Interim Report | for the six months ended 31 December 2018

Overview

Financial results for the half year ended
31 December 2018 (NZ$)

Group performance

$613m
Revenue ↑41%

$218m
EBITDA ↑53%

$153m
NPAT ↑55%

20.9c
Earnings per share (EPS)

$112m
Operating cash flow

$288m
Cash on hand

Product performance

$83m
Liquid milk ↑20%

$496m
Infant formula ↑45%

$34m
Other nutrition ↑40%

Regional highlights[1]

Australia

↑12%
Milk sales growth

#1
Infant formula brand

China

↑83%
China label
infant formula sales

5.7%
Infant formula
value consumption share

US

↑114%
Milk sales growth

10K
Store distribution

1 Refer to the operating and financial review (from page 2) for source of information

Contents

Operating and financial review

for the six months ended 31 December 2018

Record financial results and market share positions in all key markets

Step-changing investment in brand and capability

Summary of Group performance

The Company's increased investment in brand, market development and organisational capability fuelled continued strong sales growth in all key product segments - infant formula, liquid milk and milk powders.

Sales of infant formula totalled $495.5m for the half – an increase of 45.3% on the prior year driven by share gains in China and Australia. The Company also saw pleasing growth in its liquid milk business of 20.2% to $83.4m, particularly in its key markets of Australia and the US. Sales of other nutritional products grew 40.4% to $34.3m, driven predominantly by milk powders and supported by new products launched towards the end of FY18.

Gross margin percentage increased due to the benefits of scale and mix (proportion of infant formula sales now accounting for ~81% of Group sales).

This was partially offset by currency movements – most notably a weaker AUD.

Step-changing investment in brand and capability

Following a transformative FY18, the Company is focussed on delivering continued and significant growth through step-changing strategic investment in consumer insight, brand development and organisational capability.

The Company is accelerating its investment in building brand equity through enhanced marketing campaigns in its key markets of China, US and Australia, alongside continued investments in R&D and further development of its intellectual property. The Group's investment in marketing in the first half increased by 75.0% to $45.5m primarily as a result of increases in brand building activities in China and the US. The rate of investment in marketing will increase further in the second half as we increase in-market brand building activities.

A number of key senior strategic appointments have recently been completed, including the addition of Lisa Burquest as Chief People Officer, Melanie Kansil as Chief Commercial Officer and Phil Rybinski as Chief Technical Officer. These new roles build upon the existing strong and experienced group of executives and, combined with growth in the broader team and investment in infrastructure will ensure the business is well placed to continue its significant momentum, having the capacity to commercialise further growth opportunities.

We have previously signalled our intention of holding our first investor strategy conference, which will provide an opportunity to present a more comprehensive overview of our strategic focus areas. This remains a priority and will likely occur in the second half of the 2019 calendar year.

Strong balance sheet

The Company's closing cash position reflects the growth in revenue and earnings, partially offset by the Company's increased investment in Synlait Milk (August 2018). Net operating cash flow for the half was $112.3m, with cash on hand at 31 December 2018 of $287.9m. Cash conversion was impacted by the timing of tax and supplier payments, and increased debtors and infant formula inventory.

The Company closed the period with $72.8m of inventory, up from $64.1m at 30 June 2018. Owing to the continuing strong demand for *a2 Platinum*® infant formula the closing inventory position for the period was ultimately below target relative to sales. In response, steps have been taken to further enhance our approach to inventory management in market, enabling the business to adjust more quickly to demand changes. This will have the net effect of increasing inventory cover going forward.

We continue to be very well supported by our infant formula supply partner Synlait Milk, in meeting increased demand, and both teams continue to work closely together to grow our respective businesses.

Regional performance

Australia and New Zealand segment goes from strength to strength

The ANZ business segment revenues were up 37.5% to $418.4m, and EBITDA was up 64.9% to $192.0m.

The Australian fresh milk business has further strengthened with 11.7% revenue growth and a record 10.8% market share[1], up from 10.0% for the same period a year ago. *a2 Milk*™ was the fastest growing major liquid milk brand in Australian supermarkets and remains the leading premium milk brand and the only brand ranged in all major Australian supermarkets.

a2 Platinum® infant formula remains a significant growth brand in grocery, pharmacy and daigou channels – it is the market brand leader with 35.7% value share, up from 32.0% at the end of FY18[2].

