21 February 2022
NZX/ASX Market Release

Interim results in line with expectations
Early signs of positive improvement from growth strategy execution

The a2 Milk Company ("the Company", "a2MC") today announces that its 1H22 result was in line with the Company's expectations, placing the Company in a strong position to execute its strategy and deliver revenue growth in FY22 in a challenging and volatile market.

In October 2021, the Company announced its refreshed growth strategy which has been adapted to the rapidly changing infant milk formula ("IMF") market dynamics in China. The Company also outlined its medium-term indicative sales and EBITDA margin ambition. With its growth strategy review completed, the Company has moved into the execution phase focused on implementing its strategic priorities and related initiatives, which is in its early stages and progressing well.

The actions taken by the Company in 4Q21 and 1Q22 to address excess inventory are also proving effective with channel inventory levels reducing to targeted levels, product freshness improving and market pricing increasing across English label and China label IMF, enabling healthier channel economics for participants in the a2MC business system.

Key points[1]

- Market conditions continued to be challenging with the China IMF market declining by 3.3% in value during 1H22 due mainly to the cumulative impact of a lower birth rate, while the Australian and US (premium) liquid milk markets were in growth. COVID-19 and other external factors continued to impact the Company's supply chain
- Interim results in line with the Company's expectations and expecting to deliver revenue growth in FY22
- Revenue was marginally lower than 1H21 in line with guidance, down 2.5% to $660.5 million on the prior corresponding period ("pcp"), up 24.8% on 2H21
  - As disclosed in the Company's announcement on 26 August 2021, China label IMF sales were constrained by a2MC in 1Q22 to rebalance distributor inventory levels with sales down 11.4% for 1H22 vs pcp. However, consumer offtake growth in store and online was up double-digits with higher market share
  - English and other label IMF sales were down 9.8% in 1H22 vs pcp with lower market share, but with an improvement in sales trajectory during the half particularly in the ANZ reseller channel
  - ANZ liquid milk sales were up with higher market share, while USA liquid milk sales were down
- Earnings before interest tax depreciation and amortisation (EBITDA[2]) was down 45.3% on pcp to $97.6 million
- EBITDA to sales margin of 14.8% in 1H22 compared to 26.4% in 1H21; EBITDA to sales margin excluding MVM of 17.3%
- Net profit after tax ("NPAT") including the non-controlling interest was down 53.3% to $56.1 million on pcp
- Closing net cash was $667.2 million, now incorporating $80.0 million of MVM debt, with high operational cash conversion during 1H22
- Mataura Valley Milk ("MVM") acquisition and strategic partnership with China Animal Husbandry Group ("CAHG") completed in July 2021 and fully consolidated into the results. Commenced planning for a laboratory and blending and canning capability at MVM and accelerated actions to insource certain a2MC product
- Brand health metrics improved following a significant marketing campaign in 2Q22 with total brand / China label metrics improving and English label metrics remaining relatively flat. Brand investment increased in 1H22 by 37.3% vs pcp to $92.5 million in line with the Company's growth strategy
- Growth strategy refresh to respond to the rapidly changing China IMF market dynamics completed and implementation underway with good early progress across key initiatives

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

[2] 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.

- The Company's outlook for 2H22 revenue has improved. It is still expected to be significantly higher than 2H21, and with growth now expected on 1H22 and for FY22 ahead of initial expectations due mainly to growth in China label and English label IMF. However, this revenue improvement is not expected to translate into higher earnings as the Company significantly increases brand and other reinvestment consistent with its growth strategy (the Outlook section below has further detail including key industry and business risks)

Group financial performance[3,4]

As foreshadowed in the Company's FY21 Results Commentary in August 2021, 1H22 **revenue** was marginally lower than 1H21, decreasing 2.5% to $660.5 million. 1H22 revenue was impacted by a number of factors, including the lower birth rate and rapidly changing market dynamics in China. The Company's 1H22 revenue also reflects strategic actions taken by the Company in the first half to rebalance channel inventory for China label IMF. This was offset by the inclusion of five months of revenue from MVM for the first time. Excluding MVM, revenue was 8.2% lower compared to 1H21.

