were a period of consolidation for the industry, with falling cow numbers and seasonal conditions constraining production. Recent seasons have seen continuing drought conditions across many dairying and grain growing regions, further reducing cow numbers and limiting any growth in milk production.

The underlying trend has continued to fewer farms, larger herds and increasing levels of milk production per farm. Farmers have made changes to their general farm management practices and adopted a range of improved technologies, including soil testing, fodder conservation, supplementary feeding, improved animal genetics, artificial insemination programs, the use of new milking equipment and techniques and the widespread use of computers to record and monitor herd and individual cow performance.

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1 Australian Dairy Industry in Focus 2009 by Dairy Australia, 2009

2 Dairy in Australia, Datamonitor, November 2009

3 Australian Dairy Industry in Focus 2009 by Dairy Australia, 2009 and Dairy 2010 Situation and Outlook by Dairy Australia, May 2010

4 Australian Dairy Industry in Focus 2009 by Dairy Australia, 2009

5.2 Regulatory Environment

Australian dairy farmers operate in a deregulated and open market. The only government involvement is in the administration of food standards and food safety assurance systems.

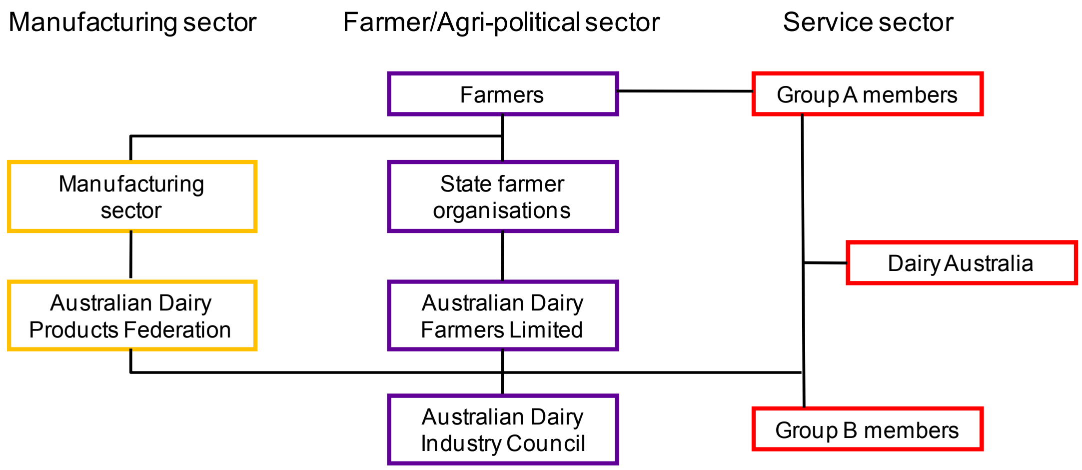
There is currently one dairy levy imposed on the sector - the Dairy Produce Levy – which is a levy on milk sent to a manufacturer. This levy provides funding for marketing, research and development and animal health programs.

Until February 2009, the industry also imposed an 11% Dairy Adjustment Levy on each litre of drinking milk bought by consumers to fund the A$2 billion deregulation package. Proceeds from the levy were used to fund the Dairy Industry Adjustment Program to help dairy farmers, their families and dairy communities adjust to a deregulated market.

5.3 Sector Participants

The Australian dairy industry is diverse, incorporating primary production, manufacturing and marketing. As a result, a number of bodies represent the various sectors and provide a framework for the industry to work together.

Australian Dairy Industry Organisations



Source: Australian Dairy Industry in Focus 2009 by Dairy Australia, 2009

Dairy Australia is the industry owned national service organisation. Formed on 1 July 2003, Dairy Australia replaced the Australian Dairy Corporation and the Dairy Research and Development Corporation. It is accountable to its members (being levy payers who elect to become members) and the industry bodies. Its mission is to ensure successful collaboration across the dairy supply chain, driving industry services and innovation for the ultimate benefit of the levy payers.

The Australian Dairy Industry Council (**ADIC**) is the industry's policy body. It co-ordinates industry policy and represents all sectors of the industry on national and international issues. The ADIC represents farmers, dairy product manufacturers and milk processors through its constituent organisations:

- Australian Dairy Farmers Limited (**ADFL**)
- Australian Dairy Products Federation (**ADPF**).

The ADIC has the task of bringing these bodies together to form a united view on issues affecting the dairy industry.

ADFL provides national representation for dairy farmers and forms the dairy commodity council of the National Farmers' Federation. Its members include the six dairy farmer organisations representing each state.

ADPF is the national organisation representing the interests of dairy product manufacturers and traders. ADPF's primary purpose is to promote the interests of its members and the dairy industry in general to the federal and state governments and other sectors of the community.

