NZX: ATM
ASX: A2M

21 August 2019

NZX/ASX Market Release

Record financial results and market shares; step-changing investment in brand and capability for further growth

Results highlights for the year ended 30 June 2019[1]

- Total revenue of $1,304.5 million – an increase of 41.4%[2]
- EBITDA[3] of $413.6 million – up 46.1%
- Net profit after tax of $287.7 million – up 47.0%
- Basic earnings per share (EPS) of 39.3 cents, an increase of 45.4%
- EBITDA to sales margin of 31.7%
- Operating cash flow of $289.1 million and a closing cash balance of $464.8 million
- Step-changing marketing investment of $135.3 million representing 10.4% of sales and an increase of 83.7%
- Infant nutrition market shares strengthened to 6.4%[4] in China with Group infant formula revenue of $1,063.8 million up 46.9%
- US milk revenue more than doubled and distribution expanded to 13,100 stores
- Australian fresh milk revenue growth of 10.7%[5] and record market share of 11.2%[6]
- Significant investment in building depth and breadth of organisational capability to support continued growth and resilience

[1] All figures are in New Zealand Dollars (NZ$) unless otherwise stated.
[2] All comparisons are with the 12 months ended 30 June 2018 (FY18), unless otherwise stated.
[3] 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.
[4] Kantar Infant Formula market tracking of Tier 1 and Key A, B, C and D cities for 12 months ending 14 July 2019 by value
[5] Local currency (AUD).
[6] Aztec Australian Grocery Weighted Scan 12 months ending 30 June 2019.

Year in summary

I have really enjoyed my first year as CEO. We are proud of all we have achieved as a team this year but also conscious of how much there is yet to be done, as we continue to build our business.

This year we focused on playing to our strengths and sharpening our strategic thinking. This enabled us to begin step-changing investment to support our considerable growth ambition.

The company delivered record financial and market share results for 2019. This was enabled by strong revenue growth across our key product segments of liquid milk, infant nutrition and other nutritional milk products, and across each of our key regions. Pleasingly, our results were underpinned by growing brand awareness, expanding product distribution and strengthening in-market execution in our two most important regions of Greater China and the US.

We have focused on really getting to know our consumers and sales channels in our core markets of China and the US. The a2 Milk Company's unique brand proposition intrinsically leverages macro consumer factors, which include a growing consumer demand for health and wellness products; a growing focus on food safety, naturalness and provenance; the growing middle class in Asia; and the rapid pace of digitalisation. While in each of our markets our consumers are quite different, our global brand proposition resonates strongly with our consumers and is unique relative to the competition.

We have also invested heavily in increasing our capability and capacity to support the development and delivery of comprehensive growth plans for our most important strategic priorities.

In effect much of our effort in FY19 was spent balancing our dual priorities of sustaining our growth momentum in the year while at the same time deepening our local consumer and market knowledge, investing to build capability and creating detailed blueprints to deliver future growth.

Our business results were driven by strong performance across our portfolio. The continued growth of our infant nutrition products was a strong contributor to the results with sales totalling $1.1 billion for the year – an increase of 46.9% on the prior year. This was driven by share gains in China and Australia. We achieved pleasing growth in our liquid milk businesses in particular within Australia and the USA – with total fresh milk growth of 22.9% and revenue of $174.9 million across the Group. We grew sales of other nutritional milk products by 17.3%, delivering total sales of $65.8 million. This was driven by milk powders and supported by new products launched towards the end of FY18 and in the fourth quarter of FY19.

Our gross margin remains strong and has improved to 54.7%. The improvement was driven by a price increase partially offset by currency movements – most notably a weaker Australian dollar.

Our balance sheet is strong with no debt and a substantial cash balance. The closing cash position reflects growth in revenue and earnings, partially offset by increased working capital, and our increased equity investment in Synlait Milk in August 2018.

Net operating cash flow for the year was $289.1 million, with cash on hand at 30 June 2019 of $464.8 million. Our balance sheet continues to strengthen, which is important as we work our way through the delivery requirements of our long-term strategy. We continue to consider the appropriate use of available capital in the context of supporting our very significant growth ambitions.

