



19 August 2020
NZX/ASX Market Release

Strong financial results and execution continuing

Results highlights for the full year ended 30 June 2020 (NZ\$)^{1,2,3}

- Total revenue of \$1.73 billion, an increase of 32.8%
- EBITDA⁴ of \$549.7 million, an increase of 32.9%
- Net profit after tax of \$385.8 million, an increase of 34.1%
- Basic earnings per share (EPS) of 52.39 cents, an increase of 33.5%
- EBITDA to sales margin of 31.7%
- Operating cash flow of \$427.4 million and a closing cash balance of \$854.2 million
- Marketing investment of \$194.3 million⁵ targeting opportunities in China and the USA, an increase of 45.1%
- Group infant nutrition revenue of \$1.42 billion, up 33.8%
- Strong growth in China label infant nutrition, with sales more than doubling to \$337.7 million and distribution expanded to ~19.1k stores
- USA milk revenue growth of 91.2% and distribution expanded to ~20.3k stores

¹ All figures are in New Zealand Dollars (NZ\$) unless otherwise stated.

² All comparisons are with the 12 months ended 30 June 2019 (FY19), unless otherwise stated.

³ All figures are quoted based on all operations of the Group, including discontinued operations, unless otherwise stated.

⁴ 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.

⁵ From continuing operations.

Summary of Group performance

The a2 Milk Company has made significant gains in revenue and earnings, with strong performances in all key product segments, and across all core markets.

Our performance was robust throughout the year and we demonstrated significant resilience in the second half managing the business in the face of the COVID-19 global pandemic.

Through these unprecedented times, we have been fortunate to continue experiencing strengthening levels of consumer demand and worked closely with our strategic partners and customers to ensure supply chains remained open and consumer needs continued to be met.

We estimate that COVID-19 had a modest positive impact on revenue and earnings for the year. Additionally, our business was favourably impacted by foreign exchange movements.

Our overall result reflects the continued growth in our **infant nutrition** segment with sales totalling \$1.42 billion for the period – an increase of 33.8% on the prior corresponding period.

In line with our strategy, our growth in China label infant nutrition products was significant, with sales effectively doubling to \$337.7 million. We achieved this while also continuing to achieve growth in our English label infant nutrition products with growth of 21.2%.

Our revenue in the third quarter was well above expectations due to the impact of changes in consumer purchase behaviour arising from the COVID-19 situation. This included an increase in pantry stocking particularly via online and reseller channels.

In our view, a proportion of consumer pantry stocking driven by COVID-19 unwound in the fourth quarter. However, this will remain a dynamic situation and we will continue to monitor changes in consumer behaviour moving forward.

We again achieved solid growth in our **liquid milk** businesses in Australia and the USA, with sales across the Group⁶ totalling \$222.0 million up 29.7%. Liquid milk sales in Australia were up 14.1% to \$152.5 million and sales in the USA almost doubled during the year to \$66.1 million, driven by improved sales velocity in established stores as well as an expanded store footprint.

Our **gross margin** percentage^{5,7} increased to 56.0%, benefiting from improved price yield and the positive effects of currency movements, partially offset by COGS increases related to infant formula.

During the year we invested \$194.3 million⁸ in marketing, to drive brand awareness and conversion to trial in our key growth markets. This was slightly lower than our forecasted \$200 million due to efficiencies in media spend in the fourth quarter.

We delivered a full year **EBITDA margin** of 31.7% which was in line with the guidance we provided in April. Net **cash flow** from operating activities for the period was \$427.4 million representing a high cash conversion rate.

Our **balance sheet** remains in a very robust position. Our closing cash position of \$854.2 million reflects growth in revenue and earnings. This will continue to be important in the execution of our growth strategy, including potential participation in manufacturing.

We finished the year with inventory of \$147.3 million. This was higher than prior years, in part reflecting our growing business, as well as the decision to carry a higher level of inventory as a safety buffer given the uncertainties of COVID-19. Additionally, at the end of the period, we have recognised a provision for a quantity of finished stock that is on-hold awaiting further testing to ensure it fully meets our standard of specification.

⁶ From continuing operations.

⁷ Gross margin percentage is calculated as revenue less cost of goods sold, divided by revenue.

⁸ From continuing operations.

Delivering on our strategic priorities and business objectives

We have made significant progress on the execution of our strategic initiatives throughout the year.

