22 August 2018

NZX/ASX Market Release

Outstanding financial performance and strong progress on delivery of strategy

Overview for the year ended 30 June 2018 (NZ$)

- Total revenue of $922.7 million – an increase of 68% over the prior corresponding period (pcp)
- EBITDA[1] of $283.0 million – up 101% on pcp
- Net profit after tax of $195.7 million – 116% ahead of the pcp
- Strong cash conversion with operating cash flow of $231.1 million – up 131% on pcp
- EBITDA to sales margin of 31% – up from 26% in the pcp
- Basic earnings per share (EPS) of 27.0 cents – up from 12.7 cents in the pcp
- Infant formula share strengthening to 5.1% in China[2] and 32% in Australia[3]
- Substantial physical distribution growth to ~10,000 stores in China and ~6,000 stores in the US
- Enhanced strategic partnerships with Synlait and Fonterra

Summary of financial performance

The Company delivered another very strong financial performance, with substantial improvements in revenue, earnings and cash generation. Increased investment in brand and market development resulted in rapid growth of infant formula and the expansion of the liquid milk business in each of the Company's established markets.

Continued impressive sales growth and trajectory

Sales of *a2 Platinum®* infant formula again grew substantially in Australia and China, with continued growth in market share. *a2 Platinum®* sales revenue was $724.2 million, an increase of 84% on the previous year. Investment continued in building brand awareness and consumer engagement, expanding distribution in priority channels and adapting to new regulatory requirements in China.

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[1] Earnings before interest, tax, depreciation and amortisation (EBITDA) is a non GAAP measure. However, the Company believes that it assists in providing investors with a comprehensive understanding of the underlying performance of the business. A reconciliation of EBITDA to net profit after tax is shown at the end of this document

[2] Kantar Infant Formula market tracking of Tier 1 and Key A cities for 12 months ending June 2018 by value (Kantar track a substantial proportion of the total market)

[3] Aztec Australian Grocery and Pharmacy Scan value share 12 months ending 30/06/18

In Australia, *a2 Milk™* branded fresh milk value share grew strongly from 9.3% to 9.8% by year end[4]. The United States business continued to grow sales velocities in key accounts, alongside a distribution footprint which increased to 6,000 stores, following expansion into the Northeast and in the natural channel. In the United Kingdom, improvement in rates of sale and expanding distribution brought gains in revenue.

The Company advanced its growth strategy through multiple initiatives – launching three new products (*a2 Platinum®* Stage 4 milk powder, *a2 Platinum®* pregnancy formula and *a2 Milk™* powder blended with Mānuka honey); entering new markets in South East Asia; and establishing a strategic relationship with Fonterra Co-operative Group Limited and an exclusive distribution agreement with Yuhan Corporation for the South Korea market.

Margin improvement and investment to deliver growth

Gross margin percentage benefited from the increased proportion of infant formula sales, currency movements and favourable net selling prices.

Investment in brand building and marketing grew by $31.6 million to $73.6 million, with increases across all markets. Due to the timing of key marketing programs in China and USA, this investment was more heavily weighted to the second half.

SG&A spend increased broadly in line with underlying revenue, reflecting a commitment to support continued growth. Corporate costs rose by $8.3 million, reflecting investment in people and associated costs to support global growth opportunities.

Strong balance sheet position

The cash position continued to improve along with revenue, earnings and working capital efficiencies. Net operating cash flow was $231.1 million, compared with $99.9 million in the previous year. Cash on hand at the end of the year was $340.5 million, compared with $121.0 million for the pcp.

Working capital benefited from improved terms with a number of customers. This was partially offset by a planned increase in infant formula inventory of $35.7 million as the Company built progressively to more sustainable levels during the year.

Enhanced strategic supply partnerships

The Company's supply base was enhanced by the extension of the comprehensive manufacturing and supply agreement for infant formula with Synlait Milk Limited (Synlait) and the establishment of a new comprehensive strategic relationship with Fonterra.

Results commentary

Reviewing the results for the 2018 year, the Managing Director and CEO Jayne Hrdlicka said: "FY18 has been a transformative year. Our brand and unique approach are working across multiple products and markets and we are seeing real momentum building in China and the US."

"The Company's financial results maintained a very strong trajectory, with a revenue increase of 68% and with operating earnings up by 101%. Significant progress has been achieved in Australia, China and the USA and important emerging market opportunities are starting to materialise.

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[4] *Aztec Australian Grocery Weighted Scan, 12 months ending 30/06/18 versus pcp*

"The ongoing momentum reflects the growing strength of our brand proposition, continued execution success in our end markets and in management of the supply chain.

