



HD The a2 **Milk Company** Limited; Full Year results for period ending 30 June 2014

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The a2 **Milk Company** Limited

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Record earnings in Australia, growth progressing in other markets

Overview

- Total Operating Revenue of \$111.300 **million** in FY14, an increase of 17% over the prior corresponding period (pcp)
- Net Profit After Tax of \$10,000, significantly impacted by an adverse movement in the NZD/AUD exchange rate compared to the pcp
- Strong balance sheet with \$16m cash on hand and no debt
- Increased market share in Australia with fresh **milk** sales up 24% over the pcp
- Modest sales of a2Platinum infant formula into **China** due to regulatory issues
- Successful launch of a2Platinum infant formula in Australia
- New UK **business** structure from January 2014
- World's first human pilot study recently released confirms A2 beta casein protein digestive benefit

The a2 **Milk Company** (a2MC) has had a strong year and continued to progress its growth initiatives, during what has been a challenging FY14. This included significant competitor activity in our core Australian market, regulatory interruptions to our infant formula growth plans in Asia and taking full control of the former joint venture **business** in the UK.

Notwithstanding these challenges, progress has been made on all fronts. The Australian **business** achieved record sales and earnings, we have developed a broader portfolio of products to complement infant formula sales into Asia and are implementing a new **business** plan for the UK **business**. In addition, we have established a new management and **board** structure to support our growth agenda and the new a2 **Milk** global **brand** positioning is being finalised.

Managing Director, Geoffrey Babidge says the continued strong performance in Australia has funded the development of the growth platforms in **China** and the UK consistent with the strategic agenda and the supporting corporate resources.

"The **Board** continues to be very pleased with the performance of the Australian **business** and its potential for further growth, and remains confident in the plans for Asia and the UK. Slower build in distribution and awareness, rather than the core a2 **Milk** product proposition, contributed to slower revenue growth in **China** and the UK markets. However, the potential for growth remains significant. Furthermore, the **Company** has progressed its planning for its fourth global growth initiative, the launch of a2 **Milk** into the United States fresh **milk** market, to commence during calendar 2015."

Chairman Cliff Cook says: "The **Company** today is stronger and better positioned than at any time previously. Our conservative balance sheet provides a secure basis for our current growth plans in international markets."

For the 12 months to 30 June 2014, revenue exceeded expectations in Australia and, with modest sales in the United Kingdom and to **China**, resulted in **Group** Sales of \$110.621 **million** for the year, an increase of 17% over the pc. Net Profit after Tax of \$10,000 compared to the pc. of \$4.120 **million**. Cash on hand at year end was \$16 **million**. Preliminary audit clearance has been obtained for these results pending finalisation of the 2014 annual report.

The trading result included:

- EBITDA before license fees for the Australian market of \$18.708 **million**; - EBITDA for the UK and **China** markets totaling (\$7.527) **million**; - Employee share scheme expenses (Non cash) of \$1.190 **million**; - Other corporate costs of \$6.839 **million**; - Income tax charge of \$0.710 **million**

The appreciation of the NZD to the AUD reduced Operating Revenue by approximately \$14 **million** and EBITDA by approximately \$2.7 **million** on the pc.

Strategic Agenda - charting the future

The Strategic Agenda of the **Company** is based on funding revenue growth in priority international markets from increasing Australian profits. The plan continues to be refined as a result of changing market dynamics and opportunities.

The **Company** previously advised of the plan to develop products such as UHT **milk** for **sale** in Asian markets. This plan is now being progressed. In addition, the **sale** of fresh a2 **Milk** sourced from Australia into **China** is a further opportunity now underway, with the first trial shipment having been made in late August 2014. These opportunities are potentially attractive in their own right and will strengthen both the a2 **Milk brand** and our infant formula **business** in Asia.

The **Company** has commented previously that an entry into the United States fresh **milk** market is under consideration. The **Company** has both strong intellectual property rights and know-how, and consumer research confirms the significant potential for a2 **Milk brand** in this market. The **Company** has developed market entry plans with the objective of a targeted, regionally focused initial launch in calendar 2015. The current **business** model assumes a cash investment of around USD20m to be funded from cash flow and internal sources over a three year period. Our focus has been to develop a plan which captures the potential of the United States market whilst, at the same time, providing the **Company** an appropriate balance of risk and reward for this positive initiative.

Advances in the science supporting the a2 **Milk** proposition included the publication of the first human trial conducted by Curtin University. The trial confirmed a clear difference in gastrointestinal function in adults consuming the A1 versus A2 beta casein protein types, both for **milk** intolerant and normal **milk** drinking people.

