The a2 Milk Company™

Half year interim report for the six months ended 31 December 2016


a2 PLATINUM
PREMIUM TODDLER MILK DRINK
A2
3


a2 Milk
Feel the Difference
Full Cream

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CEO's Report

Continuing strong growth in infant formula drives record results

Overview

The a2 Milk Company ("a2MC" or the "Company") delivered a further step upward in performance in the first half of the 2017 financial year, with operating earnings and net profit at higher levels than those for the full 2016 financial year.

The half-year performance reflects outstanding results from the Australia/New Zealand (ANZ) and China businesses, driven primarily by continuing strong growth in demand for a2 Platinum® infant formula. Revenues increased by 62% and 348% in Australia and China respectively, and Operating EBITDA[1] by 104% and 1,021% respectively. The growth rate in part reflects inventory shortages experienced during the prior corresponding period (pcp).

Results in the United Kingdom and United States also improved. The UK business increased sales and achieved positive operating earnings in the period, while the USA business achieved increased distribution and higher rates of sale in a number of key accounts.

The half-year results show continued progress against the Company's objective of building a global brand based on the health and digestive benefits of nutritional products containing only the A2 beta casein protein – free of the A1 protein.

This has involved continuing to grow the established positions in fresh milk and infant formula in Australia while also investing in the key international growth initiatives in China, the United States and the United Kingdom.

Whilst the growth in demand was evident across the half-year, there was a marked increase in infant formula sales in the 2nd quarter corresponding with the phasing of key sales events in China and an increase in market share in both Australia and China. This was achieved whilst maintaining a prudent approach to the management of production and inventory in recognition of foreshadowed changes in regulations for infant formula sold in China.

The first half FY17 result included:

- ANZ EBITDA of $70.4 million
- China EBITDA of $13.7 million
- UK and USA EBITDA of ($7.7) million
- Corporate and other costs of $12.3 million
- Basic earnings per share (EPS) of 5.51c; and diluted EPS of 5.37c

The increase in corporate and other costs in the half is primarily a result of increased spend on business development and research and development costs associated with a higher level of business activity.

Cash on hand at 31 December 2016 increased significantly to $108.4 million, reflecting the increased earnings, together with pro-active management of working capital, particularly infant formula inventory levels, during the period.

As advised at the Annual Meeting in November 2016, provided that current trends in earnings and cash flow continue and there is no need for significant capital expenditure, the Board expects to adopt a dividend policy following the completion of FY17.

Board of Directors

In line with the Company's previously announced policy of board renewal, Warwick Every-Burns was appointed an independent non-executive Director of the Company on 23 August 2016. Mr Every-Burns has been a career

[1] Operating earnings before interest, tax, depreciation and amortisation (EBITDA) is a non-GAAP measure, but 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 (NPAT) is shown on page 7.

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Consumer Packaged Goods (CPG) executive with relevant global experience, including senior roles with The Clorox Company of the USA, NationalPak (the Glad Products Company), Unilever and Treasury Wine Estates, and is currently a non-executive Director of Treasury Wine Estates.

Mel Miles retired as a Director on 23 August 2016 after six years on the Board, but continues to advise the Company in a consultancy role.

Strategic Agenda Update

The Company continues to focus on building a portfolio of milk-based nutritional products centred on the unique strengths of the A1 protein-free proposition. The broader nutritional strategy, from infant through to adult products, represents a natural evolution that the Company expects to be more attractive in the medium term than one based purely on traditional dairy.

While fresh milk and infant formula generate most of the revenue and earnings at this stage of the Company's development, the product portfolio has been broadened through the launches of branded whole milk powder in Australia and China; fresh milk (sourced from Australia) into China; and UHT long life milk and infant formula in the UK.

Growth in the product portfolio will continue with the planned launch of additional nutritional products over the next 12 months.

As an outcome of the Company's growing profile in the USA, an extension of its distribution footprint is progressing through a major retailer in the South East from March 2017. This development is referenced more fully in the relevant section below.

A comprehensive study and strategic review of the infant formula market in China was carried out in conjunction with a leading in-market consultancy during the period. The review has assisted in deepening the Company's understanding of this market at a fundamental level and has confirmed broadly the Company's current approach in China whilst also giving further insight into future opportunities.

The Company also progressed a review of growth opportunities in the South East Asian region.

The Company is strongly focused on building constructive relationships with supply and distribution partners in all markets. A particularly significant development during the half-year was the completion of a new Supply Agreement with our supply partner for a2 Platinum® infant formula, Synlait Milk. This new agreement, for a minimum term of five years, provides access to an agreed level of capacity beyond current requirements, an obligation on Synlait to supply to order, and does not include "take or pay" provisions.