"The Company has continued to invest in brand building and advertising and in the strength of the organisation, as we build capability and capacity to deliver on growth against our core opportunities.

"The extended arrangement with Synlait Milk and the new relationships with Fonterra and Yuhan Corporation are important steps in the development of both our supply chain and our capacity to develop new markets. The extended relationship with China State Farm is another important relationship, underpinning our platform for growth in China."

Strategic progress

With the Australian and China businesses delivering strong earnings, an expanded US distribution footprint and the growing strength of our brand, the Company continues to be well positioned to execute its strategy for further growth.

The growth strategy has three priorities:

- Building a branded portfolio of dairy-based nutritional products based on the A1 protein free proposition
- Investing in attractive markets where we believe we can build competitive brand strength
- Deepening our proprietary know-how and A2 protein expertise.

The first signs of competition from a major international company in the A1 protein free category appeared in March 2018. There has been no apparent impact on our sales momentum as a consequence of this launch. The Company remains confident that competition will ultimately expand the category over time. The combination of our strong and contemporary brand, deep know-how and intellectual property, agile and entrepreneurial approach; and absolute focus as a Company on A1 protein free products, means our business is uniquely positioned to benefit from category expansion. The Company will actively leverage and defend the integrity of its market position.

Brand, intellectual property and research & development

The Company has continued its investment in improving brand equity via enhanced marketing campaigns in its key markets of Australia, China and the US, R&D and further development of intellectual property. The Company's investment in marketing and R&D increased by $32.3 million and a further $2.2 million was capitalised for patents and trade marks.

Increasing investment in trade marks included a rollout of a new unifying brand trade mark that has been applied across all products and markets. Our brand assets will continue to evolve as the trade mark portfolio broadens over time.

During FY18 a clincial trial conducted in China involving 600 adults with self reported lactose intolerance found consumption of milk containing the A2 protein type reduced acute gastorintestinal symptoms. These findings were consistent with the previous pilot study published in FY16.

A pilot study carried out under the New Zealand Government High Value Nutrition programme is now complete and being submitted for publication. Furthermore, a clinical study in China amongst pre-school children examining digestive benefits of A1 protein free milk has been submitted for publication.

The Company continues to support additional science and research & development programmes to enhance its overall brand proposition.

Strategic partnerships

With a view to enhancing our supply chain and broader international market development the Company announced the formation of a comprehensive strategic relationship with Fonterra. The initial scope of the relationship incorporates:

- an exclusive nutritional powder agreement under which Fonterra will manufacture A1 protein free products in Australia for certain priority markets in South East Asia and the Middle East
- an exclusive licence to Fonterra for the production, distribution, sale and marketing of *a2 Milk™* branded liquid milk in New Zealand (commenced from July 2018)
- the opportunity to leverage Fonterra's sales and distribution capabilities in the priority markets
- joint evaluation of opportunities to sell certain Company branded dairy products, such as butter and cheese, in Australia, New Zealand and China
- Additional A1 protein free milk pools to be developed by Fonterra and the Company.

a2 Milk™ powder blended with Mānuka honey is packed by Fonterra and is the first product launched with Fonterra's assistance following the announcement of our strategic relationship.

Further steps were taken to build on the Company's global supply strategy with the comprehensive supply agreement for infant formula with Synlait Milk extended in early July 2018. This provides a two-year extension to the minimum term, an increase in the volume over which Synlait already had exclusive supply rights, increased committed production capacity and pricing terms that reflect both companies' commitment to an ongoing market-competitive pricing regime.

Consistent with the Company's desire to deepen relationships with its key partners, the Company announced on 3 August 2018 an additional investment of $162.3 million in Synlait Milk shares, bringing the total shareholding in Synlait to approximately 17.4%. This investment is intended to provide further stability over Synlait's capital position and ownership and reflects the Company's commitment to supporting key strategic partners. The Company has no plans to further increase its shareholding in Synlait.

The Company continues to take steps to minimise the risk of product substitution and counterfeit, particularly for infant formula in China. This includes improved security technology and advances in quality and authenticity proof points. During the financial year, the Company introduced a unique QR-verification system allowing verification of the authenticity of our products. The system has now been implemented across the total *a2 Platinum®* product range. Product quality and security will remain an ongoing area of focus and investment by the Company.

As recently reported, arrangements with China State Farm, the Company's exclusive import agent for China label infant nutrition products into Mainland China, were extended for a further three years, to December 2021.

