27 February 2020
NZX/ASX Market Release

Delivered strong financial results
Strategy execution gaining momentum

Results highlights for the half year ended 31 December 2019 (NZ$)[1,2,3]

- Total revenue of $806.7 million, an increase of 31.6%
- EBITDA[4] of $263.2 million, an increase of 20.5%
- Net profit after tax of $184.9 million, an increase of 21.1%
- Basic earnings per share (EPS) of 25.15 cents, an increase of 20.6%
- EBITDA to sales margin of 32.6%, better than expected
- Operating cash flow of $160.6 million and a closing cash balance of $618.4 million
- Marketing investment of $84.1 million targeting opportunities in China and the USA
- Group infant nutrition revenue of $659.2 million, up 33.1%
- Strong growth in China label infant nutrition, with sales doubling to $146.7 million and distribution expanded to 18,300 stores
- USA milk revenue more than doubled and distribution expanded to 17,500 stores

[1] All figures are in New Zealand Dollars (NZ$) unless otherwise stated.
[2] All comparisons are with the six months ended 31 December 2018 (1H19), unless otherwise stated.
[3] All figures are quoted based on all operations of the Group, without excluding discontinued operations, unless otherwise stated.
[4] 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.

Summary of Group performance

The a2 Milk Company has made substantial gains in revenue and earnings, and with strong performances in key product segments of infant nutrition and liquid milk, and across core markets.

Our overall result reflects the continued growth in our **infant nutrition** segment with sales totalling $659.2 million for the period – an increase of 33.1% on the prior corresponding period. In-line with our strategy, our strong growth in China label infant nutrition products was particularly pleasing, with sales of $146.7 million, an increase of 100%. We achieved this while also continuing to achieve strong growth in our English label infant nutrition products. During December 2019, distributors requested additional product in advance of Chinese New Year which effectively brought forward approximately $8.0 million of sales from January 2020 to December 2019.

We again achieved strong growth in our **liquid milk** businesses in Australia and the USA, with sales across the Group[5] totalling $104.4 million up 28.7%. Liquid milk sales in Australia were up 11.3% to $74.7 million and sales in the USA more than doubled compared to 1H19, driven by improved sales velocity in established stores as well as an expanded store footprint.

Our **gross margin** percentage[5,6] increased to 57.2%, benefiting from a continued mix shift to infant formula, as well as improved price yield.

We delivered an **EBITDA margin** of 32.6% which was better than expected due to our stronger underlying gross margin.

Net **cash flow** from operating activities for the period was $160.6 million representing a strong cash conversion rate. Our closing **cash** position of $618.4 million reflects growth in revenue and earnings, partially offset by increased working capital.

Our **balance sheet** remains in a strong position with no debt and a significant cash balance. This will continue to be important to provide optionality in the execution of our growth strategy.

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[5] From continuing operations.
[6] Gross margin percentage is calculated as revenue less cost of goods sold, divided by revenue.

Delivering on our strategic priorities and business objectives

We are pleased with the results of our strategy execution and continue to be energised about our key products, core markets and growth outlook.

We are committed to a focused approach to pursuing our strategic growth priorities:

1. Maximise growth from existing products in core markets;
2. Broaden our product portfolio in core markets; and
3. Expand in other targeted markets.

With the benefit of the comprehensive work undertaken during 2019 to enhance our understanding of the consumer and sales channels in our core markets, we have continued the increased levels of investment in marketing and capability to execute our growth plan.

In Australia, we have continued to build on our market leading positions in fresh milk and infant nutrition, whilst leveraging this to launch new products, such as *a2 Smart Nutrition™,* demonstrating our commitment to innovation.

In Greater China, we remain focused on strengthening our infant nutrition position in-market. It is pleasing to see our investments in brand, trade activities and people driving strong sales momentum.

In the USA, we continue to drive towards meaningful scale, with sales more than doubling compared to 1H19. We improved our in-store productivity and further expanded our distribution footprint.

Our targeted exploration of new markets continues – in October we launched infant formula in the city of Hong Kong and in December we launched infant formula in Korea with our partner, YuhanCARE (Yuhan).

Importantly, our strategic priorities translate into four business objectives:

1. Deliver Asia Pacific sales strategy outcomes;
2. Reach meaningful scale in the USA;
3. Build towards sustainable brand leadership; and
4. Deliver the organisation of the future.

We are pleased with the progress we have made against each of these business objectives in the first half and are confident that orienting our organisation around these objectives will allow us to capture near-term and longer-term growth opportunities.