ANZ

The ANZ business has continued to show very strong momentum, with sales and operating earnings in Australia considerably ahead of plan and pcp. Total revenue across all product categories increased by 62% to $206.6 million and Operating EBITDA by 104% to $70.4 million.

Growth occurred in all categories, but was driven primarily by rapid expansion in sales of a2 Platinum® infant formula, which registered substantial gains in market share and sales volumes. The brand achieved a ~25% grocery/pharmacy scan market share for the 13 weeks ending 1 January 2017 by value, compared with 16.7% in the comparable period of the prior year.

a2 Platinum® has been the fastest-growing infant formula brand in the Australian market in both the last quarter and the moving annual total, and was the No. 2 brand by market share in the latest quarter.

Close attention has been and will continue to be applied to supply chain and inventory management, taking account of foreshadowed changes in the regulatory environment. Inventory remained at below average levels for the industry in part as a result of the continued expansion in sales. There is also a strong focus on maintaining deep insight into the 'Daigou' channel, including pricing, communication and customer management. The Daigou channel has become a significant and growing sales channel from Australia to consumers in China.

Sales of a2 Milk™ fresh milk increased by 3% over the pcp. Market share by value was stable at approximately 9.3% (Australian Grocery Weighted Scan 18 December 2016 MAT). a2 Milk™ and the a2 Platinum® brands enjoyed the highest level of advertising spend across the fresh milk and infant formula categories respectively for the 12 months ending 31 October 2016.

Sales of a2 Milk™ whole milk powder, launched in June 2015, grew significantly compared with the levels achieved in the pcp.

CEO's report cont.

For the six months ended 31 December 2016

China and Other Asia

Sales and earnings from the China business grew very strongly in the half-year. Total revenue increased significantly to $37.7 million and Operating EBITDA increased to $13.7 million.

Growth in the half-year was driven by increased consumer demand aided by an increasing understanding of the unique attributes of nutritional products that contain only the A2 beta casein protein – free from A1 protein. The business continues to invest strategically in building that understanding through a promotional programme that includes extensive online activity and events in Mother & Baby stores (MBS).

The business has a flexible multi-channel infant formula strategy to achieve growth – in both China label (predominantly in MBS) and cross-border ANZ label online with major e-retailers. a2 Platinum® achieved ~2.6% value share in the quarter ending 31 December 2016 within the segment of the market as measured by Kantar[2]. This share, while growing at a substantial rate, is modest in the context of the overall market in China and thus highlights a considerable growth opportunity for the Company.

Promotional activities have included a strong focus on communicating the benefits of a2 Platinum® infant formula through a testimonial approach, featuring mothers in China and Australia reporting on their own experiences and on educating health professionals.

The e-commerce strategy is centred on building strong relationships with profile providers such as Tmall, JD.com, Mia, Kaola, VIP and other strategic platforms. The promotional calendar has a strong bias towards the first half of the financial year given sales for the three largest e-retailer events fall predominately within the first six months. Sales on 'Singles Day' more than doubled the levels achieved in the previous year across the top four e-commerce platforms, while a2 Platinum® achieved the No. 1 sales position in its category on JD.com. Sales momentum continued during the "12/12" sales event and the initial build for Chinese New Year.

The offline strategy is based on sustainably driving sales in MBS, growing the number of distribution points and significantly enhancing instore education and shopper marketing activities through investment in increased field resources and point of sale materials.

Sales of a2 Milk™ branded fresh milk sourced from Australia, in key premium retail stores and e-commerce platforms, also continued to grow from a small base.

The Company continues to closely monitor the regulation of infant and other nutritional products in China and in cross-border trade. It believes it is responding satisfactorily to the current phase of regulatory activity, including infant formula registration and labelling guidelines, and is focused on ensuring it remains well-positioned to deal with future developments.

USA

The USA business made further progress against the objectives set out for its launch phase, with pleasing gains in distribution and sales velocity. The product is positioned in the specialty milk section, which is the fastest-growing segment of the total milk category.

The a2 Milk™ brand was launched in Southern California from April 2015 and Northern California from September 2015. Two major chains, Trader Joe's and Target, began distribution in California during the half year. The business currently has distribution in about 1,800 stores in California, the Pacific Northwest and the home market of Colorado.

The sales focus remains on building unit sales per store per week (UPSW) relevant to the speciality milk category. The business is expected to deliver a progressive improvement in sales velocity in its key accounts during the financial year.