We have enhanced our approach to inventory management, enabling us to adjust more quickly to demand changes by increasing our inventory cover. We finished the year with $108.5 million of inventory, up 69.2% from the prior corresponding period and 49.0% from the first half.

Strategic progress

We have made significant progress refining our blueprint for growth and prioritised the strategic growth opportunities as follows:

1. maximise growth from existing products in core markets;
2. broaden our product portfolio in core markets; and
3. expand in other targeted markets.

To enable the successful delivery of these strategic priorities we have made significant investments during the year. Comprehensive work has been undertaken to ensure we fully understand our consumer and sales channels and better define the growth opportunities emanating from these. Following on from this we are step-changing our marketing investment, with clarity on opportunities to drive efficiencies within the path to purchase; and we are building capability to execute more broadly on our strategic growth blueprints.

Our core markets – Australia and New Zealand (ANZ), Greater China and the US represent our most significant growth opportunities in the medium term. The growth will come from both our existing product ranges and innovation within these markets. For example, the launch of *a2 Smart Nutrition™* – a fortified milk drink targeting children 4-12 years of age – enables us to migrate consumers when they grow out of infant nutrition in China.

In addition, we continued to selectively explore new market opportunities. As a part of this we undertook increased consumer research and in-market activity in Vietnam, Korea and the city of Hong Kong. Alongside the ongoing work we are doing with Fonterra, the focus continues to be milk powder products in Vietnam, testing a fresh milk presence in Singapore and Korea, and infant formula in the city of Hong Kong.

Building sustainable brand leadership via step-changing marketing investment and continued investment in intellectual property and research and development

We have significantly increased our investment in building brand value with a goal to accelerate brand awareness and trial in both China and the US. Our investment in marketing for the full year increased by 83.7% to $135.3 million, primarily as a result of increases in advertising spend in China and the US.

During the year we also invested in better understanding both Chinese and US consumer archetypes, channel dynamics and ways of improving brand awareness. Using these insights, we stepped up the rate and quantum of marketing investment in the second half in activities to drive awareness and encourage trial of our products. These activities are an important part of delivering on our growth ambition.

Research and development programmes continue to be a priority, including independent clinical studies. A clinical trial amongst 5 to 6-year-old children in China was published in July 2019. The study analysed results from 75 Chinese children with mild to moderate milk discomfort or lactose intolerance (confirmed via a urinary galactose test) and reported that replacing conventional milk with *a2 Milk™ "reduced gastrointestinal symptoms associated with milk intolerance"* in many subjects and led to *"corresponding improvements in aspects of cognitive performance"* as measured using the Subtle Cognitive Impairment Test (SCIT)[7]. The study was independently peer reviewed and published in the US

[7] Xiaoyang S, Zailing L. Effects of Conventional Milk Versus Milk Containing Only A2 ß-Casein on Digestion in Chinese Children. J Pediatr Gastroenterol Nutr. 2019 Jul 9.

based Journal of Pediatric Gastroenterology and Nutrition. Further company sponsored clinical research has progressed during the year.

Significant investment in capability development

During the year we invested strongly in both internal and external capability.

In April we welcomed Xiao Li as Chief Executive of Greater China who is building the capability and executional capacity of our team in China to support our growth momentum. In addition to Xiao Li, the China based team continues to grow and now represents over 20% of our global team.

We made a number of other senior appointments, including new roles, with the addition of Lisa Burquest as Chief People Officer, Melanie Kansil as Chief Commercial Officer and Phil Rybinski as Chief Technical Officer. We also further increased our capability in the second half with pivotal resourcing in the marketing, new product development, innovation and people capability functions.

These roles build upon the existing strong and experienced group of executives in the organisation, just as the other new starters to the company have added to our growing global team capability.

We also made additional external resource investments to broaden our in-market and technical capabilities and augment our capacity as an organisation. This has helped sustain our momentum by giving us quick access to much needed skills and capacity.

