25 February 2015

The a2 Milk Company Limited

FY15 first half results

Strong result in Australia, strategic initiatives gaining traction

Highlights

- Strong growth in revenue – an increase of 38% over the prior corresponding period (PCP)
- Continued strong growth in Australia in fresh milk and also in infant formula
- UK business progressing to plan
- a2 Platinum™ infant formula distribution into China recommencing
- Plans for launch into the USA market in Q4 FY15

Financial Summary

The a2 Milk Company (a2MC or Company) performed ahead of plan during the period and its strategic growth initiatives continued to gain momentum. The Company's strategic plan is based on funding growth in priority international markets from increasing Australian profits.

Managing Director, Geoffrey Babidge said: "The highlights for the first half were the stellar result for the Australian business in both revenue growth and operating earnings and our UK business achieving milestones consistent with our revised plan. We also focused our efforts on repositioning our China infant formula business in response to the changes in regulation of imports during 2014, and further progressed the planning for the launch of a2 Milk™ into the USA in coming months. At this stage of the Company's development the focus is on revenue growth and market building. We are comfortable with performance being on or ahead of plan against these measures at present."

As foreshadowed at the annual meeting in November 2014, the Company has now lodged an application for the listing of its securities on the Australian Securities Exchange (ASX) in addition to its existing NZX listing. The Company has separately advised of changes to the Board composition that are proposed to take place in conjunction with the ASX listing. These changes are consistent with the process of Board renewal that commenced in 2013.

Mr. Babidge said: "The proposed dual listing of the company on the ASX in the near future will be another important milestone in the continued development of the company. The ASX listing will provide a closer alignment between our capital markets profile and business operations, and we expect it to improve the liquidity of the Company's shares and access to capital markets over time."

The unaudited Group profit after tax for the six months ended 31 December 2014 was $125,000 and included:

- Total revenue of $74.79 million, an increase of 38% over the PCP;
- Group EBITDA of $3.27 million before non-recurring items, an increase of 27% over the PCP;
- EBITDA after inter-company charges[1] for the Australian and New Zealand operations of $4.88 million, an increase of 113% on the PCP;
- EBITDA associated with establishing the UK business of ($1.92) million, after inter-company charges;
- EBITDA associated with establishing the China business of ($0.61) million, after inter-company charges;
- Corporate and other EBITDA after inter-company charges of $0.92 million (before non-recurring items of $0.76 million); and
- Income tax charge of $1.56 million.

The higher income tax charge represents higher non-deductible expenses (mainly related to development and ASX listing costs), and UK losses not tax effected[2].

The balance sheet at 31 December 2014 includes cash on hand of $9.86 million. The operating cash outflow for the half primarily reflects an increase in working capital associated with the growth in infant formula and milk sales.

Management believes that the 2016 revenue projection of $230 million advised in the 2014 annual report remains appropriate. Whilst meaningful revenue from China and the UK is yet to emerge, these businesses are gaining traction and the Australian business continues to outperform expectations. In addition, sales in the USA market are expected to compensate for any shortfall in other markets.

Australian growth continues strongly

The Australia and New Zealand business continued to perform strongly, with sales growth and operating earnings in Australia well ahead of the PCP. Total revenue growth for the Australia and New Zealand business relative to the PCP was ~39%. EBITDA before inter-company charges was $13.96 million.

Fresh milk sales of a2 Milk™ increased on the PCP in AUD by 16% as a result of continued growth in brand awareness and presence in the retail trade. In response to competitor activity, the business continues to actively communicate the features and potential benefits of a2MC branded products and the distinction between the Company's products and other dairy products or brands that contain A1 beta-casein protein. Latest data shows the market share of a2 Milk™ fresh milk in Australia has grown to approximately 9.3% by value in the grocery channel (*Australian Grocery Weighted Scan December 2014 quarter*).

Improvement in processing efficiencies at the Company's Smeaton Grange processing facility partly offset an increase in raw milk costs that took effect during the period. The Company's gross margin for the period remained strong at ~35%.

A further standout for the period was the growth in sales of a2 Platinum™ infant formula in Australia in both grocery and pharmacy channels, and also in New Zealand where sales grew from a low base. Total sales of infant formula in Australia and New Zealand for the half year were $16.07 million. Our grocery distribution in Australia was broadened, with ranging in Woolworths achieved from November 2014 that complemented distribution previously achieved in Coles and major independents.

The Company continues to build milk supply in New Zealand to facilitate increased production of infant formula by our manufacturing partner, Synlait Milk Limited.

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[1] Inter-company charges include royalties, licence fees and management fees payable to the Parent, and marketing and herd testing costs payable by the Parent

[2] To date, losses from the UK business have not been recognised as a deferred tax asset

United Kingdom distribution to plan

The UK business has been implementing the revised business model as outlined in the most recent annual report. The model focuses on three key elements: (i) building distribution in existing accounts and extending into new accounts, (ii) increasing product awareness in a more targeted manner, and (iii) enhancing our price positioning and packaging formats to improve margins.

