25 February 2021
NZX/ASX Market Release

Fundamentals remain strong despite significant COVID-19 disruption

Result overview for the half year ended 31 December 2020 (NZ$)[1,2,3]

- Total revenue of $677.4 million was down 16.0% and EBITDA of $178.5 million was down 32.2% resulting in EBITDA margin of 26.4% (27.0% excluding Mataura Valley Milk acquisition costs)
- Challenges resulting from COVID-19 disruption experienced in the daigou/reseller channel with a flow on impact to the cross-border e-commerce (CBEC) channel – steps taken to re-activate these channels
- Strong performance in China label infant nutrition, with revenue growth of 45.2%, an increase in market value share to 2.4%[4], increasing in-store velocities as well as increasing distribution to 22.0k mother and baby stores (MBS)
- Solid performance in liquid milk in Australia with 16.3% revenue growth driven by higher levels of in-home consumption and a record value share of 11.7%[5]
- Changes in USA execution approach resulted in revenue growth of 22.3%, higher average velocities in key stores, distribution increasing to 22.3k stores and an improvement in EBITDA
- Continued strong investment behind the brand with $67.4 million of marketing investment in the half, building on record investment in 2H20 and supporting strong brand health metrics in key markets
- Responded to challenges by appropriately managing discretionary costs while continuing important capability investment in people, technology and infrastructure
- Finalised binding agreements for the proposed acquisition of a 75% interest in Mataura Valley Milk (MVM), which will provide supply diversification, further strengthen relationships with key strategic partners in China, and offer access to manufacturing margins over time

[1] All figures are in New Zealand Dollars (NZ$), unless otherwise stated
[2] All comparisons are with the six months ended 31 December 2019 (1H20), unless otherwise stated
[3] All figures are quoted based on all operations of the Group, without excluding discontinued operations, unless otherwise stated
[4] Source: Nielsen MBS 12-month market value share (December 2020)
[5] Source: Aztec 12-month market value share (December 2020)

Summary of Group performance

The a2 Milk Company experienced a challenging first half with **revenue** for the Group declining 16.0% to $677.4 million. This was driven by performance through the daigou and cross-border e-commerce (CBEC) channels being significantly impacted due to disruption resulting primarily from COVID-19 related issues. This was partially offset by another period of strong growth for China label infant nutrition products, with sales of $213.1 million, an increase of 45.2%.

Further growth in the liquid milk businesses in both Australia and the USA was achieved. Australian sales were up 16.3% to $86.9 million. Changes in the execution approach in the USA, focusing more on affordable premium pricing and in-store activation resulted in sales increasing 22.0%, driven by improved in-store velocities in established stores as well as an expanded store footprint.

The Company's **gross margin** percentage[6] decreased to 50.3%. This was primarily due to recognising a stock provision of $23.3 million, higher cost of goods sold for China label infant nutrition (including lactoferrin and tamper evident lid) and an adverse product mix shift with a higher proportion of liquid milk to infant nutrition sales.

Historically, the gross margin percentage for infant nutrition sales between channels has been broadly similar. However, due to different channel pricing pressures, cost of goods sold differences and foreign exchange movements, a variance in gross margin percentages between channels has emerged. China label infant nutrition has a lower gross margin percentage than English label but has a higher absolute gross margin per unit in a higher cost-to-serve channel.

EBITDA margin of 26.4% was recorded, reflecting lower revenue, a stock provision and adverse mix, although this was partially offset by the management of non-essential discretionary costs whilst continuing to invest appropriately in brand support programmes and internal capability building. Excluding Mataura Valley Milk (MVM) acquisition costs, EBITDA margin was 27.0%.

The Company's **balance sheet** remains in a strong position with no debt and a closing **cash** position of $774.6 million. This cash position was $79.5 million lower than June 2020 due to negative operating cash flow, participating in the recent Synlait capital raising and the acquisition of the Kyvalley milk processing facility. Operating cash flow was negative $9.2 million primarily due to an increase in inventory and a decrease in accounts payable.

Inventory at the end of the period was $198.6 million, $51.2 million higher than at the end of FY20. The higher level of inventory was a consequence of managing the uncertainties and complexities of COVID-19 impacting supply chains. However, due to recent challenges in the daigou and CBEC channels, the running down of this inventory has been slower than expected. As a consequence, a stock provision of $23.3 million was booked in the half. A return to more normalised stock levels is anticipated in 2H21.

