



28 August 2014

The a2 Milk Company Limited

Record earnings in Australia, growth progressing in other markets

Overview

- Total Operating Revenue of \$111.300 million in FY14, an increase of 17% over the prior corresponding period (pcp)
- Net Profit After Tax of \$10,000, significantly impacted by an adverse movement in the NZD/AUD exchange rate compared to the pcp
- Strong balance sheet with \$16m cash on hand and no debt
- Increased market share in Australia with fresh milk sales up 24% over the pcp
- Modest sales of a2Platinum® infant formula into China due to regulatory issues
- Successful launch of a2Platinum® infant formula in Australia
- New UK business structure from January 2014
- World's first human pilot study recently released confirms A2 beta casein protein digestive benefit

The a2 Milk Company (a2MC) has had a strong year and continued to progress its growth initiatives, during what has been a challenging FY14. This included significant competitor activity in our core Australian market, regulatory interruptions to our infant formula growth plans in Asia and taking full control of the former joint venture business in the UK.

Notwithstanding these challenges, progress has been made on all fronts. The Australian business achieved record sales and earnings, we have developed a broader portfolio of products to complement infant formula sales into Asia and are implementing a new business plan for the UK business. In addition, we have established a new management and board structure to support our growth agenda and the new a2 Milk™ global brand positioning is being finalised.

Managing Director, Geoffrey Babidge says the continued strong performance in Australia has funded the development of the growth platforms in China and the UK consistent with the strategic agenda and the supporting corporate resources.

“The Board continues to be very pleased with the performance of the Australian business and its potential for further growth, and remains confident in the plans for Asia and the UK. Slower build in distribution and awareness, rather than the core a2 Milk™ product proposition, contributed to slower revenue growth in China and the UK markets. However, the potential for growth remains significant. Furthermore, the Company has progressed its planning for its fourth global growth initiative, the launch of a2 Milk™ into the United States fresh milk market, to commence during calendar 2015.”

Chairman Cliff Cook says: "The Company today is stronger and better positioned than at any time previously. Our conservative balance sheet provides a secure basis for our current growth plans in international markets."

For the 12 months to 30 June 2014, revenue exceeded expectations in Australia and, with modest sales in the United Kingdom and to China, resulted in Group Sales of \$110.621 million for the year, an increase of 17% over the pcp. Net Profit after Tax of \$10,000 compared to the pcp of \$4.120 million. Cash on hand at year end was \$16 million. Preliminary audit clearance has been obtained for these results pending finalisation of the 2014 annual report.

The trading result included:

- EBITDA before license fees for the Australian market of \$18.708 million;
- EBITDA for the UK and China markets totaling (\$7.527) million;
- Employee share scheme expenses (Non cash) of \$1.190 million;
- Other corporate costs of \$6.839 million;
- Income tax charge of \$0.710 million

The appreciation of the NZD to the AUD reduced Operating Revenue by approximately \$14 million and EBITDA by approximately \$2.7 million on the pcp.

Strategic Agenda - charting the future

The Strategic Agenda of the Company is based on funding revenue growth in priority international markets from increasing Australian profits. The plan continues to be refined as a result of changing market dynamics and opportunities.

The Company previously advised of the plan to develop products such as UHT milk for sale in Asian markets. This plan is now being progressed. In addition, the sale of fresh a2 Milk™ sourced from Australia into China is a further opportunity now underway, with the first trial shipment having been made in late August 2014. These opportunities are potentially attractive in their own right and will strengthen both the a2 Milk™ brand and our infant formula business in Asia.

The Company has commented previously that an entry into the United States fresh milk market is under consideration. The Company has both strong intellectual property rights and know-how, and consumer research confirms the significant potential for a2 Milk™ brand in this market. The Company has developed market entry plans with the objective of a targeted, regionally focussed initial launch in calendar 2015. The current business model assumes a cash investment of around USD20m to be funded from cash flow and internal sources over a three year period. Our focus has been to develop a plan which captures the potential of the United States market whilst, at the same time, providing the Company an appropriate balance of risk and reward for this positive initiative.

Advances in the science supporting the a2 Milk™ proposition included the publication of the first human trial conducted by Curtin University. The trial confirmed a clear difference in gastrointestinal function in adults consuming the A1 versus A2 beta casein protein types, both for milk intolerant and normal milk drinking people.

The 2016 Revenue projection contained in the 2012 Private Placement Memorandum, amended in 2013 and adjusted for movements in exchange rate assumptions at 30 June 2014, results in adjusted Revenue from operating segments and JVs of approximately NZD230m. The Company considers this remains an appropriate overall projection based on the stages of development of each regional business and the current prospects for sale of additional products. Whilst revenue growth in China and the UK are presently well behind original plan, this shortfall should be compensated by sales of infant formula in Australia and other products in both Australia and Asia. Revenue from a prospective launch into the USA market is not included in this update.