We are committed to a focused approach to pursuing our strategic growth priorities:

1. Maximise growth from existing products in core markets;
2. Broaden our product portfolio in core markets; and
3. Expand in other targeted markets.

With the benefit of the comprehensive work undertaken during 2019 to enhance our understanding of the consumer and sales channels in our core markets, we have continued to increase levels of investment in marketing and capability to execute our growth plan.

In **Australia**, we have continued to build on our market leading positions in fresh milk and infant nutrition, whilst leveraging this to launch new products, such as a2 Smart Nutrition™, to drive further specialised nutritional products to consumers graduating from infant nutrition.

In **China**, we remain focused on strengthening our infant nutrition position in-market which we believe still has significant runway for growth. It is pleasing to see our investments in brand, trade activities and people driving strong sales momentum, in particular within our China label infant formula brand, a2 至初®, which now accounts for 24% of our total infant formula business.

In the **USA**, we continue to build brand awareness and drive towards meaningful scale.

Our targeted exploration of **new markets** continues. In October we launched a new Hong Kong label range of infant formula, in December we launched Stages 1-3 infant formula in Korea with our partner, YuhanCARE (Yuhan), and in March we entered into a new licensing agreement with AgriFoods in Canada to produce, market and distribute our fresh milk brand.

Work progressed during the year to expand our product portfolio in China. A growing range of fresh, long life milk and powder products targeting families is expected to become a meaningful growth engine over time.

Capital allocation framework

As we noted in February 2020, as part of the Board's ongoing review of the most appropriate use of capital for the business, we continue to prioritise investment in growth initiatives ahead of returning capital to shareholders.

As we have announced previously, due to the increasing scale of our infant nutrition business, we consider it now appropriate to assess participation in manufacturing capacity and capability to complement our existing supply chain relationships. Accordingly, we are presently evaluating opportunities to address this issue, with significant progress made during the year.

With our cash balance growing it has become increasingly important for the business to review our capital requirements going forward. A significant review of our capital allocation framework was commenced in the second half with a view to defining the discipline and prioritisation of our financial parameters in a way that optimises and supports our long-term plan.

Leveraging our strategic partnerships

This year has again highlighted the importance of key strategic partnerships. This remains a core element of our capital-smart business model.

We acknowledge and thank all our suppliers and customers for their support and assistance throughout the year. In particular, we acknowledge our three key strategic partners China State Farm, Synlait Milk and Fonterra. We have refocused our relationship with Fonterra and look forward to potential new opportunities to provide meaningful benefits to both companies in the medium term.

1. *Deliver Asia Pacific sales strategy outcomes*

Our Asia Pacific business revenue was \$1.66 billion, up 31.5%, with EBITDA of \$690.5 million, up 32.0%. This included:

- ANZ segment revenue of \$965.7 million, up 14.6%, with EBITDA of \$465.6 million, up 19.9%
- China & Other Asia segment revenue of \$699.4 million, up 65.1%, with EBITDA of \$224.9 million, up 66.7%

Infant nutrition

Our Asia Pacific infant nutrition portfolio comprising predominantly China and English label products delivered \$1.42 billion, up 33.8% on the prior corresponding period ('PCP'). China label infant nutrition products can be sold via mother and baby stores (MBS), modern supermarkets and domestic e-commerce retail channels. English label products can be sold through ANZ retailers, ANZ-sourced resellers and cross border e-commerce (CBEC) channels. We continue to leverage a multichannel approach to ensure we can cater to our consumers' differing shopping needs.

We have substantially increased our in-market capability with many new hires to the China team and further optimised our distributor arrangements which have allowed us to improve our in-market execution at both a brand and retail level.

Despite COVID-19 causing some disruptions and changing consumer behaviour across the marketplace, we managed to maintain our sales growth momentum. However, with a shift of sales from offline to online channels we chose to pause some of our marketing plans while we observed the impacts of these changes. As restrictions eased in China during the second half, we resumed the scale of our marketing programme including significant media investment and working with our distributors and retailers to improve our brand experience in-store. We are pleased with the impact this had on sales growth and brand awareness across all our key channels.

Infant nutrition – China label channels

We achieved sales of \$337.7 million for a2 至初® China label infant nutrition, which was over 100% growth on PCP and 62.7% growth for the half. Our MBS value share was 2.0% compared to 1.7% at HY20, up from 1.3% at FY19⁹.

These results are an outcome of consistent investment in advertising, our strategy of pursuing distribution in high productivity stores and optimising in-store execution. These efforts are underpinned by increased data analytics capability to ensure our investments are optimised.

