19 February 2024
NZX/ASX Market Release

The a2 Milk Company
1H24 Results Commentary and Outlook

Group financial performance[1,2,3]

The a2 Milk Company ("the Company", "a2MC") today announces its financial results for the 6 months ended 31 December 2023. Key results are as follows:

	1H24 ($m)	1H23 ($m)	Variance (%)
Revenue	812.1	783.3	3.7%
EBITDA[4]	113.2	107.8	5.0%
Net profit after tax *- Attributable to owners of the Company*	85.3	73.8	15.6%
Basic earnings per share (cents)	11.8	10.0	18.6%
Net cash[5]	792.1	707.2	12.0%

The Company's revenue for 1H24 was up 3.7%, driven by continued growth in the China & Other Asia segment up 16.5%, partially offset by a 24.1% decrease in the ANZ segment mainly due to a change in distribution strategy (with English label IMF sales shifting to the China & Other Asia segment). USA revenue increased by 8.6% and MVM decreased by 4.7%.

From a category perspective, IMF sales grew 1.5% with China label up 10.4% and English label down 6.9%. Liquid milk sales grew, with ANZ up 1.5% and USA up 7.0%. Other nutritional sales, which consist of non-IMF powdered milk products and China & Other Asia liquid milk, grew by 48.5%, and ingredients (MVM) decreased by 4.7%.

Gross margin percentage[6] of 46.7% was 0.2ppts higher than FY23, but 0.9ppts lower than 1H23 primarily due to higher input costs, foreign exchange movements and the adverse impact of sales mix, offsetting price increases and cost savings.

EBITDA increased by 5.0% to $113.2 million, primarily reflecting the increase in revenue and a 1.8% or $2.1 million decrease in Administrative and other expenses (SG&A) driven by reduced foreign exchange hedge losses, lower LTI expenses and other cost savings. Marketing investment increased by 1.2% to support the launch and transition of the new GB registered China label IMF product and was 16.9% of net sales revenue.

Depreciation and amortisation was similar to prior year at $8.9 million, net interest income increased to $16.6 million reflecting higher market interest rates and the effective tax rate reduced versus 1H23 (37.0%) to 35.0%, in line with FY23. NPAT including amounts attributable to non-controlling interests was $78.6 million, an increase of 14.8%. The non-controlling interests represent China Animal Husbandry Group's (CAHG's) 25% interest in MVM. Excluding this loss of $6.7 million, NPAT attributable to owners of the Company was $85.3 million, up 15.6%.

The balance sheet remains in a strong position with closing net cash of $792.1 million, up $34.9 million on FY23. In accordance with the Company's Capital Allocation Framework, a2MC has decided to continue to prioritise investment in growth opportunities (focused on supply chain transformation) and balance sheet strength, ahead of returning further capital to shareholders at this point in time but will continue to review this on a regular basis.

Inventory at the end of the period of $196.6 million was up by 1.6% on FY23 as expected, mainly due to the timing of the new GB registered China label product launch and transition. English label IMF inventory, which was higher at the start of the period due to supply issues experienced in FY23, reduced during the current period through lower purchasing. Channel inventory and product freshness remained at target levels across the business taking into consideration the China label transition.

[1] All references to full year (FY), halves (H) and quarters (Q) relate to the Company's financial year, ending 30 June.
[2] All figures are in New Zealand Dollars (NZ$), unless otherwise stated.
[3] All comparisons are with the 6 months ended 31 December 2022 (1H23), unless otherwise stated.
[4] EBITDA is a non-GAAP measure and does not have a standardised meaning prescribed by GAAP. However, the Company believes that in combination with GAAP measures, it assists in providing investors with a comprehensive understanding of the underlying operational performance of the business. A reconciliation of EBITDA to net profit after tax is shown in the Company's 1H24 Investor Presentation (slide 58) dated 19 February 2024.
[5] Including term deposits and borrowings, excluding subordinated non-current shareholder loans.
[6] Gross margin percentage is calculated as sales less cost of goods sold, divided by sales.