1. Deliver Asia Pacific sales strategy outcomes

Our Asia Pacific business revenue was $777.4 million, up 30.0%, with EBITDA of $345.4 million, up 30.2%. This included:

- ANZ segment revenue of $460.2 million, up 10.0%, with EBITDA of $227.9 million, up 18.7%
- China & other Asia segment revenue of $317.2 million, up 76.7%, with EBITDA of $117.5 million, up 60.3%
- Revenue growth benefited from favourable pricing and product mix

Infant nutrition

Our Asia Pacific infant nutrition portfolio encompasses predominantly China and English label products. China label infant nutrition products can be sold in-market in China, via mother and baby stores (MBS), modern supermarkets and China label e-commerce retail channels. English label products can be sold through Australian retailers, Australian-sourced resellers and cross border e-commerce (CBEC) channels. In addition, we supply infant nutrition products into Hong Kong and Korea. Our multichannel approach for our infant formula business gives us the flexibility to meet consumer demands across regions and through multiple distribution pathways.

Infant nutrition – China offline channels

Following a detailed strategic review in 2019, we stepped up investment in our China label infant nutrition business considerably in 2H19 and continued broadly at this level in 1H20. We have also expanded our team in China, reviewed and optimised relationships with distributors and are focusing on the biggest opportunities for growth.

We are pleased our investments to deepen our understanding of consumer and channel trends and the increased levels of investment in marketing and capability development are translating into accelerated growth in our China label business.

For the period, we achieved sales in *a2 Platinum®* China label infant nutrition of $146.7 million, double the sales we achieved in the prior corresponding period. In addition to driving in-store productivity, we also expanded our footprint to 18,300 stores, up from 16,400 stores at the end of 2H19. Furthermore, we achieved our highest market value share in the MBS channel during the period. These indicators give us confidence that our strategy is on track.

We are committed to maximising our growth opportunities, including through product innovation. We launched a China label version of our Stage 4 product in December and recently re-launched our Stages 1, 2 and 3 China label products with a tamper-evident lid for additional product security. Our infant nutrition portfolio is complemented by our other nutritional products as we broaden our appeal to existing consumers and seek to connect with new consumers.

Infant nutrition – Cross-border e-commerce

We delivered *a2 Platinum®* English label infant nutrition sales of $158.7 million, up 57.8%. The results of the 11/11 China e-commerce sales event were very positive. In JD.com, our *a2 Platinum®* Stage 3 was the top selling infant nutrition product, and we were the second best-selling brand overall. In Tmall, we were the number three infant nutrition brand overall (English and China label combined) and we were the number one CBEC flagship store.

Infant nutrition – Australia retailers and resellers

Our infant nutrition sales in Australia grew 9.5% delivering $352.0 million in revenue for the half. We remain the market brand leader in Australian grocery and pharmacy channels and continue to invest strongly behind our brand, with our level of advertising being the highest in the category.

The rate of growth in our English label channels in Australia and China reflects an evolution across channels and in consumer behaviour. In this dynamic environment, it is pleasing to continue to deliver impressive sales growth in CBEC as well as from Australian-sourced resellers.

Infant nutrition – China consumption share

In the latest 12-month data for Key & A, and B, C, D cities in China, our Kantar infant formula consumption value share increased to 6.6%[7] from 5.4%[8] in the prior corresponding period. As previously advised, while Kantar remains the best single metric for consumption, it does not fully capture all consumption. This is due to the structure and definition of the panel, and the fact that it does not have full geographic coverage. Accordingly, our view is that not all of our consumption growth is captured, particularly in Stages 3 and 4.

[7] Kantar Infant Formula market tracking of Key & A and BCD cities for 12 months ending 31 December 2019, by value.
[8] Kantar Infant Formula market tracking of Key & A and BCD cities for 12 months ending 31 December 2018, by value.

Liquid milk

Our Australian fresh milk business continues to grow. In our most mature category, we achieved double-digit revenue growth of 11.3% totalling $74.7 million. As a consequence, we achieved a record market share of 11.3%. The *a2 Milk™* brand continues to be the only fresh milk brand ranged in all major supermarket chains and we are the highest brand advertiser in the fresh milk category, maintaining very high brand awareness and loyalty figures which benefits the portfolio as a whole.

Our liquid milk sales in China and other Asia segment grew 62.0% to $1.8 million for the half year.

Other nutritional products

For other nutritional products, sales grew 21.7% to $41.7 million the majority of which is recorded in our ANZ segment.

a2 Smart Nutrition™ is showing positive signs of developing into a meaningful extension of our infant and children's nutritional portfolio, with early indications of consumer acceptance, and a China label version launched in January 2020.

The re-launch of our nutritional product targeting mothers under the new branding of *a2 Nutrition for Mothers™* was successfully completed.

We have continued to experience delays in producing our *a2 Milk™* powder blended with Mānuka honey, with this scheduled to be available by 4Q20.

We continue to target growth opportunities for other nutritional products in China.

2. *Reach meaningful scale in the USA*

USA revenue more than doubled compared to the prior corresponding period, up to $28.0 million and representing growth of 116%. We continue to gain momentum as we execute on our strategy in the USA, building towards an initial milestone of US$100 million of annualised sales.

