Strong demand doubles A2 Corporation Net Profit

04 September 2012

Highlights

- Group Profit After Tax of $4.40 million for 2012 year, up 108 per cent over the prior year
- Increased market share in Australia, sales up 48 per cent over the prior year
- UK fresh milk launch scheduled for October 2012
- Production of a2™ branded infant formula to begin from December 2012

Consumer demand for the a2™ brand fresh milk proposition has delivered A2 Corporation Limited another year of strong growth.

Revenues grew 48 per cent over the previous financial year driven primarily by the growing preference of Australian consumers for a2™brand milk – dairy milk without the A1 gene that has been linked with digestion and health issues.

Managing Director Geoffrey Babidge says the company's strong trading performance in Australia was very encouraging and is providing a platform for the strategic initiatives being progressed in a number of global markets.

"The Board is extremely pleased with the performance of the Company in the past year. We have demonstrated continued market leading growth supported by increasing consumer awareness of the differentiated and unique brand proposition."

"Our strategic growth agenda seeks to build sustainable advantage by drawing on the increasing credibility of the a2™ brand proposition and prioritising markets that have characteristics which support premium dairy product offerings. We continue to make excellent progress in this regard, evidenced by our forthcoming launch in the UK and anticipated entry into infant formula in China, and demonstrates the significant future potential of the business."

For the 12 months ended 30 June 2012, A2C achieved a Group Profit after Tax of $4,405,000. This compares to a Profit of $2,116,000 for the 12 months ended 30 June 2011. Preliminary audit clearance has been obtained for these results pending finalisation of the 2012 annual report.

The trading result comprised the following key items:

- Sales of $62,458,000, representing an increase of 48% over the prior year;
- EBITDA before share of associate earnings and unusual items of $4,737,000, an increase of 77% over the prior year;
- Proceeds on settlement of an outstanding legal dispute in Korea of $1,101,000 net of costs;

- Share of associate earnings for A2 Milk (UK) Limited of ($743,000);
- Costs associated with a Group Strategic Review of $522,000;
- International Business Development expenses of $870,000;
- Non-cash Expenses relating to share based incentive schemes of $251,000;
- Income tax credit of $287,000, due to a one-off tax benefit from the reset of the tax cost base of assets.

The balance sheet movement over the year reflected positive operating cash flows in Australia, proceeds from share placements and the legal settlement, funding of capital expenditure and our joint venture investment. Cash on hand at 30 June 2012 was $6,568,000. The Company maintains a prudent view of having little or no net debt whilst in a rapid expansion phase.

Strategic Agenda

The Company continued to rapidly progress the strategic agenda focused on 3 core growth initiatives:

- Building the beverage business in Australia and New Zealand;
- Capturing niche shares in global milk and other dairy product markets;
- Developing an Infant Formula business in highly prospective markets with an initial focus on China.

In April 2012, the Company announced a Strategic Review lead by corporate advisors Greenhill Caliburn and Clavell Capital to review the company's options to accelerate growth and maximise shareholder value. This review is ongoing and is providing valuable assistance to our growth agenda.

Operational Review

Australia and New Zealand

The Australian business performance was a standout for 2012 with operational profit well ahead of budget and the prior year.

a2 ™ sales grew strongly and represented an increase on the prior year of 48%. The company continued to increase its investment in marketing and communication including the introduction of a new "Thank-you a2" media campaign, effective public relations and social media initiatives and increased activity with the health care professional community.

We estimate the market share of a2 ™ brand milk by value in the grocery channel in the last quarter of the 2012 year to approximate 5.8%. The overall fresh milk category in Australia has continued to be impacted by the low retail pricing of generic milks which took effect in early calendar 2011.

The Company commissioned its new milk processing facility in south west Sydney in late February 2012 and is now producing to expected levels of outputs. The new facility incorporates the most advanced proven dairy processing technologies to achieve the highest quality of fresh milk and is sized to efficiently process current requirements for New South Wales with the capability for significant growth over time. The capital cost of plant and equipment approximates AUD 8.4 million. A2C continues to source the balance of its milk requirements from its contract processing partners.

Gross Margin as a percentage of sales was lower in the second half and for the year when compared to 2011. This was due to additional milk procurement costs to meet rapidly increasing demand, a number of one off costs incurred to bring the new processing facility on stream and a change in customer mix.

The Company has progressed discussions with Fresha Valley, the sole licensee for a2 ™ brand milk in New Zealand, on how best to further develop a2 ™ brand milk within New Zealand.

United Kingdom and Ireland

In November 2011, the Company announced the expansion of operations in the UK and Ireland through a sales and marketing joint venture with the leading fresh milk dairy company in Britain, Robert Wiseman Dairies (RWD). The joint venture is engaged in the sourcing, processing, marketing and distribution of a2™ brand milk products on an exclusive basis in the UK and Ireland.

The UK fresh milk market is approximately 6.5 billion litres per annum and the market opportunity for a2™ brand fresh milk has the potential to be three fold that of Australia.

RWD was founded in 1947 and operates six state of the art processing dairies, 14 distribution depots and distributes around one third of fresh milk consumed in Britain. In February 2012, RWD was acquired by the highly regarded European dairy group, Unternehmensgruppe Theo Müller Group.

A2C is very pleased with the progress of the joint venture since formation. Over the period the joint venture has established its core management team, commenced herd testing and selected initial suppliers. RWD is a valued partner with a commitment to providing all the resources required to support the development of the business.

We originally targeted the brand launch from September 2012 with the plan now to commence from October 2012. A2C’s share of joint venture costs incurred in the establishment phase to June 2012 totalled $743,000.

For some time the UK milk market (and many other western dairy markets) has been experiencing challenges around declining returns to farmers, processors and retailers. The a2™ brand proposition provides an opportunity to bring tangible benefits to all participants in the supply chain in addition to consumers.

International Business Development

During the year, the Company progressed discussions with a number of participants in key markets considered attractive for a2™ brand beverages.

The Company has continued to make significant progress in developing a market entry strategy for a2™ brand infant formula into Asia, with China a priority. In April 2012 the Company announced a strategic agreement with Synlait Milk Limited (Synlait) in New Zealand to manufacture a2™ brand nutritional powders (including milk powders and infant formulas) for A2C. Under the agreement Synlait will source a2™ milk from accredited Canterbury dairy farms and manufacture a2™ brand nutritional powders at its facility in Dunsandel. The Company has been assessing alternatives for the associated sale and distribution of a2™ brand infant formula in China and is advanced in the development of a business plan and selection of a credentialed distribution partner.

In September 2011, the Company settled its long running dispute with a former licensee in the Republic of Korea with settlement of $1.101 million (net of costs incurred in the current year). A2C is pleased to have resolved this legacy issue which will assist our growth plans and supports the strength of our intellectual property in the Asian region.

Equity raisings

The Company undertook two equity raisings during the year to support the ongoing development of the business and to broaden the institutional shareholder base.

In July 2011, Freedom Foods Group Limited (FFG) was issued 18.8 million ordinary shares for total cash consideration of $2.7 million pursuant to an option under the sale and purchase agreement for A2 Dairy Products Australia Pty Ltd.

In March 2012, the Company made a placement of 14 million ordinary shares to AMP Capital Investors (New Zealand) Limited (AMP Capital) to raise an amount of new equity of $5.2 million. AMP Capital assisted the Company by facilitating the sale of a block of A2C shares to a number of institutions on terms identical to the placement by the Company to AMP Capital, and we thank them for their assistance.

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