Gross margin percentage[5] decreased to 46.2% with underlying gross margin of 50.7% excluding MVM. The lower 1H22 gross margin was due to the inclusion of MVM, adverse product mix and cost headwinds, particularly raw milk and freight costs partially offset by price increases.

EBITDA decreased by 45.3% to $97.6 million. This reflected lower revenue and gross margin as well as a 37.3% increase in marketing investment vs pcp. Administrative and Other Expenses increased by 31.1% compared to pcp due to capability investment, re-instatement of short-term and long-term incentives, professional services fees, legal fees and higher insurance costs. This resulted in an **EBITDA margin** of 14.8% including MVM and 17.3% excluding MVM.

Net profit after tax and including the non-controlling interest was $56.1 million, a decrease of 53.3% on pcp.

The **balance sheet** remains in a strong position with closing cash of $747.2 million. The lower balance reflects the $268.5 million of capital invested in the acquisition of MVM which was completed in July 2021. The Group is now consolidating MVM debt which was $80.0 million at period end as a result of the ownership structure, and therefore had **net cash** of $667.2 million. **Operating cash flow** was $98.4 million. Excluding interest and tax, this represented 130% cash conversion[6].

Inventory at the end of the period was $127.9 million, higher than at the end of FY21, due to the inclusion of MVM. The actions taken in 4Q21 and 1Q22 to address excess English label and China label IMF channel inventory respectively, are proving to be effective with price stabilisation in the CBEC channel, significant price recovery in the ANZ reseller channel and an improvement in China label trade economics. Targeted levels of channel inventory in English label and China label channels were achieved and maintained during the period. It is, however, likely that both a2MC and channel inventory will need to be increased incrementally in 2H22 to manage COVID-19 supply chain volatility following the omicron outbreak globally and due to product innovation launches and changeovers.

China IMF market dynamics

As noted in the Company's previous announcements in May and August 2021, the China IMF market is rapidly changing and continues to be impacted by China's lower birth rate. Following an 18.1% decrease in births in 2020, there was a further 11.5% decrease in 2021 to 10.6 million[7]. In volume terms, the overall IMF market in China decreased[8] by 5.0% in 1H22 driven by the reduction in the birth rate impacting early-stage products, partially offset by strong growth in Stage 4.

Although market performance varied by channel and segment, overall, market value also decreased[8] by 3.3% in 1H22 due to the lower number of births, an increase in competitive intensity and promotional activity impacting average pricing, partially offset by a continuation of the premiumisation trend as well as a mix shift to higher-priced China label channels.

Key&A cities reported a market value decrease of 6.6% whilst in BCD cities, market value was broadly flat, highlighting a divergence of the impact of the lower birth rate across city tiers.

Local competitors continue to gain market share against the traditional multinational brands, driven both by the strength of local brands, as well as an overall mix shift from cross-border to domestic channels.

In 1H22, the ultra-premium segment (where the Company's China label product competes) performed above market and was in growth, while the premium segment performed below market. The A2 protein segment also performed significantly above market.

Despite the challenging China IMF market dynamics, a2MC performance in 1H22 in China label IMF was encouraging and performance in English label IMF was stabilising.

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[3] All figures are in New Zealand Dollars (NZ$) unless otherwise stated.

[4] All comparisons are with the 6 months ended 31 December 2020 (1H21), unless otherwise stated.

[5] Gross margin percentage is calculated as sales less cost of goods sold, divided by sales.

[6] Cash conversion defined as Operating cash flow before interest and tax/EBITDA.

[7] Source: China National Bureau of Statistics.

[8] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key&A + BCD cities) for the 26 weeks ending 31 December 2021.

a2MC regional performance

1. China & Other Asia

China & Other Asia revenue of $306.3 million was down 6.0%, with EBITDA of $59.4 million, down 37.1% on pcp. Revenue was impacted by the lower birth rate in China and the rebalancing of channel inventory for China label IMF during the period. In addition to lower revenue, the reduction in EBITDA margin reflected a significant increase in marketing investment vs pcp to drive awareness and improve new user recruitment and late-stage retention.