A portion of the Company's cash balance will be utilised to fund the proposed acquisition of MVM and ultimately the associated additional investment in a blending and canning facility, although this plan has yet to be fully developed.

In line with the Company's capital allocation framework to target additional growth opportunities, organic and external growth opportunities that will leverage its brand strength are being explored. The Company aims to maintain a healthy cash balance, which will continue to be important in providing optionality in the execution of its growth strategy as well as stability in these uncertain times.

[6] Gross margin percentage is calculated as revenue less cost of goods sold, divided by revenue

Regional performance

1. *Asia Pacific*

Revenue across Asia Pacific was impacted by the challenges experienced in the daigou and CBEC channels, partly offset by strong performance in the mother and baby store (MBS) channel and a solid performance in liquid milk in Australia.

Despite the disruption and challenges experienced in the first half, the Company continued to record strong brand health metrics in China.

ANZ segment revenue of $317.2 million was down 31.1%, with EBITDA of $117.5 million, down 48.5%. This primarily reflected the challenges experienced in the daigou and retail channels, including the cost of inventory provisioning.

China and Other Asia segment revenue of $326.0 million was up 2.8%, with EBITDA of $94.4 million, down 19.7%. This reflected the continued investment in capability as well as a lower gross margin. A proportion of inventory provisioning was also incurred in the China and Other Asia segment.

Infant nutrition

Volume growth for the overall infant nutrition market in China was broadly flat in CY20, impacted by pantry destocking, COVID-19 disruption and a lower birth rate.

Overall, the market is showing modest value growth driven by continued premiumisation while local players continue to gain share against the traditional multinational brands in an increasingly competitive environment.

Infant nutrition – China label channels

Sales in *a2 至初®* China label infant nutrition of $213.1 million was achieved, an increase of 45.2% on the prior corresponding period. The Company's 12-month rolling market value share in MBS was 2.4% at the end of December, increasing by 0.7% compared to the prior corresponding period. Distribution also increased to 22.0k stores.

This performance is pleasing given the strategic importance and size of the channel and the increasing competitive intensity. There will continue to be an opportunity to gain market share given the strong resonance the brand has with consumers.

Infant nutrition – Cross-border e-commerce (CBEC)

a2 Platinum® English and other label infant nutrition sales of $103.5 million was down 35.5%.

CBEC market value as measured by Smartpath grew in the six months to December 2020. The Company's 12-month rolling market value share in CBEC measured by Smartpath was 22.3% at the end of December, up from 21.7% at the end of FY20. Value share for the month of December was 19.5%.

However, the decline in revenue was due to a lower level of sales to informal social e-commerce channels and traders which are not measured by Smartpath and the Company's view that inventory unwound in these channels. There was also a temporary cessation of *a2 Platinum®* Hong Kong label in the period.

While our performance in the competitive "11/11" online sales event showed year-on-year growth with higher promotional activity, sales in the period following that event were below expectations with subdued pricing.

The important role daigous play in stimulating demand across multiple points of distribution and the interdependence of CBEC with the daigou/reseller channel is relevant to performance in the

CBEC channel. With this interdependence in mind, the Company is actively rebalancing inventory in the channel and continuing to refine its promotional approach.

Infant nutrition – ANZ retailers, daigou and resellers

Infant nutrition revenue in ANZ declined 40.5% to $209.5 million for the half. The sales decline in the period was driven by multiple factors.

From the start of this fiscal year, this segment was impacted by pantry destocking following strong sales in 3Q20 combined with reduced tourism from China and international student numbers as a consequence of COVID-19 travel restrictions.

In September the Company further advised that it had also started to observe additional disruption to the corporate daigou/reseller channel, particularly due to the prolonged Stage 4 lockdown in Victoria, with a contraction beyond its previous expectations. These events, combined with subdued online pricing and channel inventory unwinding, have resulted in daigou/resellers being slower to fully re-enter the market to promote the brand. While there was some improvement in the channel towards the end of the period, the recovery was not as strong as had previously been expected.

The Company continues to focus on re-activating the daigou/reseller channel and is confident that it remains an attractive and strategically important channel for distribution penetration and new user recruitment. The Company is aiming to re-activate the channel by:

- Rebalancing inventory levels and improving traceability through the channel;
- Providing temporary support to the daigou/resellers; and
- Working with corporate daigou to drive innovation in distribution.