The business continued to be the highest brand advertiser within both the milk and infant formula categories with growing brand awareness and loyalty benefitting the portfolio as a whole.

The *a2 Milk*™ brand under licence to Fonterra was launched in New Zealand early August with national advertising and distribution from late September and is performing to plan.

China performing well and poised for further growth

China segment revenue rose to $171.7m, up 50.1%, with EBITDA up 41.6% to $68.4m as a result of strong distribution and market share gains.

Our Kantar infant formula consumption value share increased to 5.7%[3] in the latest 12 month data for Tier 1 and Key A cities, up from 4.4% in the same

1 Aztec Australian Grocery Weighted Scan 12 months ending 30 December 2018 vs YA. Note, the latest market share reporting database has been updated in current period and prior year to include Costco, Aldi (SA and WA) sales

2 Aztec Australian Grocery and Pharmacy Scan 12 months ending 30 December 2018 vs June 2018

3 Kantar Infant Formula market tracking of Tier 1 and Key A cities for 12 months ending 28 December 2018 by value, vs 12 months ending December 2017

period prior year, and up from 5.1% as at end June 2018[4]. The Company recently invested in expanded market share coverage to include city tiers B, C and D and is pleased to report a market share position of 5.4% in the latest 12 month data up from 4.7% as at June 2018[5] for the composite of Tier 1 and Key A, B, C and D cities. This result demonstrates considerable momentum in lower tier cities. The positive velocity growth in store combined with the Company's stronger distribution footprint is supporting an increase in sales of China label infant formula with growth of 82.6% relative to first half year ago.

Our multi-channel strategy remains important to our success. Through the eyes of the consumer each channel plays an important role and the combined effect is beneficial. Progress made during the period by the Company in each channel has been significant.

The cross border e-commerce channel (CBEC) remains a strong pathway to the Chinese consumer for the infant formula category, enabling consumers across all regions (including those in lower tier cities) to more easily access international brands. The Company performed well during the online seasonal events and continues to perform strongly across all CBEC platforms.

Mother and Baby Stores (MBS) provide Chinese parents with a more interactive shopping experience to view brands on offer and receive information about selected products, in particular for Stages 1 and 2. This channel continues to be an important priority. During the half, focus was added to improving in-store productivity within the channel, with impressive results. Pleasingly, sales velocity growth within existing stores was a stronger contributor than growth coming from new store additions. The MBS network comprised ~12,250 stores as at the end of December. Improving in-store productivity and increasing store distribution will both continue to be an important focus in the second half as we work to lift channel share.

Modern supermarkets and Chinese label e-commerce retail channels are lesser contributors at this stage relative to CBEC and MBS but also play important roles for target consumer segments.

Our growing consumer insights gives us confidence that the Company will benefit from accelerated investment in brand building and marketing generally. Our consumers are typically deeply loyal with high trust for the brand, yet there is significant scope to build our in-market brand awareness. The business is now well positioned with strong offline and online distribution in place to benefit from step-changing marketing investment, which is expected to build further brand awareness and trial purchase within the China market. This will be a priority investment focus for the remainder of FY19 and into FY20.

4 Kantar Infant Formula market tracking of Tier 1 and Key A cities for 12 months ending 30 June 2018
5 Kantar Infant Formula market tracking of Tier 1, Key A, B, C and D cities for 12 months ending 28 December 2018 by value vs 12 months ending 30 June 2018

In August 2018 the Company renewed its agreement with China State Farm. This relationship is strong and enduring and an important part of building our business in China for the long term.

The Company is well progressed on the appointment of a CEO for Greater China who will lead the business through its next phase of growth in the region. We have been very focussed on finding a strong leader who has a demonstrated track record in creatively building successful consumer driven businesses in China.

China regulatory dynamic

The Chinese government issued a number of important regulatory updates during the half with respect to e-commerce and cross border trade in general. This included a new e-commerce law to strengthen the compliance obligations for e-commerce operators, and a new CBEC policy framework containing implementation guidance for future CBEC trade.