Offline store closures associated with COVID-19 disruptions during the third quarter meant we added fewer new stores to our offline footprint in the second half, increasing to 19.1k stores compared with 18.3k at the end of 1H20. However, we worked closely with our distributors and retail partners through these disruptions, including to fulfil orders via direct home deliveries, within the bounds of internal travel restrictions.

We launched a China label version of our Stage 4 product and introduced a tamper-evident lid for our Stages 1, 2 and 3 China label products in December, to further enhance product security and provide additional differentiation with our English label products. Our infant nutrition portfolio is complemented by our other nutritional products as we broaden our appeal to existing consumers and seek to connect with new consumers.

⁹ Source: Nielsen MBS – 12-month market value share.

Infant nutrition – Cross border e-commerce

We delivered *a2 Platinum*[®] English label infant nutrition sales of \$341.1 million, up 40.3% and reached a CBEC value share for the financial year of 21.7%, up from 20.6% at HY20 and up from 18.6% at FY19¹⁰.

It was pleasing to see our expanded market share in this strategically important sales channel given heightened competitive activity across 2H20 and we continued to invest in driving demand across e-commerce platforms. There has been a concerted effort throughout the year to better track and understand the effectiveness of our digital marketing tools with an increased focus on data analytics to further refine and optimise our approach. This will continue in FY21.

We performed well across the key e-commerce selling events throughout the year, including “11/11 singles day” in November and “6/18” in June. For the “6/18” event, our *a2 Platinum*[®] Stage 3 was the top selling infant nutrition product on JD.com. and, for the first time, we were the bestselling CBEC IMF brand overall. On Tmall, we were the second best selling CBEC IMF brand overall and the number one CBEC flagship store.

Infant nutrition – ANZ retailers and resellers

Our infant nutrition sales in ANZ grew 14.1% delivering \$745.1 million in revenue for the year. We remain the market brand leader in Australian grocery and pharmacy channels and continue to invest behind our brand, with our level of advertising being the highest in the category. Despite positive growth, COVID-19 related travel restrictions negatively impacted the reseller channel due to reduced travel between Australia and China.

Infant nutrition – market share reporting

Our business continues to evolve as we grow, particularly for consumption of Stages 3 and 4 amongst children above three years of age, and increased penetration in lower tier cities.

In our view, tracking the MBS channel with Nielsen scan data, and the CBEC channel through Smartpath, more accurately reflects our performance and yields greater market insight. As such we will move to reporting against these sources externally, in line with industry practice.

Liquid milk

It is pleasing to report that our Australian fresh milk business continues to perform well with total revenue of \$152.5 million. In our most mature category, we achieved double-digit revenue growth of 14.1%. Demand in the third quarter and start of the fourth quarter was particularly strong as consumers increased their in-home consumption during COVID-19 with many working from home for extended periods.

Furthermore, *a2 Milk*[™] maintained a 12 month value share of 11.3%¹¹ despite the strong category value growth caused by the retail price increase of private label milk. *a2 Milk*[™] continues to be the only fresh milk brand ranged in all major supermarket chains and the highest brand advertiser in the fresh milk category, maintaining very high brand awareness and loyalty which benefits the portfolio as a whole.

We have also recently entered into an arrangement to underwrite the expansion of the manufacturing facilities of our long-term fresh milk supply chain partner in Victoria, Kyvalley Dairy Group (‘Kyvalley’), to support the ongoing growth of our liquid milk business.

¹⁰ Source: Smartpath CBEC – 12-month market value share.

¹¹ IRI Australian Grocery Weighted Scan 12 months ending 30 June 2020.

Through this arrangement we will acquire Kyvalley's Kyabram milk processing facilities and fund its expansion and upgrade. Kyvalley will manage the assets under a lease and revised long-term supply agreement.

The arrangement would involve certified dairy farmers continuing to supply Kyvalley with raw milk. The arrangement remains subject to Foreign Investment Review Board approval.

Other nutritional products

For all other nutritional products, sales increased 30.5% to \$85.2 million.

The most significant proportion of our other nutritional segment remains *a2 Milk™* whole milk and skim milk powder which is now available in ANZ and China with further potential for growth across new channels, particularly in offline China retail channels.

a2 Smart Nutrition™ continues to show positive signs of becoming a meaningful extension of our infant and children's nutritional portfolio. There are encouraging indications of consumer acceptance, and a China label version of the product was launched in January 2020, initially with a focus on gaining distribution in MBS. A bigger roll-out, including a launch of 200mL *a2 Smart Nutrition™* UHT will be conducted into modern trade during FY21 as part of a broader channel push to engage families across a wider portfolio of *a2 Milk™* based products.