Each state has a food safety organisation to ensure that individual processors and dairy farmers comply with food safety standards. The Australian Dairy Authorities Standards Committee, with representatives from each state food safety organisation, ensures there is a national approach to dairy food safety issues.

From a production point of view the Australian dairy market is fragmented. However, three major market participants are:

- National Foods Limited, wholly owned by Kirin Holdings
- Fonterra Co-operative Group Limited
- Parmalat S.p.A.

5.4 Critical Success Factors for the Industry

Global Economy

An improving global economy promotes stronger consumer confidence, with developing geographies such as Asia providing growth prospects. The International Monetary Fund expects commodity prices to increase further on the strength of global demand.

Global Demand

Since mid-2009, global dairy demand has generally improved in response to a faster than expected economic recovery. In addition, China's strong demand for milk powder has been a major factor in the revival in prices. However, a negative reaction from consumers could result in softening of demand and lead to easing dairy commodity prices.

Competitive Landscape

The pricing of substitute products such as soy and vegetable oils can impact on the pricing of milk products.

Australian Market

Strong consumer confidence translates into strong volume and value growth for the dairy industry. However, the overall milk category value growth was affected by the removal of the Dairy Adjustment Levy in February 2009 and the subsequent reduction in the retail price for products.

Global Supply

Given the level of milk exports from Australia, supply of dairy products from the other dairy producing geographies affects the Australian market.

Inputs

Costs of production such as grain prices and fertilisers, water levels and interest rates all impact the industry. Any increases in costs exert pressure on famers to improve production efficiencies in order to maintain margins.

Exchange Rates

Movements in the exchange rates of major currencies have a direct impact on the pricing levels for Australian dairy exports.

5.5 Industry Growth Prospects

The overall consumption of dairy products is expected to continue to grow in response to population growth and the forecast output for 2010/11 is for 9 billion litres. However, if seasonal conditions are favourable then this forecast may be surpassed.

A survey carried out by Dairy Australia indicates that three year production intentions showed a significant decline in growth expectations. Based on these expectations, and assuming reasonable seasonal conditions and prices, milk production could range between 8.9 billion litres and 9.2 billion litres by 2012/13. However, with a sustained improvement in both milk price and climate for the majority of producers, there is potential for stronger growth into the medium term.

5.6 Fresh Milk Sector

Fresh milk and cheese represent the two largest sectors in the Australian domestic retail dairy industry.

A2DP estimates that the Australian fresh milk sector comprises approximately 1.8 billion litres, of which approximately 50% is sold through the grocery trade.

Private labels dominate fresh milk sales in the grocery trade, accounting for over half of total sales. Private labels retail at a considerable discount to branded fresh milk products.

6. Valuation of A2DP

6.1 Standard of Value

The Transaction involves the acquisition of 50% of the shares in A2DP.

We have assessed the fair market value of 50% of the shares in A2DP. Fair market value is defined as the price (expressed in terms of money or money's worth) that a willing but not anxious buyer, with access to all relevant information and acting on an arms length basis, would be prepared to pay to a willing but not anxious seller in an open, unrestricted and stable market.

6.2 Basis of Valuation

In general terms it is recognised that the value of a share represents the present value of the net cash flows expected therefrom. Cash flows can be in the form of either dividends and share sale proceeds or a residual sum derived from the liquidation of the business.

There are a number of methodologies used in valuing shares and businesses. The most commonly applied methodologies include:

- discounted cash flow (**DCF**)
- capitalisation of earnings
- net assets or estimated proceeds from an orderly realisation of assets.

Each of these valuation methodologies is applicable in different circumstances. The appropriate methodology is determined by a number of factors including the future prospects of the business, the stage of development of the business and the valuation practice or benchmark usually adopted by purchasers of the type of business involved.

The DCF method is the fundamental valuation approach used to assess the present value of future cash flows, recognising the time value of money and risk. The value of an investment is equal to the value of future free cash flows arising from the investment, discounted at the investor's required rate of return.

The capitalisation of earnings method is an adaptation of the DCF method. It requires an assessment of the maintainable earnings of the business and a selection of a capitalisation rate (or earnings multiple) appropriate to that particular business for the purpose of capitalising the earnings figure.

An assets based methodology is often used in circumstances where the assets of a company have a market value independent of the profitability of the company that owns them. A valuation based on an orderly realisation of assets is normally restricted to instances where the investor holds sufficient control to effect a sale of the assets and / or there is some indication that an orderly realisation is contemplated.

6.3 Valuation Approach

Our preferred valuation approach to assess the fair market value of 50% of A2DP is the DCF method. However, A2DP has not prepared detailed financial projections beyond the 2012 financial year and hence it is not possible to undertake any meaningful DCF analysis.