The new e-commerce law, together with the Chinese Government's continued support of CBEC, will further protect the rights and safety of consumers and the overall integrity of the CBEC channel. We fully support the changes, and the Company and its major trading partners selling English label products to Chinese consumers have been anticipating these changes and will be compliant on all regulatory requirements.

United States momentum building

a2 Milk™ sales momentum continued with sales growth of 114.1% in the half underpinned by increased investment in brand awareness and a stronger distribution base.

By the end of December 2018 US distribution exceeded 10,000 stores. More recently, a further ~2,400 stores have been added, taking the distribution of the brand to ~12,400 stores by the end of January 2019. The increase in store numbers is driven primarily by national distribution within the Kroger supermarket chain, in addition to three new regions within Costco; additional Vons and Safeway stores and further Walmart distribution. Sales velocities continue to improve through both new and established key accounts.

The significant rate of distribution growth in January is driven by building brand awareness and new store planogram reset timings within the respective retail chains. While the second half will continue to focus on increased distribution, there will also be a focus on improving in-store productivity in relatively newer stores.

Pleasingly, recent US research data indicates the US brand development looks a lot like the experience with fresh milk in Australia. The *a2 Milk*™ brand in the US is successfully growing category consumption, sourcing volume across multiple product segments and trading up consumers from conventional milk while demonstrating high levels of consumer loyalty once the brand is trialled.

There will be increased investment in 2H19 to support continued velocity growth in market. The planned investment for FY19 is now approximately US$27 million.

Other markets and further opportunities

UK liquid milk sales have continued to grow off a modest base. The business successfully transitioned between suppliers early in the half to a new carton packaging form. The delivery of scale remains challenging.

Progress continues to be made in establishing our presence in other Asian markets. Although relatively small contributors to sales growth, these markets offer opportunities for further expansion in the future.

The Company has agreed with Fonterra to build a milk pool in New Zealand that will enable direct ingredient supply to The a2 Milk Company, from second half calendar 2019. In addition, the business will continue to develop a milk pool in Victoria, Australia for raw milk supply. The joint a2MC and Fonterra team is actively working together to commercialise the next wave of opportunities which will come from our partnership and we continue to be encouraged by the potential.

Outlook

In the first half the Company has invested strongly in both internal and external capability to better understand our Chinese consumers, channel dynamics and ways of improving brand awareness.

Following a very strong first half performance, and encouraged by growing market share in China, the Company is now in a position to reinvest the benefits of scale into increased marketing activities in the second half. This is intended to drive brand awareness, predominantly in China, and the US. Increased brand and marketing investment is expected to continue into FY20.

The Company expects the Group revenue growth rate in the second half to continue broadly in line with the first half. The increased investment in brand building in 2H19 is expected to support revenue growth in FY20 and beyond.

Second half EBITDA margins will consequently be lower than first half, with full year FY19 EBITDA as a percentage of sales expected to be approximately 31-32%. This is due largely to:

- Marketing investment in 2H19 to approximately double 1H19
- Continued investment in building organisational capability

Reconciliation of EBITDA to net profit after tax (NPAT)

Earnings before interest, tax, depreciation and amortisation (EBITDA) is a non-GAAP measure. The Company believes that it provides investors with a comprehensive understanding of the underlying performance of the business.

	Half year ended 31-Dec-18 NZ $'000	Half year ended 31-Dec-17 NZ $'000
EBITDA	218,407	142,989
Depreciation & amortisation	(965)	(1,058)
EBIT	217,442	141,931
Interest income	1,615	795
Income tax expense	(66,362)	(44,257)
Net profit after tax (NPAT)	**152,695**	**98,469**

Directors' declaration for the six months ended 31 December 2018

The directors of The a2 Milk Company Limited are pleased to present the interim report for the six months ended 31 December 2018.

The interim report is unaudited and was authorised for issue by the directors on 19 February 2019.