Marketing and communication activity increased during the half-year across digital and social media platforms, through retail promotions and through a public relations programme. The product range has received mainstream media coverage, notably through the Los Angeles Times Sunday Section, Fortune, Bloomberg Newsweek, Mother Jones, Forbes, New Nutrition journal, digital publications and television stations in Southern California, with reach extended further through online media.

Supply chain efficiency was enhanced through the engagement of a second dairy processor, in the Los Angeles basin, allowing the business to ship locally to the California market. The business also entered into a non-exclusive licence with its procurement partner, Prairieland Dairy in Nebraska, to build awareness

[2]Kantar tracks China Key and A cities that comprise a substantial proportion of the total China infant formula market

CEO's report cont.

For the six months ended 31 December 2016

and distribute fresh milk in the states of Kansas, Missouri and Nebraska under the a2 Milk™ brand.

The market entry strategy for the business has centred on launching primarily in California and building an understanding of the key drivers for growth in this market prior to expansion. The Company considers it now has a clearer view of the key factors for success in this market and other potential state markets. Accordingly, it is progressing an opportunity to expand its footprint significantly with a launch into the South East of the USA, in March, in association with the Publix Group. Publix is a highly-regarded major retailer with about 1,100 stores, primarily in Florida, Georgia and the Carolinas. We anticipate ranging in all stores. To support this launch, the business expects to increase its marketing spend in the second half.

The Company is very pleased with the opportunity to expand the USA business beyond the West Coast. We acknowledge that the timing is ahead of plan and the likely investment in the USA business will consequently be higher than previously assumed. Accordingly, we now estimate that the level of further investment in this business over this year and the subsequent two years prior to positive monthly EBITDA will be approximately US$30 – 35 million. Given these changes, we have determined it appropriate to write off NZ$2.2 million of capitalised USA intangible assets.

UK

The United Kingdom business achieved a significant improvement in performance, with increased brand awareness, sales and positive operating earnings for the half-year for the first time.

Sales of a2 Milk™ branded fresh milk grew in excess of 45% on the pcp. Average rates of sale in-store improved significantly and distribution in key retailer accounts is now approximately 1,400 stocking points.

This performance was achieved by a continuing focus on consumers and retail customers, with particular benefit from the *'a2tonishing'* advertising campaign launched in May 2016 and continued into the half-year. The business also sought improved point of sale presence through its out-sourced field team and has recently achieved extra facings in a key account. The in-house digital team continued to build relationships and activities with consumers and the health care professional community.

UHT long life milk was launched in September 2016 in selected channels and grew at a satisfactory rate. The business is pleased with the continued growth of infant formula sales in the non-grocery segment and will assess the opportunity in the retail market during the next 12 months.

Research and development (R&D) and Intellectual property (IP)

The Company continues to drive and support R&D around the benefits of A1 protein-free products, and to develop its portfolio of intellectual property (including brand assets and proprietary know-how).

The breadth and depth of the IP portfolio, coupled with first mover advantage, continue to support our market position. The patent portfolio covers a range of compositional benefits and therapeutic uses of A1 protein-free products, with protection for some applications through to 2035.

R&D focus in the half-year included:

- Completion of a significant clinical study undertaken in China (600 participants) that has now been submitted for publication. The study builds upon digestive benefit findings from successful China pilot study published in April 2016 and gives further insight into digestive mechanisms
- Concurrently a study conducted in China amongst pre-schoolers has been completed and the authors are currently preparing for publication. The results are understood to be aligned with adult findings around digestive and cognitive responses
- A clinical study in association with Monash University, Australia, examining the benefits of a2 Milk™ for IBS (irritable bowel syndrome) sufferers is underway
- Clinical examination of benefits to gut and systemic inflammation at a leading USA institution, Pennington Biomedical Research Centre is underway, and
- Work pursuant to a New Zealand government grant for research to support benefit claims in international markets has commenced

In October 2016, UK-based *Nutrition Journal* reported that consumption of a2 Milk™ increases the natural production of the body's key antioxidant – Glutathione (GSH), widely recognised for its association with a range of health benefits – in milk-intolerant consumers.

CEO's report cont.

For the six months ended 31 December 2016

The Australian Federal Court case with the Lion Group initiated in June 2016 is scheduled to be heard in November 2017. The a2 Milk Company is pursuing Lion over what the Company believes are misleading and deceptive packaging and advertising claims. Lion has filed a cross claim challenging the way the Company promotes a2 Milk™. With the scientific evidence in support of the benefits of a2 Milk™ continuing to strengthen, the Company is confident in its position.

Full year FY17 outlook

An update on the Group's revenue and operating earnings for the four months to October 2016 was provided at the Annual Meeting on 22 November 2016. The Company has since delivered a very strong first half and performance in January 2017 is consistent with plan.