We have therefore assessed the fair market value of A2DP using the capitalisation of earnings method.

The capitalisation of earnings method that we have applied derives an assessment of the value of the core operating business, prior to considering how the business is financed or whether it has any significant surplus assets. This ungeared business value is commonly referred to as the enterprise value and represents the market value of the operating assets (i.e. operating working capital, fixed assets and intangible assets such as brand names, software, licences, know-how and general business goodwill) that generate the operating income of the business.

To derive the value of the A2DP shares, it is necessary to add the value of any surplus (or non-operating) assets and deduct the value of net interest bearing debt (**IBD**) from the assessed enterprise value.

6.4 Capitalisation of Earnings Valuation

Introduction

We have assessed A2DP's future maintainable earnings and have reviewed the market valuation and operational performance of comparable companies to derive a range of earnings multiples to apply to our assessed level of maintainable earnings.

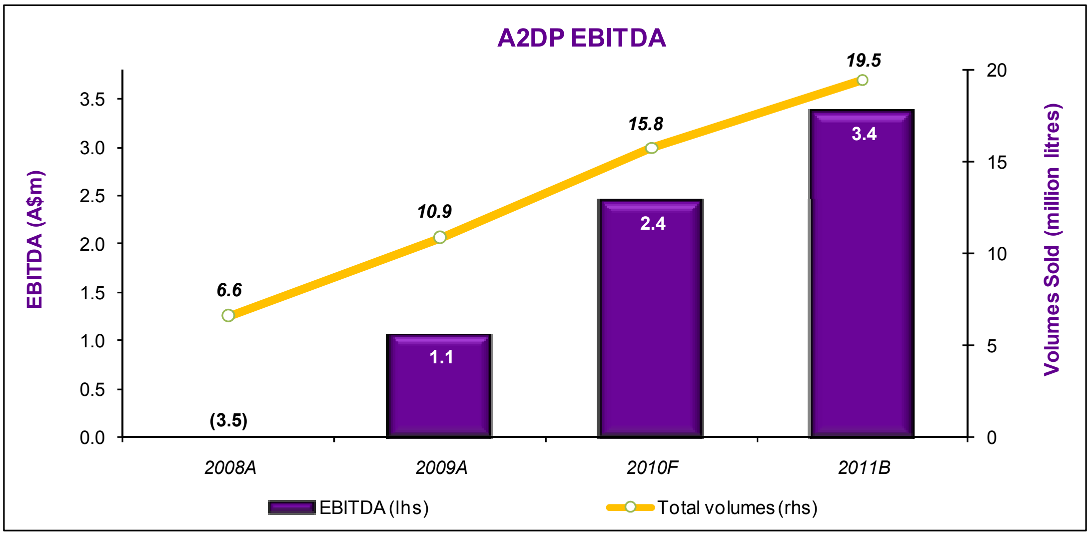
Future Maintainable Earnings

The evaluation of maintainable earnings involves an assessment of the level of profitability which (on average) the business can expect to generate in the future, notwithstanding the vagaries of the economic cycle.

The assessment of maintainable earnings is made after considering such factors as the risk profile of the business, the characteristics of the market in which it operates, its historical and forecast performance, non-recurring items of income and expenditure and known factors likely to impact on future operating performance.

We have used EBITDA as the measure of earnings. The use of EBITDA and EBITDA multiples is more common in valuing businesses for acquisition purposes as it eliminates the effect of financial leverage which is ultimately in the control of the acquirer and also eliminates any distortions from the tax position of the business and differing accounting policies in respect of depreciation and the amortisation of intangible assets.

A2DP commenced trading in June 2007. It recorded a loss at EBITDA level of A$3.5 million in the 2008 financial period on sales of 6.6 million litres. The company traded profitably in the 2009 financial year, recording EBITDA of A$1.1 million on sales of 10.9 million litres. Earnings growth has continued in the 2010 financial year, with EBITDA forecast at A$2.4 million on sales of 15.8 million litres and the budget for the 2011 financial year is for EBITDA of A$3.4 million on sales of 19.5 million litres.



Given the company's historic growth trends and the business strategy that it has formulated to continue its expansion, we are of the view that the most appropriate basis for assessing A2DP's maintainable EBITDA is its 2011 budget. Basing maintainable EBITDA on historic earnings levels is likely to understate the value of the company.

We assess A2DP's future maintainable EBITDA to be in the vicinity of A$3.4 million. In doing so, we recognise that A2DP has yet to achieve such a level of earnings and that its 2010 forecast EBITDA is 72% of 2011 budget EBITDA.