Given the role of this channel, including in new user recruitment in an increasingly competitive market, some continued pressure on consumer demand is expected.

Liquid milk

The *a2 Milk™* brand continues to be the only fresh milk brand ranged in all major supermarket chains in Australia. The Company is the leading brand advertiser in the fresh milk category, maintaining high brand awareness and loyalty metrics, benefitting the portfolio as a whole.

The Company's most mature product, Australian fresh milk, continued to grow, achieving revenue growth of 16.3% and totalling $86.9 million. The Company also achieved its highest market value share of 11.7%, primarily driven by increased levels of in-home consumption. To the extent COVID-19 restrictions ease and out-of-home consumption rebuilds, it is unlikely that these trends will continue.

Liquid milk sales in China grew 107% to $3.7 million.

Other nutritional products

The most significant proportion of the Company's other nutritional products segment remains *a2 Milk™* whole milk and skim milk powders, available in ANZ and China.

The disruption experienced in the daigou/reseller channel impacted all products in this segment with revenue declining 36.2% to $26.5 million.

As with infant nutrition products, the Company continues to focus on re-activating the daigou/reseller channel and there is further growth potential across new channels, particularly in offline China retail channels.

2. North America

USA

USA revenue increased 22.3% to $34.2 million. An improved EBITDA result was also delivered, with a significantly reduced loss of $11.6 million, representing an $18.4 million improvement on the prior corresponding period.

The impact of COVID-19 in the USA market overall has been significant. From 2020 the Company observed that consumers were becoming more value conscious given economic uncertainties and retailers were prioritising conventional and private label brands. Consequently, for 1H21 a significant portion of marketing investment was redirected towards account specific activity to position pricing at a more affordable premium level aimed at increasing shelf presence as well as investing in additional in-store activation to further build velocity.

This approach has driven continued growth in volume and gross revenue. The plan had anticipated net revenue to be broadly consistent with the prior corresponding period. However, net revenue benefitted from lower than planned trade spend and better than expected store representation.

Average velocities have grown within key accounts and distribution grew to 22.3k stores, from 20.3k stores at the end of June 2020. Brand health continues to improve with brand awareness, conversion and loyalty in the premium segment all growing during the period.

The Company is expecting, however, net revenue in the second half to be lower than the first half as it further increases trade spend.

The USA is an important market, and the Company continues to evaluate product and distribution opportunities to significantly increase the scale and profitability of the business.

Canada

In March, the Company entered into an exclusive licensing agreement with Agrifoods International Cooperative Ltd ("Agrifoods") for the production, distribution, sales and marketing of liquid milk under the *a2 Milk™* brand in the Canadian market. Products were first launched in July 2020, initially focusing on Western Canada with subsequent distribution expansion.

The Company continues to work closely with Agrifoods, providing access to intellectual property and marketing assets as well as proprietary systems and know-how relating to local milk sourcing and processing.

Proposed acquisition of Mataura Valley Milk

In December 2020, the Company announced that the terms for the acquisition of a 75% interest in Mataura Valley Milk (MVM), a dairy nutrition business located in Southland, New Zealand, were agreed.

The proposed acquisition will provide the opportunity to participate in nutritional products manufacturing, supplier and geographic diversification, and strengthen relationships with key strategic partners in China.

Over time, the proposed acquisition will offer access to manufacturing margins and the ability to provide more flexibility for product supply. This includes the potential to pursue an additional China label registration and additional innovation opportunities.

During a transitional period, MVM will operate as a manufacturer of commodity powders and some base powders for nutritional products, prior to manufacturing predominantly consumer packaged nutritional products for a2MC.

The Company previously announced that during this transitional period (FY22-24) the business will operate at approximately EBITDA break even, with the business returning a positive EBITDA from FY25. However, due to revised volume assumptions, the Company now expects an EBITDA loss of up to $10 million per annum during the transition period and still expects EBITDA to be positive from FY25. The Company is exploring business development opportunities to improve the financial performance during this period.

Prior to any further investment in a blending and canning facility and associated infrastructure, it is expected that depreciation and amortisation during the transitional period will be approximately $15 million, subject to finalisation of acquisition accounting.

The proposed transaction is subject to approval of the New Zealand Overseas Investment Office, with completion expected around the end of May 2021.