Given our increased investment in building brand awareness and distribution growth, we recorded an EBITDA loss of $30.0 million.

Our sales performance was driven by improved in-store productivity as well as through expanding our distribution footprint. Distribution grew to 17,500 stores, from 13,100 stores at the end of June 2019.

Increasing sales velocities with our most established retail customers accounted for over a quarter of our sales growth[9] and velocities in key customers were approximately 27% higher than the prior corresponding period.

Operational highlights in the half included strong performance in Costco, increasing same store velocities in Walmart, increased penetration within Kroger through achieving national coverage; bringing the brand to shelf in Safeway in the Pacific Northwest; and new distribution points in Target, Giant Eagle and Fresh Thymes.

Leveraging the consumer and channel insights obtained through a strategic review completed in 2019, we introduced new packaging and launched a new TV advertising campaign, both of which received positive feedback from the retail trade and is assisting in building brand awareness. We have also improved our in-store presence to convert awareness to trial. All these changes have contributed to increasing consumer offtake.

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[9] Most established customers defined as customers for >2 years. Based on 52-week period ended December 2019.

In July, we launched *a2 Milk®* Coffee Creamers which have been received positively and are performing to plan. As consumer demand for our products build, and our distribution footprint strengthens, we expect opportunities to launch additional new products will emerge.

3. Build towards sustainable brand leadership

Building brand value and increasing brand awareness through marketing investment remains an important focus. Our investment in the period was consistent with 2H19 at $84.1 million. The increase from the prior corresponding period was primarily a result of higher advertising spend in China and the USA.

We have leveraged our deepened understanding of consumers and purchasing behaviour in China to continuously improve our marketing mix which includes consumer advertising, in-store activations and the development of a new brand creative platform, which was launched in December 2019.

Similarly, in the USA we have leveraged our consumer insights to launch a new advertising campaign and consumer website and invested in increased in-store activation.

In addition to consumer marketing, our brand value is supported by investment in research and development programmes, an increased focus on sustainability, as well as initiatives to support the communities in which we operate.

Supporting relevant independently managed scientific studies remains important as we build our long-term brand proposition. In September 2019, the results of a clinical trial from 75 Chinese children aged between five and six with mild to moderate milk discomfort or lactose intolerance (confirmed via a urinary galactose test) were published. The study reported that replacing conventional milk with *a2 Milk™* "reduced gastrointestinal symptoms associated with milk intolerance" in many subjects and led to "a corresponding improvement in an aspect of cognitive performance" as measured using the Subtle Cognitive Impairment Test (SCIT)[10]. The study was independently peer reviewed and published in the USA based Journal of Pediatric Gastroenterology and Nutrition.

4. Deliver the organisation of the future

To support the execution of our overall Group strategy, we have continued to build capability within the organisation. In 1H20 we introduced a number of new roles to complement existing capabilities, particularly in-market in China, the USA, and within certain Group functions. We also established several initiatives designed to enhance engagement and launched a revised remuneration framework to align with our strategic direction.

Over the next two years we will be implementing new information technology systems to support the existing organisation and provide for future growth.

We also utilised external resources to accelerate the delivery of certain outcomes and to complement existing internal capabilities. As we improve internal capability, the composition and level of external resourcing should moderate over time.

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[10] 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.

Group strategic updates

Capital allocation

As part of the Board's ongoing review of the most appropriate use of capital for the business, our intention has been to prioritise investment in growth initiatives ahead of returning capital to shareholders.

Due to the increasing scale of our infant nutrition business, the Board considers it is now appropriate to assess participation in manufacturing capacity and capability to complement our existing supply chain relationships. Accordingly, we are presently evaluating opportunities to address this issue.

Leveraging our strategic partnerships

Key strategic partnerships remain a core element of our business model.

- **China State Farm:** As we continue implementing our infant nutrition strategy, China State Farm Holding Shanghai Co., Ltd's (China State Farm's) strong capabilities in importation services and product traceability as well as local market regulatory insights, will become even more important to our shared success.
- **Synlait Milk:** 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 November 2019, we extended our comprehensive manufacturing and supply arrangements to July 2025. Additionally, in December 2019 Synlait announced it had received the infant formula registration from the General Administration of Customs of the People's Republic of China (GACC) for its Auckland-based blending and canning facility. Synlait is now able to progress seeking infant formula brand registration for China for this site.
- **Fonterra:** We continue to work with Fonterra on the development of milk pools in Australia and New Zealand to build capacity to support future growth. Fonterra is already supplying us with ingredients and our joint teams are working together to commercialise new opportunities. We continue to be encouraged by the potential of this relationship.