The 2016 Revenue projection contained in the 2012 Private Placement Memorandum, amended in 2013 and adjusted for movements in exchange rate assumptions at 30 June 2014, results in adjusted Revenue from operating segments and JVs of approximately NZD230m. The **Company** considers this remains an appropriate overall projection based on the stages of development of each regional **business** and the current prospects for **sale** of additional products. Whilst revenue growth in **China** and the UK are presently well behind original plan, this shortfall should be compensated by sales of infant formula in Australia and other products in both Australia and Asia. Revenue from a prospective launch into the USA market is not included in this update.

During the year the **Company** undertook a review of the structure, composition and remuneration of the **Board**. A number of changes were approved at the November 2013 annual meeting to support the strategy to evolve the composition of the **Board** in an orderly way and ensure the skills and experience of directors support the strategic agenda. Two new non-executive directors have joined the **Board**, Ms Julia Hoare and Mr David Hearn. These appointments are consistent with the revised structure of designating directors specific responsibilities, with Julia Hoare assuming the role as Chair of the Audit & Risk Committee and David Hearn designated the **lead** director for the UK and European regional markets.

Further, the management structure was re-organised into regional and corporate functions and strengthened with additional experienced executives to assist the new market initiatives. This included Susan Massasso as Chief Marketing Officer, Philip Wohlsen as General Manager Asia and Scott Wotherspoon as CEO UK.

Australia - continues strong growth

The Australian **business** continued to perform very strongly in FY14 with sales growth and operating earnings well ahead of plan. Total revenue growth in AUD on the pcp was 31%. Revenue and earnings were unfavourably impacted by the movement in the NZD/AUD exchange rate when compared to the prior year.

Fresh **milk** sales of a2 **Milk** increased on the pcp in AUD by 24%. This is a result of the growing consumer awareness to the benefits of the product and the breadth of distribution now achieved in the retail trade. We estimate the market share of fresh a2 **Milk** in Australia to have grown to around 9.0% by value in the grocery channel (Australian Grocery Weighted Scan June 2014 quarter).

The **Company** achieved higher efficiencies at its Smeaton Grange processing facility in Sydney which contributed to an improved gross margin for fresh **milk** compared to the pcp. We continue to pursue improvements in supply chain processes and building **milk** supply. As part of this, in November 2013, Brownes Food **Operations** commenced processing fresh a2 **Milk** in Western Australia under a supply and contract pack arrangement.

Sales of a2Platinum infant formula in Australia have shown strong growth, significantly ahead of plan, in both grocery and pharmacy channels, since launch in September 2013. Conversely, sales in New Zealand have been hampered by limited distribution. Whilst sales are strong in the Australian domestic market, it is assumed a proportion is being purchased and subsequently shipped to consumers in **China** relying on the assurance of an Australian-sourced product. Whilst it is not possible to determine sales to this grey market, this further confirms our confidence in the **China** market opportunity.

The launch of a2 Thickened Cream into grocery has also been successful with sales in the period achieving expectation. The success of these latest innovations provides confidence in further broadening the product portfolio and plans are being progressed to build on the growing reputation of the **brand**.

The **business** experienced the first significant responses from competitors during the year. One **company** challenged the science around **dairy** free from A1 beta casein protein and a second more recently highlighting the protein composition of their own milks. a2MC has actively responded to these initiatives and encouragingly our sales have continued to grow. The **Company** welcomes a broader focus on the positive attributes of the A2 protein content of **dairy milk** on the proviso consumers are not misled by claims that the unique benefits of a2 **brand** products are available from any other **dairy** products or brands which contain A1 beta casein protein.

United Kingdom - new **business** plan under way

The UK **business** has operated as a wholly owned subsidiary, with a new local **board** and management structure in place, since the **acquisition** of the 50% interest of Muller Wiseman Dairies (MWD) in the former joint venture from January 2014. This new structure enables the **business** to build sales and distribution in a more focused way whilst continuing to access the scale and operational capabilities of MWD under a supply and contract pack agreement. The new UK **Board** comprises three directors - David Hearn as non-executive Chairman; William (Billy) Keane, the former Managing Director of Robert Wiseman Dairies (RWD) and current Chairman of **Dairy** UK, who is also a non-executive Director; and Geoffrey Babidge.

The original joint venture established with RWD intended to grow sales quickly across the UK fresh **milk** market. The **sale** of RWD to the Muller **Group** in early 2012, with the resulting change in priorities of our partner, contributed to a slower than planned distribution build and ultimately created the necessity to restructure this alliance going forward. Taking back control of the venture has ensured the **Company** will benefit from 100% of the future value created in this market.