Excluding interest and tax, operating cash inflow was $98.2 million, representing operational cash conversion of 86.8%[7], up 73.3ppts on the prior corresponding period that was impacted by catch-up payments delayed from FY22 into 1H23 due to COVID-19 related disruptions (outside of the Company's control).

China market update[8]

The number of newborns in China declined by 5.6% in CY23 to 9.0 million[9] which reflects an improvement in trajectory over the past several years. The Company expects a higher number of newborns in CY24 having regard to various factors and data points, including delayed births due to COVID-19, recent marriage rates, pregnancy indicators, government initiatives and historical birth rates in prior 'Year of the Dragon', with the longer-term birth rate uncertain.

The overall China IMF market declined 10.7% in volume and 13.6% in value in 1H24. The decline in Key&A cities slightly exceeded BCD cities, with Key&A market value decreasing by 13.7% in 1H24 and BCD market value decreasing by 13.5%. The overall market decline reflected the decrease in newborns over the past few years, increased competitive intensity and promotional activity (amplified by the market-wide transition to new GB registered products), and macroeconomic conditions impacting retail sales. The rolling impact of fewer newborns in prior years reduced China IMF market Stage 3 sales (the largest segment of the IMF market) in particular which declined by 18.8% in 1H24.

China label IMF market value declined 15.2% in 1H24. The mother and baby stores (MBS) channel was down 18.1%[10] in 1H24 and domestic online (DOL) was down 21.6%[11]. Across China label channels, there was significant pricing pressure impacted by the combination of volume pressure resulting from fewer newborns, market-wide transition to new GB registered products with clearance of old GB registered products, and macroeconomic conditions. The China label market value decline also led to a significant number of MBS store closures.

After a number of years of significant declines, the English label market outperformed the overall market and stabilised in 1H24 with value down 0.1%. A proportion of consumers switched back from China label channels to English label channels and the English label market recovered value share to 16.3% of the overall China IMF market, up from 14.4% in 1H23. English label channel mix continued to shift – the Daigou channel experienced a further significant decline of 18.6% in 1H24, while the offline-to-online (O2O) channel grew the fastest at 6.8% in 1H24 and cross-border e-commerce (CBEC) experienced sustained growth up 2.4%[12]. a2MC's distribution strategy is focused on continuing to expand share in the growing CBEC and O2O channels which account for approximately 64.0% of the English label market, as well as emerging channels such as Douyin/TikTok.

Market dynamics and the new GB registration process have led to increasing brand concentration within the China IMF market with the top-5 brands now representing over 50% of market value.

In the context of challenging macroeconomic and IMF market conditions, a2MC's growth in 1H24 in China label IMF of 10.4% and total IMF of 1.5% reflected a strong performance overall.

Regional performance

1. China & Other Asia

Growth in value and volume of the China & Other Asia segment was driven by the continued strong execution of the Company's growth strategy, particularly in China label. Revenue of $549.5 million was up 16.5%, with EBITDA of $135.9 million up 21.9%. The combination of increased investment and higher impact marketing campaigns underpinned further improvements in key brand health metrics and market share in 1H24. This resulted in a2MC becoming a top-5 IMF brand in the overall China IMF market taking into account the Company's share in both the China label and English label markets. New highs in overall China brand health metrics were achieved with total a2MC IMF prompted brand awareness increasing from 63% to 68%, unprompted brand awareness increasing from 23% to 25%, top of mind brand awareness increasing from 9% to 10%, and trial and loyalty metrics increasing as well with the Company's target audience[13].