Signed on behalf of the Board by:

David Hearn
Chair

Jayne Hrdlicka
Managing Director and CEO

19 February 2019

Auditor’s review report
for the six months ended 31 December 2018

Ernst & Young
200 George Street
Sydney NSW 2000 Australia
GPO Box 2646 Sydney NSW 2001

Tel: +61 2 9248 5555
Fax: +61 2 9248 5959
ey.com/au

Review Report to the Shareholders of The a2 Milk Company Limited (“the company”) and its subsidiaries (together “the group”)

We have reviewed the interim financial statements on pages 10 to 20, which comprise the statement of financial position of the group as at 31 December 2018, and the statement of comprehensive income, statement of changes in equity and statement of cash flows of the group for the period ended on that date, and a summary of significant accounting policies and other explanatory information.

This report is made solely to the company's shareholders, as a body. Our review has been undertaken so that we might state to the company's shareholders those matters we are required to state to them in a review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's shareholders as a body, for our review work, for this report, or for our findings.

Directors’ Responsibilities

The directors are responsible for the preparation and fair presentation of interim financial statements which comply with New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting* and for such internal control as the directors determine is necessary to enable the preparation and fair presentation of the interim financial statements that are free from material misstatement, whether due to fraud or error.

Reviewer’s Responsibilities

Our responsibility is to express a conclusion on the interim financial statements based on our review. We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*. NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects, in accordance with New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting*. As the auditor of the group, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

Basis of Statement

A review of interim financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly we do not express an audit opinion on those financial statements.

Other than in our capacity as auditor we have no relationship with, or interests in, the group.

Conclusion

Based on our review nothing has come to our attention that causes us to believe that the accompanying interim financial statements, set out on pages 10 to 20, do not present fairly, in all material respects, the financial position of the group as at 31 December 2018 and its financial performance and cash flows for the six month period ended on that date in accordance with New Zealand Equivalent to International Accounting Standard 34: *Interim Financial Reporting*.

Our review was completed on 19 February 2019 and our findings are expressed as at that date.

Ernst & Young

Ernst & Young
Sydney

Consolidated statement of comprehensive income (Unaudited) for the six months ended 31 December 2018

	Notes	31 Dec 18 $'000	31 Dec 17 $'000
Sales		612,875	434,629
Cost of sales		(272,255)	(218,166)
Gross margin		340,620	216,463
Other revenue		235	106
Distribution expenses		(14,835)	(13,031)
Administrative expenses	4	(35,828)	(21,757)
Marketing expenses		(45,506)	(26,007)
Other expenses	5	(27,168)	(13,772)
Operating profit		217,518	142,002
Finance income		1,615	795
Finance costs		(76)	(71)
Net finance income		1,539	724
Profit before tax		219,057	142,726
Income tax expense		(66,362)	(44,257)
Profit after tax for the period		152,695	98,469
Other comprehensive income			
Items that may be reclassified to profit or loss:			
Foreign currency translation (loss)/gain		(3,491)	2,189
Items not to be reclassified to profit or loss:			
Listed investment fair value (loss)/gain	8	(68,625)	43,317
Total comprehensive income		**80,579**	**143,975**
Earnings per share			
Basic (cents per share)		20.85	13.64
Diluted (cents per share)		20.52	13.25

The accompanying notes form part of these financial statements.

Consolidated statement of changes in equity (Unaudited) for the six months ended 31 December 2018

Six months ended 31 December 2018	Foreign currency translation reserve **$'000**	Fair value revaluation reserve **$'000**	Employee equity settled payments reserve **$'000**	**Total reserves $'000**	**Retained earnings $'000**	**Share capital $'000**	**Total equity $'000**
Balance 1 July 2018	(11,022)	122,113	12,351	123,442	290,701	141,566	555,709
Profit after tax for the period	–	–	–	–	152,695	–	152,695
Foreign currency translation differences – foreign operations	(3,491)	–	–	(3,491)	–	–	(3,491)
Listed investment – fair value movement	–	(68,625)	–	(68,625)	–	–	(68,625)
Total comprehensive income for the period	(3,491)	(68,625)	–	(72,116)	152,695	–	80,579
Transactions with owners in their capacity as owners:							
Issue of ordinary shares	–	–	–	–	–	1,828	1,828
Share issue costs	–	–	–	–	–	(42)	(42)
Share-based payments	–	–	5,904	5,904	–	–	5,904
Total transactions with owners	–	–	5,904	5,904	–	1,786	7,690
Balance 31 December 2018	**(14,513)**	**53,488**	**18,255**	**57,230**	**443,396**	**143,352**	**643,978**