As previously indicated, the Company closely monitors the outlook relating to the regulatory environment for infant formula in China and likely competitor activity in each of our markets and consequently continues to adopt a prudent approach to inventory management.

Given that the timing of major selling events in China is weighted towards the first half, and as a result of our prudent approach to inventory management, the Company is anticipating lower infant formula sales during the second half relative to 1H17, although they will be materially higher than in 2H16. In addition, the investment in marketing will likely be higher in the second half by up to $15 million, based on the planned phasing of communication and development activities across the year, in particular for the USA and China.

Geoffrey Babidge
Managing Director & Chief Executive Officer
14 February 2017

CEO's report cont.

For the six months ended 31 December 2016

Reconciliation of EBITDA to net profit after tax (NPAT)

	Half year ended 31 Dec 16 NZ $000's	Half year ended 31 Dec 15 NZ $000's	Movement %
Segment EBITDA	64,075	18,683	243%
Depreciation & amortisation	(1,608)	(1,255)	28%
EBIT	62,467	17,428	258%
Interest income	443	142	212%
Interest expense	–	(38)	(100)%
Income tax expense	(23,528)	(7,425)	217%
Net profit after tax (NPAT)	39,382	10,107	290%

Directors' declaration

For the six months ended 31 December 2016

The Directors of The a2 Milk Company Limited are pleased to present the half year interim report for the six months ended 31 December 2016.

The report presented is signed for and on behalf of the board and was authorised for issue on 14 February 2017.

The half yearly report is unaudited.

David Hearn
Chairman
14 February 2017

Geoffrey Babidge
Managing Director & Chief Executive Officer

Auditor's review report

For the six months ended 31 December 2016

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Review Report to the Shareholders of The a2 Milk Company Limited ("the company") and its subsidiaries together ("the group")

We have reviewed the interim financial statements on pages 10 to 19, which comprise the statement of financial position as at 31 December 2016, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the period ended on that date, and a summary of significant accounting policies and other explanatory information.

This report is made solely to the company's shareholders, as a body, in accordance with our engagement letter. Our review has been undertaken so that we might state to the company's shareholders those matters we are required to state to them in a review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's shareholders as a body, for our review work, for this report, or for our findings.

Directors' Responsibilities

The directors are responsible for the preparation and fair presentation of interim financial statements which comply with the New Zealand equivalent to International Accounting Standards as it relates to interim financial statements and for such internal control as the directors determine is necessary to enable the preparation and fair presentation of the interim financial statements that are free from material misstatement, whether due to fraud or error.

Reviewer's Responsibilities

Our responsibility is to express a conclusion on the interim financial statements based on our review. We conducted our review in accordance with NZ SRE 2410 *Review of Financial Statements Performed by the Independent Auditor of the Entity*. NZ SRE 2410 requires us to conclude whether anything has come to our attention that causes us to believe that the financial statements, taken as a whole, are not prepared in all material respects, in accordance with the New Zealand equivalent to International Accounting Standards as it relates to interim financial statements. As the auditor of The a2 Milk Company Limited, NZ SRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial statements.

Basis of Statement

A review of interim financial statements in accordance with NZ SRE 2410 is a limited assurance engagement. The auditor performs procedures, primarily consisting of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures.

The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with International Standards on Auditing (New Zealand). Accordingly we do not express an audit opinion on those financial statements.

Other than in our capacity as assurance practitioner we have no relationship with, or interests in, the group.

Conclusion

Based on our review nothing has come to our attention that causes us to believe that the accompanying interim financial statements, set out on pages 10 to 19, do not present fairly, in all material respects, the financial position of the group as at 31 December 2016 and its financial performance and cash flows for the six month period ended on that date in accordance with the New Zealand equivalent to International Accounting Standards. Our review was completed on 15 February 2017 and our findings are expressed as at that date.

Ernst & Young

Ernst & Young
14 February 2017
Sydney, Australia

Consolidated statement of comprehensive income (Unaudited)

For the six months ended 31 December 2016

	Notes	31 Dec 16 $'000	31 Dec 15 $'000
Sales		255,982	139,090
Cost of sales		(136,982)	(82,090)
Gross Margin		119,000	57,000
Other revenue		145	136
Distribution expenses		(9,526)	(6,631)
Administrative expenses	3	(13,707)	(13,260)
Marketing expenses		(16,037)	(10,044)
Occupancy expenses		(769)	(309)
Other expenses	4	(16,559)	(9,379)
Operating profit		62,547	17,513
Finance income		443	142
Finance costs		(80)	(123)
Net finance income		363	19
Profit before tax		62,910	17,532
Income tax expense		(23,528)	(7,425)
PROFIT AFTER TAX FOR THE PERIOD		39,382	10,107
Items of other comprehensive income that may be reclassified to profit or loss:			
Foreign currency translation loss		(1,442)	(1,999)
TOTAL COMPREHENSIVE INCOME		37,940	8,108
Earnings per share			
Basic (cents per share)		5.51	1.52
Diluted (cents per share)		5.37	1.50

The accompanying notes form part of these financial statements.

