



24 August 2016

NZX/ASX Market Release

Exceptional growth in revenue and earnings in 2016

Increasing focus on nutritional products

Highlights of financial results for the year ended 30 June 2016 (in NZ\$)

- Total revenue of \$352.8 million – an increase of 127.4% over the prior corresponding period (pcp)
- Net profit after tax of \$30.4 million, compared with a net loss after tax of \$2.1 million in the pcp
- Group Operating EBITDA¹ of \$54.6 million, up from \$4.8 million² on the pcp
- Group Operating EBITDA as a percentage of sales, before investment in international growth, of 22.4%
- Exceptional growth in sales of a2 Platinum[®] infant formula in Australia & New Zealand (ANZ) and China, with total revenue of \$214.4 million, up 414% on pcp
- Continued growth of fresh milk in Australia, with total revenue up 4%
- An improved financial performance in the United Kingdom, and further progress in repositioning the Company as a specialty milk supplier
- Investment to support the a2 Milk[™] launch programme in the United States

Managing Director's operational summary

The a2 Milk Company Limited ("Company") achieved a substantial lift in revenue and earnings in the 2016 financial year, with continued growth in the ANZ and China markets, and further progress in its targeted investment in a number of international markets.

The ANZ business achieved exceptional growth in a2 Platinum[®] infant formula products, with continued steady volume growth in a2 Milk[™] branded fresh milk and initial sales of a2 Milk[™] branded whole milk powder.

Sales of a2 Platinum[®] infant formula in China grew strongly, and the China & other Asia business delivered positive operating earnings for the first time since the Company entered the China market.

The UK business delivered an improved financial performance as it continued to transition from a fresh milk focus to a broader portfolio strategy, while the focus for the US business remained on investment to grow distribution, consumer awareness and demand for a2 Milk[™].

The Company increased its overall investment in international growth and brand development from \$15.2 million in the 2015 financial year to \$20.5 million, in line with the strategy of expansion into target markets and product categories with significant growth potential.

The Company provided increased funding and support for relevant scientific research, and to develop and enhance its portfolio of brand assets and intellectual property. There was further progress in research around the digestive and potential health benefits of products containing A2 beta casein protein-type to the exclusion of the A1 protein equivalent.

¹ Operating earnings before interest, tax, depreciation and amortisation (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. A reconciliation of EBITDA to net profit after tax is shown at the end of this document

² Before non-recurring items in FY15 of \$1.7 million, representing costs associated with the Company's listing on the Australian Stock Exchange (ASX)



Managing Director Geoffrey Babidge said: “The 2016 financial year brought significant progress in our evolution from a branded dairy products company to one increasingly focused on a broader nutrition platform.

“Continued growth in the ANZ business, and infant formula in particular, has underpinned our investment in targeted overseas markets and each of those positions was expanded during the year.

“In China, there was a marked increase in sales of a2 Platinum® infant formula and a further expansion of the Company’s supply chain following the changes made to distribution arrangements in the previous year.

“In conjunction with those developments the Company maintained a strong focus on understanding and adapting to changes in the regulatory environment for infant formula products in China. As a result of that focus, the Company considers itself well placed to respond to other potential changes over time.

“The increase in demand for a2 Platinum® infant formula in Australia and China during the first half created challenges in balancing supply, production and logistics. These have been met in conjunction with our manufacturing partner Synlait Milk Limited (Synlait), and with an expansion of milk supply from affiliated farms in New Zealand. A new supply agreement was announced yesterday that strengthens the current business relationship between the Company and Synlait by providing certainty around medium term growth plans.

“In the United States, we have been building distribution of fresh milk in California since our entry in April 2015 and now have distribution in over 1,800 stores. Progress has been behind our original plan given delays in achieving distribution with a number of larger retailers.

“While the slower build represents a revision of our initial entry plans, it does not affect the fundamental characteristics of what remains a highly attractive market for the Company’s branded products, nor our confidence in realising the opportunity.

“Meanwhile, we are pleased with the progress in building rate of sale of fresh milk in the United Kingdom and the improvement in financial results.”

Chairman’s comments

The Chairman, David Hearn, said: “The Board is extremely pleased with the progress made by the Company in the latest year, with strong growth in overall financial performance and further consumer understanding of the benefits of our products.

“In addition, the Company has continued to expand investor participation since it achieved its ASX listing. The number of shareholders has increased from approximately 3,800 prior to listing, to now over 23,300 as at 30 June 2016.

“The Board’s focus in the current year will be on assisting management to consolidate the gains in operating and financial performance, while pursuing further growth in the broader nutrition market.