Brand health metrics improved following a significant marketing campaign in 2Q22. Based on the Company's most recent tracking (Jan-22), brand health through the funnel remained strong with total brand / China label brand awareness, trial and loyalty improving, while English label awareness and other metrics remained relatively flat. This outcome was supported by an increase in 1H22 in China brand investment of 47.7% vs pcp and was weighted to 2Q22.

IMF – China label channels

Sales in *a2 至初®* China label IMF of $188.7 million were achieved, representing a decrease of 11.4% vs pcp. a2MC constrained sales to distributors in 1Q22 to rebalance channel inventory levels and improve channel dynamics. As a result of this, sales in 1Q22 were down significantly vs pcp, but were up vs pcp in 2Q22 as sales into distributors by a2MC more closely matched sales out from distributors to mother and baby store ("MBS") retailers and domestic online ("DOL") platforms.

As measured by Nielsen, retail sales for MBS (ie sales from stores to consumers by value) for the overall market were down 1% for 1H22[9]. a2MC's 12-month rolling market value share in MBS was 2.6% at the end of December 2021, versus 2.5% at the end of June 2021[9]. a2MC's retail sales for MBS increased 11% in 1H22 vs pcp[9] and *a2 至初®* was one of a few significant international brands that gained share in the period.

Distribution increased to 24.6k stores, from 22.8k at the end of June 2021[10]. As outlined at the Company's investor day in October 2021, a2MC's performance in national key accounts (NKA) has been an important growth driver. The Company has focussed its efforts on building share in NKA's and is pursuing opportunities for growth in underpenetrated national and regional key account chains as well as targeting greater penetration in BCD cities. As a result of these initiatives, the Company increased its share in Key&A and BCD cities during the half.

As measured by Smart Path, retail sales for DOL platforms by value for the overall market were up 5% for 1H22[11]. The Company's 12-month rolling market value share in DOL was 2.1% at the end of December 2021, versus 2.0% at the end of June 2021[11]. a2MC's retail sales for DOL platforms increased 17% in 1H22 vs pcp[11].

China label channel inventory reached target levels in 2Q22. The actions taken to replace distributor inventory with fresher stock were completed and resulted in a significant improvement in product freshness at the consumer level.

The Company continued to invest behind the brand to drive consumer demand. In FY21, marketing investment was weighted to the second half, including a significant marketing campaign in China in 4Q21. A similar level of investment was made in 1H22, with a particular focus on creating and targeting digital content to engage with and recruit new users in 2Q22.

IMF – Cross-border e-commerce (CBEC)

a2 Platinum® English and other label IMF revenue of $102.4 million was down 1.1%. The result reflected reduced price discounting during the "11/11" online sales period in China vs pcp, and no sales of Hong Kong label which ceased during FY21 due to COVID-19 restrictions.

During 11/11 the Company prioritised overall channel economics through reduced inventory levels and promotional activity in CBEC. As a result, and as expected, English label sales during 11/11 were down on last year, but with improved market pricing across CBEC platforms and reseller channels enhancing overall channel economics. Notwithstanding, the Company's platform rankings were maintained or improved relative to the competition.

As measured by Smart Path, retail sales (by value) for the overall CBEC market were down 6% for the period[12]. As expected, the Company's 12-month rolling market value share in CBEC was 19.5% at the end of December 2021, versus 21.1% at the end of June 2021[12]. This performance reflected actions taken in 2H21 to rebalance channel inventory, as well as a reduction in levels of cross selling from reseller channels.

Liquid milk and other nutritional products

Sales of liquid milk in China and Other Asia were up 50.3% to $5.5 million and revenue from other nutritional products was up 69.2% to $9.7 million. This reflected progress in executing against adjacent growth opportunities and leveraging learnings to adapt outside of IMF, including the launch of UHT in China. The Company expanded distribution despite significant supply disruptions due to COVID-19 and enhanced capability in the modern trade.

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[9] Nielsen MBS retail measurement service: mother and baby stores only retail sales (by value). 1H22 versus 1H21.

[10] a2MC internal data tracking of stores with active sales in the past 6 months.

[11] Smart Path China IMF online market tracking: domestic online platform sales (by value). 1H22 versus 1H21.