Sustainability

In August 2019 we announced our goals as well as our formal commitments to:

- Support the global ambition of the Paris Agreement and a 2050 net zero emissions target;
- Work with our farmers to meet the standards set by the World Organisation for Animal Health and avoid practices that contravene the Five Freedoms[11];
- Continue to improve the very high standards of our animal welfare program;
- Execute on our smarter packaging goals for higher quality and lower environmental impact; and
- Innovate to become even more efficient in product processing.

In addition, we are undertaking a sustainability assessment of our total supply chain. This includes ensuring we are compliant with modern slavery legislation.

We are also working towards implementing the Task Force on Climate-related Finance Disclosures (TCFD) Recommendations within three years, including climate risk scenario planning and embedding climate risk in our governance framework.

We are committed to supporting the communities in which we operate. As such, we recently announced initiatives to support communities in Australia affected by the bushfires. Our donation in Australia was aimed at providing funds to organisations providing front line emergency services. We were moved by the impact of these events on communities, livelihoods and the environment across much of Australia and inspired by those who supported, and continue to support, the recovery effort.

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[11] The Five Freedoms outline five aspects of animal welfare: freedom from hunger or thirst; discomfort; pain, injury or disease; fear and distress; and freedom to express (most) normal behaviour.

We have developed an assistance and support package valued at NZ$3.0 million in response to the recent coronavirus disease (COVID-19). This includes equal contributions for a product donation being dispatched to frontline medical teams and families, a cash donation to the Shanghai Red Cross to support the areas and people seriously affected, and funding to assist independent research to support the international effort to develop a vaccine for the virus. Research funding has been provided to the University of Queensland's School of Chemistry and Molecular Biosciences and the Peter Doherty Institute for Infection and Immunity (Doherty Institute).

Withdrawal from fresh milk operations in the UK

Further to our announcement in August 2019, we progressed with our withdrawal from fresh milk operations in the UK to focus on the Group's position in core regions. There have been no material financial impacts.

From 1 July 2019, UK infant nutrition customers were transferred to our China and other Asia segment.

Board and management

Pip Greenwood was appointed as an independent non-executive director of the Company with effect from 1 July 2019 and elected by shareholders at the Annual Meeting in November 2019. Pip succeeded Peter Hinton who retired on 30 June 2019.

In December 2019, former Managing Director and CEO, Geoffrey Babidge returned to the role of CEO on an interim basis following the departure of Jayne Hrdlicka. A global search for a new CEO is underway and an update will be provided at the appropriate time.

Race Strauss recently joined the business as our Chief Financial Officer.

Susan Massasso has elected to continue employment with the Company in the recently expanded role of Chief Growth and Brand Officer.

Outlook

FY20

Overall for FY20, we anticipate continued strong revenue growth across our key regions supported by increased marketing investment in China and the USA as well as the ongoing development of organisational capability to support the execution of our strategy.

Globally, there is uncertainty around the potential impact to supply chains and consumer demand in China resulting from COVID-19 and we continue to monitor the situation closely.

The health and wellbeing of our people is our primary focus and we have taken all measures to ensure our staff in China are as safe as possible. We remain vigilant to the advice of relevant authorities.

Given the essential nature of our products for many Chinese families, demand is strong, particularly through online and reseller channels, with revenue for the first two months of 2H20 above expectations. However, this is a dynamic situation and at this stage we are unable to quantify the impact, either positively or negatively, for the full year.

Notwithstanding this uncertainty, full year EBITDA margin is still anticipated to be in the range of 29-30%. 2H20 EBITDA margin is therefore expected to be lower than 1H20. The improved price yield in 1H20 is expected to be offset by:

- Increased COGS (including lactoferrin, milk price, and tamper-evident infant nutrition packaging)
- Planned increased levels of strategically important trade marketing activation in China
- Potential for increased supply chain costs resulting from COVID-19
- Phasing of marketing and capability investment weighted to 2H20; full year marketing investment expected to be approximately $200 million, as previously communicated
- Potential impact from unfavourable foreign exchange movements (weaker AUD:NZD)

Given the COVID-19 situation, we are assessing the level of discretionary marketing investment and trade marketing activation that can be effectively deployed in China for the remainder of the fiscal year.

Medium-term target

The Board considers it appropriate that the Company target an EBITDA margin in the order of 30% in the medium-term. This assumes the market performance and mix of our products remains broadly consistent and the competitive environment evolves as anticipated. We will keep the balance between growth and investment under constant review.

Reconciliation of EBITDA to net profit after tax

	Half Year Ended 31-Dec-19 $ 000's	Half Year Ended 31-Dec-18 $ 000's
Segment EBITDA	263,229	218,407
Depreciation & amortisation	(1,769)	(965)
EBIT	**261,460**	**217,442**
Net interest income	2,881	1,615
Income tax expense	(79,415)	(66,362)
Net profit after tax	**184,926**	**152,695**

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