Consolidated statement of changes in equity (Unaudited)

For the six months ended 31 December 2016

Six months ended 31 December 2016	Foreign currency translation reserve $'000	Employee equity settled payments reserve $'000	Total reserves $'000	Retained earnings $'000	Share capital $'000	Total equity $'000
Balance 1 July 2016	(9,052)	7,211	(1,841)	4,371	130,548	133,078
Profit after tax for the period	–	–	–	39,382	–	39,382
Foreign currency translation differences – foreign operations	(1,084)	–	(1,084)	–	–	(1,084)
Income tax	(358)	–	(358)	–	–	(358)
Total comprehensive income for the period	(1,442)	–	(1,442)	39,382	–	37,940
Transactions with owners in their capacity as owners:						
Issue of ordinary shares	–	–	–	–	946	946
Share issue costs	–	–	–	–	(6)	(6)
Options exercised	–	–	–	–	1,260	1,260
Share-based payments	–	1,146	1,146	–	–	1,146
Total transactions with owners	–	1,146	1,146	–	2,200	3,346
Balance 31 December 2016	(10,494)	8,357	(2,137)	43,753	132,748	174,364

Six months ended 31 December 2015	Foreign currency translation reserve $'000	Employee equity settled payments reserve $'000	Total reserves $'000	Retained earnings $'000	Share capital $'000	Total equity $'000
Balance 1 July 2015	(5,711)	4,102	(1,609)	(26,065)	86,303	58,629
Profit after tax for the period	–	–	–	10,107	–	10,107
Foreign currency translation differences – foreign operations	(1,727)	–	(1,727)	–	–	(1,727)
Income tax	(272)	–	(272)	–	–	(272)
Total comprehensive income for the period	(1,999)	–	(1,999)	10,107	–	8,108
Transactions with owners in their capacity as owners:						
Issue of ordinary shares	–	–	–	–	43,750	43,750
Share issue costs	–	–	–	–	(2,149)	(2,149)
Share-based payments	–	1,439	1,439	–	–	1,439
Total transactions with owners	–	1,439	1,439	–	41,601	43,040
Balance 31 December 2015	(7,710)	5,541	(2,169)	(15,958)	127,904	109,777

The accompanying notes form part of these financial statements.

Consolidated statement of financial position (Unaudited)

As at 31 December 2016

	Notes	31 Dec 16 $'000	30 June 16 $'000
ASSETS			
Current assets			
Cash & short term deposits		108,379	69,361
Trade and other receivables		67,863	45,407
Prepayments		17,612	15,099
Inventories		30,008	52,556
Total current assets		223,862	182,423
Non-current assets			
Property, plant & equipment		8,088	8,097
Intangible assets	6	13,068	16,314
Deferred tax assets		1,376	3,318
Total non-current assets		22,532	27,729
TOTAL ASSETS		246,394	210,152
LIABILITIES			
Current liabilities			
Trade and other payables		59,840	66,168
Current tax liabilities		11,913	10,640
Total current liabilities		71,753	76,808
Non-current liabilities			
Trade and other payables		94	228
Deferred tax liabilities		183	38
Total non-current liabilities		277	266
TOTAL LIABILITIES		72,030	77,074
NET ASSETS		174,364	133,078
EQUITY			
Equity attributable to owners of the Company			
Share capital	5	132,748	130,548
Retained earnings		43,753	4,371
Reserves		(2,137)	(1,841)
TOTAL EQUITY		174,364	133,078

The accompanying notes form part of these financial statements.