[7] Operating cash conversion defined as net cash flow from operating activities before interest and tax divided by EBITDA.
[8] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key&A + BCD cities); unless otherwise stated.
[9] China National Bureau of Statistics.
[10] Nielsen MBS retail measurement service: mother and baby stores only retail sales (by value). 1H24 versus 1H23.
[11] Smart Path China IMF online market tracking: for DOL only retail sales (by value). 1H24 versus 1H23.
[12] Smart Path China IMF online market tracking: for CBEC only retail sales (by value). 1H24 versus 1H23.
[13] a2MC internal data based on the Company's brand health tracking undertaken by Ipsos. Average brand health metrics for each financial year based on 3 surveys in FY21 and FY22, 2 surveys in FY23, and 2 surveys in 1H24. Sample skews to a2MC target consumers (ie higher income earners based in Provinces / cities that are the focus of sales and marketing activities).

China & Other Asia: China label IMF

China label IMF sales in 1H24 increased to $299.0 million, up 10.4%. The strong performance in China label IMF was supported by careful execution of the launch and transition of the Company's new upgraded China label IMF product, a2 *至初*®, formulated in line with China's new GB standard. This was achieved despite the declining market and continued volatility with most of the market transitioning to new GB products over the past ~18 months. Consumer demand for *a2 至初*® remained strong with market value share improving both in-store and online.

To support the launch and transition of the new China label IMF product *a2 至初*® range, the Company increased marketing investment with integrated campaigns across all sales channels and media with high impact advertising reinforced at point of sale. This was complemented by bespoke activities for key MBS accounts and impactful brand days with key DOL platforms to drive awareness.

MBS weighted distribution increased modestly as well as same store sales, driving share gains in the MBS channel. Offline distribution was flat at 25.9k stores at the end of December 2023, the same as at the end of June 2023[14]. A significant number of store closures occurred in the market during the period reflecting challenging retail and IMF category conditions. The Company is building share in national key accounts, increasing distribution in regional key accounts, targeting greater penetration of BCD cities, and testing new strategies for accelerated growth in prioritised provinces.

Retail market value for the MBS channel was down 18.1% in 1H24[15], reflecting the cumulative impact of fewer newborns plus store closures and disruption driven by the market wide transition to new GB products, as well as macroeconomic conditions. a2MC's market value share in MBS increased to 3.5% at the end of December 2023 compared with 3.4% at the end of June 2023, with *a2 至初*® being a top-5 share gainer in the channel.

Online growth for China label IMF was another highlight for the Company in 1H24. While retail market value for the DOL channel was down 21.6% in 1H24[16], a2MC's market value share in DOL increased to 3.6% at the end of December 2023 compared with 3.3% at the end of June 2023, and a2MC was a top-3 share gainer in the channel. Within this channel the Company's share of early-stage product sales continued to increase significantly as more users shift to online channels at all stages of their IMF lifecycle.

China & Other Asia: English label IMF[17]

The China & Other Asia segment continued to benefit from the Company's strategic decision to continue to focus on more controlled channels, being CBEC and O2O, as well as further improvement in brand health metrics. English label IMF sales in the China & Other Asia segment of $210.5 million were up 19.9%.

The Company is focused on CBEC growth and building digital marketing and e-commerce capability to further improve its execution which is having an impact, particularly on new user recruitment. While reported a2MC CBEC market share decreased from 21.6% to 21.4%[18], there was strong growth in retail sales of a2MC English label IMF through emerging CBEC channels such as Douyin/TikTok, which are not tracked by Smart Path. Similar to DOL, a2MC's share of early-stage product sales increased significantly in CBEC which has become increasingly important relative to the Daigou channel.

Development of the O2O channel has also been a key focus for English label distribution. Following the commencement of a new partnership in 2H23 with Yuou, one of the leading O2O distributors in China, a2MC has further improved its distribution footprint and share in O2O key accounts, 'long-tail' O2O and 'Pop' accounts.

The Company also refined its distribution model with the increased utilisation of drop-shipping fulfilment models via tier-1 distributors to service O2O stores and C2C networks. This reduced trade inventory positions and improved service and fulfilment time for consumers.