The key risks to A2DP achieving its 2011 budget include:

- volume growth flattening out due to the reduced ability of media to drive growth
- legal challenges to weaken the a2 Milk™ message
- milk farm-gate pricing movements
- grocery trade demands for increased trading terms
- gaining listings for yoghurt products in supermarket channels.

We have taken into account these risks in assessing an appropriate EBITDA multiple.

Earnings Multiple

Actual sales of comparable businesses can provide reliable support for the selection of an appropriate earnings multiple. In addition, we can infer multiples from other evidence such as minority shareholding trades for listed companies in New Zealand, Australia and overseas with similar characteristics to A2DP or transactions involving businesses in the same industry.

Given that future maintainable EBITDA represents prospective earnings, the EBITDA multiple applied must be a prospective multiple.

Comparable Transactions

The table below summarises the EBITDA multiples for 12 transactions undertaken by comparable companies in New Zealand and Australia in the past six years.

Comparable Company Transaction EBITDA Multiples

	EBITDA Multiples	
	Historic	**Prospective**
Low	6.0x	6.7x
High	9.8x	8.9x
Average	7.7x	7.5x
Median	7.7x	7.4x

Source: Capital IQ, brokers reports, independent adviser's reports, media releases

The analysis shows that the transactions have been in a relatively narrow prospective EBITDA multiple range of 6.7x to 8.9x at an average of 7.5x.

Comparable Listed Companies

A second approach to assessing an appropriate EBITDA multiple is to examine the trading multiples for comparable companies.

a2C is the only company listed on the NZSX or NZAX that is comparable with A2DP. However, its negative earnings mean that meaningful multiples cannot be observed.

FNP is listed on the ASX. It is currently trading at a historic EBITDA multiple of 10.6x. Warmambool Cheese and Butter Factory Company Holdings Limited (**Warmambool**) and Goodman Fielder Limited (**Goodman Fielder**) are also listed on the ASX and may be considered to have some comparability.

The table below summarises the trading EBITDA multiples for FNP, Warmambool and Goodman Fielder and for 24 overseas dairy companies with a strong milk focus that are considered to be broadly comparable with A2DP.

Comparable Company Trading EBITDA Multiples

	EBITDA Multiples	
	Historic	**Prospective**
FNP	10.6x	n/a
Warmambool	n/a	8.3x
Goodman Fielder	7.9x	7.0x
24 Overseas Dairy Companies		
Low	2.8x	5.8x
High	26.9x	22.7x
Average	13.0x	11.5x
Median	10.6x	10.4x

n/a: not applicable

Data as at 22 June 2010

Source: Capital IQ

The analysis shows a wide range of prospective EBITDA multiples for the overseas dairy companies ranging from 5.8x to 22.7x at an average of 11.5x.

Conclusion

We are of the view that the transaction EBITDA multiples for New Zealand and Australian comparable companies provide the best basis for assessing a prospective EBITDA multiple range for the A2DP operating business.

The New Zealand and Australian transaction EBITDA multiples are for target companies that are much larger than A2DP. A discount for size is commonly applied when assessing the value of much smaller companies. Off-setting this to some degree is that A2DP's future growth is potentially greater than the growth expectations for the target companies (which are more mature businesses) and A2DP's relative levels of capital expenditure and depreciation are lower than the target companies as A2DP does not undertake any processing or packaging activities.

The trading EBITDA multiples for FNP, Warmambool, Goodman Fielder and the overseas dairy companies are based on trading prices for minority parcels of shares. It is common for a premium for control to be paid when acquiring a controlling interest in a company. In such circumstances, a higher earnings multiple may be applied against the assessed maintainable earnings figure. However, this would be offset by a discount for size as A2DP is considerably smaller than FNP, Warmambool, Goodman Fielder and the overseas dairy companies and an investment in A2DP is not as liquid as an investment in the listed companies. In this instance, we are of the view that adjustment to the observed EBITDA multiples in respect of a discount for size and illiquidity exceeds an adjustment in respect of a control premium.

We consider an appropriate prospective EBITDA multiple for A2DP to be in the range of 6.0x to 7.0x.

Capitalisation of EBITDA Valuation

Based on the above, we assess the enterprise value of A2DP to be in the range of A$20.4 million to A$23.8 million.

Capitalisation of EBITDA Valuation		
	Low	**High**
Future maintainable EBITDA (A$m)	3.4	3.4
EBITDA multiple	6.0x	7.0x
A2DP enterprise value (A$m)	20.4	23.8

6.5 Value of 100% of A2DP Shares

To derive the value of the A2DP shares, it is necessary to deduct the value of A2DP's net IBD from its enterprise value.

A2DP is forecasting its net IBD will reduce to A$0.4 million by 30 June 2010 (ie by the date of the Transaction).

A2DP has no material surplus or non-operating assets.