Six months ended 31 December 2017	Foreign currency translation reserve **$'000**	Fair value revaluation reserve **$'000**	Employee equity settled payments reserve **$'000**	**Total reserves $'000**	**Retained earnings $'000**	**Share capital $'000**	**Total equity $'000**
Balance 1 July 2017	(10,948)	13,372	9,739	12,163	95,017	134,302	241,482
Profit after tax for the period	–	–	–	–	98,469	–	98,469
Foreign currency translation differences – foreign operations	2,369	–	–	2,369	–	–	2,369
Listed investment – fair value movement	–	43,317	–	43,317	–	–	43,317
Income tax	(180)	–	–	(180)	–	–	(180)
Total comprehensive income for the period	2,189	43,317	–	45,506	98,469	–	143,975
Transactions with owners in their capacity as owners:							
Issue of ordinary shares	–	–	–	–	–	2,951	2,951
Share issue costs	–	–	–	–	–	(18)	(18)
Share-based payments	–	–	1,243	1,243	–	–	1,243
Total transactions with owners	–	–	1,243	1,243	–	2,933	4,176
Balance 31 December 2017	(8,759)	56,689	10,982	58,912	193,486	137,235	389,633

The accompanying notes form part of these financial statements.

Consolidated statement of financial position (Unaudited) as at 31 December 2018

	Notes	31 Dec 18 $'000	30 Jun 18 $'000 restated
Assets			
Current assets			
Cash & short-term deposits		287,932	340,455
Trade & other receivables		76,403	59,131
Prepayments		48,107	36,015
Inventories	7	72,749	64,101
Total current assets		485,191	499,702
Non-current assets			
Property, plant & equipment		10,326	9,701
Intangible assets		15,211	15,092
Other financial assets	8	280,572	186,862
Deferred tax assets		3,913	4,861
Total non-current assets		310,022	216,516
Total assets		795,213	716,218
Liabilities			
Current liabilities			
Trade & other payables		108,272	108,934
Customer contract liabilities		11,877	898
Income tax payable		30,919	50,557
Total current liabilities		151,068	160,389
Non-current liabilities			
Trade & other payables		167	120
Total non-current liabilities		167	120
Total liabilities		151,235	160,509
Net assets		643,978	555,709
Equity attributable to owners of the Company			
Share capital	6	143,352	141,566
Retained earnings		443,396	290,701
Reserves		57,230	123,442
Total equity		643,978	555,709

The accompanying notes form part of these financial statements.

Consolidated statement of cash flows (Unaudited) for the six months ended 31 December 2018

	Notes	31 Dec 18 $'000	31 Dec 17 $'000
Cash flows from operating activities			
Receipts from customers		614,674	440,765
Payments to suppliers & employees		(424,049)	(278,627)
Interest received		1,615	795
Taxes paid		(79,943)	(46,491)
Net cash inflow from operating activities	9	112,297	116,442
Cash flows from investing activities			
Payments for property, plant & equipment		(1,755)	(1,568)
Payments for intangible assets		(640)	(578)
Payment for listed investment	8	(162,335)	–
Net cash outflow from investing activities		(164,730)	(2,146)
Cash flows from financing activities			
Proceeds from issue of equity shares	6	1,786	2,933
Net cash inflow from financing activities		1,786	2,933
Net (decrease)/increase in cash & short-term deposits		(50,647)	117,229
Cash & short-term deposits at the beginning of the period		340,455	121,020
Effect of exchange rate changes on cash		(1,876)	1,923
Cash & short-term deposits at the end of the period		287,932	240,172

The accompanying notes form part of these financial statements.

Notes to the interim financial statements for the six months ended 31 December 2018

1. Basis of preparation

The a2 Milk Company Limited (the Company) and its subsidiaries (together the Group) is a for-profit entity incorporated and domiciled in New Zealand.