The Company remains committed to its approach of deploying capital efficiently and strategically to support mutually beneficial relationships with processing and distribution partners, in line with its multi-site, multi-product and geographic diversification strategy. As part of this, the Company continues to assess its medium-term manufacturing strategy for nutritional products, including the possible ownership of blending and canning assets, potentially in conjunction with its nutritional powder supply partners.

New products and markets

Three new products were launched during the year:

- *a2 Platinum®* Stage 4 junior milk drink, to support the nutritional needs of children three years and over – launched in August 2017 in Australia and China. The product has performed above plan

- *a2 Platinum®* Premium pregnancy formula, to support mothers' nutritional needs pre-pregnancy, during pregnancy and while breastfeeding – launched in May 2018 in Australia
- Premium *a2 Milk™* powder blended with Mānuka honey brings together two naturally beneficial products to create a great tasting nutritious milk drink that can be enjoyed cold or warm – launched in June 2018 in Australia, New Zealand and through cross border e-commerce channels in China

Following the year end, *a2 Milk™* branded fresh milk was launched in New Zealand under Fonterra's *Anchor™* brand – the first meaningful in-market joint activity between Fonterra and the Company.

The Company increased its resource capability in key innovation, operations and quality roles, which will underpin future expansion of nutritional products across new and existing regions.

Arrangements were also put in place for four new markets:

- Hong Kong – Launch of *a2 Platinum®* Stages 1, 2 and 3 in September 2017
- Singapore – *a2 Milk™* branded fresh milk was launched in August 2017
- Vietnam – A small test market for *a2 Milk™* branded whole milk powder
- South Korea – An exclusive sales and distribution agreement was completed with Yuhan Corporation in April 2018

The focus on growth initiatives in targeted emerging markets will continue, building on the Company's established strategic partnerships.

Regional performance

Australia and New Zealand

The ANZ business continued to grow strongly, with total revenue up 49% on pcp to $656.6 million and EBITDA up 69% on pcp to $262.2 million.

Sales of *a2 Platinum®* infant formula increased as market share grew from 26% to 32% by value[5]. *a2 Platinum®* remains the fastest growing infant formula brand by value in Australia. The Company commenced a transition to updated packaging, incorporating a new global brand logo, for its *a2 Platinum®* infant formula in May 2018. This transition is progressing in line with expectations and is expected to be completed by September 2018.

The flexibility and strength in the Company's supply chain was evident in its ability to deliver on the continuing strong growth in demand. The Company also introduced an online platform to improve access to *a2 Platinum®* products for Australian parents.

Fresh milk revenue rose by 4% and market share by value increased to 9.8%[6]. *a2 Milk™* remains the only milk brand distributed through all six key grocery retailers in the Australian market.

The milk supply arrangements between the Company, Moxey Farms and Leppington Pastoral Company were further extended for an additional term of one year through to 30 June 2021.

Sales of *a2 Milk™* branded milk powder products were significantly higher than in the previous year. Whole milk powder and skim milk powder sales growth was complemented by the launch of Premium *a2 Milk™* powder with Mānuka honey and *a2 Platinum®* Premium pregnancy formula during the year.

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[5] *Aztec Australian Grocery and Pharmacy Scan, 12 months ending 30/06/18 versus pcp*

[6] *Aztec Australian Grocery Weighted Scan, 12 months ending 30/06/18*

The Company continued to invest strongly in its brands, with the highest national advertising spend in the infant formula and fresh milk categories in the Australian market and strong editorial media coverage. Both spontaneous and prompted consumer brand awareness grew sharply in both categories and *a2 Milk™* was named the top brand of choice for Australian 'millennials'[7].

China and Other Asia

The China and Other Asia business continued to record exceptional growth, with revenue up 163% on pcp to $233.6 million and EBITDA up 148% on pcp to $81.3 million.

Total market share for *a2 Platinum®* infant formula in the targeted regions continued to grow rapidly. Consumption market share by value grew from 2.8% MAT (Moving Annual Total basis) at June 2017 to 5.1% MAT, as measured by Kantar Worldpanel[8]. Given the nature of panel data the Company believes the MAT measure provides a more appropriate view of market share trends in China.

Increased marketing and sales investment, including the first television advertising for *a2 Platinum®* Stage 3 infant formula and an active social media programme, remained the key drivers of rising brand awareness. Further impetus was provided by a series of live-streaming events and by publication of the findings from a major clinical trial conducted in China.

The business has a flexible multi-channel strategy for infant formula in both China label and cross border e-commerce English label, to best position the brand for growth.

a2 Platinum® again participated successfully in key online sales events. In the major '11/11 Singles Day' event it was the top-selling infant formula on Kaola.com, second on JD.com and third on T-mall.