Overall, the Company increased its total English label market share from 19.1% (FY23) to 20.6% (1H24)[19].

China & Other Asia: Other nutritional products

Sales of other nutritional products in the China & Other Asia segment were up 58.2% to $39.9 million, benefitting from stronger execution, brand awareness and mix shift from ANZ channels to CBEC. The strong performances in these categories, particularly in milk powder and UHT, were supported by increased marketing investment through brand building campaigns particularly in 1Q24.

2. Australia and New Zealand

The Australia and New Zealand (ANZ) segment result was driven by lower IMF sales to the Daigou channel due to a change in a2MC's distribution strategy and a relatively strong prior corresponding period associated with the *a2 Platinum®* refresh. Overall, ANZ revenue of $162.2 million was down 24.1%, and EBITDA of $34.8 million was down 43.9%.

[14] a2MC internal data tracking of stores with active sales in the past 6 months.
[15] Nielsen MBS retail measurement service: mother and baby stores only retail sales (by value). 1H24 versus 1H23.
[16] Smart Path China IMF online market tracking: for DOL only retail sales (by value). 1H24 versus 1H23.
[17] English label IMF includes sales via CBEC, Korea, and Hong Kong Resellers.
[18] Smart Path China IMF online market tracking: for CBEC only retail sales (by value). 1H24 versus 1H23.
[19] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key & A + BCD cities). 12 month rolling share.

Australia and New Zealand: English label IMF

Daigou channel market value was down 18.6% in 1H24[20]. Whilst the Company's IMF reseller and retail sales decreased 50.7% to $54.0 million versus 1H23, it was broadly similar to 2H23, reflecting a more stable channel environment. Whilst the Company's English label IMF focus is on CBEC and O2O, the Company continued to support the Daigou channel through multi-channel consumer marketing campaigns and further enhanced reseller trade support programmes.

O2O and Daigou channel combined market value was down 10.0% with recovery in the O2O channel partially offsetting Daigou channel decline. a2MC's market share in the O2O and Daigou channel increased to 20.5% at the end of December 2023 versus 19.8% at the end of December 2022[21].

To broaden its English label IMF portfolio, the Company progressed the development of two new English label IMF products with a new commercial IMF supply partner (Yashili NZ, a subsidiary of Mengniu). Whilst *a2 Platinum®* is positioned in the Super Premium segment, *a2 Gentle Gold™* will target the Premium segment and is expected to launch in 2H24 in Australian retail channels, emerging markets in South East Asia and selected channels in China. a2MC is targeting to launch an additional English label product to be positioned above *a2 Platinum®* in FY25.

Australia and New Zealand: Liquid milk and other nutritional products

Australian liquid milk sales were up by 1.5% to $93.3 million led by the contribution from *a2 Milk® Lactose Free*, partly offset by lower consumption of the core milk range. This reflects a challenging consumer environment, with a market shift from branded milk products to private label in the category overall. a2MC's market value share of 11.3% was flat in 1H24, supported by *a2 Milk® Lactose Free* achieving 18.3% combined share in launch markets of New South Wales and Victoria, and 11.3% national share.

The Company progressed the upgrade of its Kyabram milk processing facility with Kyvalley Dairy Group. Construction of the infrastructure related aspects of the project commenced during the period with processing equipment upgrades to follow. Completion of the project is expected in 1H25.

Revenue for other nutritional products was up 26.5% to $14.1 million with continued growth in milk powder including encouraging growth of a*2 Milk™* in a tub with two new fortified products (*a2™ Immune* and *a2™ Move*) expected to launch in 2H24.

3. USA

Accelerating the path to profitability in the USA by FY25/FY26 is a priority for the Company. In 1H24, USA grew revenue 8.6% to $56.9 million and improved its landed margin (gross margin less distribution costs) resulting in an improved EBITDA loss of $8.3 million (1H23: $12.2 million, 2H23: $11.1 million).