The Company is registered in New Zealand under the Companies Act 1993, and is an FMC reporting entity under the Financial Markets Conduct Act 2013. The Company is also registered as a foreign company in Australia under the *Corporations Act 2001* (Cth, Australia). The shares of The a2 Milk Company Limited are publicly traded on the New Zealand Stock Exchange (NZX), the Australian Securities Exchange (ASX) and Chi-X Australia (Chi-X). The financial report is presented in New Zealand dollars, and all values are rounded to the nearest thousand ($'000), unless otherwise indicated.

The principal activity of the Company is the commercialisation of A1 protein free branded milk and related products in targeted global markets.

These consolidated financial statements were authorised for issue by the directors on 19 February 2019.

Statement of compliance

These interim financial statements have not been audited. The interim financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand, comply with NZ IAS 34 *Interim Financial Reporting* and IAS 34 *Interim Financial Reporting,* and have been the subject of a review by the auditors.

This interim report should be read in conjunction with the Group's annual report for the year ended 30 June 2018, available at www.thea2milkcompany.com/investor-centre/results.

The same accounting policies and methods of computation are followed in this interim report as were applied in the preparation of the Group's financial statements for the year ended 30 June 2018, other than the changes arising from the adoption of NZ IFRS 15: *Revenue from Contracts with Customers*, noted below.

Changes in significant accounting policies

The Group has applied all of the new and revised Standards and Interpretations issued by the New Zealand External Reporting Board that are relevant to the Group's operations and effective for the current accounting period. Their application has not had any material impact on the Group's assets, profits or earnings per share for the half-year ended 31 December 2018.

Adoption of NZ IFRS 15: *Revenue from Contracts with Customers*

The Group has adopted this standard from 1 July 2018, using the full retrospective method.

The adoption of the standard had no impact on the Group's consolidated total equity, retained earnings, earnings per share or cash flows; with the following adjustments made to the presentation of the Group's consolidated statement of financial position as at 30 June 2018.

30 June 2018	As reported $'000	Adjustments $'000	Before adoption of NZ IFRS 15 $'000
Trade & other receivables (current)	59,131	(6,360)	65,491
Total current assets	499,702	(6,360)	506,062
Trade & other payables (current)	108,934	(7,258)	116,192
Customer contract liabilities (current)	898	898	–
Total current liabilities	160,389	(6,360)	166,749

Trade receivables are now recognised and measured at the transaction price in accordance with NZ IFRS 15, reflecting adjustments for variable consideration such as rebates. Previously, items of variable consideration were recognised as accruals. Customer contract liabilities refer to payments in advance received from customers, previously recognised in accruals.

Additional disclosure of the Group's revenue accounting policies as required by the standard are disclosed in Note 3.

1. Basis of preparation (continued)

New standards and interpretations not yet adopted

Certain new accounting standards and interpretations have been published that are relevant to the Group's operations but are not yet mandatory for the 31 December 2018 accounting period. The Group's current assessment of the impact of these is set out below.

Accounting standard	Requirement	Impacts in future periods
NZ IFRS 16: *Leases*	NZ IFRS 16 will become mandatory for the Group's annual reporting period ending 30 June 2020, replacing the existing leases standard. The new standard removes the distinction between operating and finance leases, recognising all lease assets and liabilities on balance sheet, with limited exceptions for short-term leases and low value assets.	As a right-to-use asset and a lease liability will be recognised for operating leases, the change will result in a more front-loaded expense pattern for operating leases as compared to current straight-lining, with lease expense allocated to interest and depreciation. The right-to-use asset and lease liability will be determined based on the present value of future lease payments. The impact assessment for this standard is being carried out during FY2019.

There are no other standards that are not yet effective and that are expected to have a material impact on the Group in the current or future reporting periods.

2. Operating segments

The Group's key performance measures are segment revenue and segment results before interest, tax, depreciation and amortisation (Segment EBITDA, a non-GAAP measure). Further information and analysis of performance can be found in the Operating and financial review, which forms part of this interim report.