Strategic partnerships

Key strategic partnerships are a critical element of our business model. There were a number of major developments in this area during the year.

Synlait: In July 2018 we reaffirmed our supply agreement with Synlait for infant formula and other nutritional products. We continue to be very well supported by Synlait in meeting increased demand and our teams continue to work closely together to grow our respective businesses. In August 2018, we also announced increasing our total shareholding in Synlait to approximately 17.4%. This investment enables us to further protect our relationship with an important supply chain partner.

Fonterra: In August 2018, the *a2 Milk™* brand, under licence to Fonterra, was launched in New Zealand with national advertising and distribution and is performing well relative to plan. We have also begun sourcing direct ingredients from Fonterra with increased supply during the second half of calendar 2019. The relationship with Fonterra remains strong. Our joint teams are 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.

China State Farm: In August 2018, we renewed our strategic arrangements with China State Farm Holding Shanghai Co., Ltd. (CSF), extending our arrangements for a further three-year period from 6 December 2018. CSF is our exclusive import agent for our China label products and has been a strong partner for our infant nutrition products into mainland China since launch in 2013. In addition to importation services it has provided local market regulation consulting and product traceability quality control for our business.

Regional performance

Australia and New Zealand segment goes from strength to strength

ANZ business revenue was $842.7 million, up 28.3%, and EBITDA of $388.2 million represented an increase of 48.1%.

The Australian fresh milk business continues to strengthen with 10.7%[8] revenue growth and a record 11.2% market share[9], up from 9.8% for the same period a year ago, and 10.8% at the end of 1H19.

a2 Milk™ was the fastest growing major fresh milk brand in Australian supermarkets and remains the leading premium milk brand and the only brand ranged in all major Australian supermarkets. Our second half performance was especially strong, driven by effective and consistent marketing investment.

a2 Platinum® infant nutrition revenue grew 35.3% and remains the market brand leader in grocery and pharmacy channels.

We remain the highest brand advertiser within both the milk and infant formula categories, which continues to drive growth in brand awareness and consumer loyalty.

China business momentum continues to build

China segment business revenues rose to $405.7 million, up 73.6%, with EBITDA of $123.9 million, up 52.4% resulting from increased distribution, higher like-for-like sales velocity and continued market share gains.

Our Kantar infant formula consumption value share increased to 6.4%[10] in the latest 12-month data for Tier 1 and Key A, B, C and D cities, up from 4.8% in the same period prior year, and up from 5.4% at the end of the first half[11].

During the year we invested in expanded Kantar market share coverage to include city tiers B, C and D and are pleased to report considerable momentum in lower tier cities. Our multi-channel strategy remains important to our success in building household penetration amongst different types of consumers and across different city tiers. Through the eyes of the consumer each channel plays an important role and the combined effect is synergistic. Pleasing progress was made across all channels this year.

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. We performed well during the online seasonal events and continue 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. This channel continues to be an important priority in expanding our brand accessibility and consumer trial. Consequently, significant investment was made in-store to drive education and visibility to shoppers. During the year, we focused on improving in-store productivity within the channel with strong results. Sales velocity growth within

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[8] In constant currency.

[9] Aztec Australian Grocery Weighted Scan 12 months ending 30 June 2019 vs prior year. Note, the latest market share reporting database was updated in 1H19 and for prior year to include Costco, Aldi (SA and WA) sales.

[10] Kantar Infant Formula market tracking of Tier 1 and Key A, B, C and D cities for 12 months ending 14 July 2019 by value, vs 12 months ending 14 July 2018.

[11] Kantar Infant Formula market tracking of Tier 1 and Key A, B, C and D cities for 12 months ending 30 December 2018 by value.

existing stores was a stronger contributor than growth coming from new store additions. During the year sales of China label infant nutrition approximately doubled and the number of MBS stores was ~16,400 as at the end of June, representing a 64% increase in stores from end of FY18. Improving in-store productivity and increasing store distribution will both continue to be important focuses in the coming year.