“Over coming months, the Board will continue to review its capital management strategy, consistent with the funding requirements for the ongoing growth of the business. We intend to update shareholders on this at our annual meeting in November.”

Strategic focus

The strategy of the Company is evolving consistent with its recent success in infant nutrition. For FY16, infant nutrition products represented 61% of total revenue, and a higher proportion of earnings. These proportions are anticipated to increase further in FY17. While the largest proportion of sales was within the Australian grocery and pharmacy channels, direct sales into China increased significantly and are expected to continue to do so.

The Company is focused on building a portfolio of dairy-based nutritional products centred on the unique strengths of the A1 protein free proposition. The broader nutritional strategy, from Infant through to Adult products, represents a natural evolution that the Company expects to be more attractive in the medium term than one based purely on traditional dairy.



We remain focused geographically on growing the ANZ and China businesses and developing the market opportunities in the United Kingdom and United States. In the coming year we will also begin to explore growth initiatives in other priority Asian markets.

a2 Milk™ branded whole milk powder in retail packs was launched in June 2015, building sales in Australia and China. Further opportunities for this range, and for infant nutrition, are under review. a2 Ice Cream™ was also launched into a number of retailers in Australia from August 2015.

We are progressing plans for the New Zealand liquid milk market after the expiry of the last remaining non-exclusive licence with Fresha Valley in May 2017.

We recognise increased interest in A1 protein free products from competitors following the recent expiry of two of the founding patents registered by the Company, along with increasing awareness by consumers.

From an overall market perspective, such interest is likely to increase the awareness and credibility of the A1 protein free proposition. Moreover, the breadth and depth of the Company's intellectual property portfolio, together with its first mover advantage, is expected to continue to provide a protected position in its core markets.

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. The patent portfolio also remains strong, with 14 families of patents granted or in application at the end of the year. These cover a range of compositional benefits and therapeutic uses of A1 protein free products, with protection for some applications through to 2035.

The Company will continue to actively protect its intellectual property rights. Meanwhile it remains open to cooperation with parties in specific product or market segment opportunities.

Operating earnings (in NZ\$)

The annual result included:

- \$84.7 million EBITDA³ for the ANZ operations, an increase of 182% on the pcp
- \$9.2 million EBITDA³ for the China operations, up from a comparative loss of \$3.1 million in the pcp
- (\$20.5) million EBITDA³ for the United Kingdom and United States
- Corporate and other costs before inter-company charges of \$18.8 million, compared with \$11.7 million in the pcp
- Income tax charge of \$21.9 million, compared with \$3.4 million in the pcp
- Basic earnings per share (EPS) of 4.43c and diluted EPS of 4.31c, compared with (0.33c) and (0.32c) for the pcp

Preliminary audit clearance has been obtained for the results pending finalisation of the annual report for the year.

The increase in corporate and other costs was due primarily to higher employee share scheme expenses, increased research and development costs, legal expenses and costs associated with international growth initiatives.

Positive cash flow in the second half of the year, along with an equity raising carried out in October 2015, resulted in cash on hand of \$69.4 million at 30 June. Net operating cash flow for the year was \$21.5 million, compared with (\$8.1) million in the pcp.

The equity raising comprised a placement to institutional investors and shareholders to raise NZ\$40 million and a Share Purchase Plan to raise a further NZ\$3 million, both of which were substantially oversubscribed. This was undertaken primarily to fund the increase in working capital associated with the significant growth in infant formula sales and to maintain a conservative approach to managing the Company's capital position.

³ Before intercompany charges. Intercompany charges include licence fees and management fees payable to the Corporate Segment, and marketing and herd testing costs payable by the Corporate Segment.



ANZ

The ANZ business continued to perform very strongly, with sales and operating earnings in Australia substantially above the prior year. Total revenue across all product categories increased by 99% to NZ\$296.3 million, and Operating EBITDA before intercompany charges was NZ\$84.7 million, an increase of 182%.

Fresh milk sales increased by 4% aided by growth in emerging retailers, compared to flat category growth within mainstream grocery. Market share of a2 Milk™ branded fresh milk in Australia remained broadly stable at approximately 9.3% by value within mainstream retailers (*Australian Grocery Weighted Scan, 3 July 2016, MAT*). The result was assisted by a new “Believe in Better” marketing campaign encompassing the expanded product range of milk and infant formula. The Company is now ranked one of the highest in terms of advertising spend for fresh milk in Australia to support its market position and is the only dairy brand distributed by all six key grocery retailers in Australia.