[12] Smart Path China IMF online market tracking: for CBEC only retail sales (by value). 1H22 versus 1H21.

2. ANZ

ANZ segment revenue of $283.3 million was down 10.7%, with EBITDA of $96.2 million down 18.1% versus pcp. Compared to 2H21, ANZ segment revenue was up 16.8% and EBITDA up 206.6%. ANZ reseller channel sales trajectory has improved. The actions taken to rebalance excess inventory throughout the supply chain and improve freshness have resulted in an increase in reseller market pricing of between 20-50% since July 2021, varying by product stage and channel. Revenue in the segment was also impacted by a decrease in sales of other nutritional products, higher cost of goods sold, and foreign exchange headwinds, partially offset by continued growth in liquid milk in Australia.

IMF – ANZ resellers and retail

IMF revenue in ANZ decreased 14.2% to $179.9 million vs pcp. However, there was positive momentum with 2Q22 significantly higher than 1Q22. Whilst demand is recovering, supply is still being allocated carefully to ensure appropriate stock levels are maintained in the channel.

The Company estimates it lost market share in the daigou channel during the period, particularly in Stage 1 IMF. Kantar data[13] indicates daigou consumer sales in the market were down 13% for 1H22[14] and that a2MC's 12-month rolling daigou market share declined to 20.2% at the end of December 2021, compared to 22.5% at the end of June 2021[13]. The ANZ reseller channel is an important channel, particularly in relation to new user recruitment, and the Company is working closely with its reseller partners to optimise its effectiveness and to increase its market share as part of its growth strategy.

An initiative to increase distribution in the offline to online ("O2O") channel commenced during the period with growth expected to continue in 2H22. A key strategic focus is working with partners to increase distribution through the O2O channel and driving new user activation.

Liquid milk

Australian fresh milk revenue increased marginally by 0.2% vs pcp to $87.1 million, supported by COVID-19 lockdowns and price increases. Sales growth was impacted by foreign exchange headwinds and was 2.5% on a constant currency basis.

The business achieved a new high value share of 12.4% at the end of December 2021 compared to 12.2% at the end of June 2021[15]. Additionally, three *a2 Milk®* products achieved ranking in the top ten products in the dairy category in grocery.

Over the period brand health metrics improved with awareness and trial increasing during the period. Market share gains were achieved in all states except Western Australia, with a new high value share in New South Wales and Victoria vs pcp.

Successful trials of *a2 Milk®* UHT product were completed in 1H22, leading to a full national launch in 3Q22. The product is now available in major supermarket chains from February 2022. This is a great addition to the Australian liquid milk portfolio giving our loyal consumers a shelf-stable pantry backup or camping supply of their favourite *a2 Milk®*.

A price increase for milk in Australia was implemented in early November 2021 in response to higher raw milk prices.

a2 Milk™ by *Anchor™* in the New Zealand market continues to gain market share in the A2 protein segment with retail sales value growing 8.4%.

Other nutritional products

The disruption experienced in the ANZ reseller channel in FY21 and continued lower reseller activity in 1H22 impacted all products in this segment. Revenue decreased 21.6% to $16.3 million. A stock obsolescence provision was recognised in this category of $3.0 million in addition to clearance sales to improve inventory levels and freshness.

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[13] Kantar data based on a panel of 9,000 consumers covering 0-6 year olds and only seeks to project ~40% of the population.

[14] Kantar Worldpanel 0-6 years old Baby & Kids panel: National IMF market tracking (Key&A + BCD cities) for the 26 weeks ending 31 December 2021.

[15] IRI Australian Grocery Weighted Scan 12-months ending 31 December 2021.

3. North America

USA segment revenue decreased 5.2% versus pcp to $32.4 million and EBITDA decreased 41.5% versus pcp resulting in a loss of $16.4 million. The lower revenue was driven by the loss of certain regions of a major club channel customer due to private label substitution, weaker growth due to the easing of COVID-19 restrictions in 1Q22 that led to lower in-home consumption and unfavourable foreign exchange. Sales volumes improved in 2Q22 supported by the omicron outbreak towards the end of the period and related impact on home consumption. On a constant currency basis, revenue decreased 2.6% vs pcp and volume growth for 1H22 was down 3% but increased 13% excluding the major club channel customer. EBITDA losses increased due to lower revenue and higher freight costs. Freight costs increased further during the first half due to COVID-19 and will likely continue into the second half.