We are pleased with progress to date, with the new product positioning receiving broad acceptance across the retail trade. The new one litre semi-skimmed format was ranged in J Sainsbury stores (a new customer for a2MC) from November 2014, and one litre semi-skimmed and whole milk was accepted for ranging in our existing retail partners Tesco, Waitrose, Ocado and Morrisons from early calendar 2015. In addition, the product is to be ranged in Whole Foods Market from February 2015 and a key London wholesaler, Marigold. In each of the retailer accounts, the product is being ranged in the speciality milk area. Distribution of the new one litre product continues to grow – the product is expected to be ranged in approximately 1,000 retail outlets across the UK, which represents the broadest level of distribution achieved since entering the market in 2012. We have also commenced presenting our a2 Milk™ UHT milk range to the retail trade.

We have worked closely with, and been well supported by, our supply partner Muller Wiseman Dairies (MWD) in managing the processing and logistical issues around the packaging change. The quality of packaged product supplied by MWD continues to be of a high standard.

With the improved distribution platform now in place, our key focus is building consumer awareness and rate of sales per store in our key customer accounts. The new marketing strategy will commence from this month, with a focus on welcoming consumers who currently limit their dairy intake or exclude dairy from their diets back to milk through targeted digital media and marketing activity in-store.

The investment in the UK business during the half was GBP2.2 million, which is consistent with the FY15 financial plan. Sales revenues, whilst modest, are forecast to double during the second half.

China infant formula business resumed

As previously reported, the regulatory environment for infant formula sold in China was evolving during calendar 2014. As part of this, there were changes to access arrangements for imported product, including a requirement for manufacturing companies to achieve a new form of registration from May 2014. Our manufacturing partner, Synlait Milk Limited, achieved the new form of registration in September 2014.

As a result of the uncertainties arising from these changes, sales of a2 Platinum™ infant formula to China were on hold from May 2014 until a first order of approved registered product was dispatched in December 2014. In addition, a2MC deemed it appropriate to provide one-off marketing funds to assist distributors in their selling activities. Accordingly, we incurred an elevated level of marketing spend in the half notwithstanding that our sales were low.

In November 2014, the Company advised of changes to the supply and distribution arrangements with China State Farm Holding Shanghai Company (CSF). Under the revised arrangements, CSF has become the exclusive import agent for a2 Platinum™ infant formula imported into China and will provide government advice and support on an on-going basis. As a result, a2MC has assumed overall responsibility for distribution of infant formula products in this market and is assessing new third party distribution arrangements to expand the network in the near term. The Company continues to oversee the marketing and communication activities for the brand and is progressing development of new marketing initiatives including establishing our own e-commerce capability for sales into China. The Company considers that these changes better position the business for success.

The Company continues to develop its plans and structure for sale of fresh milk and UHT milk in China, with other Asian markets to follow. As part of the market entry strategy, from September 2014, a2 Milk™ branded fresh milk sourced from our Smeaton Grange facility has been airfreighted to Shanghai for home delivery direct to consumers. It is currently the largest fresh milk brand by volume being exported from Australia.

USA market entry plan being finalised

As previously advised, the Company has been developing a plan to launch a2MC branded milk into the USA market during the fourth quarter FY15. Significant progress was made during the half in recruiting the core management team, developing the launch product and marketing plan, identifying milk supply and commencing discussions with the retail trade.

Our plan centres on a launch into the West Coast region commencing in the fourth quarter of FY15. Since December 2014, we have completed presentations to key retailers in this market and progressed the appointment of a high quality milk processing partner. Whilst the opportunity is potentially nationwide, our phased entry plan is focused on achieving agreed milestones in the launch region prior to extending distribution into further state markets. Taking this into account, the Company will focus its selling activities in the West Coast region and base its administration activities in the centrally located State of Colorado in anticipation of further expansion over time.

Intellectual property and developments in scientific research continues

The results of a human digestion trial sponsored by a2MC and conducted by Curtin University of Western Australia were published in the European Journal of Clinical Nutrition in August 2014. This trial provided new support for the digestive benefits in humans of a2MC products and supported previous findings in published animal studies. The Company has commenced human studies in a number of markets to further build on this research.

a2MC remains committed to the continued development of its unique portfolio of intellectual property. During the half, a2MC acquired full ownership, from the NZ Milk Institute, of an Australia / New Zealand and China registered patent that relates to benefits of A2 based formulations containing additional supplements.

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Reconciliation of EBITDA

	Half year ended 31-Dec-14 NZ $000's	Half year ended 31-Dec-13 NZ $000's	Movement %
EBITDA[3]	2,504	2,576	-3%
EBITDA before non-recurring items	3,266	2,576	27%
Depreciation/amortisation	(912)	(849)	7%
EBIT before non-recurring items	2,354	1,727	36%
Share of associate/joint venture losses	-	(1,361)	-
Non-recurring items[4]	(762)	-	-
Net interest income	88	240	-63%
Income tax/(expense)	(1,555)	37	-
Net profit after tax	125	643	-81%

3. EBITDA is a non GAAP measure, but the Company believes that it provides investors with a comprehensive understanding of the underlying performance of the business
4. Non-recurring items in 2014 relate to costs associated with the ASX dual listing process during the period