Consistent with the Company’s policy of vigorously protecting its brand and intellectual property portfolio, the Australian business recently initiated Federal Court action against a competitor for alleged misleading and deceptive conduct around the competitor’s ‘contains A2 protein’ product claim.

a2 Platinum® has been the fastest growing infant formula brand in the Australian market during FY16. Its most recent market share in the grocery/pharmacy channels approximated 16% for the 52 weeks ending 5 July, 2016 by value. The Company is anticipating further growth in infant formula sales in the coming year.

China

Total China sales grew strongly, with the segment revenue up from \$4.0 million to \$38.2 million and Operating EBITDA before intercompany charges up from (\$3.1) million to \$9.2 million, delivering a positive EBITDA for the region for the first time.

Growth reflected the increasing market profile of the Company and the a2 Platinum® brand, along with rising interest among Chinese consumers in matters of health and nutrition.

a2 Milk™ branded fresh milk sourced from Australia continued to grow and received increased exposure following the independent publication of a human clinical study conducted by Professor Sun Jianqin, as detailed further below.

The Company has been progressively building a sales and distribution platform in China, and has invested significantly in marketing activity and sales support. The platform comprises:

- Local distribution, sales and marketing expertise in Shanghai, with supporting capabilities in health and nutrition;
- Distribution through e-commerce channels including JD.com, Tmall, Kaola, VIP.com, and other emerging e-commerce platforms;
- Distribution through ~1,450 mother & baby stores served by 42 distributors at fiscal year-end with plans to continue to expand in Tier A and B cities;
- An exclusive distributor agreement for five key provinces in China with DKSH (China) Co., Ltd, a well credentialed distributor in key Asian markets

These arrangements provide direct control of what is now a multi-product, multi-channel strategy for the China market. They represent a major reorganisation and expansion since late 2014, when the Company assumed sales and distribution responsibility from its former exclusive distributor.

The new structure and increased marketing support is delivering strong consumer engagement with The a2 Milk Company brands.

The a2 Milk Company™ store on Tmall was launched in July 2015, and the Company’s presence on JD.com was launched in September 2015, selling a2 Platinum® infant formula direct to consumers.



The Company participated successfully in a number of online sales events including the high-profile “11/11” Singles Day sales event in November, Chinese New Year in February and an event in June. a2 Platinum® was showcased at the annual Children Baby Mother Expo in Shanghai in July 2015.

A key focus during the year was to manage the potential impact of changes to the infant formula regulatory environment. Changes announced during the year involved:

- Taxation of Cross-Border E-Commerce (CBEC) traded commodities – with the impact being an increase in taxation on larger consignments sold from the bonded warehouse / free trade zone in China;
- Publication of product lists for CBEC traded commodities through China free trade zones – with the key implications for the Company being the inclusion of infant formula and whole milk powder products on ‘positive lists’; and
- A Registration Rule for domestic and imported infant formula products, under which these have until 1 January 2018 to complete formulation registration with the China Food and Drug Administration.

The Company believes it has responded satisfactorily to this phase of regulatory activity. We continue to adjust our manufacturing and distribution model in response to the changes, while remaining alert to potential future changes in the regulatory environment. A key agenda item in FY17 will be the future requirements for product registration and the Company is confident of meeting the requirements.

United States

The US business, commenced in Southern California from April 2015, made progress in building distribution while creating an initial marketing and communication platform. Distribution was extended to Northern California from September 2015 and to a number of retailers in the Pacific Northwest and the home market of Colorado from January 2016.

a2 Milk™ branded milk is available in four variants within the specialty milk section, the fastest growing segment of the total milk category.

While the business achieved broad trade acceptance across the state of California, the distribution build at store level has been slower than anticipated and sales performance has therefore been below the year’s target. Distribution was achieved in the important Safeway chain in Northern California from February 2016, and we continue to work with Safeway Southern California to achieve distribution during FY17. Distribution in two additional accounts, Trader Joe’s and Target, has been achieved since financial year end.

Sales focus remains on building unit sales per store per week (UPSW) relevant to the speciality milk category and pleasing progress has been made in our key retailer accounts. Marketing has included online activity, promotional programs and television advertising focused on the Los Angeles and San Francisco markets.

Milk supply is centred on farms in Nebraska and the North East and the business has initiated a best practice on-farm management programme with suppliers. Operational support from the foundation contract processor, Byrne Dairy has been important during the establishment phase and the business recently concluded an agreement with a second contract processor located in California. In conjunction with Byrne, this will enable the business to service the west coast more efficiently and be well positioned for growth in new markets over time.

The US business’ Chief Executive, Jeffrey O’Neill, encountered a serious health issue during the first half and has been replaced by another highly experienced executive, Blake Waltrip, who is already making a very strong contribution. We thank Jeff for his contribution during the year.