Positive research findings in clinical trial

During the period, research findings from a clinical trial conducted by Purdue University, Indiana USA, which involved 33 American adults with lactose maldigestion, were published.

The findings indicate that some people who suffer stomach discomfort after drinking conventional milk may have significantly reduced symptoms if they consume milk that contains only the A2 beta casein protein type and is A1 protein free.

This is the first study that has ever been conducted in the USA where the scientists examined varying levels of A2 protein in the milk that was given to participants. It reported a significant difference between milk containing 100% A2 protein (and no A1 protein) compared to conventional milk with lower levels of A2 protein.

The study was co-funded by the Company and published in the Swiss-based Nutrition Journal[7].

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[7] "Milk Containing A2 β-Casein ONLY, as a Single Meal, Causes Fewer Symptoms of Lactose Intolerance than Milk Containing A1 and A2 β-Caseins in Subjects with Lactose Maldigestion and Intolerance: A Randomized, Double-Blind, Crossover Trial", Monica Ramakrishnan, Tracy K Eaton, Omer M Sermet, Dennis A Savaiano, https://www.mdpi.com/2072-6643/12/12/3855.

Progress in sustainability

In FY20, the Company identified a number of focus areas to enhance its efforts to become a more sustainable business for the future.

The a2 Impact Fund™ was established in 1H21 as a vehicle for the Company to fund and manage investments in pursuit of its sustainability and decarbonisation goals.

The Company is committed to investing in tangible climate-related programmes that will create a positive impact on the planet. During the period this included installing solar panels at the Company's milk processing facility at Smeaton Grange and establishing a relationship with Sea Forest, a leader in the development of Asparagopsis (a type of seaweed) with the potential to reduce the methane produced by cows. Additional initiatives are under consideration with further updates to be provided later in the year.

The Company made additional progress in other focus areas during the period including enhancing its approach to animal welfare and its farm environmental plans.

Board and management

Notwithstanding some recent management changes, the Company has a strong team in place. Significant investment has been made in developing and enhancing capabilities in the business in recent times. This includes important investments to develop the Company's leaders as well as expanding teams in critical areas to support executing the strategy.

With all the challenges and uncertainties of the past year, the Company has been fortunate to be led by Geoff Babidge. Geoff has made a significant contribution since he stepped back into the business and is supporting the business to ensure a smooth leadership transition.

Lisa Burquest, Chief People, Safety and Sustainability Officer, left the business in January having made a valuable contribution to the Company during her tenure. Chief Growth and Brand Officer, Susan Massasso, will also be stepping down from her role in April to pursue new opportunities in the next stage of her career. She too has made a significant contribution over many years and has agreed to maintain a future advisory relationship with the Company.

The Board is also undergoing a period of renewal. In November 2020, it was announced that Jesse Wu would retire from the Board. However, it is pleasing to confirm that Jesse has agreed to take up an on-going role of special advisor to the Chairman following his departure. The Company is undertaking a selection process for a new Director with an update expected shortly.

Outlook

FY21

Globally there continues to be unprecedented levels of uncertainty and volatility due to COVID-19.

The Company remains confident in the underlying fundamentals of the business and will continue to invest behind the brand and in its capability to drive long term growth.

However, the pace of recovery in the daigou/reseller channel and in the CBEC channel has been slower than previously anticipated and the Company now expects revenue to be at the lower end of the previous guidance range.

A lower EBITDA margin range is now expected due to lower revenue, higher brand investment, longer daigou/reseller support, movements in foreign currency and adverse channel mix relative to what was anticipated in December.

Accordingly, the Company's FY21 outlook is now as follows:

- Group revenue for FY21 in the order of $1.4 billion
- Group EBITDA margin for FY21 of 24% to 26% (excluding MVM acquisition costs)

The outlook for FY21 assumes the actions being taken to re-activate the daigou/reseller channel deliver a significant improvement in quarter-on-quarter growth from 3Q21 to 4Q21.

Reconciliation of EBITDA to net profit after tax

	Half Year Ended 31-Dec-20 NZ$ 000's	Half Year Ended 31-Dec-19 NZ$ 000's
Group EBITDA	178,523	263,229
Depreciation and amortisation	(3,200)	(1,769)
Group EBIT	**175,323**	**261,460**
Interest income	2,114	3,055
Interest expense	(366)	(174)
Income tax expense	(57,028)	(79,415)
Net profit after tax	**120,043**	**184,926**

By order of the Board of Directors

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