The revenue increase was mainly driven by lower trade spend due to reduced promotional activity, and innovation. a2MC's market value share in the premium milk category for the Grocery channel was stable at 2.3% in December 2023 (FY23: 2.3%)[22].

a2MC commenced distribution of *a2 Platinum®* IMF during the half under the US Food and Drug Administration's (FDA) short-term Enforcement Discretion approval with selected retailers in-store and online including Amazon. Sales recognised in the half were not material and the Company continues to pursue long-term FDA approval of *a2 Platinum®* with a clinical trial underway.

The improved EBITDA loss was due to reduced promotional activity, improved input costs and distribution rates, lower marketing spend and reduced SG&A costs, partly offset by higher costs incurred with respect to pursuing long-term FDA approval.

4. Mataura Valley Milk

Accelerating MVM's path to profitability by FY26 is also a priority. During 1H24, the Company continued to execute against its supply chain transformation strategy, including developing nutritional manufacturing capability, increasing access to raw A1 protein free milk in Southland (including organic) and commencing production of *a2 Platinum® Stage 4* IMF base powder with a new commercial supply chain partner (New Zealand New Milk, a subsidiary of Lactalis).

Revenue of $43.5 million[23] and an EBITDA loss of $15.3 million were recorded for the period. The slightly higher EBITDA loss compared to 1H23 ($13.4 million) was due to the timing of sales in a volatile commodity and foreign exchange environment, reduced demand from third-party customers in China, increased investment in capability (including management changes), product development trials, and investment to support future nutritional powder production.

MVM and a2MC significantly advanced their sustainability programme including commissioning of a high-pressure electrode boiler powered by certified renewable energy[24] to materially reduce greenhouse gas emissions from the site.

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[20] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key&A + BCD cities) for the 26 weeks ending 29 December 2023.

[21] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key & A + BCD cities). 12-month rolling share. 1H24 versus 1H23.

[22] SPINS data for the Grocery channel only for the 52 weeks ending 31 December 2023 and 31 December 2022.

[23] Revenue excluding intercompany sales.

[24] MVM purchases Meridian's Certified Renewable Energy product to enable it to match the amount of electricity it uses on an annual basis with an equivalent amount of electricity put into the national grid from one of Meridian's hydro stations or wind farms (which have been independently verified as producing 100% renewable electricity).

Medium-term revenue ambition update

In October 2021, as part of its refreshed growth strategy, a2MC defined its medium-term financial ambition to grow revenue from $1.2 billion in FY21 to ~$2 billion by FY26 or later and to target EBITDA margins in the 'teens'. At the time, the Company stated that defining a specific timeline to achieve its financial goals was challenging given the pace and degree of change in the China IMF market including from the prolonged COVID-19 impact and reduction in the number of Chinese newborns.

Since announcing the Company's refreshed growth strategy, a2MC has gained significant share in the China IMF market and achieved strong growth in group revenue and EBITDA of 34.4% and 82.1% respectively[25]. a2MC has grown its China label IMF sales by 50.7%[26] and stabilised its English label IMF sales, which were up 1.0%[27]. The Company has increased its share of the total China IMF market from 4.9% to 6.4%, becoming one of the most successful brands in China and in the top-5 overall[28]. During this period, a2MC has significantly transformed its IMF channel mix, continuing to focus on more controlled channels away from the Daigou channel. As a result, the China label, CBEC and O2O channels represented ~90% of a2MC IMF sales in 1H24 compared to ~60% in FY21. The Company has also grown other nutritional products outside of the IMF category by 66.9%[29] and its combined liquid milk business in ANZ and USA by 26.5% over the period.