Average velocities grew within key accounts and distribution increased to 27.0k stores, from 26.8k stores at the end of June 2021[16]. The Company's 12-month rolling market value share in the premium milk category for the Food channel, increased from 1.8% in June 2021 to 1.9% in December 2021[17].

Two new products were launched during the period – *Hershey's a2 Milk®* and *a2 Milk® Half and Half*. Both have seen significantly higher than expected listings in trade, particularly *Hershey's a2 Milk®*.

Key marketing and public relations activities continued which resulted in driving improvements in brand health metrics, with awareness improving and the *a2 Milk®* brand being one of the top two leading brands in the category for brand loyalty.

Accelerating the path to profitability in the USA by FY25/FY26 is a key strategic focus. In addition to driving growth, as planned, the Company started to reduce trade spend in 1H22 and now intends to increase pricing in 2H22 to improve gross margins and assist with mitigating increasing distribution costs.

In Canada, products were first launched in July 2020, initially focusing on Western Canada with subsequent distribution expansion. The Company continues to work closely with Agrifoods (licensee), leveraging the Company's intellectual property and marketing assets as well as proprietary systems and know-how relating to local milk sourcing and processing.

4. Mataura Valley Milk

1H22 is the first time MVM has been included in a2MC's financial reporting. MVM segment revenue of $38.6 million and an EBITDA loss of $10.0 million were recorded for the five months of a2MC's ownership.

On 30 July 2021, a2MC completed the acquisition of a 75% interest in MVM. The acquisition provides the opportunity to participate in nutritional products manufacturing and the potential to pursue additional China label registrations and product innovation opportunities in the future. It strengthens relationships with key strategic partners in China, achieves supplier and geographic diversification, and over time will offer access to insourced manufacturing margins.

As previously indicated, a2MC's lower volumes, together with the decline in third-party nutritional volumes has impacted MVM economics and accelerating the path to profitability is a key strategic focus. In order to reach profitability during FY26 or earlier, the Company commenced manufacturing *a2 Milk®* full cream milk powder during 1H22 previously manufactured by Synlait Milk Limited ("Synlait"). The Company is working on in-sourcing certain existing English label IMF product from Synlait, is planning to develop future product innovation at the facility, and is exploring additional third-party customer opportunities. To complement this and facilitate future China label registration applications, MVM has commenced planning for a laboratory and blending and canning capability at the site.

Progress against growth strategy

The Company's ambition is to rebuild a2MC into an exciting, innovative and sustainable growth company. The Company communicated its strategic plan to the market at an Investor Day in October 2021 and has since been focused on execution. Early progress has been made against groupwide strategic initiatives as highlighted below with further detail on business unit implementation progress provided in the Company's 2022 Interim Results presentation:

1. **Invest in people and planet leadership**
    - Commenced leadership and culture change program with Executive Leadership Team and completed team engagement survey with action planning underway
    - Invested in organisational capability expansion particularly in China with a renewed focus on brand marketing (particularly digital) and e-commerce targeting DOL, CBEC and O2O growth opportunities
    - Established sustainability targets across people and planet – including GHG emissions reduction, farm environment and animal welfare, and sustainable packaging commitments
    - Announced investment to reduce GHG emissions through MVM boiler electrification sourced from renewable power and Synlait biomass boiler conversion

[16] Updated prior year comparison due to expanded data set now being supplied.

[17] SPINS data for the Food channel only for the 52 weeks ending 30 June 2021 and 31 December 2021.