The re-launch of our nutritional product targeting mothers under new branding and a reformulation of *a2 Nutrition for Mothers™* was successfully completed in 2H20.

a2 Milk™ powder blended with Mānuka honey continued to present some manufacturing challenges during the year, with the product to be reintroduced in 1H21.

2. Reach meaningful scale in North America

USA

We delivered revenue in the USA of \$66.1 million, representing growth of 91.2% compared to the prior corresponding period with brand awareness more than doubling, conversion rates up significantly. Encouragingly, over 50% of our sales growth was driven from existing stores.

Our average velocities have grown within our key accounts in the range of 14% to 74%, with many of our key accounts with average units per store per week of greater than 20-25 and some above 40. Given increased investment in building brand awareness and distribution growth, we recorded an EBITDA loss of \$50.5 million.

Distribution grew to approximately 20.3k stores, from 17.5k stores at the end of December 2019 and 13.1k stores as at end of FY19. Leveraging the consumer and channel insights obtained through a strategic review completed in 2019, we introduced new packaging and launched a new TV advertising campaign, both of which received positive feedback from consumers and the retail trade, and assisted in further building brand awareness and conversion to trial.

In July 2019, we launched *a2 Milk™* Coffee Creamers which have been received positively and are performing to plan. As consumer demand for our products build, and our distribution footprint strengthens, we expect opportunities to launch additional new products will emerge. Prior to COVID-19 our increased in-store merchandising efforts were delivering encouraging results in enhancing our sales velocities.

Whilst our consumption is up as compared to the prior period, from March, in-store foot traffic during the pandemic reduced due to retailer safety policies and purchasing limitations on milk per visit limited the growth that we may have otherwise seen for the brand. In the third quarter our plans to increase the utilisation of a merchandising team was impacted by COVID-19. However,

merchandisers have returned to stores from July and are having a positive impact on retail distribution.

The impact of COVID-19 in the USA market overall has been significant. We are seeing that consumers are becoming more value conscious given economic uncertainties, high unemployment rates and have adjusted our FY21 sales and marketing plans accordingly.

Hence, in FY21 we will shift our focus away from broadcast advertising media to a greater emphasis on in-store price and activation to drive demand. We are planning promotional initiatives in conjunction with our key retail customers with the objective of further building our facings and sales velocity.

The outcome of this shift will be growth in volume accompanied by increased trade spend with net revenue broadly consistent with FY20. With lower overall marketing spend we anticipate an improved EBITDA result for FY21.

As we build towards reaching meaningful scale in the USA, our initial milestone for the business continues to be US\$100 million of annualised sales.

Canada

In March, we entered into an exclusive licensing agreement with Agrifoods International Cooperative Ltd (“Agrifoods”) for the production, distribution, sales and marketing of *a2 Milk™* branded liquid milk for the Canadian market.

Since March, we have worked closely with Agrifoods, providing access to our intellectual property and marketing assets as well as our proprietary systems and know-how relating to the local sourcing and processing of *a2 Milk™*.

Agrifoods is leveraging its substantial capabilities in-market to establish distribution across Canada and has primary responsibility for funding this venture. The product has recently been launched to a number of customers in Western Canada.

3. Build towards sustainable brand leadership

Building brand value and increasing brand awareness through marketing investment remains an important focus. We invested \$194.3 million¹² in marketing during the year, which represented a 45.1% increase on prior year driven primarily by increases in our China marketing investment.

We leveraged our deepened understanding of consumers and purchasing behaviour in China to continuously improve our marketing mix which includes consumer advertising, in-store and event activations, digital live streaming and the development of a new brand creative platform. While we had launched this new creative in December 2019, we decided to temporarily pause and adjust the plan in the third quarter due to COVID-19. However, we resumed the activity in May as COVID-19 restrictions in China began to ease.

In addition to consumer marketing, our brand value is supported by investment in research and development programmes, an increased focus on sustainability, as well as initiatives to support the communities in which we operate.