These events have resulted in much lower sales than originally planned and consequently required a new approach to the market. The **Board** and Management have developed a new positioning strategy more targeted on providing a solution to the approximately 20% of individuals who have an issue with consuming standard **dairy milk** - to bring them back to the pleasure of drinking **dairy milk**. The revised plan is being implemented on a phased basis to meet customer requirements and we anticipate being fully in-market by the first quarter of calendar 2015.

The new model focuses on three key elements - building distribution in existing accounts from the current small base, particularly in the South East UK market; increasing awareness of the unique attributes of the product in a more targeted manner, primarily through alternative direct and digital media; and enhancing our price positioning through new packaging formats to improve margins. Therefore, while the model draws on the experience in Australia, the revised plan recognises the market dynamics and pricing in the UK are more challenging.

The **Company** is committed to the development of the UK **business**, whilst at the same time conscious of the need to balance investment and returns to build shareholder value. The investment in the

business during the second half FY14 was 2.2m Pounds. The revised **business** model assumes a lower funding requirement in calendar 2014 than advised in February 2014 and an investment for the FY15 year of approximately 3.5m Pounds. We are targeting cash breakeven on a monthly basis during the second half FY16.

Infant formula into **China** - regulation changes slowed momentum

The launch of a2Platinum infant formula to **Chinese** consumers commenced in November 2013 targeting baby maternity stores, high end supermarkets and on-line sales.

The regulatory environment for infant formula **sold** in **China** has been evolving, given the **Chinese** Government's aim to improve product quality and bring confidence back to the industry. As part of this, there have been changes to access arrangements for imported infant formula including a requirement for manufacturing companies and brands to achieve a new form of registration from May 2014. Whilst we believe this approach should ultimately be positive for quality producers, the short term impact of these changes has brought uncertainty into the market which has impacted many participants including a2MC.

The initial round of registrations did not include our manufacturing partner, Synlait **Milk** Limited (Synlait), primarily because its new canning facility had not been commissioned. The Minister of Primary industry advised in April 2014 that most if not all New Zealand based infant formula manufacturers will ultimately achieve registration.

As a result of the uncertainties around registration impacting the confidence of sub-distributors and a slower build of the network by our distributor **China** State Farm, our infant formula sales into **China** were well below plan in the second half FY14. A delay in shipments from December 2013 to February 2014 arising from new quality processes and an ingredient supply shortage also slowed sales. Notwithstanding this, our infant formula sales at a **group** level were ahead of plan given the strong performance in Australia.

The access arrangements into **China** continue to unfold and a2MC continues to monitor developments. In July 2014, the **Company** advised that an interim contract provider, New Zealand New **Milk** Limited (New **Milk**), had achieved manufacturer registration with Certification and Accreditation of the People's Republic of **China**, which enabled a2MC to resume shipments of a2Platinum packed by New **Milk**.

A further requirement advised by **Chinese** authorities will be to demonstrate "close association" between **brand** owner and manufacturer over the manufacturing process and formulation of brands. a2MC is of the view the form of its relationship with Synlait and the quality management processes across the entire supply chain should ultimately satisfy this test. We are also in discussion with **China** State Farm on ways to enhance our **business** processes and build momentum as the regulatory environment stabilises and confidence is restored.

The **Company** remains confident both in the infant formula opportunity in **China** and the processes in place in conjunction with Synlait to achieve continued access to this growing market. We are also pursuing opportunities in **China** and other Asian markets for **sale** of both UHT and fresh **milk** which will strengthen the a2 **Milk brand** and broaden our **business** in Asia.

Intellectual Capital - investment continues

Advances in the science around the benefits of **dairy** products free from A1 beta casein protein have been reported in respected international publications over the past year. They support the position that a2 **Milk** makes **dairy** nutrition accessible to many consumers who limit or avoid their intake of **dairy**. In addition, a2MC's research and development program continues to improve efficiencies around proprietary processes and have contributed to the filing of additional patents.

The results of a human digestion trial conducted by Curtin University of WA and sponsored by a2MC have been published in the European Journal of Clinical Nutrition in August 2014. This trial established strong support for the digestive benefits of a2 **Milk** (free from A1 beta casein protein) in humans. These findings complement the broad conclusions of the substantial body of earlier animal studies conducted in New Zealand and other countries. As the first human digestion study of its type in the world, this new research marks a significant step forward in understanding the difference between A1 and A2 beta casein **milk** proteins on digestion.

The potential for a2 **Milk** to benefit children predisposed to neurological or behavioral conditions has also been supported by a study undertaken at North Eastern University (Boston) and sponsored by a2MC and was recently published in the Journal of Nutritional Biochemistry.

The **Company** made significant progress in developing a new global **brand** vision which will be progressively implemented during the coming year. The first step of this was the change of **company** name for the corporate and trading entities to "The a2 **Milk Company**" from April 2014.

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