



23 August 2017

NZX/ASX Market Release

Continuing strong growth in revenue and earnings Strategic focus on broadening nutritional platform

Overview for the year ended 30 June 2017 (NZ\$)

- Total revenue of \$549.5 million – an increase of 56% over the prior corresponding period (pcp)
- EBITDA¹ of \$141.2 million – 159% ahead of the pcp
- EBITDA to sales margin of 26%, up from 15% on pcp
- Net profit after tax of \$90.6 million – 198% ahead of the pcp
- Basic earnings per share (EPS) of 12.7 cents, an increase of 186% on pcp
- Operating cash flow of \$99.9 million and a cash balance of \$121.0 million at year end
- Continued strong growth in sales and market share for a2 Platinum[®] infant formula in Australia and China
- Sales growth of a2 Milk[™] branded fresh milk and milk powders in Australia
- Increased investment in building brand awareness in the United States (US)
- Positive operating earnings in the United Kingdom (UK)
- Development of a broader nutritional products strategy and a new focus on emerging markets

The Company made further strong gains in revenue and earnings in the 2017 financial year (FY17), with outstanding performance in infant formula, and continued growth in liquid milk in each of its core markets.

Sales of a2 Platinum[®] infant formula continued to grow strongly in Australia and China in online and offline channels, consistent with growing brand awareness among consumers in both countries. Infant formula generated 72% of the Company's total revenue for the year - up from 61% in the 2016 financial year. The Company is clearly focused on sustainable growth of a2 Platinum infant formula[®] through significant investment in product supply and quality, building brand awareness and strength, and meeting the requirements of China's regulatory regime.

In Australia, a2 Milk[™] branded fresh milk achieved further growth in sales, while a2 Milk[™] branded whole milk powder, introduced in the previous year, showed strong growth.

Further progress was made in building the US business, with a continued focus on California and expansion to the South East through a premier retailer in that region and in the natural grocery channel. Brand awareness and rates of sale increased during the period and remain key metrics for the business.

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

Fresh milk sales in the UK showed strong growth on the prior year with continued marketing investment and improved customer engagement, delivering operating profits for the first time. Expanded distribution was also achieved with a number of retailers by year-end.

Marketing spend increased by \$9.0 million on pcp primarily attributed to building awareness in the US and China.

Corporate and other costs rose by \$5.7 million on the prior year reflecting increased spend on patents, trademarks, and research and development, and other costs associated with business expansion activities.

Continuing earnings momentum has led to a further strong increase in the cash position. Net operating cash flow for the year was \$99.9 million, compared with \$21.5 million in the pcp and in particular benefited from lower than targeted infant formula inventory due to strong demand. The closing cash on hand of \$121.0 million was after an investment of \$48.7 million in shares in Synlait Milk Limited.

The Board has been evaluating capital management alternatives whilst continuing to maintain a flexible and conservative capital structure and now intends to establish an on-market buyback of the Company's shares over the next 12 months of up to \$40 million. Further details of the on-market buyback will be announced prior to commencement of the buyback. In addition, the Board remains open to consider the merits of a special dividend in light of progress on the buyback and future market conditions.

Managing Director Geoffrey Babidge said: "The Company's continued growth reflects increasing consumer acceptance of the a2™ brand and the benefits of dairy-based products free from the A1 beta casein protein type.

"We have continued to support and expand our brand proposition through effective marketing and promotional activities in each of our markets. Our support for relevant scientific research and continued investment in intellectual property are also key aspects of this strategy.

"It is particularly pleasing that we have been able to respond progressively to the supply challenges arising from growth in demand for a2 Platinum® infant formula over the year which exceeded our previous expectations. A key element in fulfilling the growing demand is the renewed long-term Supply Agreement with our manufacturing partner Synlait. We have also been successful in adapting to shifts in demand for infant formula between the major retail, e-commerce and personal shopper ("Daigou") channels, recognising this is an important dynamic for continuing growth.