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

The deep consumer and sales channel insights developed during the year give us confidence that we will benefit from accelerated investment in brand building and marketing in FY20 and beyond. The business is 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 within the China market. This was a priority investment focus in FY19 and will continue to be a priority in FY20.

China regulatory dynamic

A number of important regulatory changes were introduced during the year with respect to e-commerce and cross border trade in general. This included new e-commerce law and a new CBEC policy framework containing implementation guidance for future CBEC trade.

These regulatory changes initially resulted in some orders being pulled forward into the third quarter. However, the overall impact has been minimal.

A number of announcements relating to regulation in China were made towards the end of the second half, including from China's State Administration for Market Regulation ("SAMR") and other ministries and bureaus, outlining measures to ensure successful implementation of the e-commerce legislation which, following a three-month grace period, became effective from April 2019.

We welcome measures that protect the rights and safety of consumers and the overall integrity of e-commerce channels and will continue to work closely with our partners through this process.

United States business building scale

US segment business revenues rose to $34.6 million, up 160.7%, with an EBITDA loss of $44.0 million resulting from increased investment in distribution growth and brand awareness.

US revenue has grown by over 100% during each of the last three years via a focused effort to increase brand awareness, driving in-store velocity increases and expanded distribution. While distribution continues to grow at pace, we are also focused on improving in-store productivity.

By the end of the year, our distribution exceeded 13,100 stores. This 118% increase was driven by gaining national distribution within the Kroger supermarket chain, adding three new regions within Costco, the successful addition of Vons (Southern California) and other Albertson's/Safeway divisions, and further Walmart distribution expansion. We also experienced a significant increase in the rate of distribution growth in January 2019, driven by building brand awareness and new store planogram reset timings within the respective retail chains.

Pleasingly, recent research data indicates the US brand development is progressing well. The *a2 Milk™* brand is successfully growing category consumption, sourcing volume across multiple product segments and trading up consumers from conventional milk. The brand is also experiencing high levels of consumer loyalty.

We increased levels of marketing investment in the second half to support continued velocity growth. We also delivered on our commitment to deploy approximately US$27 million of planned investment in the year.

The company remains confident of the opportunity for continued growth in the US given the high consumer propensity for premium wellness products and strong retailer support.

Growth of UK liquid milk remains challenging

UK segment revenues grew to $21.6 million, up 12.7%, with EBITDA of $4.4 million, driven by increased wholesale sales of infant formula.

The UK liquid milk business commenced in 2012 and has grown in volume and revenue every year. Since then, our company has evolved considerably, and the UK opportunity is not of sufficient scale when compared to the significant growth potential in Greater China and the US.

Subsequent to year end the Board has therefore decided to exit UK liquid milk operations during 1H20, to focus instead on strengthening our position in our core regions. UK infant nutrition customers have been transferred to our China and other Asia segment from FY20.

It is important to note that this decision does not preclude us from pursuing UK or European markets at some stage in the future for liquid milk or other nutritional products.

Outlook

We anticipate continued growth in revenue across our key regions supported by increasing brand and marketing investment in China and the US.

Full year FY20 EBITDA as a percentage of sales is expected to be broadly consistent with 2H19 EBITDA margin (28.2%) reflecting:

- increased full year marketing investment to ~12 per cent of sales;
- continued investment in organisational capability to support future growth; and
- gross margin percentage expected to be broadly consistent with FY19.

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Reconciliation of EBITDA to net profit after tax

	Full Year Ended 30-Jun-19 NZ$ 000's	Full Year Ended 30-Jun-18 NZ$ 000's	Movement %
Segment EBITDA	413,610	283,037	46.1%
Depreciation & amortisation	(2,176)	(2,174)	0.1%
EBIT	**411,434**	**280,863**	46.5%
Interest income	4,277	2,369	80.5%
Income tax expense	(127,970)	(87,548)	46.2%
Net profit after tax	**287,741**	**195,684**	47.0%