In the offline (bricks and mortar) segment, distribution grew to approximately 10,000 Mother & Baby Stores, compared with approximately 3,800 at June 2017. The stores are supported by an in-store communication programme providing consumers with product and category advice.

To support the very strong growth of the China business, the team in China continued to grow across each of the selling, marketing, supply chain and administration functions. Expanding our China team capability will be an ongoing focus into FY19.

<u>Infant Formula Regulation</u>

Synlait achieved registration of our China label infant formula products (Stages 1, 2 and 3) with the China Food and Drug Administration (CFDA) in September 2017. Registration was required for the manufacture and import of such products into China through traditional channels beyond 1 January 2018. The registration process included formulation R&D and ingredient and finished product assessment. This necessitated packaging changes to comply with strict labelling and branding requirements.

The newly-registered China label packaging was launched to the market during June 2018 and the transition to the new pack and China brand is proceeding well.

The Company continues to monitor changes in China's regulatory regime and will continue to work proactively with our partners to respond as appropriate.

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[7] *The Urban List, Food & Drink Survey, 1 May 2017 published in June 2017*

[8] *Kantar Infant Formula market tracking of Tier 1 and Key A cities for the 12 months ending 30/06/18 vs the 12 months ending 30/06/17 by value (Kantar track a substantial proportion of the total market)*

United States

The US business achieved further momentum, with increased brand awareness and sales velocities, along with continued expansion in its distribution footprint.

Distribution increased to approximately 6,000 stores in California, the Southeast, the Northeast, the Mid-Atlantic and through natural retail chains, including Sprouts Farmers Market and Whole Foods Market. The expansion into the Northeast, announced in January 2018, achieved distribution in major retailers in the region.

Sales velocities are increasing across the business in key accounts, with particular strength in the natural channel and the Northeast.

a2 Milk™ is available in four variants (including chocolate) within the specialty milk segment, the fastest growing segment of the total milk category.

Marketing investment continued with the *Love Milk Again™* advertising campaign, which was broadened on a national basis to support the expansion into the Northeast. These campaigns augment the ongoing active editorial media programme and strong digital media and shopper marketing programmes.

The Company retains a positive view of the potential for growth in the US market and the unique advantage of being the pioneer of the A1 protein free category in this market. With the current opportunity to more quickly build distribution and brand awareness on a national basis comes the need to increase marketing investment above previous guidance.

Accordingly, the planned EBITDA investment for FY19 is approximately US$22 million and the Company now expects to achieve positive monthly EBITDA within three years. This investment is predominantly marketing expenditure associated with brand building and sales activation but also includes investment in capability in market.

United Kingdom

Volume sales of *a2 Milk™* branded fresh milk increased by more than 50% against the previous year through gains in distribution and in-store sales velocity. However, the UK continues to be a challenging market to achieve scale.

As in the previous year, results include a contribution from the sale of *a2 Platinum®* infant formula in the wholesale market.

The Company will transition between suppliers of its fresh milk product early in FY19. This is not anticipated to create any disruption to sales or stock availability.

Outlook for FY19

The Company anticipates further growth in revenue particularly in respect of nutritional products in ANZ and China, and liquid milk in the United States. The focus on growth initiatives in targeted emerging markets and new product development will continue.

Marketing expenditure as a percentage of sales is expected to be higher than FY18 given continued investment in the Australian market, re-phasing of 2H18 activities in China, and appropriate investment to support US market expansion.

Overhead costs are also expected to be higher than FY18, primarily due to increasing headcount for China and the Corporate office to support continued growth and organisational development.

Notwithstanding the higher expenditure as indicated, the Company expects the EBITDA to sales ratio for FY19 to be broadly consistent with that achieved for FY18.

The Board continues to consider the appropriate use of the Company's available capital to support further value creation from the Company's growth strategy and supply chain development. This includes a review of opportunities to invest in blending and canning capability where appropriate as part of our longer-term nutritional products sourcing arrangements.

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Reconciliation of EBITDA to net profit after tax

	Full Year Ended 30-Jun-18 NZ$ 000's	Full Year Ended 30-Jun-17 NZ$ 000's	Movement %
Segment EBITDA	283,037	141,153	100.5%
Depreciation & amortisation	(2,172)	(2,689)	(19.2%)
EBIT	**280,863**	**138,464**	102.8%
Interest income	2,369	887	167.1%
Income tax expense	(87,548)	(48,705)	79.8%
Net profit after tax	**195,684**	**90,646**	115.9%