Whilst the Company's execution of its growth strategy overall has been in line with its expectations, and it is well positioned to achieve future growth, the China IMF market has contracted significantly more than expected at the time it set its ambition. The annual China birth rate has declined by 25%[30] which has driven the China IMF market value to decline by 23.6%[31]. COVID-19 impacted cross-border channels significantly, resulting in a decline of 55.2%[32] in the Daigou channel which was a key channel for the Company in the past. This has resulted in the English label market not recovering at the speed and to the extent initially assumed. Whilst the China IMF market is now showing early signs of stabilisation, it will take longer for the market to recover than initially expected due to the cumulative impact of fewer newborns and challenging market conditions.

Achieving the Company's medium-term revenue ambition of ~$2 billion by FY26 would require an additional ~$380 million in revenue growth on CY23 over the next 2.5 years. This growth would represent a compound annual growth rate of approximately 9% with higher growth required in FY25 and FY26 based on the Company's revenue guidance for FY24 which is low-to-mid single-digit percent growth (refer FY24 Outlook below). Whilst it remains possible for the Company to achieve its medium-term revenue ambition of ~$2 billion by FY26, at this stage it is likely to be achieved by FY27 or later. The Company continues to target EBITDA margins in the 'teens' with year-on-year improvement.

Delivery of a2MC's medium-term financial and non-financial ambitions remains underpinned by the successful execution of a2MC's strategy which is comprised of its five key strategic priorities:

1. Investing in people and planet leadership – particularly in relation to its capability and sustainability objectives
2. Capturing the full potential in China IMF – including expansion into lower tier cities and online channels
3. Ramping-up product innovation – including portfolio expansion in English label IMF, China label IMF and other nutritionals for kids, adults and seniors, as well as leveraging the portfolio into new markets
4. Transforming its supply chain – particularly accessing additional China label IMF registrations and developing its nutritional manufacturing capability through MVM and / or other commercial and acquisition opportunities primarily in New Zealand and China over time
5. Accelerating the path to profitability for the USA and MVM businesses

[25] a2MC Group sales and EBITDA FY21 versus LTM 2H23+1H24.
[26] a2MC sales China label FY21 versus LTM 2H23+1H24.
[27] a2MC sales English label FY21 versus LTM 2H23+1H24.
[28] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key&A + BCD cities). China and English labels combined. MAT to June 2021 versus MAT to December 2023.
[29] a2MC sales of other nutritionals FY21 versus LTM 2H23+1H24. Other nutritionals consists of non-IMF powdered milk products and China & Other Asia liquid milk.
[30] China National Bureau of Statistics.
[31] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key&A + BCD cities). China label channels. MAT to June 2021 versus MAT to December 2023.
[32] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key&A + BCD cities). Daigou channel. MAT to June 2021 versus MAT to December 2023.

FY24 Outlook

Market conditions

Despite the CY23 birth rate data published in January which reflects an improvement in the trajectory over the past several years, China IMF market conditions remain challenging with a double-digit decline in market value still expected in FY24.

Key financials

Revenue growth guidance for FY24 has improved from the prior outlook statement.

For FY24, the Company is now expecting the following relative to FY23:

- Revenue growth of low to mid single-digit percent
- IMF, other nutritional product and USA sales up (USA IMF immaterial), ANZ liquid milk sales flat and MVM sales down
- Gross margin (% of revenue) to be similar
- Marketing expenses (% of revenue) to be similar to up
- Administrative & Other expenses (% of revenue) to be similar to down
- EBITDA margin (% of revenue) to be broadly in line
- Operational cash conversion to be up
- Capital expenditure to increase to ~$30 million

Key risks

In addition to the challenges noted above and trading upside and downside, other risks include, but are not limited to, challenging macroeconomic conditions, residual COVID-19 impacts on supply and demand, new China label product transition, volume impact of price increases, cross border trade, foreign exchange movements, changes in interest rates, farmgate milk pricing and other commodity prices, and changes in the regulatory environment. These challenges and risks could materially impact expected revenue and earnings outcomes.

Authorised for release by the Board of Directors

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