During the year the Company undertook a review of the structure, composition and remuneration of the Board. A number of changes were approved at the November 2013 annual meeting to support the strategy to evolve the composition of the Board in an orderly way and ensure the skills and experience of directors support the strategic agenda. Two new non-executive directors have joined the Board, Ms Julia Hoare and Mr David Hearn. These appointments are consistent with the revised structure of designating directors specific responsibilities, with Julia Hoare assuming the role as Chair of the Audit & Risk Committee and David Hearn designated the lead director for the UK and European regional markets.

Further, the management structure was re-organised into regional and corporate functions and strengthened with additional experienced executives to assist the new market initiatives. This included Susan Massasso as Chief Marketing Officer, Philip Wohlsen as General Manager Asia and Scott Wotherspoon as CEO UK.

Australia – continues strong growth

The Australian business continued to perform very strongly in FY14 with sales growth and operating earnings well ahead of plan. Total revenue growth in AUD on the pcp was 31%. Revenue and earnings were unfavourably impacted by the movement in the NZD/AUD exchange rate when compared to the prior year.

Fresh milk sales of a2 Milk™ increased on the pcp in AUD by 24%. This is a result of the growing consumer awareness to the benefits of the product and the breadth of distribution now achieved in the retail trade. We estimate the market share of fresh a2 Milk™ in Australia to have grown to around 9.0% by value in the grocery channel (Australian Grocery Weighted Scan June 2014 quarter).

The Company achieved higher efficiencies at its Smeaton Grange processing facility in Sydney which contributed to an improved gross margin for fresh milk compared to the pcp. We continue to pursue improvements in supply chain processes and building milk supply. As part of this, in November 2013, Brownes Food Operations commenced processing fresh a2 Milk™ in Western Australia under a supply and contract pack arrangement.

Sales of a2Platinum® infant formula in Australia have shown strong growth, significantly ahead of plan, in both grocery and pharmacy channels, since launch in September 2013. Conversely, sales in New Zealand have been hampered by limited distribution. Whilst sales are strong in the Australian domestic market, it is assumed a proportion is being purchased and subsequently shipped to consumers in China relying on the assurance of an Australian-sourced product. Whilst it is not possible to determine sales to this grey market, this further confirms our confidence in the China market opportunity.

The launch of a2™ Thickened Cream into grocery has also been successful with sales in the period achieving expectation. The success of these latest innovations provides confidence in further broadening the product portfolio and plans are being progressed to build on the growing reputation of the brand.

The business experienced the first significant responses from competitors during the year. One company challenged the science around dairy free from A1 beta casein protein and a second more recently highlighting the protein composition of their own milks. a2MC has actively responded to these initiatives and encouragingly our sales have continued to grow. The Company welcomes a broader focus on the positive attributes of the A2 protein content of dairy milk on the proviso consumers are not misled by claims that the unique benefits of a2™ brand products are available from any other dairy products or brands which contain A1 beta casein protein.

United Kingdom – new business plan under way

The UK business has operated as a wholly owned subsidiary, with a new local board and management structure in place, since the acquisition of the 50% interest of Muller Wiseman Dairies (MWD) in the former joint venture from January 2014. This new structure enables the business to build sales and distribution in a more focused way whilst continuing to access the scale and operational capabilities of

MWD under a supply and contract pack agreement. The new UK Board comprises three directors - David Hearn as non-executive Chairman; William (Billy) Keane, the former Managing Director of Robert Wiseman Dairies (RWD) and current Chairman of Dairy UK, who is also a non-executive Director; and Geoffrey Babidge.

The original joint venture established with RWD intended to grow sales quickly across the UK fresh milk market. The sale of RWD to the Muller Group in early 2012, with the resulting change in priorities of our partner, contributed to a slower than planned distribution build and ultimately created the necessity to restructure this alliance going forward. Taking back control of the venture has ensured the Company will benefit from 100% of the future value created in this market.

These events have resulted in much lower sales than originally planned and consequently required a new approach to the market. The Board and Management have developed a new positioning strategy more targeted on providing a solution to the approximately 20% of individuals who have an issue with consuming standard dairy milk - to bring them back to the pleasure of drinking dairy milk. The revised plan is being implemented on a phased basis to meet customer requirements and we anticipate being fully in-market by the first quarter of calendar 2015.

The new model focuses on three key elements - building distribution in existing accounts from the current small base, particularly in the South East UK market; increasing awareness of the unique attributes of the product in a more targeted manner, primarily through alternative direct and digital media; and enhancing our price positioning through new packaging formats to improve margins. Therefore, while the model draws on the experience in Australia, the revised plan recognises the market dynamics and pricing in the UK are more challenging.