Consolidated statement of cash flows (Unaudited)

For the six months ended 31 December 2016

	31 Dec 16 $'000	31 Dec 15 $'000
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	237,823	116,014
Payments to suppliers & employees	(175,695)	(117,629)
Interest received	443	142
Interest paid	–	(38)
Taxes paid	(24,448)	(8,450)
Net cash inflow/(outflow) from operating activities	38,123	(9,961)
CASH FLOWS FROM INVESTING ACTIVITIES		
Payments for property, plant & equipment	(614)	(603)
Payments for intangible assets	(330)	(441)
Net cash outflow from investing activities	(944)	(1,044)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issue of equity shares	2,200	43,750
Payment for capital raising costs	–	(2,149)
Net cash inflow from financing activities	2,200	41,601
Net increase in cash & short term deposits	39,379	30,596
Cash & short term deposits at the beginning of the period	69,361	6,092
Effect of exchange rate changes on cash	(361)	(262)
Cash and short term deposits at the end of the period	108,379	36,426

The accompanying notes form part of these financial statements.

Notes to the consolidated interim financial statements

For the six months ended 31 December 2016

1. BASIS OF PREPARATION

The a2 Milk Company Limited (the "Company") is a for-profit entity incorporated and domiciled in New Zealand.

The Company is registered in New Zealand under the Companies Act 1993, and is a FMC reporting entity under the Financial Markets Conduct Act 2013. The shares of The a2 Milk Company Limited are publicly traded on the New Zealand Stock Exchange (NZX), and the Australian Securities Exchange (ASX). The reporting currency of the Company and its subsidiaries (together the "Group") is the New Zealand dollar.

The principal activity of the Company is the commercialisation of a2™ brand milk and related products as supported by the ownership of intellectual property that enables the identification of cattle for the production of a2™ brand milk.

These consolidated financial statements were authorised for issue by the directors on 14 February 2017.

Statement of compliance

These interim financial statements have not been audited. The interim financial statements have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand, comply with IAS 34 Interim Financial Reporting and NZ IAS 34 Interim Financial Reporting, and have been the subject of a review by the auditors.

This half year interim report should be read in conjunction with the Group's annual report for the year ended 30 June 2016, available at www.thea2milkcompany.com.

The same accounting policies and methods of computation are followed in this half year interim report as were applied in the preparation of the Group's financial statements for the year ended 30 June 2016.

Accounting Standards and Interpretations

The Group has adopted all of the new and revised Standards and Interpretations that are relevant to the Group's operations and effective for the current reporting period.

The adoptions of these new and revised Standards and Interpretations has not had any material impact on the Group's assets, profits or earnings per share for the accounting periods reported.

Certain new accounting standards and interpretations have been published that are relevant to the Group's operations but are not mandatory for the 31 December 2016 accounting period. The Group's assessment of the impact of these is set out in the Group's annual report for the year ended 30 June 2016.

2. OPERATING SEGMENTS

For management purposes, the Group is organised into business units based on geographical location along with a corporate function, and has four reportable operating segments as follows:

- The *Australia and New Zealand* segment receives external revenue from infant formula, milk and other dairy products along with royalty and licence fee income
- The *China and other Asia* segment receives external revenue from infant formula, milk and other dairy products. This segment is responsible for the infant formula supply chain from New Zealand to all markets
- The *United Kingdom and USA* segment receives external revenue from milk and infant formula sales
- The *Corporate and other* segment external revenue comprises external royalty and licence fee income

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss and is measured consistently with operating profit or loss in the consolidated financial statements.

Notes to the consolidated interim financial statements cont.

For the six months ended 31 December 2016

2. OPERATING SEGMENTS (cont.)

Change in segment EBITDA from prior period

In the latter part of the 2016 financial year, management reporting was amended to disclose segment earnings before interest, tax, depreciation and amortisation (segment EBITDA) before inter-company charges, to better reflect the underlying performance of the segments.

Previously, segment EBITDA was reported after inter-company charges comprising licence fee and management fee income from subsidiaries; and after the reimbursement of costs associated with the development of intellectual property such as marketing and herd testing.

The effect of this change was to increase the reported EBITDA profits in the Australia and New Zealand, and China and other Asia segments, and increase the reported EBITDA losses in the UK and USA, and Corporate and other segments, with no impact on the net reported EBITDA for the Group.

Prior period comparative information has been restated to reflect the amendments outlined above.

Six months to 31 December 2016	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Corporate and other $'000	Total $'000
Consolidated sales	206,496	37,651	11,835	–	255,982
Other revenue	119	–	–	26	145
Reportable segment revenue	206,615	37,651	11,835	26	256,127
Reportable segment results (Segment EBITDA)	70,379	13,728	(7,712)	(12,320)	64,075
Reconciliation to Consolidated Statement of Comprehensive Income					
Interest income					443
Interest expense					–
Depreciation & amortisation					(1,608)
Income tax expense					(23,528)
Consolidated profit after tax					39,382

Over 33% of sales come from the Company's largest three customers (2015: over 56% from three customers).

Notes to the consolidated interim financial statements cont.