"The Company is also strongly focused on China's evolving regulatory regime, in particular the requirement for registration of infant formula brands by China's Food and Drug Administration from January 2018.

"The Company has a number of initiatives under way to progress portfolio growth in nutritional products and to extend its business into emerging markets, without loss of focus on current initiatives.

"With a strong cash position and no debt the Company is in a robust position to continue the implementation of its growth strategy."

Strategic focus

With the building momentum of the a2 Platinum® brand in Australia and China, progress in developing the market opportunities in the UK and US, and a further broadening of organisational capabilities, the Company is well positioned for continuing strong growth.

The Company is intent on building a broader portfolio of dairy-based nutritional products centred on the unique strengths of the A1 protein-free proposition. This will involve a range of products across a continuum from pure fresh milk to customised infant, children and adult nutritional products that satisfy consumers' growing health needs. In addition, the Company will continue to develop its significant intellectual property portfolio and proprietary know-how to underpin its first mover advantage.

A number of product launches are planned for the 2018 financial year (FY18), including the launch of a2 Platinum® Stage 4 infant formula for children three years and above in August 2017, as well as an extension to the milk powder range.



The Company is also moving to progress its strategy for growth in emerging markets, both as a natural evolution from established positions and in response to growing levels of enquiry. Consideration is being given to markets against a matrix of factors, including consumer dynamics, channel structure, and market access.

With the growing profile of the a2™ brand, we have increasing interest from parties wishing to explore opportunities to participate in our expansion plans in a number of markets. We will review opportunities that arise from this interest where they enable our business to grow more rapidly in the context of our focused strategic agenda.

The Company's low capital model is supported by mutually beneficial medium-term relationships with processing and distribution partners. A significant example of this was the completion of a new Supply Agreement for a2 Platinum® infant formula with our supply partner Synlait in August 2016. This new agreement, for a minimum term of five years, provides access to an agreed level of capacity and an obligation to supply to order, and does not include 'take or pay' provisions. In March 2017, the Company acquired a shareholding of 8.2% in Synlait. While the Supply Agreement continues to be the cornerstone of the commercial relationship between the two parties, the Company's investment further strengthened this important relationship.

The Company continues to focus on China's evolving regulatory regime for infant formula products and cross border trade, and in particular the requirement for registration of manufacturers of infant formula brands by China's Food and Drug Administration (CFDA) from 1 January 2018.

To continue to grow our China label business, we engaged a leading in-market consultancy to undertake a comprehensive study of the China infant formula market in conjunction with management. This review assisted in deepening the Company's understanding of this market and in developing strategies to build scale in the priority offline and domestic online channels.

A key focus for our supply chain management and partners relates to minimising the risk of product substitution or counterfeit, particularly for infant formula in China. Significant progress has been made around new security technology and advances in quality and authenticity proof points that will be implemented during FY18.

Board and management

The Company continues to ensure appropriate focus and capability at the Board and management levels in support of its evolving strategy. The Board renewal process initiated in 2013 continued into FY17 to better align with the strategic plan of the Company. Warwick Every-Burns, a consumer packaged goods executive with a leadership record in China, North America, Europe, and Australia, joined the Board in August 2016. His skills and interest in business development in new and emerging markets, brand management and human resources are of significant value to the Company. Jesse Wu, who has held a range of leadership positions in consumer goods businesses in China and other markets of relevance to the Company, was appointed a Director in May 2017. Jesse held a range of senior executive roles with Johnson & Johnson in China, the Asia/Pacific region, and for their worldwide Consumer Group.

Richard Le Grice stepped down from the Board at the end of the year, having been a Director since 2007. Richard's Board tenure spanned the Company's early establishment phase and its subsequent strategic development and growth, and followed an earlier period in a management role. Mel Miles also retired as a Director in August 2016 after six years on the Board, but continues to advise the business in a consultancy role. We thank both Richard and Mel for their significant contribution to the Company.