2. **Capture full potential in China IMF**
   - Increased above and below the line China marketing investment by 47.7% million in 1H22 vs pcp
   - Progressed brand strategy refresh with new campaign to be launched later in 2H22
   - Invested in digital content generation for CBEC and ANZ resellers to support English label channels
   - Commenced China label in-market growth pilots with a mix of ATL and BTL brand and sales initiatives
   - Grew liquid milk in China and Other Asia by 50.3% and other nutritional products by 69.2% demonstrating progress in executing against adjacent growth opportunities outside of IMF
3. **Ramp-up product innovation**
   - Progressed innovation and new product development pipeline for English label and China label IMF
   - Completed and submitted SAMR China label IMF re-registration dossiers for all stages
   - Advanced English label IMF product refresh for mid-2022
   - Released UHT product in ANZ with additional products set to launch later in 2022
   - Launched Half & Half and commenced Hershey's licenced product shipments in the USA
4. **Transform our supply chain**
   - Ramped up efforts to expand MVM's A1 free milk pool targeting ~60% of total supply for the 2022 season
   - Commenced planning for laboratory and blending and canning capability at MVM with third-party services being procured in the meantime
   - Accelerated efforts to explore opportunities relating to China label market access and in-market supply capability
   - Progressed capacity expansion initiatives at Smeaton Grange and Kyabram manufacturing facilities
5. **Accelerate path to profitability for USA and MVM**
   - Ramped up initiatives to maximise USA top-line growth through new product launches
   - Commenced trade spend rollback and communicated price increases to improve USA gross margins
   - Accelerated plans to insource *a2 Milk®* branded product manufacturing from Synlait and develop third-party business at MVM to improve capacity utilisation

Outlook

Given the continuing uncertainty in a2MC's consumer markets, the Company is providing its current observations on key drivers and important issues that may impact FY22 results but not specific guidance regarding anticipated Group revenue or EBITDA.

The Company's outlook for 2H22 revenue has improved. It is still expected to be significantly higher than 2H21, and with growth now expected on 1H22 and for FY22, ahead of initial expectations due mainly to growth in China label and English label IMF. However, this revenue improvement is not expected to translate into higher earnings as the Company significantly increases brand and other reinvestment consistent with its growth strategy. Whilst there is trading upside and downside potential, COVID-19 impacts on supply chain have increased and are a key risk in 2H22 in addition to other industry and business risks previously disclosed and noted below. Further commentary on the Company's outlook for 2H22 and FY22 is provided below.

Category and business divisions

China label IMF sales are still expected to be up in FY22 and now expected to be significantly up in 2H22 versus 1H22. This is due to 1H22 having been impacted by distributor inventory rebalancing and in 2H22 as the Company's growth strategy starts to have a positive impact on MBS and DOL sales.

In **English label IMF**, sales are now expected to be up in FY22 and up in 2H22 versus 1H22 due to improved inventory levels and pricing, as well as improved execution in ANZ reseller and CBEC channels driven by the Company's growth strategy.

Incremental sales growth in **Australian liquid milk** for FY22 is still expected with sales still likely to be down in 2H22 versus 1H22 due to reduced COVID-19 related lockdowns and a corresponding reduction in levels of in-home consumption. Input costs are significantly higher than FY21, partially offset by an increase in pricing that took effect from November 2021.

In **USA liquid milk,** sales growth for FY22 is expected, with sales up significantly in 2H22 versus 1H22 due mainly to new product launches. EBITDA losses for FY22 in local currency are expected to remain at similar levels vs pcp due to a part-year impact of trade spend reductions and price increases, lower margin new product sales and continuing higher freight costs.

MVM revenue is now expected to be approximately $100 million (excluding intercompany revenue), previously expected to be $80 million. An EBITDA loss of approximately $20 million is still expected for the 11 months post-completion. No material change in EBITDA is expected despite the increase in sales due to an increase in milk costs and a reduction in more profitable nutritional sales.

Marketing and capability investment

Based on continuing strong brand fundamentals, the Company increased its brand investment, content generation and activation in 1H22 vs pcp. This will step up again in 2H22 with FY22 investment now expected to be in the order of $220 million which is higher than FY20 peak levels to drive execution of the Company's growth strategy.

The Company is continuing to invest in capability building primarily in China and also in corporate functions to support future growth. The majority of the FY22 capability impact will occur in 2H22. The Company is also expecting a realisation of short-term and long-term employee incentive costs to drive performance and to retain and attract talent. Together with the inclusion of operating costs for the MVM business, the Company is anticipating an uplift in SG&A costs in 2H22 vs 1H22 and a significant uplift vs FY21.