For management purposes, the Group is organised into business units based on geographical location along with a corporate function, and has three reportable operating segments as follows:

- The *Australia and New Zealand segment* receives external revenue from infant formula, milk and other dairy products, along with royalty and licence fee income
- The *China and other Asia segment* receives external revenue from the export of infant formula, milk and other dairy products to China and other Asia. This segment is responsible for the infant formula supply chain from New Zealand to all markets
- The *United Kingdom and USA segment* receives external revenue from milk and infant formula sales

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is assessed on segment EBITDA and is measured in conformity with the accounting policies adopted for preparing and presenting the financial statements of the Group.

Notes to the interim financial statements for the six months ended 31 December 2018

2. Operating segments (continued)

Six months to 31 December 2018	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Total $'000
Consolidated sales	418,211	171,678	22,986	612,875
Other revenue	235	–		235
Reportable segment revenue	418,446	171,678	22,986	613,110
Reportable segment results (Segment EBITDA)	191,953	68,438	(14,563)	245,828
Corporate EBITDA				(27,421)
Group EBITDA				218,407
Reconciliation to consolidated statement of comprehensive income:				
Interest income				1,615
Depreciation and amortisation				(965)
Income tax expense				(66,362)
Consolidated profit after tax				152,695

Six months to 31 December 2017	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Total $'000
Consolidated sales	304,197	114,370	16,062	434,629
Other revenue	106	–	–	106
Reportable segment revenue	304,303	114,370	16,062	434,735
Reportable segment results (Segment EBITDA)	116,402	48,322	(8,374)	156,350
Corporate EBITDA				(13,361)
Group EBITDA				142,989
Reconciliation to consolidated statement of comprehensive income:				
Interest income				795
Depreciation and amortisation				(1,058)
Income tax expense				(44,257)
Consolidated profit after tax				98,469

3. Revenue

Sales of products

The Group sells A1 protein free branded infant formula, liquid milk and related products to wholesale customers.

A sale is recognised when control of the product has transferred, being when the product is delivered to the customer and there is no unfulfilled obligation that could affect the customer's acceptance of the product. Delivery occurs when the product has been shipped to the location specified by the customer and the customer accepts the product.

Revenue from sales is recognised based on arrangements as agreed with the customer. These arrangements are applied on an order by order basis and do not commit the customers to purchase a specified quantity or type of product; nor do they commit the Group to deliver a specified quantity or type of product. The arrangements set out the terms and conditions that apply to the parties each time an order is placed by a customer and accepted by the Group, creating a sale contract for that order. The terms and conditions cover, as appropriate to the customer, pricing, settlement of liabilities, return policies and any other negotiated performance obligations.

Settlement terms range from cash-on-delivery or prepaid terms to various credit terms not exceeding 60 days from end of month. These terms reflect assessment of customer credit risk and industry practice.

Customer contract liabilities refer to payments in advance received from customers; with subsequent delivery to customer, and recognition of revenue, generally occurring within a week of receipt of the payment.

For credit customers a receivable is recognised when the products are delivered, being the point in time that the consideration is unconditional because only the passage of time is required before payment is due.

Disaggregation of revenue

In the following table, revenue is disaggregated by geographical location (reportable segments) and major product types.

Six months to 31 December 2018	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Total $'000
Infant formula	321,557	166,143	7,781	495,481
Liquid milk	67,077	1,097	15,205	83,379
Other	29,812	4,438	–	34,250
	418,446	171,678	22,986	613,110

Six months to 31 December 2017	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Total $'000
Infant formula	221,461	110,955	8,539	340,955
Liquid milk	61,109	754	7,523	69,386
Other	21,733	2,661	–	24,394
	304,303	114,370	16,062	434,735

Notes to the interim financial statements for the six months ended 31 December 2018

4. Administrative expenses

	31 Dec 18 $'000	31 Dec 17 $'000
Equity settled share-based payments	5,904	1,243
Salary and wage costs	21,481	15,159
Travel costs	3,569	2,441
Other administrative expenses	4,874	2,914
	35,828	21,757

The equity settled share-based payments charge for the period includes the cost of transitional benefits associated with the appointment of the Company's Managing Director and CEO in July 2018. These transitional benefits included 599,254 time-based rights, 357,232 of which vested in the period, with the balance remaining to vest in June and August 2019.