In June 2017, the Company announced a reorganisation of responsibilities within the senior leadership team to further support the ongoing development of its businesses in Asia Pacific. Peter Nathan, who has led the Australian business since 2007, was appointed Chief Executive Asia Pacific with a particular focus on Australia and China. A highly experienced China-based executive, Jane Xu was appointed to the new role of Executive Vice President China reporting to the Chief Executive Asia Pacific in August 2017.

Scott Wotherspoon, who previously led the China and UK businesses, assumed a new role with responsibility for the UK, development activities across Europe and a number of key strategic initiatives.



A new senior management position, Head of Business Development – Emerging Markets, was created in May. Michael Bracka, who has extensive experience in fast-moving consumer goods, joined the Company in this position.

ANZ

The ANZ business continued to perform very strongly. Total segment revenue across all product categories increased by 48% to NZ\$439.6 million, and EBITDA by 83% to NZ\$155.3 million.

Fresh milk sales rose by ~5.5% on pcp, whilst market share by value of a2 Milk™ branded fresh milk remained stable at 9.3% (*Australian Grocery Weighted Scan, 30 June 2017, MAT*). a2 Milk™ is the only milk brand distributed through all six key grocery retailers in the Australian market.

Sales of a2 Platinum® infant formula rose by ~78%, driven by increasing consumer awareness in both Australia and China. a2 Platinum® remains the fastest growing infant formula brand by value in Australia, with market share during the 2017 financial year increasing from ~16% to ~26% by value (*Australian Grocery and Pharmacy Scan, 30 June 2017, MAT*) in mainstream retailers.

Close attention continues to be applied to our infant formula supply chain and inventory management taking account of changing industry dynamics. The ‘Daigou’ channel has become a significant and growing sales channel from Australia to China for the Company and is a key focus for management. Since it became apparent that demand for a2 Platinum® would exceed our expectations, the Company worked closely with Synlait to progressively increase the production schedule. Inventory remained at below industry average levels given the continued expansion in sales.

The continued growth in both fresh milk and infant formula sales reflects increasing consumer awareness and loyalty driven by consistent brand advertising and growing media coverage of The a2 Milk Company™ brand. The business once again increased its marketing investment, resulting in the largest media spend of any brand in both the fresh milk and infant formula categories in Australia.

Sales of a2 Milk™ branded whole milk powder increased strongly and a2 Milk™ branded skim milk powder was launched in May 2017.

The milk supply arrangements between the Company, Moxey Farms and Leppington Pastoral Co were extended for a further three-year term, effective 1 July 2017. The renewed arrangements provide for increased committed and available A1 protein-free milk volumes and the removal of the previous ‘at will’ termination rights. The Company’s previous protections around its intellectual property rights, herd maintenance and quality assurance and controls are continued, whilst authority was given for the sale of milk surplus to the Company’s requirements subject to specific conditions.

The Australian Federal Court action initiated against a competitor during the previous financial year, for misleading and deceptive conduct in respect of packaging and advertising claims, remains in progress. A substantive hearing is scheduled in November 2017, and the Company remains confident of achieving a successful outcome.

China

Total sales and earnings in China continued to grow very strongly. Revenue grew from \$38.2 million to \$88.9 million, and EBITDA from \$9.2 million to \$32.7 million.

The business has a flexible multi-channel infant formula strategy in both China label (offline and online) and cross border English label (online) to achieve growth and best position the brand to meet foreshadowed changes in the regulatory environment over time.

Consumption market share for a2 Platinum® infant formula brand in targeted regions of China grew strongly, to ~3.5% for quarter ending June FY17 as measured by Kantar², growing from ~2.1% for quarter ending June FY16.

² Kantar tracks China Key and A cities that comprise a substantial proportion of the total China infant formula market



Rising awareness of a2 Platinum® and its unique benefits, built through increased marketing and sales investment, remained a key driver throughout FY17. Enhanced advertising programmes, increased focus on educating healthcare professionals and sales investment at point of sale were all important contributors to growth. a2 Platinum® again successfully participated in key online sales events including '11/11' Singles Day and Chinese New Year and achieved strong growth in Cross Border E-Commerce (CBEC) across the year.