Key financials

The outlook for **revenue** in FY22 has improved since the start of the year with the Company still expecting 2H22 revenue (including MVM) to be significantly higher than 2H21, but with growth now expected on 1H22 and for FY22 which is ahead of initial expectations due mainly to growth in China label and English label IMF.

The improved outlook for revenue in 2H22 should result in higher **gross profit** than previously expected. However, this is likely to be offset by cost of goods sold headwinds related to increasing milk, ingredient and packaging costs.. Accordingly, the Company still expects 2H22 gross margin percent to be broadly similar to 1H22.

Trading volatility and COVID-19 related supply chain risks mean that the Company still considers that a range of **EBITDA** outcomes are possible in FY22. Revenue improvement is not expected to translate into higher earnings as the Company significantly increases brand and other reinvestment consistent with its growth strategy.

Operational cash conversion is likely to be less than 100% in FY22 due mainly to the business expecting to hold higher inventory and an increase in other working capital, as well as MVM needing to make a payment to CAHG in connection with a2MC's acquisition of its 75% interest in MVM that completed in 1H22.

The Company expects that **capital expenditure** will be approximately $15-18 million during 2H22 due mainly to strategic investments in supply chain capacity and capability.

With the inclusion of MVM and completion of acquisition accounting, **depreciation and amortisation** for the Group is now expected to be approximately $18 million in FY22.

The Company still anticipates an **effective tax rate** in the order of 37-39%. However, to the extent that revenue and EBITDA are higher than expected, resulting in higher than expected income tax payable by the Company in New Zealand, the MVM losses may be utilised to reduce the effective tax rate.

The outlook assumes no material changes in macro factors such as cross border trade, changes in the regulatory environment and foreign exchange, and that COVID-19 related impacts continue at broadly current levels with increased volatility due to the omicron variant.

Overall, FY22 is expected to deliver growth in revenue against a challenging FY21 which was materially disrupted by COVID-19 related impacts. The Company has a clear ambition and growth strategy that was communicated extensively at its Investor Day in October 2021 and is now focused on investing in and executing a range of strategic initiatives to drive future growth.

Quotes for media

The a2 Milk Company's Managing Director and CEO, David Bortolussi said:

- *"Despite challenging market conditions in China and COVID-19 volatility, we are making good progress stabilising the business."*
- *"Our first half result is in line with expectations, placing the Company in a strong position to continue executing our strategy and deliver revenue growth in FY22."*
- *"The growth strategy we announced in October last year to respond to a rapidly changing China market has been completed and implementation is underway with good early progress across a range of initiatives."*
- *"We remain confident in the long-term China infant milk formula market, and we are growing share in our China label business in-store and online with strong consumer offtake and share growth."*
- *"The actions we took to address excess infant milk formula inventory last year are proving effective, and we are seeing improvements in English label channel inventory levels, market pricing and product freshness."*
- *"While English label sales were down during the half, we have seen an improvement in trajectory in the ANZ reseller / daigou channel."*
- *"Our brand health is strong, and we will continue to increase brand investment, content generation, and activation to drive awareness and conversion."*
- *"Our sales outlook for FY22 has improved but is not expected to translate into higher earnings as we significantly increase brand reinvestment consistent with our growth strategy."*

Reconciliation of Group EBITDA[18] to net profit after tax

	Half Year Ended 31-Dec-21 $'000	Half Year Ended 31-Dec-20 $'000
Group EBITDA	97,573	178,523
Depreciation and amortisation	(8,234)	(3,200)
Group EBIT	89,339	175,323
Interest income	1,740	2,114
Interest expense	(627)	(366)
Income tax expense	(34,372)	(57,028)
Net profit after tax	56,080	120,043
Attributable to:		
Owners of the Company	59,627	120,043
Non-controlling interests	(3,547)	-
	56,080	120,043

Authorised for release by the Board of Directors

David Bortolussi
Managing Director and CEO
The a2 Milk Company Limited

[18] 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.

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