Based on the above, we assess the fair market value of all the shares in A2DP to be in the range of A$20.0 million to A$23.4 million.

Value of A2DP Shares	Low A$m	High A$m
A2DP enterprise value	20.4	23.8
Net IBD as at 30 June 2010	(0.4)	(0.4)
Value of A2DP shares	20.0	23.4

6.6 Implied Multiples

The above value range implies EBITDA multiples, EBIT multiples, PE multiples and NTA multiples as set out below. The historic earnings multiples are based on A2DP's forecast for the year ended 30 June 2010. The prospective earnings multiples are based on A2DP's budget for the year ended 30 June 2011. The NTA multiples are based on A2DP's financial position as at 30 April 2010.

Implied Multiples	Historic		Prospective	
	Low	High	Low	High
EBITDA multiple	8.3x	9.7x	6.0x	7.0x
EBIT multiple	8.4x	9.8x	6.1x	7.1x
PE multiple	13.1x	15.9x	9.0x	10.5x
NTA multiple	6.7x	7.8x		

We consider these implied multiples to be reasonable.

6.7 Value of 50% of A2DP Shares

We assess the fair market value of 100% of the ordinary shares in A2DP to be in the range of A$20.0 million to A$23.4 million.

The valuation represents the full underlying standalone value of A2DP based on its current strategic and operational initiatives assuming 100% of the company was available to be acquired.

Given that the Transaction will result in a2C owning 100% of the shares in A2DP, we consider the pro rata value of 100% of the shares reflects the fair market value of the 50% shareholding that a2C will acquire. This equates to A$10.0 million to A$11.7 million.

Based on an exchange rate of NZ$1 = A$0.80, this equates to NZ$12.5 million to NZ$14.6 million.

7. Evaluation of the FNP Placement

7.1 Introduction

a2C will issue 120,376,950 fully paid ordinary shares to FNP as consideration under the Transaction, as well as granting FNP the FNP Option, the Top-up Option and the Capital Raising Right.

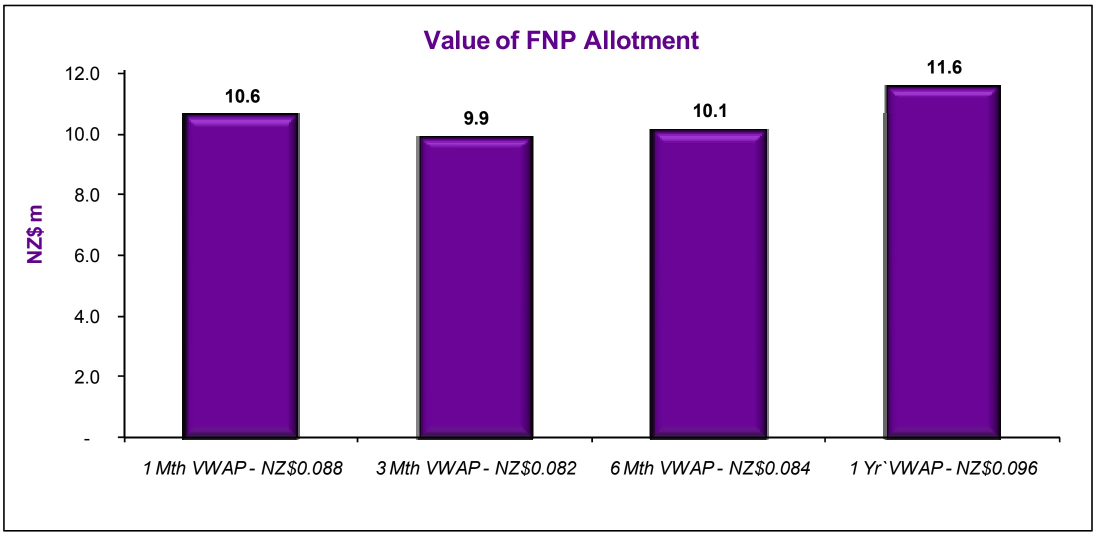
7.2 Value of 120,376,950 Shares

The 120,376,950 shares will represent 25% of the Company's shares on issue post the FNP Placement. Hence FNP will hold a minority interest in a2C – albeit a significant minority interest.

The 120,376,950 shares are not issued at a specific issue price.

We are of the view that the best indicator of the market value of the 120,376,950 shares is the current a2C share price, albeit acknowledging that the FNP Placement shares are subject to restrictive terms. An analysis of a2C's share price since 3 January 2008 is set out in section 3.8. The Company's VWAP over the past month, three months, six months and year has ranged from NZ$0.082 to NZ$0.096.

Based on the Company's VWAP over the past year, we assess the value of the FNP Placement shares to be in the range of NZ$9.9 million to NZ$11.6 million.



