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New a2 milk CEO Hrdlicka says China success requires strategy beyond daigous



by Carrie LaFrenz

Before taking the leap into her first role as chief executive of a listed group at The a2 Milk Company, Jayne Hrdlicka sat down with her boss at Qantas, Alan Joyce.

The pair had worked together for eight years when she last ran his budget airline Jetstar. Ms Hrdlicka was put through her paces by Mr Joyce, making sure it was the right move for the Kansas native.

The pair knew each other well, having first come across each other when Ms Hrdlicka was working at consultancy Bain & Co, and Mr Joyce was her client at the now defunct airline Ansett Australia.

Ms Hrdlicka wanted to bounce the idea off her respected boss, but in the end she was swayed by the many opportunities to grow a strong brand.

"It's hard to say no to a company that has such a great set of values and to have this experience of running a public company," she told *The Australian Financial Review*.

Creating new a2 products through a tie-up with Fonterra, and further refining the strategy in the complex Chinese market, are two significant opportunities Ms Hrdlicka has highlighted after two weeks in the top job. It is possible she will need to succeed on both fronts, and others, to preside over a continuing of a2's stellar run.

Revenue at the New Zealand-based maker of milk products and infant formula has risen almost seven-fold since 2014-15 and has turned it into a \$7 billion dual-listed giant. Shareholders have gained nearly 130 per cent in the past 12 months.

Share price under pressure

But there are also hurdles facing the dairy group which is trading on a very high multiple of 35-times forward earnings, according to Bloomberg. The a2 share price has been under pressure since May when the company missed analysts' full year sales expectations. The stock fell 13 per cent on the day.

It recently confirmed downgraded sales for the 2018 year, while flagging higher spending on marketing as a percentage of sales due growth in Australia and expansion into the United States. Overheads are also going up as more staff are brought on in China and at home to support the company's growing scale.

Much of the market's expectations for growth are based on a2's sales in China, where it must navigate the delicate relationship with the finicky Chinese daigou community, who purchase goods like infant formula and vitamins overseas to sell back at home via online marketplaces.

Ms Hrdlicka is just back from a week-long trip to China where she attended a trade show and talked to customers. She admitted that China is a complex consumer market that is rapidly developing, which means a2 needs to navigate both older and newer channels to be successful.

Transparency in China is difficult, especially amid a changing regulatory market. While Ms Hrdlicka said the daigou channel is important, she will continue to work to build other channels. While it is unlikely that a2 will be offered in all 90,000 mother and baby stores, a Chinese-labelled product is a major opportunity.

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The company recently confirmed revenue for the 2018 financial year had come in at \$NZ922 million (\$846 million), which was just above the downgraded forecast it provided in May. It was still an impressive 68 per cent above the previous year. Citi slashed its call to "neutral" and noted possible reseller price reductions across the Australian daigou channel and Chinese e-commerce platforms.

"We are concerned that price reductions have the potential to lead to lower margins for daigous, and make daigous hesitant to purchase new stock," Citi said.

Revenue growth

Citi added that rival baby formula maker Bellamy's Australia had much bigger issues in China, which nearly toppled the company, and that a2's model is "far from broken" and has not been impacted so far by Nestle's rival A2 product launch.

Despite the moderation in rate of growth in 2018, a2 is expecting further revenue growth in 2019 and Ms Hrdlicka is adamant there is plenty of runway left.

"You don't have to spend much time in a2 to become energised about the possibilities ahead," she said ahead of launching Fonterra's Anchor Brand a2 milk line in New Zealand on Thursday.

"It is down to us to make sure we deliver on this to the full extent."

The 56-year-old added that there are not any "big pot holes or any unsurmountable challenges ahead".

The new product launch is the second under the strategic alliance with Fonterra – the world's biggest dairy exporter, which sells Anchor butter and Mainland cheese in the US. Fonterra is already producing an a2 protein milk powder with manuka honey.

The deal with a2 means Fonterra is licensed to produce products made from a2 milk (which comes from cows that only produce the A2 milk protein) in markets not already in a2's jurisdiction.

Ms Hrdlicka said the nimble, fast-moving a2 will look to leverage Fonterra's manufacturing capability and supply chain and Fonterra will leverage a2's consumer driven brand with a

premium market position.

Full circle

The agreement will also explore a2 Milk-branded butter, cheese and China-sourced liquid milk, as well as investing in blending and canning facilities, most likely in Australia, helping to cement a2's position as a major player.

Ms Hrdlicka, who less than a year ago was appointed head of Tennis Australia, is passionate about her sports with tennis and skiing at the top of her list. She said her family has played at 92 different clubs around Australia, with her two sons who play competitive junior tennis.

Following her graduation from business school in 1988 from Dartmouth College in New Hampshire, Ms Hrdlicka worked for Bain for three years. She was lured away to private equity to help turn around Bennett Lebow's portfolio company SkyBox, a \$500 million sports trading cards business spun out of a cigarette company.

She had great success, which led her to Australia to fix up a similar private business. Ms Hrdlicka committed to one year, but remained. By 1997 she returned to Bain where she worked for 13 years, and met her then client Mr Joyce. Her second client was supermarket giant Woolworths, where she later became a director.

"It's funny how things come full circle," she said.

Ms Hrdlicka grew up in an environment where she was encouraged to be whatever she wanted without constraints.

"I feel so privileged now to have had that as a foundation. Stay true to who you are ... you could find yourself one day running an extraordinary dairy business. I think I won job lotto."