Supporting relevant independently managed scientific studies remains important as we build our long-term brand proposition. In September 2019, the results of a clinical trial from 75 Chinese children aged between five and six with mild to moderate milk discomfort or lactose intolerance (confirmed via a urinary galactose test) were published. The study reported that replacing conventional milk with *a2 Milk™* “reduced gastrointestinal symptoms associated with milk intolerance” in many subjects and led to “a corresponding improvement in an aspect of cognitive

¹² From continuing operations.

performance” as measured using the Subtle Cognitive Impairment Test (SCIT)¹³. The study was independently peer reviewed and published in the USA based Journal of Pediatric Gastroenterology and Nutrition.

We significantly stepped up our contributions to the community in 2H20 with donations to the bushfire appeal in Australia to support regional and rural communities which is the heart of our milk supply in Australia.

We also contributed through a series of initiatives to support those impacted by COVID-19 including product donations to frontline medical workers and consumers in Wuhan, a cash donation to the Shanghai Red Cross and contributions to two leading Australian universities for research into a vaccine for COVID-19.

We are also pleased with the progress we have made in our sustainability initiatives in FY20. We have significantly improved the foundations on which we will build a meaningful and impactful strategy going forward. Central to this, is the recent launch of *The a2 Impact Fund™* which will be used to bring together many of the sustainability-related activities we undertake on a daily basis, as well as amplifying our progress against a number of identified environmental and social initiatives and for a range of important stakeholder groups.

4. Deliver the organisation of the future

To support the execution of our overall Group strategy, we continue to build capability within the organisation. This year we introduced a number of new roles to complement and extend our existing capabilities, particularly in-market in China, the USA, and within certain Group functions. We increased the size of our team to over 300 people, up 41.0% from last year.

To enhance our organisational alignment and enable the right ways of working to deliver on our strategy, we recently reorganised our most senior executive team to form our Executive Committee and formed a Senior Leadership Group which comprises the senior management of the business.

We also established several initiatives designed to enhance engagement and launched a revised remuneration framework to align with our strategic direction.

Over the next two years we will be implementing new information technology systems to support the existing organisation and provide for future growth.

We also utilised external resources to accelerate the delivery of certain outcomes and to complement existing internal capabilities. As we improve internal capability, the composition and level of external resourcing will moderate over time.

I would also like to take this opportunity to recognise the efforts of all our people this year. It was one that included a number of changes and unique challenges, but the team has continued to drive forward together, building from strength.

We are proud of what we have achieved commercially and of the way our people went about embracing change, managing challenges and looking after each other as well as the business – truly espousing the values of our big small company.

¹³ Xiaoyang S, Zailing L. Effects of Conventional Milk Versus Milk Containing Only A2 β -Casein on Digestion in Chinese Children. *J Pediatr Gastroenterol Nutr.* 2019 Jul 9.

Outlook

FY21

Globally, there continues to be uncertainty resulting from COVID-19, and the potential for moderation of economic activity. This could impact consumer behaviour in our core markets, as well as participants within the supply chain, most notably in China.

Notwithstanding these uncertainties, overall for FY21, we anticipate continued strong revenue growth supported by our continued investment in marketing and organisational capability.

FY21 EBITDA margin is expected to be in the order of 30% to 31% reflecting:

- Higher raw and packaging material costs partially offset by price increases
- Increase of marketing investment
- FX benefit of prior year not expected to be replicated
- 3Q20 COVID-19 benefits not replicated

FY21 Capex is currently expected to be \$50 million due to our ERP investment and capital projects supporting fresh milk processing in Australia.

Medium-term target

As previously announced, the Board considers it appropriate that the Company target an EBITDA margin in the order of 30% in the medium-term. This assumes the market performance and mix of our products remains broadly consistent and the competitive environment evolves as anticipated. We will keep the balance between growth and investment under constant review.

Reconciliation of EBITDA to net profit after tax

	Full Year Ended 30-Jun-20 \$ 000's	Full Year Ended 30-Jun-19 \$ 000's
Segment EBITDA	549,719	413,610
Depreciation & amortisation	(4,393)	(2,176)
EBIT	545,326	411,434
Net interest income	5,746	4,277
Income tax expense	(165,235)	(127,970)
Net profit after tax	385,837	287,741

Geoffrey Babidge
Chief Executive Officer
The a2 Milk Company Limited

For further information, please contact:**Investors / Analysts**

David Akers
Head of Investor Relations
M +61 412 944 577
david.akers@a2milk.com

Media

Rick Willis
Media partner
M +61 411 839 344
rick@networkfour.com.au