The Company is committed to the development of the UK business, whilst at the same time conscious of the need to balance investment and returns to build shareholder value. The investment in the business during the second half FY14 was £2.2m. The revised business model assumes a lower funding requirement in calendar 2014 than advised in February 2014 and an investment for the FY15 year of approximately £3.5m. We are targeting cash breakeven on a monthly basis during the second half FY16.

Infant formula into China – regulation changes slowed momentum

The launch of a2Platinum® infant formula to Chinese consumers commenced in November 2013 targeting baby maternity stores, high end supermarkets and on-line sales.

The regulatory environment for infant formula sold in China has been evolving, given the Chinese Government's aim to improve product quality and bring confidence back to the industry. As part of this, there have been changes to access arrangements for imported infant formula including a requirement for manufacturing companies and brands to achieve a new form of registration from May 2014. Whilst we believe this approach should ultimately be positive for quality producers, the short term impact of these changes has brought uncertainty into the market which has impacted many participants including a2MC.

The initial round of registrations did not include our manufacturing partner, Synlait Milk Limited (Synlait), primarily because its new canning facility had not been commissioned. The Minister of Primary industry advised in April 2014 that most if not all New Zealand based infant formula manufacturers will ultimately achieve registration.

As a result of the uncertainties around registration impacting the confidence of sub-distributors and a slower build of the network by our distributor China State Farm, our infant formula sales into China were well below plan in the second half FY14. A delay in shipments from December 2013 to February 2014 arising from new quality processes and an ingredient supply shortage also slowed sales. Notwithstanding this, our infant formula sales at a group level were ahead of plan given the strong performance in Australia.

The access arrangements into China continue to unfold and a2MC continues to monitor developments. In July 2014, the Company advised that an interim contract provider, New Zealand New Milk Limited (New Milk), had achieved manufacturer registration with Certification and Accreditation of the People's Republic of China, which enabled a2MC to resume shipments of a2Platinum® packed by New Milk.

A further requirement advised by Chinese authorities will be to demonstrate "close association" between brand owner and manufacturer over the manufacturing process and formulation of brands. a2MC is of the view the form of its relationship with Synlait and the quality management processes across the entire supply chain should ultimately satisfy this test. We are also in discussion with China State Farm on ways to enhance our business processes and build momentum as the regulatory environment stabilises and confidence is restored.

The Company remains confident both in the infant formula opportunity in China and the processes in place in conjunction with Synlait to achieve continued access to this growing market. We are also pursuing opportunities in China and other Asian markets for sale of both UHT and fresh milk which will strengthen the a2 Milk™ brand and broaden our business in Asia.

Intellectual Capital – investment continues

Advances in the science around the benefits of dairy products free from A1 beta casein protein have been reported in respected international publications over the past year. They support the position that a2 Milk™ makes dairy nutrition accessible to many consumers who limit or avoid their intake of dairy. In addition, a2MC's research and development program continues to improve efficiencies around proprietary processes and have contributed to the filing of additional patents.

The results of a human digestion trial conducted by Curtin University of WA and sponsored by a2MC have been published in the European Journal of Clinical Nutrition in August 2014. This trial established strong support for the digestive benefits of a2 Milk™ (free from A1 beta casein protein) in humans. These findings complement the broad conclusions of the substantial body of earlier animal studies conducted in New Zealand and other countries. As the first human digestion study of its type in the world, this new research marks a significant step forward in understanding the difference between A1 and A2 beta casein milk proteins on digestion.

The potential for a2 Milk™ to benefit children predisposed to neurological or behavioral conditions has also been supported by a study undertaken at North Eastern University (Boston) and sponsored by a2MC and was recently published in the Journal of Nutritional Biochemistry.

The Company made significant progress in developing a new global brand vision which will be progressively implemented during the coming year. The first step of this was the change of company name for the corporate and trading entities to "The a2 Milk Company" from April 2014.

For further information contact:

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Reconciliation of EBITDA

	Year Ended 30 June 2014 NZD \$000's	Year Ended 30 June 2013 NZD \$000's	Increase
EBITDA per announcement	\$3,566	\$10,640	-66%
Share of Associate Earnings	-\$1,361	-\$3,719	-63%
Non-recurring items	\$0	-\$824	-100%
Interest income	\$455	\$288	58%
Interest expense	-\$40	-\$114	-65%
Depreciation/Amortisation	-\$1,900	-\$1,107	72%
Income tax income/(expense)	-\$710	-\$1,044	-32%
Net Profit After Tax	\$10	\$4,120	-100%

Notes:

1. EBITDA is a non GAAP measure, however, the Company believes that it provides investors with a comprehensive understanding of the underlying performance of the business
2. Non recurring items in 2013 related to Costs associated with the Strategic Review.