7.3 Restrictive Terms

The 120,376,950 shares cannot be sold or offered for sale for one year after the shares are allotted to FNP.

However, FNP may transfer the shares to a wholly owned body corporate, accept a share buyback offer made to all shareholders or accept a takeover offer for a2C if the takeover offer is recommended by the Company's directors.

The restrictive terms ensure that a large parcel of shares will not be placed for sale on the market in the short term, which otherwise could have a negative impact on the Company's share price.

8. Valuation of the FNP Option

8.1 Introduction

The FNP Option will allow FNP to subscribe for additional a2C ordinary shares (the **Option Shares**) which if exercised will result in FNP holding up to 27.5% of the ordinary shares in a2C.

8.2 Terms

Grant Date

If all the resolutions are approved, the FNP Option will be granted to FNP on the date that the Transaction is completed. This is expected to be 21 July 2010.

Issue Price

No consideration is payable by FNP for the FNP Option.

Exercise of the Option

The FNP Option can be exercised at any time up to 12 months after the completion of the Transaction.

The FNP Option can only be exercised once. It can be exercised for some or all of the Option Shares.

Term

The FNP Option will lapse on the earlier of:

- the date on which FNP sells any of the a2C shares it holds and
- the option period.

Exercise Price

The exercise price for the FNP Option will be the New Zealand dollar equivalent of A$0.11 per share at the date of exercise.

Transferability

FNP cannot transfer its rights under the FNP Option to any other person.

8.3 Valuation Methodology and Approach

The FNP Option can be exercised at any time within 12 months from completion of the Transaction. Therefore the option is an American option (as opposed to a European option which can only be exercised on one particular day).

The Binomial option-valuation model (**Binomial Model**) and the Black-Scholes option-valuation formula (**Black-Scholes Formula**) are commonly used in commercial practice to value options. The Binomial Model is more appropriate for the valuation of American options and options over shares which are expected to pay dividends during the exercise period, although variants of the Black-Scholes Formula exist to handle the valuation of such options.

The key variables in determining the value of an American Option are:

- the exercise price of the option
- the risk free rate of return
- the current spot price or market value of the underlying instrument
- the volatility of the returns on the underlying instrument
- the time to expiry
- the expected distributions to be made on the underlying instrument.

The values derived from the Binomial Model and Black-Scholes Formula represent the value of options over existing shares. The FNP Option is in effect a warrant and hence a2C will issue new shares when the option is exercised. Accordingly, an adjustment must be made to the values derived from the Binomial Model and Black-Scholes Formula to take into account the dilutionary effect of the FNP Option.

Furthermore, the values derived from the Binomial Model and Black-Scholes Formula represent the value of options which are freely tradable. Given that the FNP Option is not able to be traded, we have further adjusted the values derived from the Binomial Model and Black-Scholes Formula to allow for the lack of marketability of the FNP Option.

8.4 Valuation Assessment

Valuation Parameters

The key variables applied in our assessment of the value of the FNP Option are:

- valuation date – 21 July 2010, being the expected date of the completion of the Transaction
- exercise price – NZ$0.138, based on A$0.11 per share at an exchange rate of NZ$1 = A$0.80
- the risk free rate of return – 3.8% based on the current yield on New Zealand Government one year bonds
- the current market value of the a2C's shares - NZ$0.088 (based on the one month VWAP)
- volatility - 40% to 60% (based on the observed volatility levels of movements in a2C's share price since 3 January 2008 as well as other factors that influence expected future volatility)
- the time to expiry – 21 July 2011
- expected distributions – nil.

Dilutionary Effect

The Binomial Model and Black-Scholes Formula assume that the options are over existing shares. However, the FNP Option is akin to a warrant. a2C will need to issue new shares when the option is exercised and therefore the new shares will have a dilutionary effect. This is taken into account in our valuation.

We have assumed that the number of shares on issue prior to the exercise of the FNP Option is 481,507,800, being the 361,130,850 fully paid ordinary shares currently on issue plus the 120,376,950 shares issued under the FNP Placement.

Assuming FNP elects to exercise the FNP Option so as to increase its shareholding to 27.5%, the exercise of the FNP Option will result in a further 16,603,717 shares being issued (assuming no other changes to a2C's share capital).

Discount for Restrictive Terms

The Binomial Model and Black-Scholes Formula assume that the options being valued can be sold on a secondary market. The terms of the FNP Option forbid the trading of the option. Accordingly, a discount to the values derived from the Binomial Model and Black-Scholes Formula is required to reflect the restrictive terms. We have applied a discount of 20% to the values assessed under the Binomial Model and Black-Scholes Formula (adjusted for dilution).