We have seen pleasing growth in the business' offline (bricks and mortar) footprint, with distribution growing to ~3,800 stores. Whilst this represents strong growth in offline, the business is managing its expansion in a structured way in order to maximise the outcomes from its investment in the medium term. The study undertaken by our in-market consultants is assisting in this regard.

The China team has been further developed across each of the sales, distribution, marketing, quality and health and nutrition functions, primarily based in Shanghai.

Infant Formula Regulation

The Company continues to closely monitor and respond to changes in China's regulatory regime for infant formula products.

In particular, this includes providing support to Synlait in its application for registration of a2 Platinum® infant formula with the CFDA. This follows the April 2016 announcement by China's Ministry of Finance that infant formula brands would require registration for products imported from 1 January 2018.

The dossier application for CFDA registration was submitted by Synlait in May 2017, and has been accepted for review. This is an important milestone and reflects strong capability and collaboration between Synlait and the Company. Both companies continue to be confident that Synlait's registration application with CFDA will progress as expected.

The application seeks to ensure that direct exports to China of the Company's China label infant formula products (a2 Platinum® infant formula), which currently comprise ~8% of our total infant formula sales, can continue from 1 January 2018. We understand that inventory received in China before that date may continue to be sold without CFDA registration and we will consider this as mitigation against any unforeseen delays in the registration process.

In November 2016, China's Ministry of Commerce indicated that it would temporarily extend the grace period for registration of goods imported through the CBEC channel to the end of December 2017. Following this, in March 2017 China Customs announced an extension in implementing new import documentation requirements for CBEC products until the end of December 2017. The Company expects further announcements relating to infant formula trade within the CBEC channel during the next six months.

United States

The US business made further progress on its strategy to build brand awareness and progressively expand its footprint on a region-by-region basis.

a2 Milk™ is available in five variants within the specialty milk segment, the fastest growing segment of the total milk category. A new chocolate flavoured product was added during the year and launched at the Natural Products Expo West - one of the largest retail events of its kind in the US.

The business continued to build distribution and sales velocities in California and has now achieved broad trade acceptance across the state. Based on the increasing profile of the Company, the business expanded into the South East from March 2017 through a new relationship with a premier retailer in that region, Publix, which has approximately 1,100 stores in Florida, Georgia and the Carolinas. The business also achieved increased distribution of the a2 Milk™ brand through the leading retailer of natural and organic foods, Whole Foods Market, and is currently ranged in seven out of 11 regions, including the Mid-Atlantic, the South, Florida and more recently, the North East. At 30 June 2017, the Company had distribution in approximately 3,000 stores across the US.



Investment in the second half in a new integrated multi-media marketing campaign 'Love Milk Again' alongside up-weighted shopper marketing programmes, further contributed to the steady growth in unit sales per store per week amongst key retailers. The supply chain was enhanced with the support of a second contract processor in the Los Angeles basin to supply more economically to the California market. Performance in fulfilment and product quality from our initial East Coast processor has been very satisfactory.

Building consumer awareness and sales velocities in California and the South East regions remains the key focus before meaningful expansion into further markets. Based on recent performance, we have updated our financial outlook, which now assumes investment of approximately US\$25 million over the course of FY18 and FY19 before positive monthly EBITDA in FY20.

As the level of forecast investment to establish the US business has increased progressively over time, it was determined appropriate to write off the intangible assets relating to this subsidiary of NZ\$2.2 million at 31 December 2016.

United Kingdom

The UK business returned its first annual operating profit, assisted by strong growth in a2 Milk™ branded fresh milk sales and a contribution from infant formula sales.