For the six months ended 31 December 2016

2. OPERATING SEGMENT INFORMATION (cont.)

Six months to 31 December 2015	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Corporate and other $'000	Total $'000
Consolidated sales	127,803	8,400	2,887	–	139,090
Other revenue	107	–	–	29	136
Reportable segment revenue	127,910	8,400	2,887	29	139,226
Reportable segment results (Segment EBITDA)	34,528	1,225	(8,113)	(8,957)	18,683
Reconciliation to Consolidated Statement of Comprehensive Income					
Interest income					142
Interest expense					(38)
Depreciation & amortisation					(1,255)
Income tax expense					(7,425)
Consolidated profit after tax					10,107

Other Segment Information	Australia and New Zealand $'000	China and other Asia $'000	UK and USA $'000	Corporate and other $'000	Total $'000
Segment assets					
31 December 2016	107,789	54,662	16,455	67,488	246,394
30 June 2016	89,001	60,140	15,962	45,049	210,152
Segment liabilities					
31 December 2016	23,740	41,063	4,782	2,445	72,030
30 June 2016	29,550	33,141	4,671	9,712	77,074

3. ADMINISTRATIVE EXPENSES

	31 Dec 16 $'000	31 Dec 15 $'000
Employee equity compensation	1,146	1,439
Salary & wage costs	8,769	8,162
Travel costs	1,861	1,990
Other administrative expenses	1,931	1,669
	13,707	13,260

Notes to the consolidated interim financial statements cont.

For the six months ended 31 December 2016

4. OTHER EXPENSES

	31 Dec 16 $'000	31 Dec 15 $'000
Directors' fees and expenses	315	279
Consultancy & accounting	4,624	3,156
Legal expenses	1,783	1,352
Depreciation & amortisation	1,608	1,255
Patents, trademarks and research & development	1,896	1,023
Promotion & merchandising	1,711	575
Impairment of intangible assets (Note 6)	2,435	–
Other operating expenses	2,187	1,739
	16,559	9,379

The increase in consultancy and accounting fees relates primarily to the China market and other business development opportunities.

5. SHARE CAPITAL

	Share Capital $'000	Number of shares
Movements in contributed equity		
Fully paid ordinary shares:		
Balance 30 June 2016	130,548	712,000,065
Exercise of options	1,260	2,000,000
Exercise of rights	–	320,000
Partly paid shares fully paid	946	1,550,000
Share issue costs	(6)	–
Balance 31 December 2016	132,748	715,870,065
Partly paid ordinary shares:		
Balance 30 June 2016	–	11,300,000
Shares fully paid	–	(1,550,000)
Balance 31 December 2016	–	9,750,000
Total ordinary shares on issue:		
30 June 2016	130,548	723,300,065
31 December 2016	132,748	725,620,065

Partly paid ordinary shares carry the same rights and entitlements on a fractional basis, as fully paid ordinary shares, with such fractions being equivalent to the proportion which the amount paid is of the total amount paid and amounts still payable on the shares.

Notes to the consolidated interim financial statements cont.

For the six months ended 31 December 2016

6. INTANGIBLE ASSETS

	Patents $'000	Trademarks $'000	Software $'000	Project development $'000	Goodwill $'000	Total $'000
Net book value at 1 July 2016	832	902	628	3,571	10,381	16,314
Additions	–	202	39	89	–	330
Amortisation	(9)	–	(208)	(832)	–	(1,049)
Impairment	–	(372)	–	(1,715)	(348)	(2,435)
Net foreign currency exchange differences	–	–	(2)	(20)	(70)	(92)
Net book value at 31 December 2016	823	732	457	1,093	9,963	13,068

Impairment of goodwill and intangible assets

The Company assessed indications of impairment at 31 December 2016, including consideration of the financial performance of its Cash Generating Units (CGUs) to which Goodwill is allocated. In performing this assessment it noted an operating loss in the USA CGU (in the UK and USA reportable segment) for the six month period ended 31 December 2016, which triggered impairment testing of that CGU. Furthermore, a number of trademark assets belonging to the Corporate segment that are no longer likely to be used were identified, resulting in the impairment of those assets.

USA CGU

The USA CGU receives external revenue from the sale of liquid milk products in the USA. During the period the business plan has been amended to accelerate expansion of distribution within the USA. This acceleration is expected to require a higher level of investment prior to the CGU achieving a cash break-even position. The recoverable amount of the USA CGU at 31 December 2016 has been determined based on a value-in-use calculation using risk adjusted cash flow projections based on financial estimates approved by senior management. The discount rate applied in this calculation was 10%, consistent with the calculation for the year ended 30 June 2016. As a result of this testing the following assets of the USA CGU have been written off: goodwill; project development costs; and USA specific trademarks. Other CGU assets, including working capital and property, plant & equipment, have been assessed as fully recoverable, with no impairment booked on these items. The carrying value of these other assets was $856,000 as at 31 December 2016. The total impairment charge booked through net profit before tax (NPBT) relating to goodwill, trademarks and project development costs in the UK and USA segment is $2,235,000.