Notwithstanding the delay in achieving the desired level of distribution, the business is well positioned to move forward, albeit with higher establishment costs than originally anticipated. Our plan remains to focus on achieving the targeted distribution, sales velocity and consumer awareness targets in California before expanding into further markets.

The plan now assumes further Investment of ~USD20-25 million over the next two to three years prior to positive monthly EBITDA.



United Kingdom

The business returned a better than breakeven result for the fourth quarter of FY16 and anticipates a breakeven result for the full year FY17.

The UK business is migrating from a fresh milk focus to a portfolio strategy encompassing liquid milk and infant formula, and potentially products sold through distributors or under license in Europe. a2 Platinum® infant formula was introduced to the wholesale market from earlier in the year and UHT long life milk became available from September 2015.

Sales of a2 Milk™ branded fresh milk, whilst modest, continued to show growth, particularly in the last quarter. Distribution was stable in key retailer accounts, but the business continued to seek ways to increase facings in store.

The business continues to improve point of sale presence, has undertaken targeted promotional activities and continues to build relationships with the health care professional community. A new 'a2tonishing' marketing campaign was developed and launched from May 2016 and will continue during FY17.

The business continues to be well supported by its fresh milk manufacturing partner Müller Milk & Ingredients and has recently negotiated an extension to its packaging agreement.

Science, research and development

Scientific understanding of the benefits from consumption of milk products containing only the A2 beta casein protein type has continued to accumulate. This reflects the work of a number of institutions, some of which have been supported in financial and/or practical terms by the Company.

In December 2015 the New Zealand Government committed NZ\$1.1 million over three years to High Value Nutrition research in association with AgResearch, a Crown Research Institute, and The University of Auckland.

In April 2016 the results of a study led by Professor Sun Jianqin from Huadong Hospital, an affiliate of the renowned Fudan University in Shanghai, were published in the UK-based *Nutrition Journal*. These indicated that milk containing only the A2 beta-casein protein has a natural affinity with the human body and digestion; and that gut inflammation caused by the A1 protein can be avoided by consuming milk products with only the A2 protein.

Several new research studies have been initiated, including:

- Expanded clinical trial in China, involving 600 participants, to build upon findings from successful earlier China study published in FY16;
- Further clinical trials in China to assess the benefits of the A2 beta casein protein amongst pre-schoolers and infants; and
- A clinical trial in the United States with a leading biomedical research centre into the benefits of a2 Milk® for digestive function

The Company will continue to provide support for research to clarify the consumer benefits of milk products containing only the A2 beta-casein protein type.



Outlook

The Company expects continued growth in the 2017 financial year, in particular from infant formula and milk powders in Australia and China and improved momentum in the US business. Whilst there are changing regulatory dynamics in the China market, the Company remains confident in the medium term opportunities and its ability to adapt to the evolving market circumstances. The Company will provide an update on financial performance at the Annual Meeting, in November 2016.

For further information contact:

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Reconciliation of EBITDA to Net Profit After Tax

	Full Year Ended 30-Jun-16 NZ\$ 000's	Full Year Ended 30-Jun-15 NZ\$ 000's	Movement %
EBITDA	54,576	3,129	1,644%
EBITDA before non-recurring items	54,576	4,810	1,035%
Depreciation/Amortisation	(2,742)	(1,949)	41%
EBIT before non-recurring items	51,834	2,861	1,712%
Non-recurring items ⁴	-	(1,681)	(100%)
Interest Income	502	150	234%
Interest Expense	(37)	(49)	(24%)
Income tax/(expense)	(21,863)	(3,372)	548%
Net Profit After Tax	30,436	(2,091)	<i>NM</i>

NM = not meaningful

Forward Looking Information

Certain statements in this release constitute forward looking statements and comments about future events, including the Company's expectations about the performance of its businesses as at the date of this release. By their nature, forward looking statements involve known and unknown risks, uncertainties, assumptions and other important factors, many of which are beyond the control of the Company and which may cause actual results, performance or achievements to differ materially from those expressed or implied by such statements. Forward looking statements are provided as a general guide only, and should not be relied on as an indication or guarantee of future performance. No assurances can be given that any forward looking statements referred to in this release will be realised. Any forward looking information speaks only as of the date of this release. Past performance is not indicative of future performance and no guarantee of future returns is implied or given. Nothing contained in this release is a promise, representation, warranty or guarantee as to the past, present or the future performance of the Company. The Company makes no representation, and gives no assurance or guarantee that the occurrence of the events expressed or implied in any forward looking statements in this release will occur or that any assumption that underpins any forward looking information is reasonable.

Nothing in this release is a solicitation, invitation, advice or encouragement to buy, sell or hold shares in the Company.

⁴ Non-recurring items in FY15 relate to costs associated with the Company's listing on the ASX