8.5 Valuation Conclusion

Based on the above, we assess the fair value of the FNP Option to be in the vicinity of NZ$0.1 million.

9. Valuation of the Top-up Option

9.1 Introduction

The Top-up Option will allow FNP to acquire fully paid a2C ordinary shares equal to 25% of any of the 20,000,000 partly paid a2C ordinary shares that become fully paid (ie up to 5,000,000 fully paid ordinary shares).

9.2 Terms

Grant Date

If all the resolutions are approved, the Top-up Option will be granted to FNP on the date that the Transaction is completed. This is expected to be 21 July 2010.

Issue Price

No consideration is payable by FNP for the Top-up Option.

Exercise of the Option

The Top-up Option can be exercised at any time that any of the 20,000,000 partly paid shares become fully paid.

10,000,000 partly paid shares can be exercised up to 10 September 2011 and 10,000,000 partly paid shares can be exercised up to 24 August 2014.

Term

The Top-up Option will lapse on the earlier of:

- the date on which FNP sells any of the a2C shares it holds and
- the option period.

Exercise Price

The exercise price for the Top-up Option will be nil per share.

Transferability

FNP cannot transfer its rights under the Top-up Option to any other person.

9.3 Valuation Assessment

The Top-up Option can only be exercised if holders of the partly paid shares fully pay up the shares. The partly paid shares are currently paid up to NZ$0.001 each and require a further NZ$0.099 to be paid per share before they are fully paid up.

It is reasonable to assume that the holders of the partly paid shares will only pay up the remaining NZ$0.099 per share if the a2C shares are worth at least NZ$0.10 each.

The likelihood of the Top-up Option being exercised is therefore influenced by the likelihood of the a2C share price being at least NZ$0.10 and whether the partly paid shares are converted into fully paid shares. The NZ$0.10 share price is commonly referred to as a barrier and options with these features are referred to as *Up and In Barrier Options*.

Assuming the partly paid shares are converted into fully paid shares, which in turn assumes that the barrier condition of a share price of NZ$0.10 is met, the Top-up Option can then be exercised. Therefore the Top-up Option is an *American Option* (as opposed to a *European Option* which can only be exercised on one particular day).

While the Binomial Model and the Black-Scholes Formula are commonly used to value options, the complexities associated with American Up and In Barrier Options requires the use of a three-dimensional lattice model (a **Trinomial Lattice**) to assess the value of the Top-up Option.

Valuation Parameters

The key variables applied in our assessment of the value of the Top-up Option are:

- valuation date – 21 July 2010
- exercise price - nil per share
- the risk free rate of return – 3.8%
- the current market value of the a2C's shares - NZ$0.088
- volatility - 40% to 60%
- the time to expiry – 10 September 2011 for 10,000,000 partly paid shares and 24 August 2014 for the other 10,000,000 partly paid shares
- expected distributions – nil
- effective barrier terms – a share price of NZ$0.10.

Dilutionary Effect

The Trinomial Lattice assumes that the options are over existing shares. However, the Top-up Option is in effect a warrant. a2C will need to issue new shares when the option is exercised and therefore the new shares will have a dilutionary effect. This is taken into account in our valuation.

Discount for Restrictive Terms

The Trinomial Lattice assumes that the option being valued can be sold on a secondary market. The terms of the Top-up Option forbid the trading of the option. Accordingly, a discount to the value derived from the Trinomial Lattice is required to reflect the restrictive terms. We have applied a discount of 20% to the values assessed under the Trinomial Lattice (adjusted for dilution).

9.4 Valuation Conclusion

Based on the above, we assess the fair value of the Top-up Option to be in the vicinity of NZ$0.3 million.

10. Sources of Information, Reliance on Information, Disclaimer and Indemnity

10.1 Sources of Information

The statements and opinions expressed in this report are based on the following main sources of information:

- the draft notice of special meeting
- the SSIA between a2C and FNP dated 21 May 2010
- the a2C *3 Year Strategic Plan & Growth Vision F2011 – F2013* dated November 2009
- various a2C directors' board minutes
- the a2C annual reports for the years ended 31 March, 2007 and 2008, the 15 months ended 30 June 2009 and the half year report for the six months ended 31 December 2009
- the A2DP *3 Year Growth Plan* dated May 2009
- the A2DP annual report for the year ended 30 June 2009
- the A2DP management accounts for the ten months ended 30 April 2010
- the A2DP forecast for the year ended 30 June 2010
- the A2DP *2011 Budget Review*
- data in respect of a2C, FNP and comparable companies from NZX Data and Capital IQ
- publicly available data in respect of the Australian dairy industry.

During the course of preparing this report, we have had discussions with and/or received information from the directors and executive management of a2C and a2C's financial and legal advisers.