Growth reflected increased rates of sale in stores and further improvements in brand awareness, driven by the success of the '*a2tonishing*' marketing campaign which commenced late last year, and a number of improvements in merchandising.

The business delivered increased facings in-store and improved point of sale presence. It undertook targeted promotional activities and deepened relationships with the healthcare professional community.

The business expanded distribution through major retailers towards the end of the year. Gains included additional store numbers with J. Sainsbury, along with additional ranging for semi-skimmed milk and listing of whole milk. A new listing for fresh milk was achieved in June 2017 with Asda WalMart, in a number of its stores. By year end, the brand was distributed in ~1,600 stores.

The business continues to be well supported by its fresh milk manufacturing partner Müller Milk & Ingredients. a2 Platinum® infant formula continued to be sold in the wholesale market, having been introduced during the 2016 financial year.

Science, research and development

The Company has continued to support research and development in respect of the benefits from consumption of milk products that do not contain the A1 beta casein protein.

Research projects progressed during FY17 included:

- a significant human study in China to support digestive benefit findings from an earlier published study, which provides further insight into the mechanism underpinning the digestive benefits;
- a clinical study in China amongst pre-school children examining digestive comfort and cognitive function has been submitted for publication. Results are aligned with findings from recent adult publications;
- a first acute human study progressed under the New Zealand Government High Value Nutrition programme has been completed, with outcomes providing significant insight, clarification and support to previous research recently run in China and Australia. The results will be presented at the annual conference for the Academy of Nutrition and Dietetics USA in Chicago in October 2017;
- a clinical examination of the benefits of A1 protein-free milk with respect to digestive function, inflammation and aspects of metabolic function at Pennington Biomedical Research Center in the US; and
- a clinical study in association with Monash University, Australia, examining the digestive and cognitive benefits of a2 Milk™ for irritable bowel syndrome sufferers.



In September 2016, the *Nutrition Journal* publication reported that consumption of a2 Milk™ increases natural production of the body's key antioxidant, Glutathione (GSH), in milk-intolerant consumers. GSH is widely recognised for its association with a range of health benefits.

Intellectual property and brand development

The Company has a market leading investment in the a2 Milk™ brand and a growing reputation in the a2 Platinum® brand within its core markets. With increased awareness and interest around the A1 protein-free proposition, the Company continues to take appropriate steps to protect and enhance its intellectual property portfolio. This includes a focus on patents and trademarks across its chosen markets.

The patent portfolio remains strong, covering a range of compositional benefits and therapeutic uses of A1 protein-free products, with protection for specific benefits potentially up to 2037.

In addition, the Company has taken steps towards a new singular brand trademark to bring consistency and impact to packaging and branding across the product portfolio.

Outlook

a2MC expects continued growth in the 2018 financial year, in particular from infant formula and milk powder products in Australia and China and improved momentum in the US and UK businesses. We are also positive around opportunities to broaden the nutritional products portfolio. The Company will continue to manage the infant formula supply chain closely and expects product availability of a2 Platinum® in Australia and China to progressively improve from current levels. Accordingly, the Company's working capital outlook assumes an increase in infant formula inventory to more sustainable levels during the year.

The Company is pleased with progress on the CFDA registration process for a2 Platinum® infant formula and remains confident in its ability to continue to adapt to the dynamic regulatory and market circumstances in China. Importantly, the opportunities for growth in the China market and potentially South East Asia, remain significant.

The Company expects to provide an update on financial performance at its Annual Meeting in November 2017.

Reconciliation of EBITDA to net profit after tax

	Full Year Ended 30-Jun-17 NZ\$ 000's	Full Year Ended 30-Jun-16 NZ\$ 000's	Movement %
Segment EBITDA	141,153	54,576	159%
Depreciation & amortisation	(2,689)	(2,742)	(2%)
EBIT	138,464	51,834	167%
Interest income	887	502	77%
Interest expense	-	(37)	-
Income tax expense	(48,705)	(21,863)	123%
Net profit after tax	90,646	30,436	198%