5. Other expenses

	31 Dec 18 $'000	31 Dec 17 $'000
Directors' fees and expenses	469	427
Professional service fees	10,335	3,455
Legal expenses	1,366	3,875
Depreciation and amortisation	965	1,058
Patents, trademarks and research and development	2,853	1,796
Occupancy expenses	868	964
Insurance	2,118	1,321
Net foreign exchange loss/(gain)	1,020	(2,957)
Other operating expenses	7,174	3,833
	27,168	13,772

The increase in professional service fees reflects the Group's investment in advisory services to support its strategic growth initiatives in key markets.

6. Share capital

Movements in contributed equity:

	Number of shares	Share Capital $'000
Fully paid ordinary shares:		
Balance 30 June 2018	730,039,067	141,566
Movements in the period:		
Exercise of options	2,900,998	1,828
Vesting of time-based rights	357,232	–
Share issue costs	–	(42)
	3,258,230	1,786
Balance 31 December 2018	733,297,297	143,352
Partly paid ordinary shares:		
Balance 30 June 2018	1,500,000	–
Balance 31 December 2018	1,500,000	–
Total ordinary shares on issue:		
30 June 2018	731,539,067	141,566
31 December 2018	734,797,297	143,352

7. Inventories

	31 Dec 18 $'000	30 Jun 18 $,000
Raw materials	9,100	5,051
Finished goods	28,387	50,641
Goods in transit	35,262	8,409
Total inventories at the lower of cost and net realisable value	72,749	64,101

Movements in goods in transit balances result from the timing of shipments of infant formula and milk powder products from New Zealand to Australia and China.

Notes to the interim financial statements for the six months ended 31 December 2018

8. Financial assets and liabilities

Other financial assets of $280,572,000 (30 June 2018: $186,862,000) consist of shares in Synlait Milk Limited (Synlait), a dairy processing company listed on the New Zealand Stock Exchange and the Australian Securities Exchange. In August 2018 the Company made a further investment in Synlait, acquiring 14,840,527 shares for $162,335,000, increasing its total holding in Synlait to 17.394%.

This listed investment is the only financial instrument carried by the Group at fair value and is classified at fair value through other comprehensive income; valued using Level 1 valuation inputs: quoted prices (unadjusted) in active markets for identical assets or liabilities.

A fair value loss of $68,625,000 was recognised for the period.

The carrying amounts of cash and short-term deposits, and trade and other receivables and payables are a reasonable approximation of their fair values.

9. Reconciliation of after tax profit with net cash flows from operating activities

	31 Dec 18 $'000	31 Dec 17 $'000
Net profit for the period	152,695	98,469
Adjustments for non-cash items:		
Depreciation & amortisation	965	1,058
Share-based payments	5,904	1,243
Net foreign exchange gain	(929)	(522)
Deferred tax	948	(1,202)
Changes in working capital:		
Trade & other receivables	(17,272)	(2,561)
Prepayments	(12,092)	(10,443)
Inventories	(8,648)	(25,169)
Trade & other payables	(615)	52,177
Customer contract liabilities	10,979	–
Income tax payable	(19,638)	3,392
Net cash inflow from operating activities	112,297	116,442

Corporate directory

Company	The a2 Milk Company Limited Level 10 51 Shortland Street Auckland 1010 New Zealand
New Zealand share registry	Link Market Services Limited PO Box 91976 Victoria Street West Auckland 1142 New Zealand Telephone: +64 9 375 5998
Australian share registry	Link Market Services Limited Locked Bag A14 Sydney South NSW 1235 Australia Telephone: +61 1300 554 474
Auditor	Ernst & Young 200 George Street Sydney NSW 2000 Australia
Registered offices	Level 10 51 Shortland Street Auckland 1010 New Zealand Level 4 182 Blues Point Road McMahons Point NSW 2060 Australia Telephone: +61 2 9697 7000
Corporate website	www.thea2milkcompany.com
Company directors	David Hearn (Chair & Non-Executive Director) Julia Hoare (Deputy Chair & Independent, Non-Executive Director) Jayne Hrdlicka (Managing Director & CEO) Peter Hinton (Independent, Non-Executive Director) Warwick Every-Burns (Independent, Non-Executive Director) Jesse Wu (Independent, Non-Executive Director)


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