The directors of a2C have confirmed that we have been provided for the purpose of this Independent Adviser's Report with all information relevant to the FNP Placement and the FNP Option that is known to them and that all the information is true and accurate in all material aspects and is not misleading by reason of omission or otherwise.

Including this confirmation, we have obtained all the information that we believe is necessary for the purpose of preparing this Independent Adviser's Report.

In our opinion, the information set out in this Independent Adviser's Report is sufficient to enable the Company's directors and the shareholders to understand all the relevant factors and to make an informed decision in respect of the FNP Placement and the FNP Option.

10.2 Reliance on Information

In preparing this report we have relied upon and assumed, without independent verification, the accuracy and completeness of all information that was available from public sources and all information that was furnished to us by a2C and its advisers.

We have evaluated that information through analysis, enquiry and examination for the purposes of preparing this report but we have not verified the accuracy or completeness of any such information or conducted an appraisal of any assets. We have not carried out any form of due diligence or audit on the accounting or other records of a2C. We do not warrant that our enquiries would reveal any matter which an audit, due diligence review or extensive examination might disclose.

10.3 Disclaimer

We have prepared this report with care and diligence and the statements in the report are given in good faith and in the belief, on reasonable grounds, that such statements are not false or misleading. However, in no way do we guarantee or otherwise warrant that any forecasts of future profits, cash flows or financial position of a2C will be achieved. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured. They are based upon assumptions, many of which are beyond the control of a2C and its directors and management. Actual results will vary from the forecasts and these variations may be significantly more or less favourable.

We assume no responsibility arising in any way whatsoever for errors or omissions (including responsibility to any person for negligence) for the preparation of the report to the extent that such errors or omissions result from our reasonable reliance on information provided by others or assumptions disclosed in the report or assumptions reasonably taken as implicit.

Our evaluation has been arrived at based on economic, exchange rate, market and other conditions prevailing at the date of this report. Such conditions may change significantly over relatively short periods of time. We have no obligation or undertaking to advise any person of any change in circumstances which comes to our attention after the date of this report or to review, revise or update this report.

We have had no involvement in the preparation of the notice of meeting issued by a2C and have not verified or approved the contents of the notice of meeting. We do not accept any responsibility for the contents of the notice of meeting except for this report.

10.4 Indemnity

a2C has agreed that, to the extent permitted by law, it will indemnify Simmons Corporate Finance and its directors and employees in respect of any liability suffered or incurred as a result of or in connection with the preparation of the report. This indemnity does not apply in respect of any negligence, wilful misconduct or breach of law. a2C has also agreed to indemnify Simmons Corporate Finance and its directors and employees for time incurred and any costs in relation to any inquiry or proceeding initiated by any person. Where Simmons Corporate Finance or its directors and employees are found liable for or guilty of negligence, wilful misconduct or breach of law or term of reference, Simmons Corporate Finance shall reimburse such costs.

11. Qualifications and Expertise, Independence, Declarations and Consents

11.1 Qualifications and Expertise

Simmons Corporate Finance is a New Zealand owned specialist corporate finance advisory practice. It advises on mergers and acquisitions, prepares independent expert's reports and provides valuation advice.

The person in the company responsible for issuing this report is Peter Simmons, B.Com, DipBus (Finance), CFIP.

Simmons Corporate Finance and Mr Simmons have significant experience in the independent investigation of transactions and issuing opinions on the merits and fairness of the terms and financial conditions of the transactions.

11.2 Independence

Simmons Corporate Finance does not have at the date of this report, and has not had, any shareholding in or other relationship with a2C or FNP that could affect our ability to provide an unbiased opinion in relation to this transaction.

Simmons Corporate Finance has not had any part in the formulation of the Transaction, the FNP Placement, the FNP Option or any aspects thereof. Our sole involvement has been the preparation of this report.

Simmons Corporate Finance will receive a fixed fee for the preparation of this report. This fee is not contingent on the conclusions of this report or the outcome of the Transaction, the FNP Placement and the FNP Option. We will receive no other benefit from the preparation of this report.

11.3 Declarations

An advance draft of this report was provided to the Company's directors for their comments as to factual accuracy, as opposed to opinions, which are the responsibility of Simmons Corporate Finance alone. Changes made to the report as a result of the circulation of the draft have not changed the methodology or our conclusions.

Our terms of reference for this engagement did not contain any term which materially restricted the scope of the report.

11.4 Consents

We consent to the issuing of this report in the form and context in which it is to be included in the notice of meeting to be sent to a2C's shareholders. Neither the whole nor any part of this report, nor any reference thereto may be included in any other document without our prior written consent as to the form and context in which it appears.

Peter Simmons
Director
Simmons Corporate Finance Limited
23 June 2010