Corporate Segment – Trademark assets

A number of trademark assets belonging to the Corporate segment that are no longer likely to be used have been identified, indicating that these assets are impaired. The impairment of these assets, totalling $200,000, has been included in the impairment charge booked through NPBT for the period.

The total impairment charge of $2,435,000 recognised in NPBT for the above is recorded within other expenses (note 4) in the consolidated statement of comprehensive income.

Notes to the consolidated interim financial statements cont.

For the six months ended 31 December 2016

7. RECONCILIATION OF PROFIT AFTER TAX WITH NET CASH FLOWS FROM OPERATING ACTIVITIES

	31 Dec 16 $'000	31 Dec 15 $'000
Profit after tax for the period	39,382	10,107
Adjustments for non-cash items:		
Depreciation & amortisation expense	1,608	1,255
Expense recognised in profit & loss in respect of equity-settled share-based payments	1,146	1,439
Net foreign exchange gain	(925)	(634)
Deferred tax	2,087	(2,080)
Impairment of intangible assets (note 6)	2,435	–
	45,733	10,087
Movements in working capital:		
(Increase) in trade and other receivables	(22,456)	(25,514)
(Increase) in prepayments	(2,513)	(16,837)
(Increase) / decrease in inventories	22,548	(11,245)
Increase / (decrease) in trade and other payables	(6,462)	29,083
Increase in current tax liabilities	1,273	4,465
Net cash inflow/(outflow) from operating activities	38,123	(9,961)

The net decrease in inventories largely reflects a combination of growth in demand for infant formula, and a prudent approach to the management of infant formula production and inventory.

8. NET TANGIBLE ASSETS PER SECURITY

	31 Dec 16 $	30 Jun 16 $
Net tangible assets per security	0.22	0.16

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Company Directors
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Julia Hoare (Deputy Chairman & Non-Executive Director)
Geoffrey Babidge (Managing Director & Chief Executive Officer)
Richard Le Grice (Non-Executive Director)
Peter Hinton (Non-Executive Director)
Warwick Every-Burns (Non-Executive Director)


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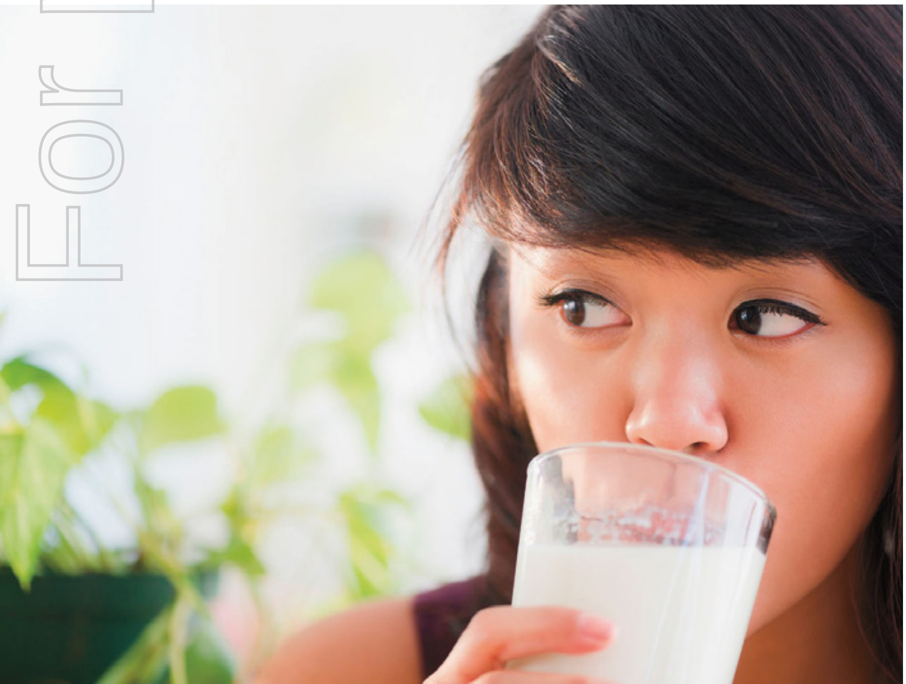

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